

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

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2013

or

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

For the transition period from to

Commission File Number: 1-11681

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**XSTELOS HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

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

**22-3439443**  
(IRS Employer Identification No.)

**630 Fifth Avenue, Suite 2260**  
**New York, NY 10020**  
(Address of principal executive offices including zip code)

**(212) 729-4962**  
(Registrant's telephone number, including area code)

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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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 common stock, par value \$.001 per share, as of August 12, 2013: 24,265,799.

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**XSTELOS HOLDINGS, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
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**PART 1. FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share amounts)

	<u>June 30, 2013</u>	<u>December 31, 2012 *</u>
	(Unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 17,118	\$ 16,671
Marketable securities, at fair value	584	1,441
Royalties receivable	6,554	7,179
Prepaid expenses and other current assets	373	424
Fixed assets held for sale	139	220
Deferred tax asset, net	2,201	3,956
Assets of discontinued operations	403	933
Total current assets	<u>27,372</u>	<u>30,824</u>
Restricted cash	2,500	2,500
Property and equipment, net	1,485	1,510
Investment in affiliate	219	-
Intangible assets, net	50,403	52,410
Goodwill	10,920	10,920
Deferred financing costs and other noncurrent assets	1,183	1,345
Deferred tax asset	17,066	16,062
<b>TOTAL ASSETS</b>	<u>\$ 111,148</u>	<u>\$ 115,571</u>

\*Derived from audited financial information

See accompanying notes to condensed consolidated financial statements.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share amounts)

	<u>June 30, 2013</u>	<u>December 31, 2012 *</u>
	Unaudited	
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 2,801	\$ 2,562
Income taxes payable	423	-
Current maturities of long term debt, net of original issue discount	11,637	13,311
Liabilities of discontinued operations	754	773
<b>Total current liabilities</b>	<b>15,615</b>	<b>16,646</b>
Other long term liabilities	26	26
Long term debt, net of current maturities and original issue discount	31,259	35,041
<b>Total liabilities</b>	<b>46,900</b>	<b>51,713</b>
<b>Commitments and Contingencies</b>		
Stockholders' equity:		
Preferred stock, \$0.01 par value, authorized 1,000,000 shares, and nil issued and outstanding shares	-	-
Common stock, \$0.001 par value, authorized 30,000,000 shares, and 24,257,178 shares issued and outstanding at June 30, 2013, and 24,242,249 shares issued and outstanding at December 31, 2012	24	24
Additional paid-in capital	35,270	35,245
Retained earnings	26,571	26,730
Stockholders' Equity	61,865	61,999
Non-controlling interest	2,383	1,859
<b>Total Stockholders' Equity</b>	<b>64,248</b>	<b>63,858</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 111,148</b>	<b>\$ 115,571</b>

\*Derived from audited financial information

See accompanying notes to condensed consolidated financial statements.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**AND COMPREHENSIVE INCOME (LOSS)**

(Unaudited)

(in thousands, except share and per share amounts)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
<b>ROYALTY REVENUE</b>	\$ 6,554	\$ 7,650	\$ 12,187	\$ 14,791
<b>Operating Expenses</b>				
Selling, general and administrative expense	1,255	1,174	3,260	2,584
Depreciation and amortization	1,016	1,066	2,032	2,070
Total operating expenses	<u>2,271</u>	<u>2,240</u>	<u>5,292</u>	<u>4,654</u>
<b>OPERATING INCOME</b>	4,283	5,410	6,895	10,137
Interest expense, net	(2,165)	(2,632)	(4,436)	(5,381)
Rental revenue	41	13	81	13
Loss on marketable securities	(95)	(533)	(69)	(527)
Gain on sale of real estate	-	7,652	-	7,652
Loss on disposal of non-operating assets	-	(116)	(38)	(116)
<b>EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	2,064	9,794	2,433	11,778
Income tax expense	<u>1,550</u>	<u>39</u>	<u>2,092</u>	<u>101</u>
<b>EARNINGS FROM CONTINUING OPERATIONS</b>	514	9,755	341	11,677
<b>EARNINGS FROM DISCONTINUED OPERATIONS, net of tax</b>	<u>13</u>	<u>246</u>	<u>24</u>	<u>390</u>
<b>NET EARNINGS</b>	527	10,001	365	12,067
Less: Net earnings attributable to the non-controlling interest	<u>398</u>	<u>655</u>	<u>524</u>	<u>1,256</u>
<b>NET EARNINGS ATTRIBUTABLE TO CONTROLLING INTEREST</b>	129	9,346	(159)	10,811
Other comprehensive loss:				
Unrealized loss on marketable securities	<u>-</u>	<u>(3)</u>	<u>-</u>	<u>(61)</u>
<b>COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO CONTROLLING INTEREST</b>	<u>\$ 129</u>	<u>\$ 9,343</u>	<u>\$ (159)</u>	<u>\$ 10,750</u>

