

CYBERLUX CORP  
Form 10-Q  
November 23, 2009

**U.S. SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2009.

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934

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

For the Period Ended September 30, 2009

Commission file number 000-33415

**CYBERLUX CORPORATION**

(Name of Small Business Issuer in Its Charter)

**Nevada**

(State of Incorporation)

**91-2048978**

(IRS Employer Identification  
No.)

**4625 Creekstone Drive, Suite 130**

**Research Triangle Park**

**Durham, NC 27703**

(Address of Principal Executive Offices)

**(919) 474-9700**

Edgar Filing: CYBERLUX CORP - Form 10-Q

Issuer's Telephone Number

Indicate by check mark whether the issuer (1) 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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

Number of shares outstanding of the issuer's Common Stock as of November 23, 2009: 2,868,177,756

**CYBERLUX CORPORATION**

**Quarterly Report on Form 10-Q for the**

**Quarterly Period Ending September 30, 2009**

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

1

Condensed Consolidated Balance Sheets:  
September 30, 2009 (Unaudited) and December 31, 2008 (Audited)

1

Condensed Consolidated Statements of Losses:  
Three and Nine Months Ended September 30, 2009 and 2008 (Unaudited)

2

Condensed Consolidated Statements of Cash Flows:  
Nine months Ended September 30, 2009 and 2008 (Unaudited)

3

Notes To Condensed Consolidated Financial Information:  
September 30, 2009

4

Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

41

Item 3. Controls And Procedures

47

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings.

48

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

48

Item 3. Defaults Upon Senior Securities.

49

Item 4. Submission of Matters to a Vote of Security Holders.

49

Item 5. Other Information.

49

Item 6. Exhibits

50

**Cautionary Statement on Forward-Looking Statements.**

The discussion in this Report on Form 10-Q, including the discussion in Item 2 of PART I, contains forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on current expectations, estimates and projections about the Company's business, based on management's current beliefs and assumptions made by management. Words such as "expects", "anticipates", "intends", "believes", "plans", "seeks", "estimates", and similar expressions or variations of these words are used to identify such forward-looking statements. Additionally, statements that refer to the Company's estimated or anticipated future results, sales or marketing strategies, new product development or performance or other non-historical facts are forward-looking and reflect the Company's current perspective based on existing information. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results and outcomes may differ materially from what is expressed or forecasted in any such forward-looking statements. Such risks and uncertainties include those set forth below in Item 1 as well as previous public filings with the Securities and Exchange Commission. The discussion of the Company's financial condition and results of operations included in Item 2 of PART I should also be read in conjunction with the financial statements and related notes included in Item 1 of PART I of this quarterly report. These quarterly financial statements do not include all disclosures provided in the annual financial statements and should be read in conjunction with the Risk Factors and annual financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2008 as filed with the Commission on May 18, 2009. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

**PART I. FINANCIAL INFORMATION****Item 1.****Financial Statements****CYBERLUX CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2009 (unaudited)</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Current assets:		
Cash & cash equivalents	\$ 1,025	\$ 260
Accounts receivable, net of allowance for doubtful accounts of \$7,760	2,643	249,924
Inventories, net of allowance of \$43,333	36,582	53,202
Other current assets	127,236	32,198
Total current assets	167,486	335,584
Property, plant and equipment, net of accumulated depreciation of \$208,400 and \$194,788, respectively	35,378	48,990
Other assets		
Deposits	25,511	25,511
Patents and development costs, net of accumulated amortization and write off of \$3,183,440 and \$3,043,756, respectively	791,534	931,217
Total other assets	817,045	956,728
Total Assets	\$ 1,019,909	\$ 1,341,302
<b>LIABILITIES AND DEFICIENCY IN STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Cash overdraft	\$	\$ 41,113
Accounts payable	1,790,107	1,239,145
Accrued liabilities	3,621,789	3,425,885
Short-term notes payable - related parties	1,186,274	402,823
Short-term notes payable		192,865
Warrant payable	691,795	935,000
Short-term convertible notes payable	5,305,054	4,645,207
Total current liabilities	12,595,019	10,882,038

