

ATHERSYS, INC / NEW  
Form 10-Q  
November 10, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

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

Commission file number: 001-33876

**Athersys, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-4864095**  
(I.R.S. Employer  
Identification No.)

**3201 Carnegie Avenue, Cleveland, Ohio**  
(Address of principal executive offices)

**44115-2634**  
(Zip Code)

Registrant's telephone number, including area code: (216) 431-9900

**Former name, former address and former fiscal year, if changed since last report: Not Applicable**

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. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The number of outstanding shares of the registrant's common stock, \$0.001 par value, as of November 1, 2014 was 77,515,339.

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**ATHERSYS, INC.**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****Athersys, Inc.****Condensed Consolidated Balance Sheets**

(In thousands, except share and per share data)

	<b>September 30, 2014 (Unaudited)</b>	<b>December 31, 2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 32,368	\$ 31,948
Accounts receivable	665	520
Prepaid expenses and other	416	387
Total current assets	33,449	32,855
Equipment, net	1,331	1,333
Total assets	\$ 34,780	\$ 34,188
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 2,891	\$ 2,243
Accrued compensation and related benefits	909	1,067
Accrued clinical trial costs	85	88
Accrued expenses	692	884
Deferred revenue		86
Note payable	181	
Total current liabilities	4,758	4,368
Note payable		176
Warrant liabilities	3,204	9,823
Stockholders equity:		
Preferred stock, at stated value; 10,000,000 shares authorized, and no shares issued and outstanding at September 30, 2014 and December 31, 2013		
Common stock, \$0.001 par value; 150,000,000 shares authorized, and 77,515,339 and 70,749,212 shares issued at September 30, 2014 and December 31, 2013, respectively, and 77,515,339 and 70,683,480 shares outstanding at September 30, 2014 and December 31, 2013, respectively	78	71
Additional paid-in capital	306,706	284,323
Treasury stock, at cost; 65,732 shares at December 31, 2013		(135)

Accumulated deficit	<b>(279,966)</b>	(264,438)
Total stockholders' equity	<b>26,818</b>	19,821
Total liabilities and stockholders' equity	<b>\$ 34,780</b>	\$ 34,188

*See accompanying notes to unaudited condensed consolidated financial statements.*

**Table of Contents****Athersys, Inc.****Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)**

(In thousands, except share and per share data)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2014	2013	2014	2013
<b>Revenues</b>				
Contract revenue	\$ 75	\$ 87	\$ 155	\$ 365
Grant revenue	218	534	1,233	1,153
Total revenues	293	621	1,388	1,518
<b>Costs and expenses</b>				
Research and development	5,775	4,689	17,756	15,372
General and administrative	1,695	1,450	5,303	4,512
Depreciation	91	86	272	257
Total costs and expenses	7,561	6,225	23,331	20,141
Loss from operations	(7,268)	(5,604)	(21,943)	(18,623)
Other income (expense), net	9	(4)	80	28
Income (expense) from change in fair value of warrants, net	2,540	(6)	6,335	(2,353)
<b>Net loss and comprehensive loss</b>	\$ (4,719)	\$ (5,614)	\$ (15,528)	\$ (20,948)
Net loss per share - Basic	\$ (0.06)	\$ (0.10)	\$ (0.20)	\$ (0.38)
Weighted average shares outstanding - Basic	77,320,425	57,646,306	76,755,599	55,722,235
Net loss per share - Diluted	\$ (0.08)	\$ (0.10)	\$ (0.23)	\$ (0.38)
Weighted average shares outstanding - Diluted	78,349,840	59,248,031	78,495,281	55,722,235

*See accompanying notes to unaudited condensed consolidated financial statements.*

**Table of Contents****Athersys, Inc.****Condensed Consolidated Statements of Cash Flows**

(In thousands)

(Unaudited)

	<b>Nine months ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Operating activities</b>		
Net loss	\$ (15,528)	\$ (20,948)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	272	257
Stock-based compensation	1,894	918
Change in fair value of warrant liabilities	(6,335)	2,353
Changes in operating assets and liabilities:		
Accounts receivable	(145)	37
Prepaid expenses and other assets	(29)	3
Accounts payable and accrued expenses	295	(890)
Deferred revenue and other	(81)	
Net cash used in operating activities	(19,657)	(18,270)
<b>Investing activities</b>		
Purchases of equipment	(270)	(331)
Net cash used in investing activities	(270)	(331)
<b>Financing activities</b>		
Proceeds from issuance of common stock and warrants, net	19,701	10,617
Purchase of treasury stock	(292)	(137)
Proceeds from exercise of warrants	938	402
Net cash provided by financing activities	20,347	10,882
Increase (decrease) in cash and cash equivalents	420	(7,719)
Cash and cash equivalents at beginning of the period	31,948	25,533
Cash and cash equivalents at end of the period	\$ 32,368	\$ 17,814

*See accompanying notes to unaudited condensed consolidated financial statements.*

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**Athersys, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

Three- and Nine-Month Periods Ended September 30, 2014 and 2013

**1. Background and Basis of Presentation**

We are an international biopharmaceutical company that is focused primarily on the field of regenerative medicine and operate in one business segment. Our operations consist primarily of research and product development activities.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013. The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and Article 10 of Regulation S-X. Accordingly, since they are interim statements, the accompanying financial statements do not include all of the information and notes required by GAAP for complete financial statements. The accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of financial position and results of operations for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Our critical accounting policies, estimates and assumptions are described in Management s Discussion and Analysis of Financial Condition and Results of Operations, which is included below in this Quarterly Report on Form 10-Q.

**2. Recently Issued Accounting Standard**

In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 requires an entity to recognize revenue in a manner that depicts 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. To achieve that core principle, the amendment provides five steps that an entity should apply when recognizing revenue. The amendment also specifies the accounting of some costs to obtain or fulfill a contract with a customer and expands the disclosure requirements around contracts with customers. An entity can either adopt this amendment retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the update recognized at the date of initial application. The amendment is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. We are in the process of evaluating, but have not determined, the impact that the adoption of ASU 2014-09 will have on our consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements - Going Concern, Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern, which establishes management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern and, if so, to provide related footnote disclosures. ASU 2014-15 provides a definition of the term substantial doubt and requires an assessment for a period of one year after the date that the financial statements are issued or available to be issued. Management will also be required to evaluate and disclose whether its plans alleviate that doubt. The guidance is effective for the annual periods ending after December 15, 2016 and interim periods thereafter with early adoption permitted. We are in the process of evaluating the impact the new guidance will have on our disclosures.





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Basic and diluted net loss per share have been computed using the weighted-average number of shares of common stock outstanding during the period. The table below reconciles the net loss and the number of shares used to calculate basic and diluted net loss per share for the three and nine month periods ended September 30, 2014 and 2013, in thousands.

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
<b>Numerator:</b>				
Net loss attributable to common stockholders - Basic	\$ (4,719)	\$ (5,614)	\$ (15,528)	\$ (20,948)
Less: income from change in fair value of warrants	(1,160)	(33)	(2,504)	
Net loss attributable to common stockholders used to calculate diluted net loss per share	\$ (5,879)	\$ (5,647)	\$ (18,032)	\$ (20,948)
<b>Denominator:</b>				
Weighted-average shares outstanding - Basic	77,320	57,646	76,756	55,722
Potentially dilutive common shares outstanding:				
Warrants	1,030	1,602	1,739	
Weighted-average shares used to calculate diluted net loss per share	78,350	59,248	78,495	55,722
Basic earnings per share	\$ (0.06)	\$ (0.10)	\$ (0.20)	\$ (0.38)
Dilutive earnings per share	\$ (0.08)	\$ (0.10)	\$ (0.23)	\$ (0.38)

We have outstanding options, restricted stock units and warrants that are not used in the calculation of diluted net loss per share because to do so would be antidilutive. The following instruments were excluded from the calculation of diluted net loss per share because their effects would be antidilutive:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Stock options	6,261,164	5,130,329	6,261,164	5,130,329
Restricted stock units	2,142,779	2,674,348	2,142,779	2,674,348
Warrants	6,310,000	1,459,026	6,310,000	5,409,027
Total	14,713,943	9,263,703	14,713,943	13,213,704

**4. Fair Value of Financial Instruments***Fair Value Measurements*

We classify the inputs used to measure fair value into the following hierarchy:

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Adjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or significant inputs other than quoted prices that are observable for the asset or liability.
- Level 3 Unobservable inputs for the asset or liability.

The following table provides a summary of the fair values of our assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 (in thousands):

Description	Fair Value Measurements at September 30, 2014 Using			
	Balance as of September 30, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrant liabilities	\$ 3,204	\$	\$	\$ 3,204

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We review and reassess the fair value hierarchy classifications on a quarterly basis. Changes from one quarter to the next related to the observability of inputs in a fair value measurement may result in a reclassification between fair value hierarchy levels. There were no reclassifications for all periods presented.

The estimated fair value of warrants accounted for as liabilities, representing a level 3 fair value measure, was determined on the issuance date and subsequently marked to market at each financial reporting date. We use the Black-Scholes valuation model to value the warrant liabilities at fair value. The fair value is estimated using the expected volatility based on our historical volatility for warrants issued after January 1, 2013, or for warrants issued prior to 2013, using the historical volatilities of comparable companies from a representative peer group selected based on industry and market capitalization. The fair value of the warrants is determined using probability weighted-average assumptions, when appropriate. The following inputs were used at September 30, 2014:

	Expected Volatility	Risk-Free Interest Rate	Expected Life
Warrants with one year or less remaining term	114.77%	0.13%	0.50 year
Warrants with greater than one year remaining term	67.59% - 78.63%	0.13% - 0.58%	1.34 - 2.46 years

A roll-forward of fair value measurements using significant unobservable inputs (Level 3) for the warrants is as follows (in thousands):

	Three months ended September 30, 2014		Nine months ended September 30, 2014	
<b>Balance July 1, 2014</b>	<b>\$</b>	<b>5,744</b>	<b>Balance January 1, 2014</b>	<b>\$</b> <b>9,823</b>
Issuance of warrants			Issuance of warrants January 2014	2,012
Exercise of warrants			Exercise of warrants	(2,296)
Gain included in income from change in fair value of warrants for the period		(2,540)	Gain included in income from change in fair value of warrants for the period	(6,335)
<b>Balance September 30, 2014</b>	<b>\$</b>	<b>3,204</b>	<b>Balance September 30, 2014</b>	<b>\$</b> <b>3,204</b>

**5. Collaborative Arrangements and Revenue Recognition***Pfizer*

In 2009, we entered into a collaboration with Pfizer Inc. ( Pfizer ) to develop and commercialize our MultiSt<sup>®</sup> product candidate to treat inflammatory bowel disease ( IBD ) for the worldwide market on an exclusive basis. We are eligible to receive milestone payments upon the successful achievement of certain development, regulatory and commercial milestones, for which we evaluated the nature of the events triggering these contingent payments and concluded that these events constituted substantive milestones that will be recognized as revenue in the period in which the underlying triggering event occurs. No significant milestone revenue has been recognized to date.

Pfizer pays us for manufacturing product for clinical development and commercialization purposes, which is recognized in the period that the manufacturing services are performed. Pfizer has responsibility for development and regulatory, including decision-making regarding the advancement or cessation of further development under the collaboration. If the product is successfully developed, Pfizer would also have sole responsibility for commercialization. We may elect to co-develop with Pfizer, in which case, the parties would share development and commercialization expenses and profits (if any) on an agreed basis beginning at Phase 3 clinical development. Alternatively, we may elect to not co-develop with Pfizer, in which case Pfizer will pay us tiered single-digit royalties on worldwide commercial sales of MultiStem IBD products. Any royalties may be subject to certain reductions related to market exclusivity, patent claims and credits from sales milestone payments. In the event that Pfizer does not move the program forward, the development and commercialization rights would revert to us.

**Table of Contents***RTI Surgical, Inc.*

In 2010, we entered into an agreement with RTI Surgical, Inc. ( RTI ) to develop and commercialize biologic implants using our technology for certain orthopedic applications in the bone graft substitutes market on an exclusive basis. We are eligible to receive cash payments upon the successful achievement of certain commercial milestones. We evaluated the nature of the events triggering these contingent payments and concluded that these events are substantive and that revenue will be recognized in the period in which each underlying triggering event occurs. No milestone revenue has been recognized to date. In addition, we are entitled to receive tiered royalties on worldwide commercial sales of implants using our technologies based on a royalty rate starting in the mid-single digits and increasing into the mid-teens. Any royalties may be subject to a reduction if third-party payments for intellectual property rights are necessary or commercially desirable to permit the manufacture or sale of the product.

**6. Stock-based Compensation**

We have two incentive plans that authorized an aggregate of 11,500,000 shares of common stock for awards to employees, directors and consultants. These equity incentive plans authorize the issuance of equity-based compensation in the form of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares and units, and other stock-based awards. As of September 30, 2014, an aggregate of 1,342,905 shares of common stock underlying stock-based awards have been issued or exercised under our equity incentive plans. In the three-month period ended September 30, 2014, restricted stock units equivalent to 302,359 shares of common stock vested during the period.

As of September 30, 2014, a total of 1,753,152 shares were available for issuance under our equity compensation plans and stock-based awards to purchase 8,403,943 shares of common stock were outstanding. For the three-month periods ended September 30, 2014 and 2013, stock-based compensation expense was approximately \$714,000 and \$606,000, respectively. At September 30, 2014, total unrecognized estimated compensation cost related to unvested stock-based awards was approximately \$6,117,000, which is expected to be recognized by the end of 2018 using the straight-line method.

**7. Issuance of Common Stock and Warrants**

In January 2014, we completed a registered direct offering generating net proceeds of approximately \$18.8 million through the issuance of 5,000,000 shares of common stock and warrants to purchase 1,500,000 shares of common stock with an exercise price of \$4.50 per share that expire on July 15, 2016. The securities were sold in multiples of a fixed combination of one share of common stock and a warrant to purchase 0.30 shares of common stock at an offering price of \$4.10 per fixed combination.

During the quarter ended September 30, 2014, we did not sell any shares to Aspire Capital, and during the nine-month period ended September 30, 2014, we sold 250,000 shares of common stock at an average price of \$3.78 per share. In accordance with the equity purchase agreement, we could elect to sell to Aspire Capital up to \$23.5 million of shares of common stock.

As of September 30, 2014, we had the following outstanding warrants to purchase shares of common stock:

<b>Number of</b>	<b>Exercise Price</b>	<b>Expiration</b>
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**Underlying Shares**

1,310,000	\$	3.55	February 2, 2016
3,021,077	\$	1.01	March 14, 2017
3,500,000	\$	2.50	March 31, 2015
1,500,000	\$	4.50	July 15, 2016
<b>9,331,077</b>			

**8. Warrant Liabilities**

We account for common stock warrants as either liabilities or as equity instruments depending on the specific terms of the warrant agreement. Registered common stock warrants that could require cash settlement are accounted for as liabilities. We classify these warrant liabilities on the consolidated balance sheet as a non-current liability. The warrant liabilities are revalued at fair value at each balance sheet date subsequent to the initial issuance. Changes in the fair market value of the warrant are reflected in the consolidated statement of operations as income (expense) from change in fair value of warrants.

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The warrants we issued in the January 2014 and December 2013 registered direct offerings contain a provision for a cash payment in the event that the shares are not delivered to the holder within two trading days. The cash payment equals \$10 per day per \$2,000 of warrant shares for each day late. The warrants issued in the March 2012 private placement and the February 2011 registered direct offering each contain a provision for net cash settlement in the event that there is a fundamental transaction (e.g., merger, sale of substantially all assets, tender offer, or share exchange). If a fundamental transaction occurs in which the consideration issued consists of all cash or stock in a non-public company, then the warrant holder has the option to receive cash equal to a Black Scholes value of the remaining unexercised portion of the warrant. Further, the March 2012 warrants include price protection in the event we sell stock below the exercise price, as defined, and the exercise price as reduced in February 2013 to \$1.01 per share as a result of the October 2012 public offering.

The warrants have been classified as liabilities, as opposed to equity, due to the potential adjustment to the exercise price that could result upon late delivery of the shares or potential cash settlement upon the occurrence of certain events as described above, and are recorded at their fair values at each balance sheet date.

**9. Income Taxes**

We have net operating loss and research and development tax credit carryforwards that may be used to reduce future taxable income and tax liabilities. Our deferred tax assets have been fully offset by a valuation allowance due to our cumulative losses. As a result of our October 2012 equity offering, our net operating loss carryforwards are significantly limited for use under Section 382 of the Internal Revenue Code.