See accompanying notes to condensed consolidated financial statements.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**AND COMPREHENSIVE INCOME (LOSS)**

(Unaudited)

(in thousands, except share and per share amounts)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
<b>BASIC NET EARNINGS (LOSS) PER COMMON SHARE</b> attributed to the controlling interest:				
Earnings (loss) from continuing operations	\$ 0.01	\$ 0.39	\$ (0.01)	\$ 0.90
Earnings from discontinued operations	0.00	0.01	0.00	0.03
<b>BASIC NET EARNINGS (LOSS) PER COMMON SHARE</b>	<u>\$ 0.01</u>	<u>\$ 0.40</u>	<u>\$ (0.01)</u>	<u>\$ 0.93</u>
Weighted average common shares outstanding used for basic per common share.				
	<u>24,257,097</u>	<u>23,184,834</u>	<u>24,253,397</u>	<u>11,528,421</u>
<b>DILUTED NET EARNINGS (LOSS) PER COMMON SHARE</b> attributed to the controlling interest:				
Earnings (loss) from continuing operations	\$ 0.01	\$ 0.37	\$ (0.01)	\$ 0.85
Earnings from discontinued operations	0.00	0.01	0.00	0.03
<b>DILUTED NET EARNINGS (LOSS) PER COMMON SHARE</b>	<u>\$ 0.01</u>	<u>\$ 0.38</u>	<u>\$ (0.01)</u>	<u>\$ 0.88</u>
Weighted average common shares outstanding used for diluted earnings per common share.				
	<u>26,201,172</u>	<u>24,591,466</u>	<u>24,253,397</u>	<u>12,227,851</u>

See accompanying notes to condensed consolidated financial statements.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**  
**For the Six Months Ended June 30, 2013**  
(Unaudited)  
(in thousands, except share and per share amounts)

	Common Stock		Accumulated Additional Paid-in Capital	Retained Earnings	Controlling Interest	Non- Controlling Interest	Total
	Shares	Amount					
Balance as of January 1, 2013	24,242,249	\$ 24	\$ 35,245	\$ 26,730	\$ 61,999	\$ 1,859	\$ 63,858
Net earnings (loss)	-	-	-	(159)	(159)	524	365
Issuance of stock for services	14,929	-	25	-	25	-	25
<b>Balance as of June 30, 2013</b>	<u>24,257,178</u>	<u>\$ 24</u>	<u>\$ 35,270</u>	<u>\$ 26,571</u>	<u>\$ 61,865</u>	<u>\$ 2,383</u>	<u>\$ 64,248</u>

See accompanying notes to condensed consolidated financial statements.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(in thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities:</b>		
Net earnings	\$ 365	\$ 12,067
<i>Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:</i>		
Depreciation and amortization	2,032	2,070
Non-cash interest	301	171
Loss on marketable securities	69	527
Gain on sale of real estate	-	(7,652)
Loss on disposal of non-operating assets	38	116
Deferred tax expense	750	-
Issuance of stock for services	25	12
<i>Changes in operating assets and liabilities</i>		
(Increase) decrease in accounts receivable	625	(664)
Decrease in prepaid expenses and other current assets	581	304
Decrease in other noncurrent assets	8	86
Increase (decrease) in accounts payable, accrued expenses and other current liabilities	604	(208)
Increase (decrease) in income taxes payable and other long-term liabilities	41	(250)
<b>Net cash provided by operating activities</b>	<b>5,439</b>	<b>6,579</b>
<b>Cash flows from investing activities:</b>		
Purchase of investment in affiliate	(250)	-
Purchase of marketable securities	-	(777)
Proceeds from sale of marketable securities	818	734
Proceeds from disposal of non-operating assets	42	27
Proceeds from sale of real estate	-	13,825
<b>Net cash provided by investing activities</b>	<b>610</b>	<b>13,809</b>
<b>Cash flows from financing activities:</b>		
Payments on long term debt	(5,602)	(5,781)
<b>Net cash used in financing activities</b>	<b>(5,602)</b>	<b>(5,781)</b>
Net increase in cash and cash equivalents	447	14,607
Cash and cash equivalents, beginning of period	16,671	7,847
<b>Cash and cash equivalents, end of period</b>	<b>\$ 17,118</b>	<b>\$ 22,454</b>