## Long-term liabilities:

Derivative liability relating to convertible debentures	14,518,241	24,384,586
Warrant liability relating to convertible debentures	113,364	255,042
Total long-term liabilities	14,631,605	24,639,628
Total liabilities	27,226,624	35,521,666
Commitments and Contingencies		
Redeemable Series A convertible preferred stock, \$0.001 par value; 200 shares designated, 26.9806 issued and outstanding as of September 30, 2009 and December 31, 2008; liquidation preference of \$219,892 as of September 30, 2009 and December 31, 2008	134,900	134,900
DEFICIENCY IN STOCKHOLDERS' EQUITY		
Class B convertible preferred stock, \$0.001 par value, 4,650,000 shares designated; 8,500,000 and 3,650,000 shares issued and outstanding as of September 30, 2009 and December 31, 2008, respectively; liquidation preference of \$8,500,000 and \$3,650,000 as of September 30, 2009 and December 31, 2008, respectively	8,500	3,650
Class C convertible preferred stock, \$0.001 par value, 700,000 shares designated; 150,000 shares issued and outstanding as of September 30, 2009 and December 31, 2008, liquidation preference of \$4,122,108 and \$3,992,333, as of September 30, 2009 and December 31, 2008, respectively	150	150
Common stock, \$0.001 par value, 5,000,000,000 shares authorized; 1,574,511,088 and 814,426,120 shares issued and outstanding as of September 30, 2009 and December 31, 2008, respectively	1,574,511	814,426
Additional paid-in capital	17,255,352	17,277,230
Accumulated deficit	(45,180,128 )	(52,410,720 )
Deficiency in stockholders' equity	(26,341,615 )	(34,315,264 )
Total liabilities and (deficiency) in stockholders' equity	\$ 1,019,909	\$ 1,341,302

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

**CYBERLUX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
REVENUE:	\$ 7,157	\$ 69,256	\$ 53,254	\$ 401,162
Cost of goods sold	(2,247 )	(47,295 )	(44,632 )	(267,815 )
Gross margin	4,910	21,961	8,622	133,347
 OPERATING EXPENSES:				
Depreciation	4,202	6,209	13,612	20,167
Research and development	21,666		26,064	1,386
General and administrative expenses	465,203	1,351,634	1,604,029	2,890,873
Total operating expenses	491,071	1,357,843	1,643,705	2,912,426
 NET LOSS FROM OPERATIONS	(486,161 )	(1,335,882 )	(1,635,083 )	(2,779,079 )
 Unrealized gain/(loss) relating to adjustment of derivative and warrant liability to fair value of underlying securities	4,676,309	2,754,714	10,008,023	(3,032,859 )
Interest expense, net	(367,549 )	(517,553 )	(1,137,488 )	(1,887,066 )
Debt acquisition costs	(2,000 )	9,289	(4,800 )	(442,423 )
 Net income (loss) before provision for income taxes	3,820,598	910,568	7,230,652	(8,141,427 )
 Income taxes)			60	515
 INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	\$ 3,820,598	\$ 910,568	\$ 7,230,592	\$ (8,141,942 )



Weighted average number of common shares outstanding-basic	1,314,192,247	667,942,486	1,082,118,691	602,506,202
Weighted average number of common shares outstanding-fully diluted	Note A	Note A	Note A	
Income (Loss) per share-basic	\$ 0.00	\$ 0.00	\$ 0.01	\$ (0.01 )
Loss per share-fully diluted	Note A	Note A	Note A	
Preferred dividend	\$ 24,000	\$ 24,000	\$ 72,000	\$ 72,000

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

**CYBERLUX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW**  
**(Unaudited)**

	<b>Nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss) available to common stockholders	\$ 7,230,592	\$ (8,141,942 )
Adjustments to reconcile net income (loss) to cash used in operating activities		
Depreciation	13,612	20,167
Amortization	139,683	394,417
Common stock issued in connection issuance of debt		385,108
Common stock issued in connection for services rendered	21,000	878,800
Series B preferred stock issued for services rendered	52,650	
Beneficial conversion feature relating to convertible debenture		184,736
Accretion of convertible notes payable	601,224	1,254,665
Unrealized (gain) loss on adjustment of derivative and warrant liability to fair value of underlying securities	(10,008,023 )	3,032,858
(Increase) decrease in:		
Accounts receivable	201,118	23,888
Inventories	16,620	103,128
Prepaid expenses and other assets	(95,038 )	(7,500 )
Increase (decrease) in:		
Cash overdraft	(41,113 )	(26,041 )
Accounts payable	1,266,212	372,758
Accrued liabilities	195,904	633,076
Net cash (used in) operating activities	(405,559 )	(891,882 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from issuance of convertible debentures		500,000
Proceeds from sale of common stock	279,500	526,050
Net proceeds (payments) from borrowing on long term basis	68,201	(156,263 )
Net proceeds to notes payable, related parties	58,623	21,759
Net cash provided by financing activities:	406,324	891,546

Edgar Filing: CYBERLUX CORP - Form 10-Q

Net increase (decrease) in cash and cash equivalents	765	(336 )
Cash and cash equivalents at beginning of period	260	626
Cash and cash equivalents at end of period	\$ 1,025	\$ 290
Supplemental disclosures:		
Interest Paid	\$	\$
Income Taxes Paid	\$ 60	\$
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Unrealized (gain) loss in adjustment of derivative and warrant liability to fair value of underlying securities	\$ (10,008,023 )	\$ 3,032,858
Series B preferred stock issued for services rendered	\$ 52,650	\$
Common stock issued for services rendered	\$ 21,000	\$ 878,800

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

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES**

General

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Accordingly, the results from operations for the nine month period ended September 30, 2009, are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. The unaudited condensed financial statements should be read in conjunction with the December 31, 2008 financial statements and footnotes thereto included in the Company's Form 10-K for the year ended December 31, 2008.