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

This discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this Quarterly Report on Form 10-Q and the audited financial statement and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013. Operating results are not necessarily indicative of results that may occur in future periods.

### **Overview and Recent Developments**

We are an international biopharmaceutical company that is focused primarily in the field of regenerative medicine. Our MultiStem<sup>®</sup> cell therapy is currently being evaluated in multiple clinical trials. Our current clinical development programs are focused on treating inflammatory and immune disorders, neurological conditions, cardiovascular disease, and other conditions. We are also applying our pharmaceutical discovery capabilities to identify and develop small molecule compounds with potential applications in indications such as obesity, related metabolic conditions and certain neurological conditions.

#### *Current Programs*

By applying our proprietary MultiStem cell therapy product, we have established therapeutic product development programs treating inflammatory and immune disorders, neurological conditions, cardiovascular disease, and other conditions. Our programs in the clinical development stage include the following:

**Ischemic Stroke:** In our ongoing Phase 2 clinical study, we are evaluating the administration of MultiStem cell therapy to patients that have suffered an ischemic stroke. In contrast to treatment with thrombolytics, which must be administered within 3 to 4 hours after a stroke, we are treating patients one to two days after the stroke has occurred. In preclinical studies, administration of a single dose of MultiStem therapy, even several days after a stroke, resulted in significant and durable improvements. This double blind, placebo-controlled trial is being conducted at leading stroke centers across the United States and Europe. The study is expected to enroll approximately 136 patients. Enrollment is nearing completion and interim safety and initial efficacy results are expected to be available and communicated following analysis of the ninety-day patient data.

**Inflammatory Bowel Disease:** MultiStem therapy is being evaluated in a Phase 2 clinical study involving administration of MultiStem to patients suffering from ulcerative colitis, or UC, the most common form of inflammatory bowel disease, or IBD. This study is being conducted with our partner, Pfizer, and we released interim results in April 2014. The study is expected to run through 2014 to complete the secondary evaluations. The interim results showed that a single administration of MultiStem to a patient population with chronic advanced disease failed to show a meaningful clinical effect at the eight-week evaluation period. Despite not showing a significant improvement compared to placebo in the primary efficacy endpoints, the MultiStem therapy demonstrated favorable tolerability and safety in the eight weeks following treatment. Furthermore, at four weeks, the proportion of responders treated with MultiStem had a statistically significant improvement in their Mayo rectal bleeding score, as compared to patients treated with placebo, raising the possibility of a transient effect from a single MultiStem dose. Additional detail is being collected through the course of 2014, and further analysis of this and other data, such as biomarker information, is being undertaken by Pfizer. In the event that Pfizer does not move forward with the program, development and commercialization rights would revert to us.

Acute Myocardial Infarction: We have evaluated the administration of MultiStem to patients that suffered an acute myocardial infarction, or AMI, in a Phase 1 clinical study. The results of this study demonstrated a favorable safety profile and encouraging signs of improvement in heart function among patients that exhibited severely compromised heart function prior to treatment. This data was published in a leading peer reviewed scientific journal, and one-year follow-up data suggested that the benefit observed was sustained over time. We have been awarded a grant for up to \$2.8 million to support the advancement of this clinical program, and we are completing preparations for the launch of this Phase 2 clinical study.

Hematopoietic Stem Cell Transplant / GvHD: We have completed a Phase 1 clinical study of the administration of MultiStem cells to patients suffering from leukemia or certain other blood-borne cancers in which patients undergo radiation therapy and then receive a hematopoietic stem cell transplant. Such patients are at significant risk for serious complications, including graft-versus-host disease, or GvHD, an imbalance of immune system function caused by transplanted immune cells that

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attack various tissues and organs in the patient. Data from the study demonstrated the safety of MultiStem cells in this indication and suggested that the therapy may have a beneficial effect in reducing the incidence and severity of GvHD, as well as providing other benefits. The MultiStem therapy has been designated an orphan drug by both the United States Food and Drug Administration, or FDA, and the European Medicines Agency, which may provide market exclusivity and other substantial incentives and benefits. We have interacted with the FDA and also engaged with the EMA to finalize trial design. Currently, we are staging this program for future development dependent our other clinical programs and the achievement of certain business development and financial objectives.

We are conducting or supporting clinical activity in other areas, such as solid organ transplant, which is an investigator initiated study being conducted at a leading transplant center in Europe. We are also engaged in the preparation stages for clinical studies in other targeted areas.

In addition to our current and anticipated clinical development activities, we are engaged in preclinical development and evaluation of MultiStem therapy in other inflammatory and immune, neurological and cardiovascular disease areas, as well as certain other indications. We conduct such work both through our own internal research efforts and through a broad global network of collaborators.

We are in discussions with third parties about collaborating in the development of MultiStem therapy for certain programs and may enter into one or more business partnership(s) to advance these programs.

We have also partnered with RTI on the development of products for certain orthopedic applications using our stem cell technologies in the bone graft substitutes market. We began recognizing royalty revenue from product sales in 2014 and may receive other payments upon the successful achievement of certain commercial milestones.

We are also engaged in the development of novel small molecule therapies to treat obesity and other conditions, such as schizophrenia. We may elect to enter into a partnership to advance the development of our 5HT2c agonist program, either for the treatment of obesity, schizophrenia, or both indications.

### *Financial*

In January 2014, we completed a registered direct offering generating net proceeds of approximately \$18.8 million through the issuance of 5,000,000 shares of common stock and warrants to purchase 1,500,000 shares of common stock with an exercise price of \$4.50 per share that expire on July 15, 2016. The securities were sold in multiples of a fixed combination of one share of common stock and a warrant to purchase 0.30 shares of common stock at an offering price of \$4.10 per fixed combination.

Under our equity purchase agreement with Aspire Capital Fund LLC, or Aspire Capital, we sold 250,000 shares of common stock at an average price of \$3.78 per share during the nine-month period ended September 30, 2014. During the nine months ended September 30, 2014, we received proceeds of approximately \$938,000 from the exercise of warrants, resulting in the issuance of 928,924 shares of common stock in the aggregate.

### **Results of Operations**

Since our inception, our revenues have consisted of license fees, contract revenues and milestone payments from our collaborators, and grant proceeds primarily from federal, state and foundation grants. We have derived no revenue from the commercial sale of therapeutic products to date, but we receive royalties on commercial sales by a licensee of products using our technologies. Research and development expenses consist primarily of external clinical and preclinical study fees, manufacturing costs, salaries and related personnel costs, legal expenses resulting from

intellectual property prosecution processes, facility costs, and laboratory supply and reagent costs. We expense research and development costs as they are incurred. We expect to continue to make significant investments in research and development to enhance our technologies, advance clinical trials of our product candidates, expand our regulatory affairs and product development capabilities, conduct preclinical studies of our product and manufacture our product candidates. General and administrative expenses consist primarily of salaries and related personnel costs, professional fees and other corporate expenses. We expect to continue to incur substantial losses through at least the next several years.

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**Table of Contents*****Three Months Ended September 30, 2014 and 2013***

*Revenues.* Revenues decreased to \$0.3 million for the three months ended September 30, 2014 from \$0.6 million in the comparable period in 2013, reflecting a \$0.3 million decrease in our grant revenues. Our grant revenues fluctuate from period to period based on the timing of grant-related activities and the award and expiration of new grants. Contract revenue remained consistent at \$0.1 million for each of the three months ended September 31, 2014 and 2013. Absent any new collaborations, we expect our contract revenues to continue at similar levels for the remainder of the year and to be comprised of royalty payments from RTI and potential license and milestone payments from Bristol-Myers Squibb.

*Research and Development Expenses.* Research and development expenses increased to \$5.8 million for the three months ended September 30, 2014 from \$4.7 million in the comparable period in 2013. The \$1.1 million increase is primarily comprised of an increase in preclinical and clinical development costs of \$0.4 million, an increase in research supplies of \$0.4 million, an increase in personnel costs of \$0.2 million and an increase in stock-based compensation of \$0.1 million. The increase in our preclinical and clinical development costs is primarily due to increased manufacturing costs, clinical study costs and regulatory costs. The increase in research supplies was due to an increase in internal process development activities. The increase in personnel costs related to selective personnel additions and annual compensation increases. We expect our 2014 annual research and development expenses to be higher than the 2013 expenses based on our planned clinical development and manufacturing process development activities, and such costs will vary over time based on clinical manufacturing and clinical trial activity during any given period. Other than external expenses for our clinical and preclinical programs, we do not track our research expenses by project; rather, we track such expenses by the type of cost incurred.

*General and Administrative Expenses.* General and administrative expenses increased to \$1.7 million for the three months ended September 30, 2014 from \$1.5 million in the comparable period in 2013. The increase was due primarily to an increase in personnel costs of \$0.1 million and an increase in legal and professional costs of \$0.1 million compared to the same period in 2013. The increase in personnel costs related primarily to annual compensation increases, and legal and professional costs primarily due to increased professional services. We expect our 2014 quarterly general and administrative expenses to continue at similar levels during the remainder of the year.

*Depreciation.* Depreciation expense of \$0.1 million remained consistent during each of the three-month periods ended September 30, 2014 and 2013.

*Other Income (Expense), net.* Other income (expense), net, for the three-month period ended September 30, 2014 and 2013 remained relatively consistent during the periods, and was comprised of interest income and expense and foreign currency gains and losses.

*Income (Expense) from Change in Fair Value of Warrants, net.* Income of \$2.5 million was recognized during the three months ended September 30, 2014 for the market value change in our warrant liabilities, compared to \$6,000 of expense in the comparable period in 2013. The fluctuation is related to the impact of new warrant issuances and changes in warrant value as affected by the exercise prices, our stock price and the remaining lives of the issued warrants.

***Nine Months Ended September 30, 2014 and 2013***

*Revenues.* Revenues decreased to \$1.4 million for the nine months ended September 30, 2014 from \$1.5 million in the comparable period in 2013 reflecting a \$0.2 million decrease in our contract revenues, partially offset by a \$0.1 million dollar increase in our grant revenue. Our grant revenues fluctuate from period to period based on the timing of

grant-related activities and the award of new grants. Absent any new collaborations, we expect our contract revenues to continue at similar levels for the remainder of the year and to be comprised of RTI royalty payments and potential license and milestone payments from Bristol-Myers Squibb.

*Research and Development Expenses.* Research and development expenses increased to \$17.8 million for the nine months ended September 30, 2014 from \$15.4 million in the comparable period in 2013. The increase of \$2.4 million related primarily to an increase in personnel costs of \$0.8 million, an increase in stock-based compensation of \$0.5 million, an increase in sponsored research costs of \$0.2 million, an increase in research supplies of \$0.5 million, an increase in legal and professional fees of \$0.2 million and an increase

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in other research and development costs of \$0.2 million. Personnel costs rose due to selective personnel additions and annual compensation increases. Stock-based compensation increased primarily due to additional months of ratable expense from restricted stock units granted in June 2013. Sponsored research costs increased primarily due to an increase in grant-funded programs involving collaboration with certain academic research institutions. The increase in research supplies was due to an increase in internal process development activities. The increase in legal fees resulted from increased patent expenses associated with patent prosecution, national filings, and interparty proceedings and related filings. The increase in our clinical and preclinical costs is primarily due to increased manufacturing costs, increased clinical study costs and increased process development costs. We expect our 2014 annual research and development expenses to be higher than the 2013 expenses based on our planned clinical development and manufacturing process development activities, and such costs will vary over time based on clinical manufacturing and clinical trial activity during any given period. Other than external expenses for our clinical and preclinical programs, we do not track our research expenses by project; rather, we track such expenses by the type of cost incurred.

*General and Administrative Expenses.* General and administrative expenses increased to \$5.3 million for the nine months ended September 30, 2014 from \$4.5 million in the comparable period in 2013. The \$0.8 million increase was due primarily to an increase in personnel costs of \$0.3 million and an increase in stock based compensation of \$0.5 million compared to the same period in 2013. The increase in personnel costs related primarily to annual compensation increases, and stock-based compensation increased primarily due to the impact of vesting of restricted stock units granted in June 2013. We expect our 2014 quarterly general and administrative expenses to continue at similar levels during the remainder of the year.

*Depreciation.* Depreciation expense of \$0.3 million remained consistent during each of the nine-month periods ended September 30, 2014 and 2013.

*Other Income (Expense), net.* Other income (expense), net, for the nine-month period ended September 30, 2014 and 2013 remained relatively consistent during the periods, and was comprised of interest income and expense and foreign currency gains and losses.

*Income (Expense) from Change in Fair Value of Warrants, net.* Income of \$6.3 million was recognized during the nine months ended September 30, 2014 for the market value change in our warrant liabilities, and expense of \$2.4 million was recognized during the nine months ended September 30, 2013. The fluctuation is related to the impact of new warrant issuances and changes in warrant value as affected by the exercise prices, our stock price and the remaining lives of the issued warrants.

**Liquidity and Capital Resources**

Our sources of liquidity include our cash balances and any available-for-sale securities on hand. At September 30, 2014, we had \$32.4 million in cash and cash equivalents. We have primarily financed our operations through business collaborations, grant funding and equity financings. We conduct all of our operations through our subsidiary, ABT Holding Company.

We have incurred losses since inception of operations in 1995 and had an accumulated deficit of \$280 million at September 30, 2014. Our losses have resulted principally from costs incurred in research and development, clinical and preclinical product development, acquisition and licensing costs, and general and administrative costs associated with our operations. We have used the financing proceeds from equity and debt offerings and other sources of capital to develop our technologies, to discover and develop therapeutic product candidates, develop business collaborations and to acquire certain technologies and assets.

In January 2014, we generated net proceeds of approximately \$18.8 million in a registered direct offering. Also, in December 2013, we completed a registered direct offering generating net proceeds of approximately \$18.4 million.

We have an equity purchase agreement with Aspire Capital, whereby Aspire Capital is committed to purchase up to an aggregate of \$25.0 million of shares of our common stock over a two-year period ending in 2015, subject to our election to sell any such shares. Under the agreement, we have the right to sell shares, subject to certain volume limitations and a minimum floor price, at a modest discount to the prevailing market price.



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During the quarter ended September 30, 2014, we did not sell any shares to Aspire Capital, and during the nine-month period ended September 30, 2014, we sold 250,000 shares of common stock at an average price of \$3.78 per share. In accordance with the equity purchase agreement, we could elect to sell to Aspire Capital up to \$23.5 million of shares of common stock.

During the nine months ended September 30, 2014, we received proceeds of approximately \$938,000 from the exercise of warrants, resulting in the issuance of 928,924 shares of common stock in the aggregate.

Under the terms of our agreement with Pfizer, we are eligible to receive milestone payments of up to \$105 million upon the successful achievement of certain development, regulatory and commercial milestones, though there can be no assurance that we will achieve any milestones. No significant milestone payments have been received as of September 30, 2014. Pfizer pays us for manufacturing product for clinical development and commercialization purposes. Pfizer has responsibility for development and regulatory, including decision-making regarding the advancement or cessation of further development under the collaboration. If the product is successfully developed, Pfizer would also have sole responsibility for commercialization. We may elect to co-develop with Pfizer, in which case, the parties would share development and commercialization expenses and profits (if any) on an agreed basis beginning at Phase 3 clinical development. Alternatively, we may elect to not co-develop with Pfizer, in which case Pfizer will pay us tiered single-digit royalties on worldwide commercial sales of MultiStem IBD products. Any royalties may be subject to certain reductions related to market exclusivity, patent claims and credits from sales milestone payments. In the event that Pfizer does not move the program forward, the development and commercialization rights would revert to us.

Under the terms of our RTI agreement, we are eligible to receive cash payments upon the successful achievement of certain commercial milestones, though there can be no assurance that such milestones will be achieved, and no milestone payments have been received as of September 30, 2014. In addition, we are entitled to receive tiered royalties on worldwide commercial sales of implants using our technologies based on a royalty rate starting in the mid-single digits and increasing into the mid-teens, and we began receiving royalty payments in 2014. Any royalties may be subject to a reduction if third-party payments for intellectual property rights are necessary or commercially desirable to permit the manufacture or sale of the product.

We remain entitled to receive license fees for targets that were delivered to Bristol-Myers Squibb under our completed 2001 collaboration, as well as milestone payments and royalties on compounds developed by Bristol-Myers Squibb using our technology, though there can be no assurance that we will achieve any such milestones or royalties.