See accompanying notes to condensed consolidated financial statements



**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(in thousands)

**Six Months Ended June 30,**  
**2013**      **2012**

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:**

Interest paid	<u>\$ 4,093</u>	<u>\$ 5,147</u>
Taxes paid	<u>\$ 917</u>	<u>\$ 254</u>

See accompanying notes to condensed consolidated financial statements

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**

**I. Business and Basis of Presentation**

*Background*

Xstelos Holdings, Inc. (“Xstelos”) was formed as a Delaware corporation on January 20, 2012, and on January 23, 2012 entered into a Plan of Reorganization (the “Plan of Reorganization”) with Footstar, Inc. (“Footstar”) pursuant to which Footstar contributed all of its assets to Xstelos, including its cash, real estate and its 80.5% interest in FCB I Holdings, Inc. (“FCB Holdings”). In exchange for the contribution of all of its assets, Xstelos assumed all of Footstar’s liabilities and issued all of its shares of common stock to Footstar. On April 23, 2012, Xstelos issued 24,263,194 shares of its common stock to Footstar. Footstar then distributed all of the Xstelos common stock to holders of Footstar’s common stock as of April 23, 2012, the record date, pro rata on a one-for-one basis. Immediately thereafter, Footstar’s stockholders became the owners of all of the outstanding shares of common stock of Xstelos, and the Xstelos stockholders’ holdings were proportionate to their percentage ownership of Footstar shares as of April 23, 2012, the record date for the distribution.

As discussed below, on April 5, 2011, Xstelos Corp. and subsidiaries (formerly Footstar Corporation and subsidiaries, the Predecessor Company), a wholly owned subsidiary of Footstar (“Xstelos Corp” and, together with Xstelos and its subsidiaries and their operations prior to the Plan of Reorganization, the “Company”), completed the CPEX Transaction (as defined below). In the CPEX Transaction, the Company acquired CPEX Pharmaceuticals, Inc. (“CPEX”), an emerging specialty pharmaceutical company. As a result of the CPEX Transaction, an indirect majority-owned subsidiary of Xstelos Corp merged with and into CPEX, with CPEX surviving as a wholly-owned subsidiary of FCB Holdings. FCB Holdings is owned 80.5% by Xstelos Corp and 19.5% by Ouray Holdings I AG, an investment holding company (which was the affiliate and ultimate transferee of the 19.5% interest from the original holder, together the “Investment Holding Company”). Neither Ouray Holdings I AG nor the Investment Holding Company is affiliated with either Xstelos or Jonathan Couchman, our Chairman of the Board, President, Chief Executive Officer and Chief Financial Officer.

Following the completion of the CPEX Transaction, Footstar and Xstelos entered into the Plan of Reorganization. On May 5, 2012, Footstar finally and completely liquidated and dissolved in accordance with its Plan of Dissolution.

The condensed consolidated financial statements of the Company were determined, in accordance with the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”), to represent the consolidated historical assets and liabilities contributed to Xstelos, which prior to January 19, 2012 were those of Xstelos Corp. and Subsidiaries.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. In the opinion of Company’s management, all adjustments that are of a normal recurring nature, considered necessary for fair presentation, have been included in the accompanying condensed consolidated financial statements. These unaudited condensed consolidated financial statements for the interim periods are not necessarily indicative of results for the full year, or any other period. For further information, refer to the audited consolidated financial statements and notes thereto for the year ended December 31, 2012, filed with the SEC on April 1, 2013.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**

*CPEX Pharmaceuticals, Inc. Acquisition*

In August 2010, Footstar's Board of Directors was made aware of an opportunity regarding a potential strategic transaction with CPEX Pharmaceuticals, Inc. ("CPEX"), an emerging specialty pharmaceutical company whose shares were traded on the Nasdaq Capital Market under the symbol "CPEX". Substantially all of CPEX's revenue is a royalty stream under a licensing agreement with Auxilium Pharmaceuticals, Inc. ("Auxilium") pursuant to which CPEX licenses its CPE-215® technology with a testosterone formulation to Auxilium and receives royalties of 12% from Auxilium based upon Auxilium's sales of Testim®. Testim® is a gel for testosterone replacement therapy, which is a formulation of CPEX's technology with testosterone. Auxilium is currently marketing Testim® in the United States, Europe and Canada.