Business and Basis of Presentation

Cyberlux Corporation (the "Company") is incorporated on May 17, 2000 under the laws of the State of Nevada. Until December 31, 2004, the Company was a development stage enterprise as defined under Accounting Standards Codification subtopic 915-10 Development Stage Entities. The Company develops, manufactures and markets long-term portable lighting products for commercial and industrial users. While the Company has generated revenues from its sale of products, the Company has incurred expenses, and sustained losses. Consequently, its operations are subject to all risks inherent in the establishment of a new business enterprise. As of September 30, 2009, the Company has accumulated losses of \$45,180,128.

The consolidated financial statements include the accounts of its wholly owned subsidiaries, SPE Technologies, Inc. and Hybrid Lighting Technologies, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

Revenue Recognition

Revenues are recognized in the period that products are provided. For revenue from product sales, the Company recognizes revenue in accordance with Accounting Standards Codification subtopic 605-10, Revenue Recognition ( ASC 605-10 ). ASC 605-10 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectability is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectability of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company defers any revenue for which the product has not been delivered or is subject to refund until such time that the Company and the

customer jointly determine that the product has been delivered or no refund will be required. At September 30, 2009 and December 31, 2008, the Company did not have any deferred revenue.

ASC 605-10 incorporates Accounting Standards Codification subtopic 605-25, Multiple-Element Arrangements ( ASC 605-25 ). ASC 605-25 addresses accounting for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets. The effect of implementing ASC 605-25 on the Company's financial position and results of operations was not significant.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**

Reclassification

Certain reclassifications have been made in prior year's financial statements to conform to classifications used in the current year.

Concentrations of Credit Risk

Financial instruments and related items which potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and trade receivables. The Company places its cash and temporary cash investments with credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit. The Company periodically reviews its trade receivables in determining its allowance for doubtful accounts. At September 30, 2009 and December 31, 2008, allowance for doubtful receivable was \$7,760 and \$1,803, respectively.

Stock based compensation

Effective January 1, 2006, the beginning of the Company's first fiscal quarter of 2006, the Company adopted the fair value recognition provisions of Accounting Standards Codification subtopic 718-10, Compensation (ASC 718-10) using the modified-prospective transition method. Under this transition method, stock-based compensation expense was recognized in the financial statements for granted, modified, or settled stock options. Compensation expense recognized included the estimated expense for stock options granted on and subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of ASC 718-10, and the estimated expense for the portion vesting in the period for options granted prior to, but not vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of ASC 718-10. Results for prior periods have not been restated, as provided for under the modified-prospective method.

ASC 718-10 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under ASC 718-10 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

Upon adoption of ASC 718-10, the Company is using the Black-Scholes option-pricing model as its method of valuation for share-based awards granted beginning in fiscal 2006, which was also previously used for the Company's pro forma information required under ASC 718-10. The Company's determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, and certain other market variables such as the risk free interest rate.

As more fully described in Note H, the Company granted stock options over the years to employees of the Company under a non-qualified employee stock option plan. As of September 30, 2009, 52,432,307 stock options were

outstanding and exercisable.

Net Income (loss) Per Common Share

The Company computes earnings per share under Accounting Standards Codification subtopic 260-10, Earnings Per Share ( ASC 260-10 ). Net earnings (losses) per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock and dilutive common stock equivalents outstanding during the period. Dilutive common stock equivalents consist of shares issuable upon conversion of convertible preferred shares and the exercise of the Company's stock options and warrants (calculated using the treasury stock method). During the nine months ended September 30, 2008, common stock equivalents are not considered in the calculation of the weighted average number of common shares outstanding because they would be anti-dilutive, thereby decreasing the net loss per common share.

The following reconciliation of net income and share amounts used in the computation of income (loss) per share for the three and nine months ended September 30, 2009 and three months ended September 30, 2009:

## CYBERLUX CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

(Unaudited)

## NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)

Net Income (loss) Per Common Share (continued)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009
Net income used in computing basic net income per share	\$ 3,820,598	\$ 910,568	\$ 7,230,592
Impact of assumed assumptions:			
Accretion of convertible debenture charged to interest expense	169,005	374,575	601,224
Impact of equity classified as liability:			
Gain on derivative and warrant liability marked to fair value	(4,676,309 )	(2,754,714 )	(10,008,023 )
Net loss in computing diluted net loss per share:	\$ (686,706 )	\$ (1,469,571 )	\$ (2,176,207 )

The weighted average shares outstanding used in the basic net income per share computations for the three and nine months ended September 30, 2009 was 1,314,192,247 and 1,082,118,691, respectively and 669,942,486 for the three months ended September 30, 2008. In determining the number of shares used in computing diluted loss per share, the Company did not add approximately 28,635,273,897 potentially dilutive securities for the three and nine months ended September 30, 2009 and 5,340,576,417 for the three months ended September 30, 2008 because the effect would be anti-dilutive. The potentially dilutive securities added were mostly attributable to the warrants, options and convertible debentures outstanding. As a result, the diluted loss per share for the three and nine months ended September 30, 2009 and three months ended September 30, 2008 was \$0.00.