We are obligated to pay the University of Minnesota a royalty based on worldwide commercial sales of licensed products if covered by a valid licensed patent. The low single-digit royalty rate may be reduced if third-party payments for intellectual property rights are necessary or commercially desirable to permit the manufacture or sale of the product.

In 2012, we entered into an arrangement with the Global Cardiovascular Innovation Center and the Cleveland Clinic Foundation in which we are entitled to proceeds of up to \$500,000 in the form of a forgivable loan to fund certain remaining preclinical work using MultiStem to treat congestive heart failure and for preparing the program for an investigational new drug application, or IND, with the FDA. Interest on the loan accrues at a fixed rate of 4.25% per annum and is added to the outstanding principal. The loan is forgivable based on the achievement of a certain milestone within three to four years. As of September 30, 2014, we had drawn \$166,000 of this financing, which is recorded as a current liability of \$181,000 (including accrued interest) since the note is due in the first quarter of 2015 if the forgiveness conditions are not met.

We will require substantial additional funding in order to continue our research and product development programs, including preclinical evaluation and clinical trials of our product candidates and manufacturing process development. At September 30, 2014, we had available cash and cash equivalents of \$32.4 million, and we intend to meet our short-term liquidity needs with available cash. Over the longer term, we will make use of available cash, but will have to continue to generate additional funding to meet our needs, through business development opportunities, as well as grant-funding opportunities. Additionally, we are raising capital from time to time through the equity purchase agreement with Aspire Capital, subject to its volume and price limitations. We also manage our cash by deferring certain discretionary costs and staging certain development costs to extend our operational runway, as needed. Over time, we may consider the sale of additional equity securities, or possibly borrowing from financing institutions.

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Our capital requirements over time depend on a number of factors, including progress in our clinical development programs, our clinical and preclinical pipeline of additional opportunities and their stage of development, additional external costs such as payments to contract research organizations and contract manufacturing organizations, additional personnel costs, and the costs in filing and prosecuting patent applications and enforcing patent claims. The availability of funds impacts our ability to advance multiple clinical programs concurrently, and any shortfall in funding could result in our having to delay or curtail research and development efforts. Further, these requirements may change at any time due to technological advances, business development activity or competition from other companies. We cannot assure you that adequate funding will be available to us or, if available, that it will be available on acceptable terms.

We expect to continue to incur substantial losses through at least the next several years and may incur losses in subsequent periods. The amount and timing of our future losses are highly uncertain. Our ability to achieve and thereafter sustain profitability will be dependent upon, among other things, successfully developing, commercializing and obtaining regulatory approval or clearances for our technologies and products resulting from these technologies.

### *Cash Flow Analysis*

Net cash used in operating activities was \$19.7 million for the nine months ended September 30, 2014 and \$18.3 million for the nine months ended September 30, 2013, representing the use of cash to fund operations, clinical trials, and preclinical and process development activities. We expect that net cash used in operating activities will be higher in total in 2014 compared to 2013 in connection with increased clinical development activities for our MultiStem product candidates and platform. Net cash used in operating activities has fluctuated significantly on a quarter-to-quarter basis over the past few years primarily due to the receipt of collaboration fees and payment of specific clinical trial costs, such as clinical manufacturing campaigns, contract research organization costs, and manufacturing process development projects.

Net cash used in investing activities was \$0.3 million for each of the nine months ended September 30, 2014 and 2013 related to the purchase of equipment supporting our operations. We anticipate that our overall capital equipment expenditures will be similar in 2014 as compared to 2013.

Financing activities provided cash of \$20.3 million for the nine months ended September 30, 2014 related to the January 2014 registered direct offering, the exercise of common stock warrants, and equity sales to Aspire Capital, net of treasury stock purchases. Financing activities provided cash of \$10.9 million for the nine months ended September 30, 2013 as a result of equity sales to Aspire Capital and the exercise of common stock warrants during the period.

Investors in certain of our equity offerings have received warrants to purchase shares of our common stock, of which warrants to purchase an aggregate of 9.3 million shares remain outstanding at September 30, 2014 with a weighted average exercise price of \$2.49 per share. The exercise of warrants could provide us with cash proceeds. During the three months ended September 30, 2014, no warrants were exercised.

We have no off-balance sheet arrangements.

### **Critical Accounting Policies and Management Estimates**

The SEC defines critical accounting policies as those that are, in management's view, important to the portrayal of our financial condition and results of operations and demanding of management's judgment. Our discussion and analysis of financial condition and results of operations are based on our consolidated financial statements, which have been

prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these financial statements requires us to make estimates on experience and on various assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. A description of these accounting policies and estimates is included in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2013. There have been no material changes in our accounting policies and estimates as described in our Annual Report. For additional information regarding our accounting policies, see Note B to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

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### **Cautionary Note on Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. These forward-looking statements relate to, among other things, the expected timetable for development of our product candidates, our growth strategy, and our future financial performance, including our operations, economic performance, financial condition, prospects, and other future events. We have attempted to identify forward-looking statements by using such words as anticipates, believes, can, continue, could, estimates, expects, intends, may, plans, potential, should, suggest, will, expressions. These forward-looking statements are only predictions and are largely based on our current expectations. These forward-looking statements appear in a number of places in this Quarterly Report on Form 10-Q.

In addition, a number of known and unknown risks, uncertainties, and other factors could affect the accuracy of these statements. Some of the more significant known risks that we face are the risks and uncertainties inherent in the process of discovering, developing, and commercializing products that are safe and effective for use as human therapeutics, including the uncertainty regarding market acceptance of our product candidates and our ability to generate revenues. These risks may cause our actual results, levels of activity, performance, or achievements to differ materially from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements.

Other important factors to consider in evaluating our forward-looking statements include:

our ability to raise capital to fund our operations;

the timing and nature of results from our MultiStem clinical trials;

the possibility of delays in, adverse results of, and excessive costs of the development process;

our ability to successfully initiate and complete clinical trials of our product candidates;

uncertainty regarding market acceptance of our product candidates and our ability to generate revenues, including MultiStem cell therapy for the prevention of GvHD and the treatment of IBD, AMI, stroke and other disease indications;

changes in external market factors;

changes in our industry's overall performance;

changes in our business strategy;

our ability to protect and defend our intellectual property and related business operations, including the successful prosecution of our patent applications and enforcement of our patent rights, and operate our business in an environment of rapid technology and intellectual property development;

our possible inability to realize commercially valuable discoveries in our collaborations with pharmaceutical and other biotechnology companies;

our ability to meet milestones under our collaboration agreements;

our collaborators' ability to continue to fulfill their obligations under the terms of our collaboration agreement;

the success of our efforts to enter into new strategic partnerships and advance our programs, including, without limitation, in Japan;

our possible inability to execute our strategy due to changes in our industry or the economy generally;

changes in productivity and reliability of suppliers; and

the success of our competitors and the emergence of new competitors.

Although we currently believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee our future results, levels of activity or performance. We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. You are advised, however, to consult any further disclosures we make on related subjects in our reports on Forms 10-Q, 8-K and 10-K furnished to the SEC. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

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

***Interest Rate Risk***

Our exposure to interest rate risk is related to our investment portfolio and our borrowings. Fixed rate investments and borrowings may have their fair market value adversely impacted from changes in interest rates. Due in part to these factors, our future investment income may fall short of expectations. Further, we may suffer losses in investment principal if we are forced to sell securities that have declined in market value due to changes in interest rates. When appropriate based on interest rates, we invest our excess cash primarily in debt instruments of the United States government and its agencies and corporate debt securities, and as of September 30, 2014, we had no investments. Over the past several years, we have been investing conservatively due to economic conditions and have prioritized liquidity and the preservation of principal in lieu of potentially higher returns. As a result, we have experienced no losses on the principal of our investments.

We enter into loan arrangements with financial institutions when needed and when available to us. At September 30, 2014, we had no borrowings outstanding other than a potentially forgivable note payable associated with local grant funding bearing fixed, forgivable interest of 4.25% per annum.

**Item 4. Controls and Procedures.**

**Disclosure controls and procedures**

Our management, under the supervision of and with the participation of our Chief Executive Officer and our Vice President of Finance, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as of the end of the period covered by this quarterly report on Form 10-Q. Based upon this evaluation, our Chief Executive Officer and Vice President of Finance have concluded that, as of the end of the period covered by this quarterly report on Form 10-Q, our disclosure controls and procedures were effective.

**Changes in internal control over financial reporting**

During the third quarter of 2014, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Table of Contents****PART II. OTHER INFORMATION****Item 6. Exhibits.**

Exhibit No.	Description
31.1	Certification of Gil Van Bokkelen, Chairman and Chief Executive Officer, pursuant to SEC Rules 13a-14(a) and 15d-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Laura K. Campbell, Vice President of Finance, pursuant to SEC Rules 13a-14(a) and 15d-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Gil Van Bokkelen, Chairman and Chief Executive Officer, and Laura Campbell, Vice President of Finance, pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document



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**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.

Date: November 10, 2014

ATHERSYS, INC.

/s/ Gil Van Bokkelen  
Gil Van Bokkelen  
Chairman and Chief Executive Officer  
(principal executive officer authorized to sign on behalf of the registrant)

/s/ Laura K. Campbell  
Laura K. Campbell  
Vice President of Finance  
(principal financial and accounting officer authorized to sign on behalf of the registrant)

**Table of Contents****EXHIBIT INDEX**

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101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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rif; font-size: 10pt"> Tax fees - N/A All other fees - N/A Total \$99,750

(1) Includes fees for the 2017 audits of our annual financial statements and reviews of our quarterly financial information filed with the SEC.

**Relationship with Independent Accountants**

On May 31, 2018, the Audit Committee of the Company engaged EKS&H to serve as the independent registered public accounting firm for the Company. With the exception of consulting with EKS&H on the treatment of the Company's debt for equity exchange completed in December 2017, the Company has not consulted EKS&H on any matter relating to either (i) the application of accounting principles to a specific transaction, either completed or contemplated, or the type of audit opinion that might be rendered on our financial statements or (ii) any matter that was the subject of a disagreement (as that term is defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions) or a "reportable event" (as that term is defined in Item 304(a)(1)(v) of Regulation S-K) for the fiscal years ended December 30, 2017 and December 30, 2016.

On April 30, 2018, the Company's Chairman of the Audit Committee and Chief Financial Officer received formal notice that Moss Adams, made the decision to decline to stand for re-election as the Company's independent registered public accounting firm for the year ended December 31, 2018, and the auditor-client relationship between Moss Adams and the Company ended upon the filing of the Company's Form 10-Q for the quarter ended March 31, 2018, filed on May 14, 2018. Neither the Audit Committee of the Company nor the Board of Directors recommended Moss Adams' decision to not stand for re-election. A representative from Moss Adams will not be present at the Annual Meeting in person or by telephone to respond to questions.

Effective November 16, 2017, Hein & Associates LLP ("Hein"), the independent registered public accounting firm for the Company for the fiscal year ended December 30, 2016, combined with Moss Adams. As a result of this transaction, on November 16, 2017, Hein resigned as the independent registered public accounting firm for the Company. Concurrent with such resignation, the Company's audit committee approved the engagement of Moss Adams as the new independent registered public accounting firm for the Company.

Moss Adams audited our financial statements for the year ended December 31, 2017. Hein, which, combined with Moss Adams, audited our financial statements for the years ended December 31, 2016 and 2015. There were no disagreements between the Company and Moss Adams concerning any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which were not resolved to the satisfaction of that firm.

The audit reports of Hein on the Company's financial statements for the years ended December 31, 2016 did not contain an adverse opinion or a disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope or accounting principles except, the audit report of Hein on the Company's financial statements for the year ended December 31, 2016 contained an explanatory paragraph indicating that there was substantial doubt about the ability of the Company to continue as a going concern. The circumstances surrounding this disclosure were subsequently alleviated as described in the Company's Form 10-Q for the quarter ended September 30, 2017.

During the two most recent fiscal years ended December 31, 2016 and through the subsequent interim period preceding Hein's resignation, there were no disagreements between the Company and Hein on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of Hein would have caused them to make reference thereto in their reports on the Company's financial statements for such years.

During the two most recent fiscal years ended December 31, 2017 and through the subsequent interim period preceding Moss Adams' declination to stand for re-election and Hein's resignation, there were no reportable events within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K, except that for the year ended December 31, 2016, a material weakness existed in the Company's internal control over financial reporting, as described in Item 9A to the Company's annual report on Form 10-K for the year ended December 31, 2016 and Item 4 of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2017.

**Board Recommendation**

The Board recommends you vote “FOR” Proposal 2. For the reasons provided in this Proxy Statement, we are asking shareholders to vote “FOR” the following resolution:

“RESOLVED, that the shareholders ratify the Audit Committee’s appointment of EKS&H LLLP, certified public accountants, to act as the auditors of the Company’s financial statements for the year ending December 31, 2018.”

### **PROPOSAL 3: ADVISORY VOTE ON EXECUTIVE COMPENSATION**

Our shareholders are entitled to cast an advisory “say-on-pay” vote at the Annual Meeting to approve the compensation of the Company’s executive officer as disclosed in this Proxy Statement. The Company will hold an advisory vote on executive compensation every year until the next required advisory vote with respect to the frequency of advisory votes on executive compensation. At the 2017 annual shareholders meeting, the say-on-pay vote was 879,537 votes for, 224,878 against, and 9,341 shares abstaining.

As an advisory vote, this Proposal 3 is not binding on the Board or the Compensation Committee. However, the Compensation Committee, which is responsible for designing and administering the Company’s executive compensation program, values the opinions expressed by shareholders in their vote on this proposal and will continue to consider the outcome of the vote when making future compensation decisions for named executive officers.

Our executive compensation programs are designed to provide a competitive level of compensation to attract, motivate and retain talented and experienced executives and to motivate them to achieve short-term and long-term corporate goals that enhance shareholder value.

#### **Board Recommendation**

The Board recommends you vote for Proposal 3. For the reasons provided in this Proxy Statement, we are asking shareholders to vote “FOR” the following resolution:

“RESOLVED, that the shareholders approve, on an advisory basis, the compensation philosophy, policies and procedures and the compensation of our named executive officers for 2017 as disclosed in the proxy statement for U.S. Energy’s 2018 Annual Meeting of Shareholders pursuant to the compensation disclosure rules of the SEC, the compensation tables and the narrative disclosures that accompany the compensation tables.”

## COMPENSATION DISCUSSION AND ANALYSIS

### EXECUTIVE COMPENSATION

#### Summary Compensation Table

The table below sets forth information regarding compensation for our named executive officers for the years indicated:

Name and Position	Year	Salary	Bonus	Stock Awards	Option Awards	All Other Compensation	Total
David A. Veltri	2017	\$359,008	-	\$34,999 <sup>(2)</sup>	-	-	\$393,999
Chief Executive Officer	2016	\$359,000	-	-	-	\$ 3,072	<sup>(3)</sup> 362,072
Ryan L. Smith	2017	\$150,658 <sup>(1)</sup>	-	-	\$94,757	\$ 80,400	<sup>(4)</sup> \$325,815
Chief Financial Officer	2016	-	-	-	-	-	-

Mr. Smith began receiving an annual base salary of \$240,000 beginning on May 23, 2017 when he was appointed (1) Chief Financial Officer of the Company by the Board. Mr. Smith previously consulted for the Company from January 16, 2017 until his appointment as Chief Financial Officer.

On September 23, 2016, the Board of Directors granted restricted stock to each member of the Board for 58,500 shares per Board member. In connection with the resignations of four members of the Company's Board of (2) Directors, the restricted stock grants were amended and all members of the Board of Directors subsequently agreed to accept 33,332 fully-vested shares each, in lieu of the 58,500 share grants.

(3) All Other Compensation for Mr. Veltri during 2016 is primarily comprised of a \$3,072 401(k) contribution.

(4) All Other Compensation in 2017 for Mr. Smith is primarily comprised of consulting fees.

#### Outstanding Equity Awards

The following table provides information relating to the unexercised stock options and the unvested stock awards for the Named Executive Officers as of December 31, 2017. Each award to each named executive is shown separately, with a footnote describing the award's vesting schedule.

Name	Stock Option Awards		Option Exercise Price	Option Expiration Date	Restricted Stock Awards	
	Number of Securities Underlying Unexercised Options	Invested			Shares of Restricted Stock That Have Not Vested	Market Value
David A. Veltri	16,666	-	\$ 9.00	1/25/2025	-	\$ 0
Ryan L. Smith	-	100,000 (1)	\$ 1.16	11/10/2027	-	\$ 0

(1) In November 2017, Mr. Smith was granted a stock option award for 100,000 shares of common stock, of which one-half of the shares vest on the anniversary dates of the grant in November 2018 and 2019.