From August 2010 through January 3, 2011, Footstar negotiated the terms of a strategic merger transaction with CPEX pursuant to which CPEX would become a majority-owned indirect subsidiary of Footstar (the "CPEX Transaction").

On January 3, 2011, CPEX, FCB Holdings and FCB I Acquisition Corp. ("FCB Acquisition"), a wholly-owned subsidiary of FCB Holdings, entered into an Agreement and Plan of Merger (the "CPEX Transaction Agreement").

On April 5, 2011, the parties completed the CPEX Transaction pursuant to the CPEX Transaction Agreement. As a result of the CPEX Transaction, FCB Acquisition merged with and into CPEX, with CPEX surviving as a wholly owned subsidiary of FCB Holdings. The consolidated financial statements include the results of CPEX from the date of acquisition.

Pursuant to the CPEX Transaction, CPEX common stock that was outstanding immediately prior to the effective time of the CPEX Transaction, other than shares held by stockholders who properly exercised their appraisal rights and shares owned by CPEX as treasury stock, was automatically cancelled and converted into the right to receive \$27.25 in cash, without interest and less any applicable withholding taxes.

The acquisition of CPEX was accounted for as a purchase under The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 805. The purchase price of approximately \$76.2 million (which includes cash paid and liabilities assumed) was allocated to the fair value of tangible and identifiable intangible assets acquired and liabilities assumed. The excess of the purchase price over the estimated fair value of tangible and identifiable intangible assets acquired and liabilities assumed has been allocated to goodwill.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**

On April 5, 2011, in connection with the CPEX Transaction, FCB I LLC (“Borrower”), a wholly owned subsidiary of FCB Acquisition which became a wholly owned subsidiary of CPEX upon FCB Acquisition’s merger with and into CPEX, borrowed approximately \$64 million under that certain Loan Agreement dated January 3, 2011 (the “Term Loan Agreement”), by and among Borrower, The Bank of New York Mellon, as Agent, and certain Lenders from time to time party thereto, in the form of a secured term loan to Borrower. The term loan under the Term Loan Agreement bears interest at “LIBOR” plus 16% per annum, with a minimum LIBOR rate of 1% and matures on the earlier of January 3, 2026 or the date any of CPEX’s patents that are associated with Testim®, a topical testosterone gel, expire, and contains customary events of default for loans of such nature. As part of the Term Loan Agreement, CPEX contributed to Borrower all of its intellectual property rights in Testim® and rights to the royalty stream pursuant to the license agreement with Auxilium, and the loan is secured by Borrower’s interest in all such rights. Repayment of the loan is made through a waterfall arrangement whereby, if certain conditions are met, the Testim® royalty stream is distributed on a quarterly basis as follows: first to pay certain fees and expenses of Agent and Borrower, second to pay fees of the banks maintaining the accounts associated with the loan, third to pay any expenses of Agent used to protect the loan collateral and any other unreimbursed fees or expenses of Agent or any Lender, fourth to replenish any shortfall in the interest reserve (which is \$2.5 million), fifth to pay interest due, sixth to pay 65% of the remaining royalty funds to Agent for the benefit of the Lenders as payment toward loan principal, and finally to Borrower for its benefit.

Upon consummation of the CPEX Transaction, FCB Holdings was owned 80.5% by Xstelos Corp and 19.5% by the Investment Holding Company. The Investment Holding Company is affiliated with a minority Lender under the Term Loan Agreement (as defined above).

On April 4, 2011, in connection with the CPEX Transaction, Xstelos Corp made a \$3 million bridge loan to FCB Holdings under that certain Loan Agreement dated as of April 4, 2011 (the “Xstelos Corp Loan Agreement”), by and between FCB Holdings and Xstelos Corp. The loan bore interest at 20% per annum and provided for a fee of 3% of the principal amount (less accrued interest) payable to Xstelos Corp, which was due upon repayment of the loan. The bridge loan was repaid on April 5, 2011, prior to maturity.