Patents

The Company acquired in December 2006, for \$2,270,000, and January 2007, for \$1,387,000, patents in conjunction with the acquisitions of SPE Technologies, Inc and Hybrid Lighting Technologies, Inc, respectively. The patents have an estimated useful life of 7 years. Accordingly, the Company recorded an amortization charge to current period earnings of \$46,561 and \$131,473 for the three month periods ended September 30, 2009 and 2008, respectively and \$139,683 and \$394,417 for the nine months ended September 30, 2009 and 2008, respectively. Patents are comprised of the following:

Description	Cost	Accumulated	Net carrying
-------------	------	-------------	--------------



		<b>amortization and impairments</b>	<b>value at September 30, 2009</b>
Development costs	\$ 293,750	\$ 293,750	\$ -0-
Patents	2,294,224	1,502,690	791,534
Patents	1,387,000	1,387,000	-0-
Total	\$ 3,974,974	\$ 3,183,440	\$ 791,534

During the year ended December 31, 2008, the Company management performed an evaluation of its intangible assets (Patents) for purposes of determining the implied fair value of the assets at acquisition date(s). The tests indicated that the recorded remaining book value of its patents exceeded their fair value, as determined by discounted cash flows and accordingly recorded an impairment charge of \$1,698,229 to current operations. Considerable management judgment is necessary to estimate the fair value. Accordingly, actual results could vary significantly from management's estimates.

#### Derivative Financial Instruments

The Company's derivative financial instruments consist of embedded derivatives related to the 10% Secured Convertible Debentures (see Note B). These embedded derivatives include certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company record the derivatives and related warrants at their fair values as of the inception date of the Note Agreement and at fair value as of each subsequent balance sheet date. In addition, under the provisions of Accounting Standards Codification subtopic 815-40, Derivatives and Hedging; Contracts in Entity's Own Equity

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**

Derivative Financial Instruments (continued)

( ASC 815-40 ) as a result of entering into the Notes, the Company is required to classify all other non-employee stock options and warrants as derivative liabilities and mark them to market at each reporting date. Any change in fair value inclusive of modifications of terms will be recorded as non-operating, non-cash income or expense at each reporting date. If the fair value of the derivatives is higher at the subsequent balance sheet date, the Company will record a non-operating, non-cash charge. If the fair value of the derivatives is lower at the subsequent balance sheet date, the Company will record non-operating, non-cash income. Conversion-related derivatives were valued using the intrinsic method and the warrants using the Black Scholes Option Pricing Model with the following assumptions: dividend yield of 0%; annual volatility of 217%; and risk free interest rate from 0.18% to 2.98%. The derivatives are classified as long-term liabilities.

Registration rights

In with raising capital through the issuance of Convertible Notes, the Company has issued convertible debentures and warrants in that have registration rights with liquidated damages for the underlying shares. As the contract must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to ASC 815-40, the net value of the of the underlying embedded derivative and warrants at the date of issuance was recorded as liabilities on the balance sheet. Liquidated damages are estimated and accrued as a liability at each reporting date. The Company has accrued an estimated \$816,586 in liquidation damages.

Comprehensive Income (Loss)

The Company adopted Accounting Standards Codification subtopic 220-10, Comprehensive Income ( ASC 220-10 ) which establishes standards for the reporting and displaying of comprehensive income and its components. Comprehensive income is defined as the change in equity of a business during a period from transactions and other events and circumstances from non-owners sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. ASC 220-10 requires other comprehensive income (loss) to include foreign currency translation adjustments and unrealized gains and losses on available for sale securities.

Fair Value of Financial Instruments

Accounting Standards Codification subtopic 825-10, Financial Instruments ( ASC 825-10 ) requires disclosure of the fair value of certain financial instruments. The carrying value of cash and cash equivalents, accounts payable and accrued liabilities, and short-term borrowings, as reflected in the consolidated balance sheets, approximate fair value because of the short-term maturity of these instruments. All other significant financial assets, financial liabilities and equity instruments of the Company are either recognized or disclosed in the consolidated financial statements together with other information relevant for making a reasonable assessment of future cash flows, interest rate risk and credit

risk. Where practicable the fair values of financial assets and financial liabilities have been determined and disclosed; otherwise only available information pertinent to fair value has been disclosed.

Effective January 1, 2008, the company adopted Accounting Standards Codification subtopic 820-10, Fair Value Measurements and Disclosures ( ASC 820-10 ) and Accounting Standards Codification subtopic 825-10, Financial Instruments ( ASC 825-10 ), which permits entities to choose to measure many financial instruments and certain other items at fair value. Neither of these statements had an impact on the Company's financial position, results of operations or cash flows.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets.