#### Potential Payment Upon Termination or Change in Control

Our named executive officers are eligible to receive certain severance benefits and change in control benefits pursuant to their employment agreement. The potential severance and change in control benefits that our named executive officers could have received as of December 31, 2017 are described below.

The Company entered into employment agreements with Mr. Veltri on October 23, 2015 and with Mr. Smith on May 18, 2017. Mr. Veltri's employment agreement has a term of two years with automatic renewals for two successive one year terms. Mr. Smith's agreement has a term continuing until January 1, 2019, following which Mr. Smith's employment will be on at "at-will" basis.

The employment agreements provide for base salary, bonus and entitle the named executive officers to participate in the Company's Amended and Restated 2012 Equity and Performance Incentive Plan under such terms and conditions as the Company may determine for any applicable calendar year.

In the event that Mr. Veltri incurs a termination from employment by the Company without Cause (defined below) outside of a Change in Control (as defined below) event, Mr. Veltri would be entitled to receive the following benefits: (a) the base salary owing under the employment agreement through the date of termination; (b) accrued vacation; (c) any reimbursable business expense; (d) cash payment equal to 18 months of COBRA; (e) severance equal to 1.5x of the current annual base salary, plus an amount equal to the current year target bonus as of the date of termination; and (f) accelerated vesting of any unvested equity-based awards as prescribed for and in accordance with

the relevant terms of the applicable equity-based compensation programs and award agreements.

In the event that Mr. Veltri incurs a termination from employment by the Company without Cause or for Good Reason (as defined below) in connection with a Change in Control within twelve months of such Change in Control, Mr. Veltri would be entitled to receive the following benefits: (i) the payments identified (a) through (d) of the preceding paragraph; (ii) accelerated vesting of any unvested equity-based awards (iii) any earned but unpaid bonus; (iv) severance pay in an amount equal to 2x the current year's annual base salary, plus an amount equal to the current year target bonus; (v) reasonable attorney fees incurred as a result of such termination; and (vi) cash payment equal to the cost of coverage under all life insurance, medical, health, accident, and disability programs in which the executive was entitled to participate immediately prior to the Change in Control for a period of two years from the termination.



Mr. Veltri's employment agreement defines Cause as: (i) the negligent and continued failure by the executive to substantially perform his duties with the Company (other than any such failure resulting from disability) after a written demand for substantial performance improvement is delivered to the executive, identifying the manner in which the executive has not substantially performed his duties, or describing his participation in misconduct which is materially injurious to the Company, monetarily or otherwise, unless done or omitted to be done, in good faith and with a reasonable belief that the action or omission was in the best interest of the Company; which failure is not remedied upon notice within 10 calendar days; (ii) that the executive shall have committed an intentional act of fraud, embezzlement or theft in connection with his duties with, or in the course of his employment with, the Company, or been convicted of a felony or other crime involving moral turpitude; (iii) intentional wrongful damage to or misappropriation of property of the Company; (iv) an intentional or grossly negligent refusal or failure to perform executive's duties, or to carry out the reasonable directions of the Company's Board of Directors (other than on account of illness or other physical or mental disability), which refusal or failure is not remedied within the 10 calendar days after receipt by the executive of written notice from the Company thereof, or insubordination; or (v) a material breach of any of the provisions of the employment agreement applicable to executive, which breach is not remedied within the 10 calendar days after receipt by the executive of written notice from the Company of such breach; and in any case any such act or failure to act shall be determined by the Board of Directors of the Company to have been materially harmful to the Company. For purposes of the employment agreement, no act, or failure to act, on the part of the executive shall be deemed "intentional" unless done, or omitted to be done, by the executive not in good faith and without a reasonable belief that his action or omission was in the best interests of the Company, as determined by the Board of Directors of the Company in its sole but reasonable discretion.

Mr. Veltri's employment agreement defines Change in Control as a change in the control of the Company of a nature which would be required to be reported in response to Item 6(e) of the Schedule 14A to Regulation 14A, as promulgated under the Exchange Act (or any successor thereto); provided that, without limitation, a Change in Control shall be deemed to have occurred if: (i) any person is or becomes the beneficial owner directly or indirectly, of 50% or more of a class of equity securities of the Company, or of securities which in the aggregate provide such beneficial owner with 50% or more of the votes entitled to be cast with respect to the election of members of the Board of Directors; (ii) during any period of two consecutive years, the individuals who at the beginning of such period constituted the Board of Directors cease for any reason to constitute a majority thereof; (iii) any person acquires, directly or indirectly, more than 25% of the outstanding shares of voting securities of the Company, coupled with or followed by the election as directors of the Company of persons who were not directors at the time of such acquisition, if such directors comprise a majority of the Board; (iv) as a result of a tender offer, merger, consolidation, sale of assets, contested election or any combination of those or similar transaction, the directors of the Company immediately before such transaction(s) shall cease to constitute a majority of the Board or of any successor to the Company; (v) the acquisition, directly or indirectly, by another person or entity, in a single transaction or series of related transactions of all or substantially all (greater than 50%) of the Company's assets; or (vi) the Company's shareholders approve a plan of liquidation of the Company.

Mr. Veltri's employment agreement defines Good Reason as the termination by Mr. Veltri of his employment subsequent to a Change in Control of the Company within one hundred and twenty (120) days after the occurrence of any of the following events: (i) a significant and material adverse change in the nature or scope of the executive's duties and responsibilities or other working condition with the Company; (ii) the assignment to the executive of any duties inconsistent with the positions, responsibilities and status of the executive with the company immediately prior

to the Change in Control; (iii) any removal of the executive from, or failure to re-elect the executive to, any of such position, except in connection with termination of employment for Cause, disability, retirement or as a result of the executive's death or termination by the executive, other than for Good Reason; (iv) a reduction by the Company in the executives base salary as in effect immediately prior to the Change in Control; (v) reassignment of the executive to offices more than 25 miles from the location of the Company's principal executive offices immediate prior to the Change in Control; (vi) failure by the Company to continue in effect any benefit or compensation plan, stock ownership plan, stock purchase plan, stock option plan, life insurance plan, health and accident plan, or disability plan in which the executive is participating immediately prior to the Change in Control, the taking of any action by the Company which would adversely affect the executive's participation in or materially reduce his benefits under any such plan, or deprive the executive of any material fringe benefit enjoyed immediately prior to the Change in Control; (vii) a failure by the Company to make timely payment to the executive of any amounts he is entitled to under the employment agreement; (viii) any purported termination of the executive's employment by the Company which is not effected pursuant to a notice of termination (as defined in the employment agreement).

In the event that Mr. Smith incurs a termination from employment by the Company without Cause (defined below) outside of a Change of Control (as defined below) event, Mr. Smith would be entitled to receive the following benefits: (a) all accrued by unpaid base salary through the date of termination; (b) unpaid or unreimbursed expenses; (c) any benefits provided under the Company's employee benefits plans in accordance with the terms contained in such plans; (d) reasonable relocation costs in accordance with written company policy; (e) unpaid bonus; (f) cash payment equal to twelve (12) months of the employee's base salary; (g) cash payment equal to 12 months of COBRA; and (h) immediate vesting of any and all equity or equity-related award previously awarded to the employee irrespective of the type of award.

In the event that Mr. Smith terminates his employment for Good Reason (defined below) outside of a Change of Control event, Mr. Smith would be entitled to receive the following: (i) the payments identified in (a) through (d) of the preceding paragraph; (ii) unpaid bonus; and (iii) a cash payment equal to twelve months of COBRA.

In the event that Mr. Smith incurs a termination from employment by the Company without Cause or for Good Reason in connection with a Change of Control during the twelve (12) month period following such Change of Control, Mr. Smith would be entitled to receive the following: (a) all accrued but unpaid base salary through the date of termination; (b) unpaid or unreimbursed expenses; (c) any benefits provided under the Company's employee benefits plans in accordance with the terms contained in such plans; (d) reasonable relocation costs in accordance with written company policy; (e) unpaid bonus; (f) cash payment equal to 12 months of COBRA (g) immediate vesting of any and all equity or equity-related award previously awarded to the employee irrespective of the type of award; (h) cash payment equal to 1x of the total base salary plus an amount equal to the total value of the annual bonus amount paid during the preceding fiscal year.

Mr. Smith's employment agreement defines Cause as: (i) a material breach of the terms and conditions of employee's employment agreement with the Company, (ii) employee's act(s) of gross negligence or willful misconduct in the course of employee's employment hereunder that is injurious to the Company, (iii) willful failure or refusal by employee to perform in any material respect employee's duties or responsibilities, (iv) misappropriation by employee of any assets of the Company, (v) embezzlement or fraud committed by employee, or at employee's direction, (vi) employee's conviction of, or pleading "guilty" or "no contest" to a felony under state or federal law.

Mr. Smith's employment agreement defines Change of Control as the first to occur of any of the following: (i) "change of control event" with respect to the Company, within the meaning of Treas. Reg. §1.409A-3(i)(5); (ii) during any period of two years, individuals who at the beginning of such period constitute the Board (and any new director whose election by the Company's shareholders was approved by a vote of at least a majority of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was so approved) cease for any reason to constitute a majority thereof; or (iii) a merger, consolidation, or reorganization of the Company with or involving any other entity, other than a merger, consolidation, or reorganization that would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least 50% of the combined voting power of the securities of the Company (or such surviving entity) outstanding immediately after such merger, consolidation, or reorganization.

Mr. Smith's employment agreement defines Good Reason as: without employee's consent, (i) a material diminution in employee's title, duties, or responsibilities, (ii) the failure of the Company to pay any compensation pursuant to the employment agreement when due or to perform any other obligation of the Company under the employment agreement, or (iii) the relocation of employee's principal place of employment by more than fifty (50) miles.

### Non-Employee Director Compensation

We generally use a combination of cash and share-based incentive compensation to attract and retain qualified candidates to serve on our Board of Directors. Additionally, our directors are reimbursed for reasonable travel expenses incurred in attending meetings. In setting director compensation, we consider the significant amount of time that directors expend fulfilling their duties to us as well as the skill level required of such directors. For the year ended December 31, 2017, all non-employee director compensation was paid in stock awards and cash as shown below:

Current Director Name <sup>(1)</sup>	Nature of Director Fees		Stock Awards	Total
	Director	Committee		
J. Weldon Chitwood	-	-	\$11,766 <sup>(4)</sup>	\$11,766
John G. Hoffman	-	-	11,766 <sup>(4)</sup>	11,766
Javier F. Pico	-	-	11,766 <sup>(4)</sup>	11,766
All directors as a group	-	-	\$35,297	\$35,297

Former Director Name <sup>(1)</sup>	Nature of Director Fees		Stock Awards	Total
	Director	Committee		
Thomas R. Bandy	\$13,333 <sup>(2)</sup>	-	<sup>(3)</sup> \$34,999	<sup>(4)</sup> \$48,332
Jerry W. Danni	13,333 <sup>(2)</sup>	2,000	<sup>(3)</sup> 34,999	<sup>(4)</sup> 50,332
Leo A. Heath	13,333 <sup>(2)</sup>	1,333	<sup>(3)</sup> 34,999	<sup>(4)</sup> 49,665
James B. Fraser	13,333 <sup>(2)</sup>	-	<sup>(3)</sup> 34,999	<sup>(4)</sup> 48,332
Stephen V. Conrad	6,667 <sup>(2)</sup>	6,667	<sup>(3)</sup> 34,999	<sup>(4)</sup> 48,333
All directors as a group	\$60,000	\$10,000	\$174,995	\$244,994

David A. Veltri was appointed to our Board of Directors on December 31, 2015. Mr. Veltri has been omitted from this table since he does not receive additional compensation for serving as a director of the Company. Mr. Veltri's (1) compensation is described above under "Executive Compensation." Steven V. Conrad announced his resignation from the Board of Directors effective March 3, 2017. Thomas R. Bandy, Jerry W. Danni, Leo A. Heath and James B. Fraser announced their resignations from the Board of Directors on May 2, 2017.

(2) Historically, each of our independent directors has received annual cash compensation for serving on our Board of Directors of \$40,000, payable at the rate of \$3,333 per month. Effective May 8, 2017, with the appointment of new directors J. Weldon Chitwood, John G. Hoffman and Javier F. Pico, each of our independent directors agreed to

forego their fees temporarily as a cost savings measure.

Independent directors receive additional fees for serving as the Chairman of our board committees. Mr. Conrad received an annual fee of \$12,000 to serve as Chairman of the Audit Committee. Upon Mr. Conrad's resignation from the Board of Directors, Mr. Fraser agreed to serve as Chairman of the Audit Committee and was expected to receive an additional \$12,000 in annual fees going forward; Mr. Danni received an annual fee of \$6,000 to serve as Chairman of our Compensation Committee; and Mr. Heath received an annual fee of \$4,000 to serve as Chairman of our Nominating Committee. Effective May 8, 2017, with the appointment of new directors J. Weldon Chitwood, John G. Hoffman and Javier F. Pico, each of our committee chairmen agreed to forego their fees temporarily as a cost savings measure.

On September 23, 2016, the Board of Directors granted restricted stock to each member of the Board for 58,500 shares per Board member for an aggregate grant of 351,000 shares. In connection with the resignations of four members of the Company's Board of Directors, the restricted stock grants were amended, and the members of the Board of Directors subsequently agreed to accept 33,332 fully-vested shares each, in lieu of the 58,500 share grants.

### Equity Compensation Plan Information

A summary of the combined activity in each of the Company's equity incentive plans for the year ended December 31, 2017, is as follows:

	Number of Shares to be Issued Upon:				
	Exercise of Outstanding Options	Weighted Average Exercise Price Shares	Vesting of Restricted Stock Number of Shares	Weighted Average Grant Date Price	Securities Available for Future Issuance
Plans Approved by Shareholders					
2001 Incentive Stock Option Plan	67,558	\$ 15.12	-	-	-
2008 Stock Option Plan for Independent Directors and Advisory Board Members	29,779	\$ 19.66	-	-	-
2012 Equity and Performance Incentive Plan	292,350	\$ 5.23	205,547	\$ 1.26	981,008
Total	389,687	\$ 8.05	205,547	\$ 1.26	981,008

## **Certain Relationships and Related Transactions**

### **Family Employment**

The Company has adopted a nepotism policy pursuant to which family members of any employee, which include fathers, mothers, siblings, sons, daughters, nieces, nephews or grandchildren, may not be hired or terminated by a direct family member. Additionally, family members are not allowed to participate in any discussion relating to the setting of compensation rates for other family members. In addition, an immediate relative of any employee can only be hired after the Compensation Committee has reviewed the application of the direct family member and has satisfied itself that (a) the position is necessary, (b) the position has been adequately advertised, (c) other applicants have been interviewed by non-family managers of the Company and (d) that the family member is the most qualified for the position. Further, written approval from the Chairman of the Compensation Committee must be received along with an approved rate of pay before any family members of any employees, officers or directors can be employed and paid by the Company.

### **Related Person Transaction Policy**

From time to time, we have entered into transactions with certain “related persons,” a category that generally includes executive officers, directors, and beneficial owners of five percent or more of our common stock, and immediate family members of these persons and entities in which one of these persons has a direct or indirect material interest. We refer to transactions with these related persons as “related party transactions.” The Audit Committee is responsible for the review and approval of each related party transaction exceeding \$120,000, although, as a matter of practice, the Committee reviews, and, if appropriate, approves, all related party transactions regardless of the amount involved.

The Audit Committee considers all relevant factors when determining whether to approve a proposed related party transaction, including (without limitation):

the size of the transaction and the amount of consideration that might be paid to a related person;

the nature of the interest of the applicable related person; and

whether the transaction involves the provision of goods or services to us that are available from unaffiliated third parties.

## **Implementation of the Policy**

In determining whether to approve a proposed related party transaction, the Audit Committee must be reasonably satisfied that:

the transaction likely will significantly benefit all shareholders, even though it will provide a benefit to the related parties; and

goods or services of comparable quality either cannot be obtained from third parties in time to meet the Company's needs or can be obtained but at a significantly higher cost.

In appropriate circumstances, the Committee may enlist outside sources to obtain information about the possibility of using third party vendors' goods and/or services.

Compensation of certain related persons other than executive officers is determined by the Compensation Committee rather than the Audit Committee as discussed in "Family Employment." The policy has been followed by the Committee since 2004.