On April 4, 2011, in connection with the CPEX Transaction, Black Horse Capital LP and Black Horse Capital Master Fund Ltd. (together, “Black Horse”) made a \$10 million bridge loan to FCB Holdings under that certain Loan Agreement dated as of April 4, 2011 (the “Black Horse Loan Agreement”), by and between Black Horse and FCB Holdings. The bridge loan under the Black Horse Loan Agreement had substantially the same terms as the bridge loan under the Xstelos Corp Loan Agreement, and was repaid on April 5, 2011, prior to maturity. FCB Holdings also reimbursed Black Horse for transaction fees related to the CPEX acquisition of approximately \$830,000.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2013**

Xstelos Corp is party to a consulting and advisory agreement (the "Consulting Agreement") with the Investment Holding Company for such entity to provide certain consulting and advisory services to Xstelos Corp relating to intellectual property and other matters. The agreement provides for payment solely to the extent Xstelos Corp has received dividends from FCB Holdings, of which \$8,050,000 was received by Xstelos and \$1,950,000 by the Investment Holding Company in 2012. Amounts payable pursuant to the Consulting Agreement are to be paid into an escrow account. As of June 30, 2013, no amounts have been paid. The Company is evaluating the appropriateness of funding the escrow at this time. Pursuant to the Consulting Agreement, under certain circumstances, some or all of the consulting fee may be required to be made available to FCB I Holdings in anticipation of specific expenses. Under certain circumstances, pursuant to the terms of the agreement, up to six years may lapse between the filing of the consolidated tax return by Xstelos Corp relating to the period for which such consulting fee was paid and its release from escrow. Annual amounts to be paid, following receipt of such dividends pursuant to the terms of the agreement, would be \$1,000,000 for 2011, \$750,000 for 2012, \$750,000 for 2013, \$500,000 for 2014 and \$250,000 for 2015 and annually thereafter through the agreement termination. The agreement terminates upon the conclusion of the monetization of CPEX's intellectual property, subject to the terms of the agreement. The Company has accrued approximately \$2.1 million as of June 30, 2013 under this agreement, and expensed approximately \$0.2 million and \$0.2 million for the three months ended June 30, 2013 and 2012, respectively, and expensed approximately \$0.4 million and \$0.4 million, for the six months ended June 30, 2013 and 2012, respectively.

Direct acquisition costs, consisting of investment banking fees and legal fees directly related to the acquisition of CPEX of approximately \$1.1 million and \$1.3 million were expensed as period costs, and were not capitalized for the period ended December 31, 2011. Financing costs were not expensed as acquisition costs, but treated as loan origination costs and are included in deferred financing costs in the accompanying consolidated balance sheets and are being amortized over the estimated life of the loan, approximately 6 years, using the effective interest rate method, and recorded as a component within non-cash interest expense. Amortization costs of approximately \$79,000 and \$45,000 were expensed for the three months ended June 30, 2013 and 2012, respectively, and \$154,000 and \$88,000, for the six months ended June 30, 2013 and 2012, respectively. Deferred financing costs of approximately \$1.1 million as of June 30, 2013, net of accumulated amortization of \$0.5 million is included in deferred financing costs and other noncurrent asset in the accompanying balance sheet.

*Licensed Product*

We earn royalty revenues on sales of Testim®, a testosterone gel that incorporates our CPE-215 drug delivery technology. Patents covering CPE-215 relating to a testosterone topical formulation are licensed to Auxilium, and Testim® was launched in the U.S. in early 2003 as a testosterone replacement therapy. Testim® has been approved for marketing in Canada and 15 countries in Europe. Auxilium uses its sales force to market Testim® in the U.S. and has partnered with Paladin Labs Inc. to market the drug in Canada and with Ferring International S.A. to market the drug in Europe.

CPEX and Auxilium are parties to a License Agreement dated May 31, 2000 pursuant to which Auxilium obtained a sole and exclusive, worldwide, royalty-bearing license (including sub-license rights) to make, have made on their behalf, use and sell anywhere in the world any and all pharmaceutical compositions which contain (A) testosterone as the single active ingredient; and (B) CPE-215 and which are covered by a valid CPEX patent, all related patents and technology. Initially this license was based solely upon the issued U.S. Patent No. 5,023,252. Since this patent expired in June 2008, Auxilium's license is now based upon issued U.S. Patent No. 7,320,968 and the following others recently obtained: U.S. Patent Nos. 7,608,605; 7,608,606; 7,608,607; 7,608,608; 7,608,609; 7,608,610; 7,935,690; 8,063,029; and 8,178,518. These patents expire July 21, 2023 to January 18, 2025. In addition, Auxilium was granted the exclusive right to enter into another license agreement to acquire rights in these patents and technology for the development of combination products, which right expires upon the termination of the original License Agreement. The License Agreement continues for an indefinite term but it is terminable by us if Auxilium fails to make timely payments and may also be terminated by either party if (i) the other party becomes insolvent, (ii) the other party fails to cure a breach within 30 days or (iii) CPEX is dissolved.