The estimated useful lives of property, plant and equipment are as follows:

Furniture and fixtures	7 years
Office equipment	3 to 5 years
Leasehold improvements	5 years
Manufacturing equipment	3 years

We evaluate the carrying value of items of property, plant and equipment to be held and used whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying value of an item of property, plant and equipment is considered impaired when the projected undiscounted future cash flows related to the asset are less than its carrying value. We measure impairment based on the amount by which the carrying value of the respective asset exceeds its fair value. Fair value is determined primarily using the projected future cash flows discounted at a rate commensurate with the risk involved.

Liquidity

As shown in the accompanying consolidated financial statements, the Company incurred net loss from operations of \$1,635,083 for the nine month period ended September 30, 2009. The Company's current liabilities exceeded its current assets by \$12,427,533 as of September 30, 2009.

Recent Accounting Pronouncements

With the exception of those stated below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the nine months ended September 30, 2009, as compared to the recent accounting pronouncements described in the Annual Report that are of material significance, or have potential material significance, to the Company.

Effective July 1, 2009, the Company adopted the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 105-10, *Generally Accepted Accounting Principles - Overall* ( ASC 105-10 ). ASC 105-10 establishes the *FASB Accounting Standards Codification* (the Codification ) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. All guidance contained in the Codification carries an equal level of authority. The Codification superseded all existing non-SEC accounting and

reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification is non-authoritative. The FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates ( ASUs ). The FASB will not consider ASUs as authoritative in their own right. ASUs will serve only to update the Codification, provide background information about the guidance and provide the bases for conclusions on the change(s) in the Codification. References made to FASB guidance throughout this document have been updated for the Codification.

In August 2009, the FASB issued ASU No. 2009-05, *Measuring Liabilities at Fair Value*, which provides additional guidance on how companies should measure liabilities at fair value under ASC 820. The ASU clarifies that the quoted price for an identical liability should be used. However, if such information is not available, a entity may use, the quoted price of an identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities traded as assets, or another valuation technique (such as the market or income approach). The ASU also indicates that the fair value of a liability is not adjusted to reflect the impact of contractual restrictions that prevent its transfer and indicates circumstances in which quoted prices for an identical liability or quoted price for an identical liability traded as an asset may be considered level 1 fair value measurements. This ASU is effective October 1, 2009. The Company is currently evaluating the impact of this standard, but would not expect it to have a material impact on the Company's consolidated results of operations or financial condition.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE A-SUMMARY OF ACCOUNTING POLICIES (continued)**

Recent Accounting Pronouncements (continued)

In September 2009, the FASB issued ASU No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, that amends ASC 820 to provide guidance on measuring the fair value of certain alternative investments such as hedge funds, private equity funds and venture capital funds. The ASU indicates that, under certain circumstance, the fair value of such investments may be determined using net asset value (NAV) as a practical expedient, unless it is probable the investment will be sold at something other than NAV. In those situations, the practical expedient cannot be used and disclosure of the remaining actions necessary to complete the sale is required. The ASU also requires additional disclosures of the attributes of all investments within the scope of the new guidance, regardless of whether an entity used the practical expedient to measure the fair value of any of its investments. This ASU is effective October 1, 2009. The Company is currently evaluating the impact of this standard, but would not expect it to have a material impact on the Company's consolidated results of operations or financial condition.

In October 2009, the FASB issued ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force*, that provides amendments to the criteria for separating consideration in multiple-deliverable arrangements. As a result of these amendments, multiple-deliverable revenue arrangements will be separated in more circumstances than under existing U.S. GAAP. The ASU does this by establishing a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. A vendor will be required to determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis. This ASU also eliminates the residual method of allocation and will require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method, which allocates any discount in the overall arrangement proportionally to each deliverable based on its relative selling price. Expanded disclosures of qualitative and quantitative information regarding application of the multiple-deliverable revenue arrangement guidance are also required under the ASU. The ASU does not apply to arrangements for which industry specific allocation and measurement guidance exists, such as long-term construction contracts and software transactions. ASU No. 2009-13 is effective beginning January 1, 2011. The Company is currently evaluating the impact of this standard on its consolidated results of operations and financial condition.

In October 2009, the FASB issued ASU No. 2009-14, *Certain Revenue Arrangements That Include Software Elements a consensus of the FASB Emerging Issues Task Force*, that reduces the types of transactions that fall within the current scope of software revenue recognition guidance. Existing software revenue recognition guidance requires that its provisions be applied to an entire arrangement when the sale of any products or services containing or utilizing software when the software is considered more than incidental to the product or service. As a result of the amendments included in ASU No. 2009-14, many tangible products and services that rely on software will be accounted for under the multiple-element arrangements revenue recognition guidance rather than under the software

revenue recognition guidance. Under the ASU, the following components would be excluded from the scope of software revenue recognition guidance: the tangible element of the product, software products bundled with tangible products where the software components and non-software components function together to deliver the product's essential functionality, and undelivered components that relate to software that is essential to the tangible product's functionality. The ASU also provides guidance on how to allocate transaction consideration when an arrangement contains both deliverables within the scope of software revenue guidance (software deliverables) and deliverables not within the scope of that guidance (non-software deliverables). ASU No. 2009-14 is effective beginning January 1, 2011. The Company is currently evaluating the impact of this standard on its consolidated results of operations and financial condition.