## **Related Party Transactions**

The Company had a related party payable to its Chief Executive Officer of \$0.05 million as of December 31, 2017 for the reimbursement of ordinary business expenses incurred on behalf of the Company.

## **PROPOSAL 4: APPROVAL OF AMENDMENTS TO U.S. ENERGY CORP. AMENDED AND RESTATED 2012 EQUITY AND PERFORMANCE INCENTIVE PLAN**

### **Background and Purpose**

Our Board has unanimously adopted, and is submitting for shareholder approval, certain amendments to the U.S. Energy Corp. Amended and Restated 2012 Equity and Performance Incentive Plan (the “2012 Plan”). The purpose of amending the 2012 Plan is to increase the number of shares issuable under the 2012 Plan, add contractors of the Company as Eligible Individuals, as that term is defined in the 2012 Plan, and to increase the limitation on grants to an Eligible Individual. The increase in number of shares issuable under the 2012 Plan will allow us to continue to make future grants of equity incentive awards under the 2012 Plan to directors, officers, and employees. The addition of contractors as Eligible Individuals will allow us to be competitive in the market for contractors by giving the Company the ability to pay contractor compensation in equity of the Company. The increase to the limitation on grants to an Eligible Individual will allow the Company to more adequately compensate its directors, officers, employees and contractors while enabling the Company to attract new talent. As described more fully below, we consider such amendments to the 2012 Plan to be a key component of our compensation structure. The past grants received by our executive officers and directors under the 2012 Plan during fiscal year 2017 are set forth above in the sections titled “Executive Compensation” and “Director Compensation,” respectively.

The 2012 Plan was originally adopted on April 24, 2012 and has been amended from time to time. When the 2012 Plan was originally adopted, we reserved 200,000 shares of common stock, as adjusted for the six-for-one reverse stock split in 2016, for issuance under the 2012 Plan. We reserved an additional 333,333 shares of common stock, as adjusted for the six-for-one reverse stock split in 2016, for issuance in connection with the 2012 Plan when it was amended in 2015 and reserved an additional 1,000,000 shares of common stock for issuance when it was last amended in 2017. As of December 31, 2017, 981,008 shares of our common stock remained available for issuance under the 2012 Plan. See “Equity Compensation Plan Information” set forth above in the section titled “Executive Compensation” for additional information regarding the number of shares of our common stock that are available for issuance under the 2012 Plan.

Accordingly, our Board has determined that there are not sufficient shares available for issuance under the 2012 Plan to make future equity grants, a key component of our compensation structure. We consider the 2012 Plan to be an essential element of total compensation of our directors, executive officers and employees and believe the 2012 Plan promotes our interests and the interests of our shareholders by attracting and retaining the services of key employees and qualified directors and encouraging a sense of proprietorship in the Company and stimulating the active interest of those persons receiving awards under the 2012 Plan in our development and success. By increasing the number of shares of common stock available for issuance as awards under the 2012 Plan by 1,000,000 shares, or approximately 8% of our currently outstanding shares of common stock, we believe we will have the flexibility to use equity awards to continue to support our growth strategy and our ability to attract and retain talented executives and employees. Because the amount and timing of specific equity awards in the future is dependent on our employee headcount,



management performance, competitive compensation practices and other factors, some of which are beyond our control, it is not possible to know when or if the currently proposed increase in the shares available under the 2012 Plan will be exhausted or the amount of subsequent dilution that may ultimately result from such awards.

The Board's rationale for reserving an additional 1,000,000 shares of common stock for issuance under the 2012 Plan, is that the Company needs more capacity in the 2012 Plan for purposes of attracting talent as it expands its operations. An increase will help motivate the Company's officers, directors and employees to accomplish the Company's goals while balancing the dilutive effect of such additional shares to the shareholders. In addition, there are not sufficient shares currently available for issuance under the 2012 Plan to make future equity grants.

If approved by the shareholders, the amendment to increase the number of common shares reserved for issuance under the 2012 Plan would amend Section 3(a)(i) to read in its entirety as follows:

“(i) Subject to adjustment as provided in Section 13 of the Plan, a maximum of 2,141,008 Shares may be delivered pursuant to Awards under this Plan.”

The 2012 plan, as currently adopted, limits grants to individual participants during any fiscal year of the Company to 400,000 shares. Accordingly, our Board has determined that the limitations on grants to individual participants is too restrictive. The Board believes that increasing the limit on grants to individual participants will better allow the Company to meet its compensation objectives and to attract talent and motivate the Company's officers, directors and employees to accomplish the Company's goals.

If approved by the shareholders, the amendment to increase the number of common shares reserved for issuance under the 2012 Plan would amend Section 3(b)(i) to read in its entirety as follows:

“(i) Subject to adjustment as provided in Section 13 of this Plan, the maximum number of shares with respect to which Awards may be granted hereunder to any Participant or Director during any fiscal year of the Company shall be 800,000 shares (the “Limitation”). If an Option is canceled, the canceled Option shall continue to be counted toward the Limitation for the year granted. An Option (or a Stock Appreciation Right) that is repriced during any fiscal year is treated as the cancellation of the Option (or Stock Appreciation Right) and grant of new Option (or Stock Appreciation Right) for purposes of the Limitation for that fiscal year.”

The 2012 Plan, as currently adopted, does not permit the Company to grant equity awards to contractors of the Company. Accordingly, our Board has determined that the Company does not have competitive compensation policies in effect to attract and retain qualified consultants.

If approved by the shareholders, the amendment to add consultants as Eligible Individuals under the 2012 Plan would amend Section 2(k) to read in its entirety as follows:

“Eligible Individual” means an officer, employee, Director, or contractor of the Company or any one or more of its Subsidiaries”

If Proposal 4 is not approved by shareholders, the Board of Directors believe the Company will not have sufficient shares for future grants under the 2012 Plan, will not be able to meet its compensation objectives, attract talent and motivate the Company's officers, directors and employees to accomplish the Company's goals, and will not be able to attract and retain qualified contractors.

A copy of the 2012 Plan, as amended, is included as *Appendix A* to this Proxy Statement.

### **Tax Considerations**

Our ability to obtain a federal income tax deduction for amounts paid under the 2012 Plan could be limited by Section 162(m) of the Code. Pursuant to Section 162(m) of the Code, the federal income tax deduction for the Company will generally be unavailable for annual compensation in excess of \$1 million paid to any of our "covered employees" (within the meaning of Section 162(m) of the Code), which generally include the chief executive officer, the chief financial officer and the three other most highly compensated officers of the Company. In the past, amounts that constituted "performance-based compensation" generally did not count toward the \$1 million limit. Nevertheless, under statutory changes mandated by the newly enacted Tax Cuts and Jobs Act ("TCJA"), performance-based compensation is no longer excluded from the application of the \$1 million limitation. Statutory changes to Section 162(m) of the Code mandated by TCJA regarding the deductibility of executive compensation do not, however, apply to executive remuneration paid pursuant to a binding, written contract in existence on November 2, 2017, to the extent that the terms of the binding contract are not or were not modified in any material respect on or after such date.

### **Interest of Certain Persons in Matters to Be Acted Upon**

Other than as a result of their right to participate in the 2012 Plan, no person who was a director or executive officer of the Company in the year ended December 31, 2017, or any associate of theirs, has any substantial interest in this proposal.

### **Required Vote and Recommendation**

Provided a quorum of at least a majority of the issued and outstanding shares of common stock is present (in person or by proxy), this proposal will be approved if the votes cast favoring the proposal exceeds the votes cast opposing the proposal. Abstentions and broker non-votes will not be counted as having been voted on the proposal and will not have an effect on the proposal.

## **Board Recommendation**

The Board recommends you vote for Proposal 4. For the reasons provided in this Proxy Statement, we are asking shareholders to vote “FOR” the following resolution:

“RESOLVED, that the shareholders approve the vote to approve the amendments to the U.S. Energy Corp. Amended and Restated 2012 Equity and Performance Incentive Plan to increase the number of shares of common stock reserved for issuance under the 2012 Plan by 1,000,000, add contractors of the Company as Eligible Individuals under the 2012 Plan, and to increase the limitation on grants to an Eligible Individual.”

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## **PROPOSAL 5: ADJOURNMENT PROPOSAL**

At the Annual Meeting, we may adjourn, or ask shareholders to vote to adjourn, the Annual Meeting to solicit additional proxies in favor of the approval of the proposals in this Proxy Statement if we have not obtained sufficient votes to approve the proposals. Approval of the adjournment proposal requires the affirmative vote of a majority of the votes cast on the matter. Because this vote is a non-routine matter under applicable rules, your bank, broker or other nominee cannot vote without instructions from you.

### **Board Recommendation**

The Board recommends you vote “FOR” Proposal 5. For the reasons provided in this Proxy Statement, we are asking shareholders to vote “FOR” the following resolution:

“**RESOLVED**, that the shareholders approve the adjournment of the Annual Meeting, if necessary, to solicit additional proxies for the proposals contained in this Proxy Statement.”

## Report of the Audit Committee

Management is responsible for the preparation of the Company's financial statements, and the reporting process, as well as maintaining effective internal control over financial reporting and assessing the effectiveness of the controls. For the fiscal year ended December 30, 2017 Moss Adams LLP was responsible for auditing the annual financial statements of the Company and expressing an opinion as to whether they are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States. For the fiscal year ending December 30, 2018 EKS&H LLLP is responsible for auditing the annual financial statements and expressing an opinion as to whether they are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States. The Audit Committee is responsible for, among other things, reviewing and selecting the independent registered public accounting firm, reviewing our annual and interim financial statements, and pre-approving all engagement letters and fees for audit and non-audit services provided by our independent accountant.

In performing its oversight functions in connection with the Company's financial statements as of and for the year ended December 31, 2017, the Audit Committee has:

Reviewed and discussed the audited financial statements with management and the Company's independent registered accounting firm, including the quality of the accounting principles, and the reasonableness of significant judgments made in the preparation of the financial statements;

Discussed with the Company's independent registered accounting firm those matters required to be discussed by the statement on Auditing Standards No. 61, as amended and as adopted by the Public Accounting Oversight Board in Rule 3200T;

Received written disclosures from the Company's independent registered accounting firm regarding its independence as required by the PCAOB and discussed with the independent registered accounting firm its independence; and

Reviewed and approved the services provided by the independent registered accounting firm.

Based upon the foregoing reports and discussions, and subject to the limitations on the roles and responsibilities of the Audit Committee referred to in its charter, the Audit Committee recommended to the Board, and the Board has approved, that the Company's audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on March 28, 2018.

In addition, the Audit Committee engaged EKS&H as the Company's independent registered public accounting firm for the year ending December 30, 2018, and any interim periods, subject to the ratification of this engagement by the shareholders.

Respectfully submitted by the Audit Committee of the Board

*/s/Javier F. Pico, Chairman*

*/s/J. Weldon Chitwood*

*/s/John G. Hoffman*

## **INCORPORATION OF CERTAIN INFORMATION BY REFERENCE**

We are incorporating by reference specified documents that we file with the SEC, which means that incorporated documents are considered part of this Proxy Statement. We are disclosing important information to you by referring you to those documents and information we subsequently file with the SEC will automatically update and supersede information contained in this Proxy Statement and in our other filings with the SEC. This document incorporates by reference the Company's Annual Report on Form 10-K and Form 10-K/A for the year ended December 31, 2017, filed on March 28, 2018, and April 25, 2018 respectively, the Company's quarterly report on Form 10-Q for the quarter ended March 30, 2018, filed on May 14, 2018, and the Company's current reports on Form 8-K filed on March 28, 2017, May 8, 2017, September 22, 2017, October 5, 2017, November 7, 2017, November 17, 2017, December 29, 2017, January 5, 2018, March 29, 2018, May 4, 2018, and June 4, 2018.



Appendix A

**U.S. Energy Corp.**

**Amended and Restated 2012 Equity and Performance Incentive Plan**

**Adopted By the Board:** ~~April 24, 2010, March 20, 2015, April 27, 2017~~ April 24, 2018

**Approved by the Shareholders:** ~~June 29, 2012, June 19, 2015, July 17, 2017~~ September \_\_, 2018

**Effective:** ~~July 1, 2012-2015, July 17, 2017~~ September \_\_, 2018

1. **Purpose.** The purpose of the 2012 Equity and Performance Incentive Plan is to attract and retain officers and other employees of U.S. Energy Corp., a Wyoming corporation, and its Subsidiaries and to provide to such persons incentives and rewards for superior performance.

2. **Definitions.** As used in this Plan,

(a) “Award” means any Option, Stock Appreciation Right, Restricted Stock, Performance Share, Performance Unit, Other Share-Based Award, or any other right, interest or option related to Shares or other property (including cash) granted pursuant to the provisions of this Plan.

(b) “Base Price” means the price to be used as the basis for determining the Spread upon the exercise of a Free-Standing Appreciation Right and a Tandem Appreciation Right.

(c) “Board” means the Board of Directors of the Company and, to the extent of any delegation by the Board to a committee (or subcommittee thereof) pursuant to Section 14 of this Plan, such committee (or subcommittee).

(d) “Change in Control” has the meaning set forth in Section 11.

(e) “Code” means the Internal Revenue Code of 1986, as amended from time to time, and the rules and regulations thereunder, as such law, rules and regulations may be amended from time to time.

(f) “Common Stock” means the Common Stock, par value \$0.01 per share, of the Company or any security into which such Common Stock may be changed by reason of any transaction or event of the type referred to in Section 13 of this Plan.

(g) “Company” means U.S. Energy Corp., a Wyoming corporation, and its successors.

(h) “Date of Grant” means the date specified by the Board on which a grant of Options, Stock Appreciation Rights, Performance Shares, Performance Units or other awards contemplated by Section 9 of this Plan, or a grant or sale of Restricted Stock, Restricted Stock Units, or other awards contemplated by Section 9 of this Plan, will become effective (which date will not be earlier than the date on which the Board takes action with respect thereto).

(i) “Director” means a member of the Board of Directors of the Company.

(j) “Effective Date” means July 1, 2012. As amended, the Effective Date shall be the later of (1) July 1, 2015, or (2) the date that shareholder approval is obtained for the Amended and Restated 2012 Equity and Performance Incentive Plan.

(k) “Eligible Individual” means an officer, employee, Director, or contractor of the Company or any one or more of its Subsidiaries.

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(l) “Evidence of Award” means an agreement, certificate, resolution or other type or form of writing or other evidence approved by the Board that sets forth the terms and conditions of the Awards granted. An Evidence of Award may be in an electronic medium, may be limited to notation on the books and records of the Company and, unless otherwise determined by the Board, need not be signed by a representative of the Company or a Participant.

(m) “Exchange Act” means the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder, as such law, rules and regulations may be amended from time to time.

(n) “Free-Standing Appreciation Right” means a Stock Appreciation Right granted pursuant to Section 5 of this Plan that is not granted in tandem with an Option.

(o) “Incentive Stock Options” means Options that are intended to qualify as “incentive stock options” under Section 422 of the Code or any successor provision.

(p) “Management Objectives” means the measurable performance objective or objectives established pursuant to this Plan for Participants who have received grants of Performance Shares or Performance Units or, when so determined by the Board, Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, dividend credits or other awards pursuant to this Plan. Management Objectives may be described in terms of Company-wide objectives or objectives that are related to the performance of the individual Participant or of the Subsidiary, division, department, region or function within the Company or Subsidiary in which the Participant is employed. The Management Objectives may be made relative to the performance of one or more other companies or subsidiaries, divisions, departments, regions or functions within such other companies, and may be made relative to an index of one or more of the performance objectives themselves.

If the Board determines that a change in the business, operations, corporate structure or capital structure of the Company, or the manner in which it conducts its business, or other events or circumstances render the Management Objectives unsuitable, the Board may in its discretion modify such Management Objectives or the related level or levels of achievement, in whole or in part, as the Board deems appropriate and equitable.

(q) “Market Value per Share” means, as of any particular date, the closing sale price of a share of Common Stock as reported on the principal national securities exchange on which the Common Stock is listed. If the Common Stock is not traded on a given date, the Market Value per Share means the closing price for a share of Common Stock on the principal national securities exchange on which the Common Stock is traded for the immediately preceding date on which the Common Stock is traded. If the Common Stock is not listed on a national securities exchange, the Market Value per Share shall be the fair market value of a share of Common Stock as determined in good faith by the Board

in accordance with the fair market value pricing rules set forth in Section 409A of the Code.