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Pursuant to the terms of the Agreement, CPEX receives royalties of 12% of Auxilium's annual net sales of Testim® in the U.S. and Canada. In the event that CPEX does not have, or does not maintain, an enforceable patent in a country in which Auxilium products are sold, the royalty rate due to CPEX from sales in that particular country reduces from the aforementioned rates to a rate in the low single-digits.

The testosterone replacement market has expanded as more baby-boomers enter middle age and more attention is focused on male hormonal deficiency and the benefits of replacement therapy. Hypogonadism, a condition in men where insufficient amounts of testosterone are produced, is thought to affect one out of every five men in the U.S. and Europe aged over 50. Symptoms associated with low testosterone levels in men include depression, decreased libido, erectile dysfunction, muscular atrophy, loss of energy, mood alterations, increased body fat and reduced bone density. This condition is currently significantly under-treated. Growing patient awareness together with education continue to spur demand for testosterone replacement therapy.

**2. Significant Accounting Policies**

*Principles of Consolidation*

The condensed consolidated financial statements include the accounts of the Company and its majority owned, and wholly-owned, subsidiaries which were derived from the historical accounting records of Xstelos Corp, prior to January 19, 2012, and reflect the historical financial positions, results of operations, and cash flows for the periods described herein. Intercompany balances and transactions between the entities have been eliminated. For simplicity of presentation, these condensed consolidated financial statements are referred to as financial statements herein.

*Use of Estimates*

The Company's condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the revenues and expenses reported during the period, and includes, among others, lives of intangible assets, estimate of long-term debt classified as current, and valuation allowances on deferred taxes. These estimates and assumptions are based on management's judgment and available information and, consequently, actual results could differ from these estimates.

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*Cash equivalents*

Cash and cash equivalents consist of highly liquid instruments with maturities of three months or less from the date acquired and are stated at cost which approximates their fair market value. At times the Company has cash and cash equivalents balances in excess of the FDIC and SIPC insured limits.

At June 30, 2013, restricted cash of \$2,500,000 pledged to support a bank credit facility, is classified as a non-current asset. The restricted cash serves as collateral for the loan in connection with the CPEX Transaction that provides financial assurance that the Company has the ability to service the loan, as discussed in Note 7 – Long Term Debt. The cash is held in custody by the loan agent, is restricted as to withdrawal or use, and is currently not invested and does not bear interest.

*Royalties receivable and allowances for uncollectible accounts*

When necessary, receivable balances are reported net of an estimated allowance for uncollectible accounts. Estimated uncollectible receivables are based on the amount and status of past due accounts, contractual terms with customers, the credit worthiness of customers and the history of uncollectible accounts. Royalties receivable as of June 30, 2013 and December 31, 2012, and related royalty revenue for the three and six months ended June 30, 2013 and 2012, are due from its licensee, Auxilium, for sales of Testim®. All receivables are uncollateralized and therefore are subject to credit risk.

The Company determined no allowance for uncollectible accounts was necessary as of June 30, 2013 and December 31, 2012.

*Prepaid expenses and other current assets*

Prepaid expenses and other current assets primarily consist of interest paid in advance on outstanding notes payable balance. Prepaid expenses are recorded at cost and expensed as they are incurred.

*Fixed assets held for sale*

Fixed assets held for sale consist of laboratory equipment, which were obtained in the CPEX acquisition. As these assets are not in service, no depreciation expense has been recorded. These assets are reflected at the lower of net book value or their estimated fair value, less costs to sell.

*Marketable Securities*

The Company accounts for its marketable securities pursuant to FASB ASC Topic 320, "Investments in Debt and Equity Securities." Under this topic, the Company initially accounted for this security with readily determinable fair values as available-for-sale. During the second quarter of 2012, the Company reclassified the security to trading security. The securities reflected on the accompanying condensed consolidated balance sheets is at fair market value based on quoted market prices with the unrealized gains and losses reported in the condensed consolidated statements of income and comprehensive income.