## CYBERLUX CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

(Unaudited)

## NOTE B-CONVERTIBLE DEBENTURES

Notes payable at September 30, 2009 and December 31, 2008:

	September 30, 2009			December 31, 2008		
	Gross	Less:	Net	Gross	Less:	Net
	Principal	Unamortized		Principal	Unamortized	
	Amount	Discount		Amount	Discount	
10% convertible note payable, unsecured and due September, 2003; accrued and unpaid interest due at maturity; Note holder has the option to convert note principal together with accrued and unpaid interest to the Company's common stock at a rate of \$0.50 per share. The Company is in violation of the loan covenants	\$ 2,500		\$ 2,500	\$ 2,500		\$ 2,500
10% convertible note payable, unsecured and due September, 2003; accrued and unpaid interest due at maturity; Note	25,000		25,000	25,000		25,000



holder has the option to convert note principal together with accrued and unpaid interest to the Company's common stock at a rate of \$0.50 per share. The Company is in violation of the loan covenants

10% convertible debenture, due three years from date of the note with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a) \$0.03 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date.

The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. The Company is in violation of the loan covenants (see below)

	\$ 1,094,091		\$ 1,094,091		\$ 1,094,091		\$		\$ 1,094,091
--	--------------	--	--------------	--	--------------	--	----	--	--------------



## CYBERLUX CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

(Unaudited)

## NOTE B-CONVERTIBLE DEBENTURES (continued)

	September 30, 2009			December 31, 2008		
	Gross	Less:		Gross	Less:	
	Principal	Unamortized		Principal	Unamortized	
	Amount	Discount	Net	Amount	Discount	Net
10% convertible debenture, due three years from date of the note with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a) \$0.6 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. The Company is in violation of the loan covenants (see	\$ 800,000	\$	\$ 800,000	\$ 800,000	\$	\$ 800,000

below)

8% convertible debenture, due three years from date of the note with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights (see below)

700,000	700,000	700,000	700,000
---------	---------	---------	---------

<p>8% convertible debenture, due March 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The</p>	\$ 500,000	\$	\$ 500,000	\$ 500,000	\$ 38,813	\$ 461,187
---	------------	----	------------	------------	-----------	------------

Company granted the  
note holder a security  
interest in  
substantially all of  
the Company's assets  
and intellectual  
property and  
registration rights.  
(See below)

## CYBERLUX CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

(Unaudited)

## NOTE B-CONVERTIBLE DEBENTURES (continued)

	September 30, 2009			December 31, 2008		
	Less:			Gross	Less:	
	Gross Principal	Unamortized		Principal	Unamortized	
	Amount	Discount	Net	Amount	Discount	Net
6 % convertible debenture, due July 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)	\$ 500,000	\$	\$ 500,000	\$ 500,000	\$ 94,977	\$ 405,023

6% convertible debenture, due September 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights.  
(See below)

280,000	\$	\$ 280,000	\$ 280,000	\$ 68,530	\$ 211,470
---------	----	------------	------------	-----------	------------

6% convertible debenture, due December 2009 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security

\$ 600,000	\$ 43,836	\$ 556,164	\$ 600,000	\$ 193,425	\$ 406,575
------------	-----------	------------	------------	------------	------------

interest in  
substantially all of  
the Company's assets  
and intellectual  
property and  
registration rights.  
(See below)



## CYBERLUX CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

(Unaudited)

## NOTE B-CONVERTIBLE DEBENTURES (continued)

	September 30, 2009			December 31, 2008			
	Less:		Net	Gross	Less:		
	Gross Principal	Unamortized		Principal	Unamortized	Net	
	Amount	Discount	Amount	Discount	Net		
8% convertible debenture, due April 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights.	\$ 400,000	\$ 72,694	\$ 327,306	\$ 400,000	\$ 172,420	\$ 227,580	

(See below)

8% convertible debenture, due May 2010 with interest payable quarterly during the life of the note.

The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date.

The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights.

(See below)

150,000	29,041	120,959	150,000	66,428	83,562
---------	--------	---------	---------	--------	--------

8% convertible debenture, due June 2010 with interest payable quarterly during the life of the note.