(r) “Optionee” means the Eligible Individual named in an Evidence of Award evidencing an outstanding Option.

(s) “Option Price” means the purchase price per Share payable on exercise of an Option.

(t) “Option” means an option to purchase Common Stock granted pursuant to Section 4 of this Plan.

(u) “Participant” means an Eligible Individual who has received an Award under this Plan.

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(v) “Performance Period” means, in respect of a Performance Share or Performance Unit, a period of time established pursuant to Section 8 of this Plan within which the Management Objectives relating to such Performance Share or Performance Unit are to be measured.

(w) “Performance Share” means a bookkeeping entry that records the equivalent of one share of Common Stock awarded pursuant to Section 8 of this Plan.

(x) “Performance Unit” means a bookkeeping entry awarded pursuant to Section 8 of this Plan that records a unit equivalent to \$1.00 or such other value as is determined by the Board.

(y) “Plan” means this U.S. Energy Corp. 2012 Equity and Performance Incentive Plan, as may be amended from time to time.

(z) “Restricted Stock” means Common Stock granted or sold pursuant to Section 6 of this Plan as to which the applicable Restriction Period has not yet lapsed.

(aa) “Restriction Period” means the period of time during which Restricted Stock is subject to a substantial risk of forfeiture or Restricted Stock Units are subject to restrictions, as provided in Section 6 and Section 7 of this Plan.

(bb) “Restricted Stock Unit” means an award made pursuant to Section 7 of this Plan of the right to receive Common Stock or cash at the end of a specified period.

(cc) “Share” means one share of Common Stock.

(dd) “Spread” means, on any applicable measurement date, the excess of the Market Value per Share over the Option Price or Base Price provided for in an Option or Stock Appreciation Right, respectively.

(ee) “Separation from Service” means a Participant’s Termination of Employment with the Company and any of its Subsidiaries or affiliates that qualifies as a “separation from service” for purposes of Section 409A of the Code. A

Separation from Service will be deemed to occur where the Participant and the Company, its Subsidiary or affiliate, reasonably anticipate that the bona fide level of services the Participant will perform (whether as an employee or as an independent contractor) will be permanently reduced to a level that is less than thirty-seven and a half percent (37.5%) of the average level of bona fide services the Participant performed during the immediately preceding 36 months (or the entire period the Participant has provided services if the Participant has been providing services to the Company and any of its Subsidiaries or affiliates for less than 36 months).

(ff) “Stock Appreciation Right” means a right granted pursuant to Section 5 of this Plan, and includes both Tandem Appreciation Rights and Free-Standing Appreciation Rights.

(gg) “Subsidiary” means a corporation, company or other entity (i) more than 50 percent of whose outstanding shares or securities (representing the right to vote for the election of directors or other managing authority) are, or (ii) which does not have outstanding shares or securities (as may be the case in a partnership, joint venture or unincorporated association), but more than 50 percent of whose ownership interest representing the right generally to make decisions for such other entity is, now or hereafter, owned or controlled, directly or indirectly, by the Company except that for purposes of determining whether any person may be a Participant for purposes of any grant of Incentive Stock Options, “Subsidiary” means any corporation in which at the time the Company owns or controls, directly or indirectly, more than 50 percent of the total combined voting power represented by all classes of stock issued by such corporation.

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(hh) “Tandem Appreciation Right” means a Stock Appreciation Right granted pursuant to Section 5 of this Plan that is granted in tandem with an Option.

(ii) “Termination of Employment” means the termination of a Participant’s employment with, or performance of services for, the Company and any of its Subsidiaries or affiliates. Unless otherwise determined by the Board, if a Participant’s employment with the Company and its affiliates terminates but such Participant continues to provide services to the Company and its affiliates in a non-employee capacity, such change in status shall not be deemed a Termination of Employment. A Participant shall be deemed to incur a Termination of Employment in the event of the disaffiliation of such Participant’s subsidiary, affiliate, or division unless the Board specifies otherwise. Temporary absences from employment because of illness, vacation or leave of absence and transfers among the Company and its Subsidiaries and affiliates do not constitute a Termination of Employment. If an Award is subject to Section 409A of the Code, however, Termination of Employment for purposes of that Award shall mean the Participant’s Separation from Service.

### **3. Shares Available Under the Plan.**

#### **(a) Maximum Shares Available Under Plan.**

- (i) Subject to adjustment as provided in Section 13 of this Plan, a maximum of 1,981,008 shares of Common Stock may be delivered pursuant to Awards granted under this Plan.

Shares of Common Stock covered by an Award shall not be counted as used unless and until they are actually issued to a Participant and, therefore, the total number of shares of Common Stock available under the Plan as of a given date shall not be reduced by any Common Stock relating to prior Awards that have expired or have been forfeited or cancelled. If the Award is to be settled in cash, the number of shares of Common Stock on which the

- (ii) Award is based shall not count toward the share limits set forth in this Section 3. Notwithstanding anything to the contrary contained herein: (A) if shares of Common Stock are tendered or otherwise used in payment of the Option Price of an Option or the Base Price of a Stock Appreciation Right, the total number of shares of Common Stock covered by the Option or Stock Appreciation Right being exercised shall count against the aggregate Plan limit described above and (B) shares of Common Stock withheld by the Company to satisfy the tax withholding obligation shall count against the aggregate Plan limit described above.

#### **(b) Limitations on Grants to Individual Participant.**

- (i) Subject to adjustment as provided in Section 13 of this Plan, the maximum number of shares with respect to which Awards may be granted hereunder to any Participant or Director during any fiscal year of the Company shall be

800,000 shares (the “Limitation”). If an Option is canceled, the canceled Option shall continue to be counted toward the Limitation for the year granted. An Option (or a Stock Appreciation Right) that is repriced during any fiscal year is treated as the cancellation of the Option (or Stock Appreciation Right) and grant of new Option (or Stock Appreciation Right) for purposes of the Limitation for that fiscal year.

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**4. Options.** The Board may, from time to time and upon such terms and conditions as it may determine, grant to Eligible Individuals options to purchase Common Stock. Each grant of Options will be evidenced by an Evidence of Award which shall contain such terms and conditions as the Board may approve that are not inconsistent with the following terms and conditions and those of the remainder of the Plan:

(a) Each Evidence of Award will specify the number of shares of Common Stock to which it pertains subject to the limitations set forth in Section 3 of this Plan.

(b) Each Evidence of Award will specify an Option Price per share, which may not be less than the Market Value per Share on the Date of Grant (or 110% of the Market Value Per Share in the case of an Incentive Stock Option issued to the owner of 10% or more of the voting power of the Company or any of its Subsidiaries).

(c) Each Evidence of Award will specify whether the Option Price will be payable, to the extent permitted by applicable statutes and regulations, either (a) in cash or by certified or bank check at the time the Option is exercised or (b) in the discretion of the Committee, in any form of lawful consideration approved by the Committee. As of the Effective Date (and subject to any future action by the Committee to restrict the forms of consideration that may be used to pay the Option Price) the Committee has approved the following: (i) by delivery to the Company of other Common Stock, duly endorsed for transfer to the Company, with a Market Value per Share on the date of delivery equal to the Option Price (or portion thereof) due for the number of Shares being acquired, or by means of attestation whereby the Participant identifies for delivery specific shares of Common Stock that have an aggregate Market Value per Share on the date of attestation equal to the Option Price (or portion thereof) and receives a number of shares of Common Stock equal to the difference between the number of shares thereby purchased and the number of identified attestation shares of Common Stock; (ii) a “cashless” exercise program established with a broker; (iii) reduction in the number of shares of Common Stock otherwise deliverable upon exercise of such Option with a Market Value per Share equal to the aggregate Option Price at the time of exercise; (iv) any combination of the foregoing methods; or (v) any other form of legal consideration that may be acceptable to the Committee including but not limited to “net” or “immaculate” exercise. Unless otherwise specifically provided in the Evidence of Award, the exercise price of Common Stock acquired pursuant to an Option that is paid by delivery (or attestation) to the Company of other Common Stock acquired, directly or indirectly from the Company, shall be paid only by shares of Common Stock of the Company that have been held for more than six months (or such longer or shorter period of time required to avoid a charge to earnings for financial accounting purposes). Notwithstanding the foregoing, during any period for which the Common Stock is publicly traded (i.e., the Common Stock is listed on any established stock exchange or a national market system) an exercise by a Director or officer that involves or may involve a direct or indirect extension of credit or arrangement of an extension of credit by the Company, directly or indirectly, in violation of Section 402(a) of the Sarbanes-Oxley Act of 2002 shall be prohibited with respect to any Award under this Plan.

(d) Successive grants may be made to the same Participant whether or not any Options previously granted to such Participant remain unexercised.

(e) Each Evidence of Award will specify the period or periods of continuous service by the Optionee with the Company or any Subsidiary, if any, that is necessary before the Options or installments thereof will become exercisable. The Evidence of Award may provide for the earlier exercisability of such Options in the event of the retirement, death or disability of a Participant, or a Change of Control.

(f) Any Evidence of Award Option may specify Management Objectives that must be achieved as a condition to the Options becoming exercisable.

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(g) Options granted under this Plan may be (i) options, including, without limitation, Incentive Stock Options that are intended to qualify under particular provisions of the Code, (ii) options that are not intended so to qualify, or (iii) combinations of the foregoing. Incentive Stock Options shall be designated as such in the Evidence of Award and may only be granted to Participants who meet the definition of “employees” under Section 3401(c) of the Code.

(h) No grant of Options may be accompanied by a tandem award of dividend equivalents or provide for dividends, dividend equivalents or other distributions to be paid on such Options.

(i) The exercise of an Option will result in the cancellation on a share for-share basis of any Tandem Appreciation Right authorized under Section 5 of this Plan.

(j) Each Evidence of Award shall specify the period during which the Option may be exercisable; provided, however that no Option will be exercisable more than 10 years from the Date of Grant (5 years for any Incentive Stock Option issued to any owner of 10% or more of the outstanding voting securities of the Company or any of its Subsidiaries). Each Evidence of Award may provide for accelerated expiration of the Option upon the Participant’s Termination of Employment.

## **5. Stock Appreciation Rights.**

(a) The Board may, from time to time and upon such terms and conditions as it may determine, authorize the granting (i) to any Optionee, of Tandem Appreciation Rights in respect of Options granted hereunder, or (ii) to any Eligible Individual, of Free-Standing Appreciation Rights. A Tandem Appreciation Right will be a right of the Optionee, exercisable by surrender of the related Option, to receive from the Company an amount determined by the Board, which will be expressed as a percentage of the Spread (not exceeding 100 percent) of the Tandem Appreciation Right at the time of exercise. Tandem Appreciation Rights may be granted at any time prior to the exercise or termination of the related Options; provided, however, that a Tandem Appreciation Right awarded in relation to an Incentive Stock Option must be granted concurrently with such Incentive Stock Option. A Free-Standing Appreciation Right will be a right of the Participant to receive from the Company an amount determined by the Board, which will be expressed as a percentage of the Spread (not exceeding 100 percent) of the Free Standing Appreciation Right at the time of exercise.

(b) Each grant of Stock Appreciation Rights will be evidenced by an Evidence of Award which shall identify the Stock Appreciation Right as a Free-Standing Appreciation Right or a Tandem Appreciation Right (and in the case of Tandem Appreciation Rights shall identify the related Option) and shall contain such terms and conditions as the Board may approve that are not inconsistent with the following terms and conditions of this section and section 5(c) and 5(d) below (as applicable), and those of the remainder of the Plan:

- Each Evidence of Award shall specify the amount payable upon exercise of the Stock Appreciation Right and
- (i) may provide that such may be paid by the Company in cash, in Common Stock or in any combination thereof and may retain in the Board the right to elect among those alternatives.
  - (ii) Any Evidence of Award may specify that the amount payable on exercise of a Stock Appreciation Right may not exceed a maximum specified by the Board at the Date of Grant.
  - (iii) No grant of Stock Appreciation Rights may be accompanied by a tandem award of dividend equivalents or provide for dividends, dividend equivalents or other distributions to be paid on such Stock Appreciation Rights.

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(c) Each Evidence of Award of Tandem Appreciation Rights shall specify the Base Price of such Tandem Appreciation Rights (which shall generally equal the Option Price of the Related Option) and will provide that such Tandem Appreciation Rights may be exercised only at a time and during the period when the related Option is also exercisable and at a time when the Spread is positive, and by surrender of the related Option for cancellation. Successive grants of Tandem Appreciation Rights may be made to the same Participant regardless of whether any Tandem Appreciation Rights previously granted to the Participant remain unexercised.

(d) Regarding Free-Standing Appreciation Rights only:

- (i) Each Evidence of Award will specify in respect of each Free-Standing Appreciation Right a Base Price, which will be equal to or greater than the Market Value per Share on the Date of Grant;

Each Evidence of Award will specify the period or periods of continuous service by the Participant with the Company or any Subsidiary, if any, that is necessary before the Free-Standing Appreciation Right or installments

- (ii) thereof will become exercisable. The Evidence of Award may provide for the earlier exercisability of such Free-Standing Appreciation Rights in the event of the retirement, death or disability of a Participant, or a Change of Control;

- (iii) Any Evidence of Award of Free-Standing Appreciation Rights may specify Management Objectives that must be achieved as a condition of the Free-Standing Appreciation Rights becoming exercisable;

Each Evidence of Award shall specify the period during which the Free-Standing Appreciation Right may be exercisable; provided, however that no Free-Standing Appreciation Right will be exercisable more than 10 years

- (iv) from the Date of Grant. Each Evidence of Award may provide for accelerated expiration of the Free-Standing Appreciation Right upon the Participant's Termination of Employment; and

- (v) Successive grants of Free-Standing Appreciation Rights may be made to the same Participant regardless of whether any Free-Standing Appreciation Rights previously granted to the Participant remain unexercised.

**6. Restricted Stock.** The Board may, from time to time and upon such terms and conditions as it may determine, grant or sell Restricted Stock to Participants. Each grant or sale of Restricted Stock will be evidenced by an Evidence of Award which shall contain such terms and conditions as the Board may approve that are not inconsistent with the following terms and conditions and those of the remainder of the Plan:

(a) Each such grant or sale will constitute an immediate transfer of the ownership of Common Stock to the Participant in consideration of the performance of services, entitling such Participant to voting, dividend and other ownership rights, but subject to the substantial risk of forfeiture and restrictions on transfer hereinafter referred to.

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(b) Each such grant or sale may be made without additional consideration or in consideration of a payment by such Participant that is less than or equal to the Market Value per Share at the Date of Grant.

(c) Each Evidence of Award will provide that the Restricted Stock covered by such grant or sale will be subject to a “substantial risk of forfeiture” within the meaning of Section 83 of the Code during the Restriction Period, which “substantial risk of forfeiture” may lapse upon the passage of time and/or upon achievement of Management Objectives referred to in subparagraph (e) below.

(d) Each such grant or sale will provide that during the Restriction Period for which such substantial risk of forfeiture is to continue, the transferability of the Restricted Stock will be prohibited or restricted in the manner and to the extent prescribed by the Board in the Evidence of Award (which restrictions may include, without limitation, rights of repurchase or first refusal in the Company or provisions subjecting the Restricted Stock to a continuing substantial risk of forfeiture in the hands of any transferee).

(e) Any Evidence of Award may specify Management Objectives that, if achieved, will result in termination or early termination of the restrictions applicable to such Restricted Stock. Each Evidence of Award may specify in respect of such Management Objectives a minimum acceptable level of achievement and may set forth a formula for determining the number of shares of Restricted Stock on which restrictions will terminate if performance is at or above the minimum or threshold level or levels, or is at or above the target level or levels, but falls short of maximum achievement of the specified Management Objectives.

(f) Notwithstanding anything to the contrary contained in this Plan, any Evidence of Award may provide for the earlier termination of restrictions on such Restricted Stock in the event of the retirement, death or disability of a Participant, or a Change of Control.

(g) Any such grant or sale of Restricted Stock may require that any or all dividends or other distributions paid thereon during the Restriction Period be subject to the same restrictions as the underlying award and/or reinvested or deemed reinvested in additional shares of Restricted Stock. In the event such dividends are not reinvested or deemed reinvested in additional shares of Restricted Stock, they shall be paid in cash (without interest) on the date on which the Restriction Period lapses.

(h) Unless otherwise directed by the Board, (i) all certificates representing shares of Restricted Stock will be held in custody by the Company until all restrictions thereon will have lapsed, together with a stock power or powers executed by the Participant in whose name such certificates are registered, endorsed in blank and covering such Shares, or (ii) all shares of Restricted Stock will be held at the Company’s transfer agent in book entry form with

appropriate restrictions relating to the transfer of such shares of Restricted Stock.