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During the three month and six month period ended June 30, 2013, the Company received gross proceeds of approximately \$792,000 and \$817,000, respectively, from the sale of shares of its marketable securities and recognized a loss due to a decrease in market value of approximately \$103,000 and \$91,000, respectively. The decrease is offset by realized gain on sale of marketable securities of approximately \$39,000 and \$53,000 for the three and six month period ended June 30, 2013, respectively. As of June 30, 2013, marketable securities consisted of stock at a fair value of approximately \$0.6 million.

*Investment in Affiliate*

On February 27, 2013, Xstelos Corp. and Myrexix, Inc. (a related party through common management) (“Myrexix”) entered into a stock purchase agreement. Xstelos agreed to purchase 7,000,000 newly issued shares of Myrexix common stock representing approximately 20% of all outstanding Myrexix common stock after giving effect to such purchase. The shares were purchased for an aggregate purchase price of \$250,000, representing its fair value at the time of the transaction. The Company has accounted for this transaction under the equity method. The equity in the loss of affiliate for Myrexix for the period April 1, 2013 through June 30, 2013 was \$31,000, which decreased the carrying value of the investment in affiliate to \$219,000 and has been reflected in the accompanying condensed consolidated balance sheet as of June 30, 2013. The financial operations for Myrexix for the period February 28, 2013 through March 31, 2013 were not significant and thus no adjustment to the carrying value has been reflected in the accompanying condensed balance sheet as of June 30, 2013.

*Property and Equipment*

The Company, through its acquisition of CPEX, owns a 16,434 square foot commercial building situated on approximately 14 acres of land in Exeter, New Hampshire (“Exeter”). It is located approximately 50 miles north of Boston, Massachusetts. During the second quarter of 2012, management withdrew its plan to sell the Exeter property. The Company is currently leasing the Exeter property and is not marketing this property for sale. As a result of this decision, in accordance with FASB ASC 360-10-35-44, the property was reclassified as held-for-use, which requires the asset to be reclassified at the lower of carrying value before the asset was classified as held for sale, less the depreciation that would have been recorded had the asset been continuously classified as held for sale, or the fair value on the date it was decided that it would not be sold. As a result, approximately \$13,000 and \$25,000 of depreciation expense has been recorded for the three months and six months ended June 30, 2013 related to this asset. This building was reported as Real estate held for sale from April 5, 2011 through May 31, 2012, and reclassified to fixed assets in use once the Company started leasing the property.

The Company recognizes rental income from the lease of the Exeter property. The term of the lease is 63 months, through August 31, 2017, of which the lease agreement contains provisions for future rent increases and periods in which rent payments are abated, with an average monthly income of approximately \$13,000. In accordance with generally accepted accounting principles, the Company records monthly rent income, on a straight line basis, equal to the total of the payments due over the lease term, divided by the number of months of the lease term. The difference between rental income recorded and the amount received is debited or charged to “deferred rent income”. As of June 30, 2013, approximately \$40,000 of deferred rental income is included in deferred financing costs and other noncurrent assets, in the accompanying condensed consolidated balance sheets, and for the three months and six months ended June 30, 2013, approximately \$41,000 and \$81,000 has been recorded as rental income, in the accompanying condensed consolidated statements of income and comprehensive income.



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*Real estate*

On April 27, 2012, the Company signed a purchase agreement and sold its property in Mahwah, New Jersey, which contains the Company's former corporate headquarters building, improvements and 21 acres of underlying land (collectively, the "Mahwah Real Estate") to a third party buyer for approximately \$14.6 million less selling and other costs of approximately \$0.8 million, and recognized a gain of approximately \$7.7 million.

*Goodwill and intangible assets*

Costs incurred in connection with acquiring licenses, patents, and other proprietary rights are capitalized as intangible assets. These assets are amortized on a straight-line basis over the applicable useful life from the dates of acquisition. Such assets are reviewed whenever events or changes in circumstances indicate that the assets may be impaired, by comparing the carrying amounts to their estimated future undiscounted cash flows, and adjustments are made for any diminution in value below the carrying value.

The assets acquired in the CPEX acquisition included approximately \$59.4 million of intangible assets which were assigned primarily to CPEX's patents and license agreement associated with Testim®, a topical testosterone gel. The acquired intangible asset has a remaining useful life of approximately 13 years, with the patent expiring on January 3, 2026.