The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest

150,000	33,288	116,712	150,000	70,685	79,315
---------	--------	---------	---------	--------	--------

intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

## CYBERLUX CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

(Unaudited)

## NOTE B-CONVERTIBLE DEBENTURES (continued)

	September 30, 2009			December 31, 2008		
	Less:		Net	Gross	Less:	
	Gross Principal	Unamortized		Principal	Unamortized	Net
	Amount	Discount	Amount	Discount	Amount	Discount
8% convertible debenture, due June 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's	\$ 150,000	37,260	\$ 112,740	\$ 150,000	\$ 74,658	\$ 75,342

assets and intellectual property and registration rights. (See below)

8% convertible debenture, due July 2010 with interest payable quarterly during the life of the note. The note is convertible into the Company's common stock at the lower of a)\$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for twenty days before, but not including, conversion date. The Company granted the note holder a security interest in substantially all of the Company's assets and intellectual property and registration rights. (See below)

	150,000	39,041	110,959	150,000	76,438	73,562
--	---------	--------	---------	---------	--------	--------

10% convertible notes payable, unsecured and due 2010;	58,623	58,623				
--	--------	--------	--	--	--	--

accrued and  
unpaid interest  
due at maturity;  
Note holder has  
the option to  
convert note  
principal  
together with  
accrued and  
unpaid interest  
to the Company's  
common stock at  
a rate of \$0.50  
per share. The  
Company is in  
violation of the  
loan covenants

Total	5,560,214	255,160	5,560,214	5,501,591	856,384	4,645,207
Less: current maturities:	5,560,214	255,160	5,560,214	5,501,591	856,384	4,645,207
Long term portion	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company entered into a Securities Purchase Agreement with four accredited investors on April 23, 2005 for the issuance of an aggregate of \$1,500,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants to purchase 25,000,000 shares of the Company s common stock. The Convertible Notes accrue interest at 10% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company s common stock at a rate of the lower of a) \$0.03 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 270.43% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$1,500,000 in exchange for total proceeds of \$1,352,067. The proceeds that the Company received were net of prepaid interest of \$72,933 representing the first eight month s interest and related fees and costs of \$75,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on April 23, 2005. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$945,313 and \$554,687 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

.

Requirement to pay principal and interest when due

.

Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

Change of control

Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31, 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise



**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$-0- and \$155,665, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on October 24, 2005 for the issuance of \$800,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants to purchase 800,000 shares of the Company's common stock. The Convertible Note accrues interest at 10% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.06 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 142.28% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$800,000 in exchange for total proceeds of \$775,000. The proceeds that the Company received were net of related fees and costs of \$25,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on October 24, 2005. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$743,770 and \$56,230 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

Requirement to pay principal and interest when due

.

Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

.

Change of control

.

Trading market limitations

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31, 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$-0- and \$200,183, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on December 28, 2005 for the issuance of \$700,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes were warrants to purchase 700,000 shares of the Company s common stock. The Convertible Note accrues interest at 8% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company s common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 158.81% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$700,000 in exchange for total proceeds of \$675,000. The proceeds that the Company received were net of related fees and costs of \$25,000.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on December 28, 2005. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$655,921 and \$44,079 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

.

Requirement to pay principal and interest when due

.

Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

.

Change of control

.

Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase

Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31, 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM" or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$-0- and \$175,160, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on March 31, 2006 for the issuance of \$500,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants to purchase 19,000,000 shares of the Company s common stock. The Convertible Note accrues interest at 8% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company s common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 11.01% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$500,000 in exchange for total proceeds of \$460,000. The proceeds that the Company received were net of related fees and costs of \$40,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on March 31, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$136,612 and \$363,388 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

.

Requirement to pay principal and interest when due

.

Provide shares of the Company s common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

.

Change of control

.

Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31, 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if



**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$38,813 and \$125,114, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on July 28, 2006 for the issuance of \$500,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants to purchase 15,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 6% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 10.00% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$500,000 in exchange for total proceeds of \$490,000. The proceeds that the Company received were net of related fees and costs of \$10,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on July 28, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$200,000 and \$300,000 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

.

Requirement to pay principal and interest when due

.

Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

.

Change of control

.

Trading market limitations

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31, 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$94,977 and \$125,114, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on September 26, 2006 for the issuance of \$280,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants

to purchase 10,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 6% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 9.36% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$280,000 in exchange for total proceeds of \$259,858. The proceeds that the Company received were net of related fees and costs of \$20,142.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on September 26, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

At the inception of the Securities Purchase Agreement, the Company allocated \$100,513 and \$179,487 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

.

Requirement to pay principal and interest when due

.

Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

.

Change of control

.

Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$68,530 and \$70,064, respectively.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company entered into a Securities Purchase Agreement with four accredited investors on December 20, 2006 for the issuance of \$600,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants to purchase 20,000,000 shares of the Company s common stock. The Convertible Note accrues interest at 6% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company s common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 15.00% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$600,000 in exchange for total proceeds of \$590,000. The proceeds that the Company received were net of related fees and costs of \$10,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on December 20, 2006. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$360,000 and \$240,000 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

.

Requirement to pay principal and interest when due

.