**7. Restricted Stock Units.** The Board may, from time to time and upon such terms and conditions as it may determine, grant Restricted Stock Units to Eligible Individuals. Each grant of Restricted Stock Units will be evidenced by an Evidence of Award which shall contain such terms and conditions as the Board may approve that are not inconsistent with the following terms and conditions and those of the remainder of the Plan:

(a) Each such grant will constitute the agreement by the Company to deliver one share of Common Stock per Restricted Stock Unit (or to deliver the cash equivalent thereof) to the Participant in the future in consideration of the performance of services, but subject to the fulfillment of such conditions (which may include the achievement of Management Objectives) during the Restriction Period as the Board may specify in the Evidence of Award. Each Evidence of Award may specify in respect of such Management Objectives a minimum acceptable level of achievement and may set forth a formula for determining the number of Common Shares subject to the Restricted Stock Units as to which restrictions will terminate if performance is at or above the minimum or threshold level or levels, or is at or above the target level or levels, but falls short of maximum achievement of the specified Management Objectives.

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(b) Notwithstanding anything to the contrary contained in this Plan, any Evidence of Award may provide for the earlier lapse or modification of the Restriction Period in the event of the retirement, death or disability of a Participant, or a change of Control.

(c) During the Restriction Period, the Participant will have no right to transfer any rights under his or her award and will have no rights of ownership in the Restricted Stock Units and will have no right to vote the Common Shares subject to the Restricted Stock Units, but the Board may in the Evidence of Award authorize the payment of dividend equivalents on either a current, deferred or contingent basis, either in cash or in additional shares of Common Stock, provided that dividend equivalents shall not be paid in a manner that would cause any tax to be due under 409A of the Code.

(d) Each Evidence of Award Unit will specify the time and manner of payment of the Restricted Stock Units that have been earned. Each Evidence of Award will specify that the amount payable with respect thereto will be paid by the Company in Common Stock or cash. If a cash payment is made in lieu of delivering shares of Common Stock, the amount of such payment shall be based on the Market Value per Share as of the date on which the Restriction Period lapsed with respect to each Restricted Stock Unit.

**8. Performance Shares and Performance Units.** The Board may, from time to time and upon such terms and conditions as it may determine, grant Performance Shares and Performance Units that will become payable to a Participant upon achievement of specified Management Objectives during the Performance Period. Each grant or sale of Performance Shares and Performance Units will be evidenced by an Evidence of Award which shall contain such terms and conditions as the Board may approve that are not inconsistent with the following terms and conditions and those of the remainder of the Plan:

(a) Each Evidence of Award will specify the number of Performance Shares or Performance Units to which it pertains, which number may be subject to adjustment to reflect changes in compensation or other factors.

(b) The Performance Period with respect to each Performance Share or Performance Unit will be such period of time as will be determined by the Board at the time of grant, and may be subject to earlier lapse or other modification in the event of the retirement, death or disability of a Participant, or a Change of Control.

(c) Any Evidence of Award will specify Management Objectives which, if achieved, will result in payment or early payment of the award, and each Evidence of Award may specify in respect of such Management Objectives a minimum acceptable level of achievement and may set forth a formula for determining the number of Performance Shares or Performance Units that will be earned if performance is at or above the minimum or threshold level or

levels, or is at or above the target level or levels, but falls short of maximum achievement of the specified Management Objectives. The grant of Performance Shares or Performance Units will specify that, before the Performance Shares or Performance Units will be earned and paid, the Board must certify that the Management Objectives have been satisfied.

(d) Each Evidence of Award will specify the payment to be made pursuant to any award of Performance Shares or Performance Units and the time and manner of such payment. Any Evidence of Award may specify that the amount payable with respect thereto may be paid by the Company in cash, in Common Stock or in any combination thereof and may retain in the Board the right to elect among those alternatives.

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(e) Any Evidence of Award may specify that the amount payable or the number of shares of Common Stock issued with respect thereto may not exceed maximums specified by the Board at the Date of Grant.

(f) The Evidence of Award may provide for the payment of dividend equivalents to the holder thereof either in cash or in additional shares of Common Stock subject in all cases to payment on a contingent basis based on the Participant's earning of the Performance Shares with respect to which such dividend equivalents are paid, provided that dividend equivalents shall not be paid in a manner that would cause any tax to be due under 409A of the Code.

#### **9. Other Awards.**

(a) The Board may, subject to limitations under applicable law, grant to any Eligible Individual such other awards that may be denominated or payable in, valued in whole or in part by reference to, or otherwise based on, or related to, shares of Common Stock or factors that may influence the value of such shares, including, without limitation, convertible or exchangeable debt securities, other rights convertible or exchangeable into Common Stock, purchase rights for Common Stock, awards with value and payment contingent upon performance of the Company or specified Subsidiaries, affiliates or other business units thereof or any other factors designated by the Board, and awards valued by reference to the book value of shares of Common Stock or the value of securities of, or the performance of specified Subsidiaries or affiliates or other business units of the Company. The Board shall determine the terms and conditions of such awards. Shares of Common Stock delivered pursuant to an award in the nature of a purchase right granted under this Section 9 shall be purchased for such consideration, paid for at such time, by such methods, and in such forms, including, without limitation, cash, shares of Common Stock, other awards, notes or other property, as the Board shall determine.

(b) Cash awards, as an element of or supplement to any other award granted under this Plan, may also be granted pursuant to this Section 9 of this Plan.

(c) The Board may grant Common Stock as a bonus, or may grant other awards in lieu of obligations of the Company or a Subsidiary to pay cash or deliver other property under this Plan or under other plans or compensatory arrangements, subject to such terms as shall be determined by the Board in a manner that complies with Section 409A of the Code.

(d) Share-based awards pursuant to this Section 9 are not required to be subject to any minimum vesting period.

**10. Transferability.**

(a) Except as otherwise determined by the Board, no Option, Stock Appreciation Right or other Award shall be transferable by the Participant except by will or the laws of descent and distribution, and in no event shall any such Award be transferred for value. Except as otherwise determined by the Board, Options and Stock Appreciation Rights will be exercisable during the Participant's lifetime only by him or her or, in the event of the Participant's legal incapacity to do so, by his or her guardian or legal representative acting on behalf of the Participant in a fiduciary capacity under state law and/or court supervision.

(b) Any Evidence of Award may provide that part or all of the shares of Common Stock that are (i) to be issued or transferred by the Company upon (A) the exercise of Options or Stock Appreciation Rights, (B) upon the termination of the Restriction Period applicable to Restricted Stock Units or (C) upon payment under any grant of Performance Shares or Performance Units or (ii) no longer subject to the substantial risk of forfeiture and restrictions on transfer referred to in Section 6 of this Plan, will be subject to further restrictions on transfer that are consistent with applicable law.

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## 11. Change in Control.

(a) In the event of a Change in Control, but notwithstanding any other provision of the Plan to the contrary, the Board may, in its discretion, take any of the actions listed in this Section 11.

(i) provide that any Options and Stock Appreciation Rights outstanding which are not then exercisable and vested shall become immediately vested and fully exercisable;

(ii) provide that any Restricted Stock, Restricted Stock Unit and other Awards shall become vested in full;

provide that Performance Criteria applicable to Performance Shares and Performance Units or Management Objectives applicable to other Awards shall be deemed to be satisfied and such Awards shall be considered to be earned and payable in full;

(iv) provide for the assumption or substitution of equal or greater value of any Award on such terms and conditions as the Board deems appropriate and consistent with Section 409A of the Code;

make such settlements of outstanding Awards as it deems appropriate, including, without limitation, the  
(v) cancellation of outstanding Awards in exchange for payments of cash, property or a combination thereof having an aggregate value equal to the value of such Awards, as determined by the Board in its sole discretion; and

provide for the cancellation without payment of each Option or Stock Appreciation Right or other Award with an  
(vi) Option Price or Base Price (or similar amount) greater than the consideration offered in connection with any such Change in Control.

(a) The Board's actions need not be uniform, and may result in disparate treatment among Participants, Awards, and portions of the same Award, as the Board determines in its sole and absolute discretion.

Notwithstanding the foregoing, in the event the Board does not, for any reason, provide for the assumption or  
(b) substitution with an award of equal or greater value of any Award (or portion thereof) pursuant to the Change in Control transaction, such Award (or portion thereof) shall become vested in full immediately prior to such Change in Control.

(c) To the extent the Board provides for the assumption or substitution with an award of equal or greater value of an outstanding Award (or portion thereof), then, to the extent not otherwise vested by the Board in accordance with the provisions of this Section 11 and notwithstanding any other provision of this Plan to the contrary, during the 12-month period following a Change in Control: (i) upon the involuntary termination of an Optionee or Participant's employment other than termination for Cause; (ii) upon the voluntary termination of employment by the Participant following a material and adverse change in the Optionee or Participant's compensation, responsibilities, functions or reporting relationship; or (iii) in the event an Optionee or Participant resigns rather than accept a mandatory relocation greater than 50 miles; then, in any such event, all outstanding Awards held by such Optionee or Participant shall become vested as of the Date of Termination. Any Option or Stock

Appreciation Right held by the Optionee or Participant as of the date of the Change in Control that remains outstanding as of the date of Termination of Employment may thereafter be exercised, until the earlier of (i) the third anniversary of the date of Termination of Employment; or (ii) the expiration of the Term of such Option or Stock Appreciation Right. Restricted Stock shall immediately be vested free and transferable. Restricted Stock Units, Performance Shares, Performance Units and other Awards shall be vested as of the Termination of Employment and settled as soon as practicable as specified in the Evidence of Award; provided, however, that if the Award is subject to Section 409A and the Optionee or Participant is a Specified Employee, the Award shall be settled on the first day of the seventh month following the Participant's Termination of Employment.

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(d) For purposes of the Plan, a “Change in Control” shall mean any of the following events:

(i) The acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act (a “Person”)) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 25% or more of the then-outstanding Shares of Common Stock plus any other outstanding shares of stock of the Corporation entitled to vote in the election of directors (the “Outstanding Company Voting Securities”); provided, however, that the Company and any employee benefit plan (or related trust) sponsored by it shall not be deemed to be a Person; or

(ii) A change in the composition of the Board such that the individuals who constitute the Board (the “Incumbent Board”) cease for any reason to constitute at least a majority of the Board. For this purpose, any individual whose election or nomination for election by the Company’s shareholders was approved by a vote of at least two-thirds of the directors then comprising the Incumbent Board shall be considered a member of the Incumbent Board; or

(iii) The consummation of a reorganization, merger, statutory share exchange or consolidation or similar corporate transaction involving the Company or any of its Subsidiaries or a sale or other disposition of substantially all of the assets of the Company or a material acquisition of assets or stock of another entity by the Company or any of its Subsidiaries, (each, a “Business Combination”) if:

(A) the individuals and entities that were the beneficial owners of the Outstanding Company Voting Securities immediately prior to such Business Combination do not beneficially own, directly or indirectly, more than 50% of the then-outstanding shares of stock and the combined voting power of the then-outstanding voting securities of the corporation resulting from such Business Combination; or

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- (B) a Person beneficially owns, directly or indirectly, 25% or more of the then-outstanding shares of stock of the corporation resulting from such Business Combination; or
  - (C) members of the Incumbent Board do not comprise at least a majority of the members of the board of directors of the corporation resulting from such Business Combination; or
- (iv) A complete liquidation or dissolution of the Company.

If an Award is subject to Section 409A of the Code, any provision regarding the timing or form of payment upon a Change in Control shall be set forth in the Award Agreement when the Award is granted. The payment or settlement of any such Award that is subject to Section 409A of the Code shall accelerate upon a Change in Control only if the event also constitutes a “change in ownership,” “change in effective control,” or “change in the ownership of a substantial portion of the Company’s assets” as defined under Section 409A of the Code. Any adjustment to the Award that does not affect the Award’s status under Section 409A (including, but not limited to, accelerated vesting or adjustment of the amount of the Award) may occur upon a Change-in-Control as defined in the Plan without regard to this paragraph, even if the event does not constitute a “change in ownership,” “change in effective control,” or “change in the ownership of a substantial portion of the Company’s assets” under Section 409A.

## 12. Securities Act Compliance.

- (a) If the Board deems it necessary to comply with the Securities Act of 1933, as amended, and the regulations and rulings thereunder, the Board may require a written investment intent representation by the Optionee or Participant and may require a restrictive legend be affixed to certificates for shares of Common Stock.
- (b) If, based upon the opinion of counsel for the Company, the Committee determines that the exercise or nonforfeiture of, or delivery of benefits pursuant to, any Award would violate any applicable provision of (i) U.S. federal, state or local securities law or (ii) the listing requirements of any national securities exchange on which are listed any of the Company’s equity securities, then the Committee may postpone any such exercise, nonforfeiture or delivery, as the case may be, until such provisions would be satisfied. Nothing herein shall require the Company to take any actions to cause such exercise, nonforfeiture or delivery to comply with all such provisions.

**13. Adjustments.** The Board shall make or provide for such adjustments in the numbers of shares of Common Stock covered by outstanding Awards, the Option Price of Options and the Base Price of Stock Appreciation Rights, Options and in the kind of shares covered thereby, as the Board, in its sole discretion, exercised in good faith, may determine is equitably required to prevent dilution or enlargement of the rights of Participants or Optionees that otherwise would result from (a) any stock dividend, stock split, combination of shares, recapitalization or other change in the capital structure of the Company, (b) any merger, consolidation, spin-off, split-off, spin-out, split-up, reorganization, partial or complete liquidation or other distribution of assets, issuance of rights or warrants to purchase securities, or (c) any



other corporate transaction or event having an effect similar to any of the foregoing. The Board shall also make or provide for such adjustments in the numbers of shares of Common Stock specified in Section 3 of this Plan as the Board in its sole discretion, exercised in good faith, may determine is appropriate to reflect any transaction or event described in this Section 13; provided, however, that any such adjustment to the number specified in Section 3(a)(i) will be made only if and to the extent that such adjustment would not cause any Option intended to qualify as an Incentive Stock Option to fail to so qualify.

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#### 14. Administration of the Plan.

(a) This Plan will be administered by the Board, which may from time to time delegate all or any part of its authority under this Plan to the Compensation Committee (the “Committee”) of the Board (or a subcommittee thereof), as constituted from time to time. To the extent of any such delegation, references in this Plan to the Board will be deemed to be references to such Committee or subcommittee. A majority of the Board or Committee (or subcommittee), as applicable, will constitute a quorum, and the action of the members of the Board or Committee (or subcommittee) present at any meeting at which a quorum is present, or acts unanimously approved in writing, will be the acts of the Board or Committee (or subcommittee).

(b) The interpretation and construction by the Board of any provision of this Plan or of any agreement, notification or document evidencing the grant of Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Shares, Performance Units or other awards pursuant to Section 9 of this Plan and any determination by the Board pursuant to any provision of this Plan or of any such agreement, notification or document will be final and conclusive. No member of the Board will be liable for any such action or determination made in good faith.

(c) The Board or, to the extent of any delegation as provided in Section 14(a), the Committee, may delegate to one or more of its members or to one or more officers of the Company, or to one or more agents or advisors, such administrative duties or powers as it may deem advisable, and the Board, the committee, or any person to whom duties or powers have been delegated as aforesaid, may employ one or more persons to render advice with respect to any responsibility the Board, the Committee or such person may have under the Plan. The Board or the Committee may, by resolution and consistent with applicable law, authorize one or more officers of the Company to do one or both of the following on the same basis as the Board or the Committee: (i) designate employees to be recipients of awards under this Plan; (ii) determine the size of any such awards; provided, however, that (A) the Board or the Committee shall not delegate such responsibilities to any such officer for awards granted to an employee who is an officer, Director, or more than 10% beneficial owner of any class of the Company’s equity securities that is registered pursuant to Section 12 of the Exchange Act, as determined by the Board in accordance with Section 16 of the Exchange Act; (B) the resolution providing for such authorization sets forth the total number of shares of Common Stock such officer(s) may grant; and (C) the officer(s) shall report periodically to the Board or the Committee, as the case may be, regarding the nature and scope of the awards granted pursuant to the authority delegated.