Provide shares of the Company s common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

Change of control

Trading market limitations

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31, 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise



**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$149,589 and \$150,137, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on April 18, 2007 for the issuance of \$400,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants to purchase 10,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 8% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 235.00% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$400,000 in exchange for total proceeds of \$360,000. The proceeds that the Company received were net of related fees and costs of \$40,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on April 18, 2007. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date. At the inception of the Securities Purchase Agreement, the Company allocated \$386,378 and \$13,622 to the embedded derivatives and related warrants, respectively.

The Securities Purchase Agreement contains the following covenants:

Requirement to pay principal and interest when due

.

Provide shares of the Company's common stock to the Holder(s) upon exercise by the Holder(s)

.

Timely file a registration statement with the SEC and obtain effectiveness and maintain effectiveness

.

Maintain sufficient number of authorized shares, subject to Stockholder approval for full conversion of any remaining Security Purchase Agreement

.

Change of control

.

Trading market limitations

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

The Company agreed to file a registration statement with the SEC to affect the registration of the shares of its common stock underlying the Security Purchase Agreement and the warrants within 30 days from the date of receipt of written demand of the Investors. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 90 days after the date of the Securities Purchase Agreement. If the Registration Statement is not filed and/or not declared effective as described above, the Company will be required to pay liquidated damages in the form of cash or the Company's common stock, at the Company's discretion, in an amount equal to 2% of the unpaid principal balance per month to the date on which the Registrable Securities (in the opinion of counsel to the Initial Investors) may be immediately sold to the public without registration or restriction (including, without limitation, as to volume by each holder thereof) under the 1933 Act.

As of September 30, 2009 and December 31, 2008, the Company has not maintained an effective registration statement and therefore is in default of the Security Purchase agreement. As such, at the option of the Holders of a majority of the aggregate principal amount of the outstanding Notes issued pursuant to the Purchase Agreement and through the delivery of written notice to the Company by such Holders (the "DEFAULT NOTICE"); the Notes shall become immediately due and payable and the Company shall pay to the Holder an amount equal to the greater of (i) 130% times the sum of (w) the then outstanding principal amount of this Note plus (x) accrued and unpaid interest on the unpaid principal amount of this Note to the date of payment plus (y) Default Interest (at 15% per annum), if any, plus (z) any amounts owed to the Holder pursuant to the Registration Rights Agreement. The then outstanding principal amount of the Note to the date of payment plus the amounts referred to in clauses (x), (y) and (z) shall collectively be known as the "DEFAULT SUM") or (ii) the "parity value" of the Default Sum to be prepaid, where parity value means (a) the highest number of shares of Common Stock issuable upon conversion of or otherwise pursuant to such Default Sum, treating the Trading Day immediately preceding the Mandatory Prepayment Date as the "Conversion Date" for purposes of determining the lowest applicable Conversion Price, unless the Default Event arises as a result of a breach in respect of a specific Conversion Date in which case such Conversion Date shall be the Conversion Date), multiplied by (b) the highest Closing Price for the Common Stock during the period beginning on the date of first occurrence of the Event of Default and ending one day prior to the Mandatory Prepayment Date (the "DEFAULT AMOUNT") and all other amounts payable hereunder shall immediately become due and payable, together with all costs including legal fees and expenses of collection. If the Borrower fails to pay the Default Amount within five (5) business days of written notice that such amount is due and payable, then the Holder shall have the right at any time, so long as the Borrower remains in default (and so long and to the extent that there are sufficient authorized shares), to require the Borrower, upon written notice, to immediately issue, in lieu of the Default Amount, the number of shares of Common Stock of the Borrower equal to the Default Amount divided by the Conversion Price then in effect.

For the nine month periods ended September 30, 2009 and 2008, the Company amortized the debt discount and charged to interest expense \$99,726 and \$100,091, respectively.

The Company entered into a Securities Purchase Agreement with four accredited investors on May 1, 2007 for the issuance of \$150,000 of convertible notes ( Convertible Notes ) and attached to the Convertible Notes was warrants to

purchase 10,000,000 shares of the Company's common stock. The Convertible Note accrues interest at 8% per annum, payable quarterly, and are due three years from the date of the note. The note holder has the option to convert any unpaid note principal to the Company's common stock at a rate of the lower of a) \$0.10 or b) 25% of the average of the three lowest intraday trading prices for the common stock on a principal market for the 20 trading days before, but not including, conversion date. The effective interest rate at the date of inception was 80.83% per annum.

As of September 30, 2009, the Company issued to investors of the Convertible Notes a total amount of \$150,000 in exchange for total proceeds of \$150,000.

The Company's identified embedded derivatives related to the Securities Purchase Agreement entered into on May 1, 2007. These embedded derivatives included certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company allocate the relative fair values of the derivatives and related warrants as of the inception date of the Securities Purchase Agreement up to the proceeds amount and to fair value as of each subsequent balance sheet date.

**CYBERLUX CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2009**

**(Unaudited)**

**NOTE B-CONVERTIBLE DEBENTURES (continued)**

At the inception of the Securities Purchase Agreement, the Company allocated \$135,154 and \$14,846 to the embedded derivatives and related warrants, respectively.