**15. Clawback.** Any benefits the Optionee or Participant may receive under this Plan shall be subject to repayment or forfeiture as may be required to comply with (i) any applicable listing standards of a national securities exchange adopted in accordance with Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (regarding recovery of erroneously awarded compensation) and any implementing rules and regulations of the U.S. Securities and Exchange Commission adopted thereunder, (ii) similar rules under the laws of any other jurisdiction and (iii) any policies adopted by the Company to implement such requirements, all to the extent determined by the Company in its discretion to be applicable to the Optionee or Participant.

**16. Recapture Provisions.** Any Evidence of Award may provide for the cancellation or forfeiture of an award or the forfeiture and repayment to the Company of any gain related to an award, or other provisions intended to have a similar effect, upon such terms and conditions as may be determined from time to time by the Board.

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**17. Non U.S. Participants.** In order to facilitate the making of any grant or combination of grants under this Plan, the Board may provide for such special terms for awards to Participants who are foreign nationals or who are employed by the Company or any Subsidiary outside of the United States of America or who provide services to the Company under an agreement with a foreign nation or agency, as the Board may consider necessary or appropriate to accommodate differences in local law, tax policy or custom. Moreover, the Board may approve such supplements to or amendments, restatements or alternative versions of this Plan (including without limitation, sub-plans) as it may consider necessary or appropriate for such purposes, without thereby affecting the terms of this Plan as in effect for any other purpose, and the Secretary or other appropriate officer of the Company may certify any such document as having been approved and adopted in the same manner as this Plan. No such special terms, supplements, amendments or restatements, however, will include any provisions that are inconsistent with the terms of this Plan as then in effect unless this Plan could have been amended to eliminate such inconsistency without further approval by the stockholders of the Company.

**18. Withholding Taxes.** To the extent that the Company is required to withhold federal, state, local or foreign taxes in connection with any payment made or benefit realized by a Participant or other person under this Plan, and the amounts available to the Company for such withholding are insufficient, it will be a condition to the receipt of such payment or the realization of such benefit that the Participant or such other person make arrangements satisfactory to the Company for payment of the balance of such taxes required to be withheld, which arrangements (in the discretion of the Board) may include relinquishment of a portion of such benefit. If a Participant fails to make arrangements for the payment of tax, the Company may withhold such tax from any other form of remuneration payable to the Participant, including, if it determines in its sole and absolute discretion, from shares of Common Stock payable pursuant to the Award having a value equal to the amount required to be withheld. When a Participant is required to pay the Company an amount required to be withheld under applicable income and employment tax laws, the Participant may elect to satisfy the obligation, in whole or in part, by electing to have withheld, from the shares required to be delivered to the Participant, shares of Common Stock having a value equal to the amount required to be withheld, or by delivering to the Company other shares of Common Stock held by such Participant. The shares used for tax withholding will be valued at an amount equal to the Market Value per Share of such Common Stock on the date the benefit is to be included in Participant's income. In no event shall the Market Value per Share of the Common Stock to be withheld and delivered pursuant to this Section 18 to satisfy applicable withholding taxes in connection with the benefit exceed the minimum amount of taxes required to be withheld. Participants shall also make such arrangements as the Company may require for the payment of any withholding tax obligation that may arise in connection with the disposition of shares of Common Stock acquired upon the exercise of Options.

#### **19. Amendments, Termination Etc.**

(a) The Board may at any time and from time to time amend the Plan in whole or in part; provided, however, that if an amendment to the Plan (i) would materially increase the benefits accruing to participants under the Plan, (ii) would materially increase the number of securities which may be issued under the Plan, (iii) would materially modify the requirements for participation in the Plan or (iv) must otherwise be approved by the stockholders of the Company in order to comply with applicable law or the rules of the principal national securities exchange upon which the Common Stock is traded or quoted, then, such amendment will be subject to stockholder approval and will not be effective

unless and until such approval has been obtained.

(b) Except in connection with a corporate transaction or event described in Section 13 of this Plan, the terms of outstanding awards may not be amended to reduce the Option Price of outstanding Options or the Base Price of outstanding Stock Appreciation Rights, or cancel outstanding Options or Stock Appreciation Rights in exchange for cash, other awards or Options or Stock Appreciation Rights with an Option Price or Base Price, as applicable, that is less than the Option Price of the original Options or Base Price of the original Stock Appreciation Rights, as applicable, without stockholder approval.

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(c) If permitted by Section 409A of the Code, but subject to Section 20d) hereof, in case of termination of employment by reason of death, disability or normal or early retirement, or in the case of unforeseeable emergency or other special circumstances, of a Participant who holds an Option or Stock Appreciation Right not immediately exercisable in full, or any shares of Restricted Stock as to which the substantial risk of forfeiture or the prohibition or restriction on transfer has not lapsed, or any Restricted Stock Units as to which the Restriction Period has not been completed, or any Performance Shares or Performance Units which have not been fully earned, or any other awards made pursuant to Section 9 subject to any vesting schedule or transfer restriction, or who holds Common Stock subject to any transfer restriction imposed pursuant to Section 10(b) of this Plan, or in the case of a change of control, the Board may, in its sole discretion, accelerate the time at which such Option, Stock Appreciation Right or other award may be exercised or the time at which such substantial risk of forfeiture or prohibition or restriction on transfer will lapse or the time when such Restriction Period will end or the time at which such Performance Shares or Performance Units will be deemed to have been fully earned or the time when such transfer restriction will terminate or may waive any other limitation or requirement under any such award.

(d) Subject to Section 20(b) hereof, the Board may amend the terms of any award theretofore granted under this Plan prospectively or retroactively. Subject to Section 13 above, no such amendment shall impair any material right of any Participant without his or her consent. The Board may, in its discretion, terminate this Plan at any time. Termination of this Plan will not affect the rights of Participants or their successors under any awards outstanding hereunder and not exercised in full on the date of termination.

## **20. Compliance with Section 409A of the Code.**

(a) To the extent applicable, it is intended that this Plan and any grants made hereunder comply with the provisions of Section 409A of the Code, so that the income inclusion provisions of Section 409A(a)(1) of the Code do not apply to the Participants. This Plan and any grants made hereunder shall be administered in a manner consistent with this intent. Any reference in this Plan to Section 409A of the Code will also include any regulations or any other formal guidance promulgated with respect to such Section by the U.S. Department of the Treasury or the Internal Revenue Service.

(b) Neither a Participant nor any of a Participant's creditors or beneficiaries shall have the right to subject any deferred compensation (within the meaning of Section 409A of the Code) payable under this Plan and grants hereunder to any anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment or garnishment. Except as permitted under Section 409A of the Code, any deferred compensation (within the meaning of Section 409A of the Code) payable to a Participant or for a Participant's benefit under this Plan and grants hereunder may not be reduced by, or offset against, any amount owing by a Participant to the Company or any of its affiliates.

(c) If, at the time of a Participant's separation from service (within the meaning of Section 409A of the Code), (i) the Participant shall be a specified employee (within the meaning of Section 409A of the Code and using the identification methodology selected by the Company from time to time) and (ii) the Company shall make a good faith determination that an amount payable hereunder constitutes deferred compensation (within the meaning of Section 409A of the Code) the payment of which is required to be delayed pursuant to the six-month delay rule set forth in Section 409A of the Code in order to avoid taxes or penalties under Section 409A of the Code, then the Company shall not pay such amount on the otherwise scheduled payment date but shall instead pay it, without interest, on the earlier of the tenth business day following (i) the seventh month after such Separation of Service, (ii) the Participant's death, (iii) or such earlier date or event on which such amount may be paid without violating the provisions of Code Section 409A.

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(d) Notwithstanding any provision of this Plan and grants hereunder to the contrary, in light of the uncertainty with respect to the proper application of Section 409A of the Code, the Company reserves the right to make amendments to this Plan and grants hereunder as the Company deems necessary or desirable to avoid the imposition of taxes or penalties under Section 409A of the Code. In any case, a Participant shall be solely responsible and liable for the satisfaction of all taxes and penalties that may be imposed on a Participant or for a Participant's account in connection with this Plan and grants hereunder (including any taxes and penalties under Section 409A of the Code), and neither the Company nor any of its affiliates shall have any obligation to indemnify or otherwise hold a Participant harmless from any or all of such taxes or penalties.

## 21. Code Section 162(m) Provisions.

### (a) Covered Employees.

Notwithstanding any other provision of the Plan, if the Committee determines that any Award is being granted to a Participant who is, or is likely to be, as of the end of the tax year in which the Company would claim a tax deduction in connection with such Award, a "covered employee" (within the meaning of 162(m) (3) of the Code), then the Committee may provide that this Section 21 is applicable to such Award.

### (b) Performance Goals.

(i) If an Award is subject to this Section 18, then the lapsing of restrictions thereon and the distribution of Shares or other property pursuant thereto, as applicable, shall be subject to the achievement of one or more specified levels of Performance Criteria as defined in Appendix A. Such Performance Criteria may be based solely by reference to the Company's performance or the performance of a division or business unit of the Company, or based upon the relative performance of other companies or upon comparisons of any of the indicators of performance relative to other companies. The Committee may also exclude the impact of an event or occurrence which the Committee determines should appropriately be excluded, including (a) restructurings, discontinued operations, extraordinary items, and other unusual or non-recurring charges, (b) an event either not directly related to the operations of the Company or not within the reasonable control of the Company's management, or (c) a change in accounting standards required by generally accepted accounting principles; provided that the Committee may not make any adjustment to the extent it would adversely affect the qualification of any compensation payable under such Performance Criteria as "performance-based compensation" under Section 162(m). Such Performance Criteria shall be set by the

Committee within the time period prescribed by, and shall otherwise comply with the requirements of, Section 162(m) of the Code, or any successor provision thereto, and the regulations thereunder. Before any payments are made with



respect to any Awards subject to this Section 21, the Committee shall certify in writing whether and to what extent the Performance Criteria relating to such payment have been met.

**(c) Other Restrictions.**

The Committee shall have the power to impose such other restrictions on Awards subject to this Section 21 as it (i) may deem necessary or appropriate to ensure that such Awards satisfy all requirements for “performance-based compensation” within the meaning of Section 162(m)(4)(C) of the Code, or any successor provision thereto.

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## 22. Code Section 280G Reduction in Awards.

(a) Notwithstanding anything to the contrary contained in this Plan, in the event the Company determines, in its sole discretion, that any payment or distribution by the Company to or for the benefit of any Participant (whether paid or payable or distributed or distributable pursuant to the terms of this Plan or otherwise) (collectively, “Payments”) would be subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties are incurred by the Participant with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the “Excise Tax”), then there shall be made a calculation under which such Payments provided to the Participant are reduced to the extent necessary so that no portion thereof shall be subject to the Excise Tax (the “4999 Limit”). A comparison shall then be made between (A) Participant’s Net After-Tax Benefit (as defined below) assuming application of the 4999 Limit; and (B) Participant’s Net After-Tax Benefit without application of the 4999 Limit. If (B) exceeds (A), then no limit on the Payments received by Participant under this Agreement shall be imposed by this Section 22. Otherwise, the amount payable to Executive pursuant to this Agreement shall be reduced so that no such Payment is subject to the Excise Tax. “Net After-Tax Benefit” shall mean the sum of (x) all payments that Participant receives or is entitled to receive that are in the nature of compensation and contingent on a change in the ownership or effective control of the Company or in the ownership of a substantial portion of the assets of the Company within the meaning of Code Section 280G(b)(2) (either, a “Section 280G Transaction”), less (y) the amount of federal, state, local and employment taxes and Excise Tax (if any) imposed with respect to such payments.

(b) In the event that a reduction in Payments is required pursuant to the immediately preceding paragraph, then, except as provided below with respect to Payments that consist of health and welfare benefits, the reduction in Payments shall be implemented by determining the “Parachute Payment Ratio” (as defined below) for each Payment and then reducing the Payments in order beginning with the Payment with the highest Parachute Payment Ratio. For Payments with the same Parachute Payment Ratio, such Payments shall be reduced based on the time of payment of such Payments, with amounts being paid furthest in the future being reduced first. For Payments with the same Parachute Payment Ratio and the same time of payment, such Payments shall be reduced on a pro-rata basis (but not below zero) prior to reducing Payments next in order for reduction. For purposes of this Section, “Parachute Payment Ratio” shall mean a fraction, the numerator of which is the value of the applicable Payment as determined for purposes of Code Section 280G, and the denominator of which is the financial present value of such Parachute Payment, determined at the date such payment is treated as made for purposes of Code Section 280G (the “Valuation Date”). In determining the denominator for purposes of the preceding sentence (1) present values shall be determined using the same discount rate that applies for purposes of discounting payments under Code Section 280G; (2) the financial value of payments shall be determined generally under Q&A 12, 13 and 14 of Treasury Regulation 1.280G-1; and (3) other reasonable valuation assumptions as determined by Company shall be used. Notwithstanding the foregoing, Payments that consist of health and welfare benefits shall be reduced after all other Payments, with health and welfare Payments being made furthest in the future being reduced first.

Notwithstanding the foregoing, if a Participant is a party to an employment or other agreement with the Company or participates in a severance program sponsored by the Company or one of its affiliates that contains express provisions regarding Section 280G or Section 4999 of the Code (or any similar successor provision), the Section 280G or Section

4999 provisions of such employment or other agreement or plan, as applicable, shall control as to any Payments due that Participant.

23. **Governing Law.** The Plan and all grants and awards and actions taken thereunder shall be governed by and construed in accordance with the internal substantive laws of the State of Wyoming.

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24. **Effective Date/Expiration.** This Plan will be effective as of the Effective Date, which is the date on which the Plan is adopted by the Board. The Plan shall be submitted to the Company's stockholders for approval. Unless the Plan is approved by the Company's stockholders within twelve (12) months before or after the Effective Date, the Plan and all Awards made under it shall be void and of no force and effect. No grant will be made under this Plan more than ten (10) years from the date the Plan is adopted, or the date the Plan is approved by the Company's shareholders, whichever is earlier but all grants made on or prior to such date will continue in effect thereafter subject to the terms thereof and of this Plan. The provisions of this Section 24 shall be applied to the Plan, as amended and restated, as if the Plan were originally established on the date that the Amended and Restated 2012 Equity and Performance Incentive Plan is adopted, and accordingly, the Plan will not expire until ten (10) years following the date the Amended and Restated 2012 Equity and Performance Incentive Plan is adopted.

**25. Miscellaneous.**

(a) The Company will not be required to issue any fractional shares of Common Stock pursuant to this Plan. The Board may provide for the elimination of fractions or for the settlement of fractions in cash.

(b) This Plan will not confer upon any Participant any right with respect to continuance of employment or other service with the Company or any Subsidiary, nor will it interfere in any way with any right the Company or any Subsidiary would otherwise have to terminate such Participant's employment or other service at any time.

(c) To the extent that any provision of this Plan would prevent any Option that was intended to qualify as an Incentive Stock Option from qualifying as such, that provision will be null and void with respect to such Option. Such provision, however, will remain in effect for other Options and there will be no further effect on any provision of this Plan.

(d) No award under this Plan may be exercised by the holder thereof if such exercise, and the receipt of cash or stock thereunder, would be, in the opinion of counsel selected by the Board, contrary to law or the regulations of any duly constituted authority having jurisdiction over this Plan.

(e) Absence or leave approved by a duly constituted officer of the Company or any of its Subsidiaries shall not be considered interruption or termination of service of any employee for any purposes of this Plan or awards granted hereunder.

(f) No Participant shall have any rights as a stockholder with respect to any shares subject to awards granted to him or her under this Plan prior to the date as of which he or she is actually recorded as the holder of such shares upon the stock records of the Company.

(g) The Board may, to the extent compliant with applicable law, condition the grant of any award or combination of awards authorized under this Plan on the surrender or deferral by the Participant of his or her right to receive a cash bonus or other compensation otherwise payable by the Company or a Subsidiary to the Participant.

(h) If any provision of the Plan is or becomes invalid, illegal or unenforceable in any jurisdiction, or would disqualify the Plan or any award under any law deemed applicable by the Board, such provision shall be construed or deemed amended or limited in scope to conform to applicable laws or, in the discretion of the Board, it shall be stricken and the remainder of the Plan shall remain in full force and effect.

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**VOTE VIA THE INTERNET – [www.proxyvote.com](http://www.proxyvote.com)**

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

**ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS**

*U.S.  
Energy  
Corp.*

*950 S.  
Cherry  
Street*

If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

*Suite 1515*

**VOTE BY PHONE – 1-800-690-6903**

*Denver,  
CO 80246*

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the meeting date. Have your proxy card in hand when you call and then follow the instructions.

**VOTE BY MAIL**

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.