Goodwill is recorded when the consideration paid for an acquisition exceeds the fair value of the net tangible and identifiable intangible net assets acquired. FASB ASC Topic 350 requires that goodwill not be amortized but must be reviewed for impairment at least annually and if a triggering event were to occur in an interim period. The Company performs at least an annual assessment of goodwill for impairment or whenever events or circumstances indicate that the carrying value of goodwill may not be recoverable from future cash flows. The Company's annual impairment test is performed at the end of its fiscal year.

Pursuant to the acquisition of CPEX, the Company recorded goodwill of approximately \$10.9 million. As of June 30, 2013, no impairment has been charged against goodwill recorded in the acquisition of CPEX.

In September 2011, the FASB issued authoritative guidance that permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Company adopted this guidance in 2012 in connection with its annual testing of goodwill for impairment concluding on a qualitative basis that there was no impairment of the CPEX goodwill.

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*Income taxes*

The Internal Revenue Code requires any company that satisfies the definition of a personal holding company (“PHC”) and has undistributed personal holding company income (“UPHCI”) at the end of the year, to be subject to the PHC tax in addition to the regular income taxes. A PHC is taxed on its UPHCI at the dividend tax rate, which is currently 20.0%. A company is taxed as a PHC if, during the last six months of the tax year, (1) more than 50% of the value of the company’s stock is held by five or fewer individuals and (2) at least 60% of the company’s adjusted ordinary gross income constitutes PHC income. UPHCI is generally taxable income with certain adjustments, including a deduction for federal income taxes and dividends paid. The Company was subject to the personal holding company tax for the 2011 and 2012 tax years. Since the Company did not have UPHCI for 2011 or 2012, it did not pay any PHC tax for these years. If the Company is subject to PHC tax in 2013, and assuming that the PHC tax rate remains at 20%, the Company may incur significant PHC tax, none of which may be offset by the Company’s federal net operating loss carry forward.

As discussed further in Note 8 – Income Taxes, the Company records deferred tax assets and liabilities based on the differences between the book and tax bases of assets and liabilities and on operating loss carryforwards using enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. These amounts are adjusted, as appropriate, to reflect enacted changes in tax rates expected to be in effect when the temporary differences reverse.

The Company follows FASB ASC Topic 740 when accounting for tax contingencies. The guidance prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under GAAP, tax benefits are initially recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions must initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon effective settlement with the tax authority assuming full knowledge of the position and relevant facts.

The Company does not have any unrecognized tax contingencies. The Company’s policy is to recognize interest and penalties related to tax matters in the income tax provision in the Consolidated Statements of Income and Comprehensive Income. There were no tax related interest and penalties for the periods ended June 30, 2013 and 2012. Tax years beginning in 2010 are generally subject to examination by taxing authorities, although net operating losses from all years are subject to examinations and adjustments for at least three years following the year in which the attributes are used.

The Company determined the deferred tax provision under the liability method, whereby deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using currently enacted tax rates.

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The Company reviews the valuation of deferred tax assets based on positive evidence, such as projections of future taxable earnings along with negative evidence, such as operational uncertainties. As a result of the 2011 CPEX acquisition, the Company recorded an approximately \$19.5 million net deferred tax liability, and reduced approximately \$19.5 million of the valuation allowance against the NOL carryforward tax asset, which is reflected as an income tax benefit for the year ended December 31, 2011. Additionally, the Company concluded that it is more likely than not that certain deferred tax assets will be realized as of December 31, 2012, based primarily on the actual earnings from CPEX operations since the date of acquisition in April 2011, and the forecasted performance of CPEX, and reduced the previously recorded valuation allowance resulting in a tax benefit of approximately \$20.0 million in 2012.

*Revenue Recognition*

CPEX recognizes revenue from royalties on Auxilium's sales of Testim® in accordance with FASB ASC Topic 605-10, which requires sales to be recorded upon delivery, provided that there is evidence of a final arrangement, there are no uncertainties surrounding acceptance, title has passed, collectability is reasonably assured and the price is fixed or determinable. Since 2003, Auxilium has sold Testim® to pharmaceutical wholesalers and chain drug stores, which have the right to return purchased products prior to the units being dispensed through patient prescriptions.

*Stock Based Compensation*

The Company accounts for its stock based employee compensation plans under FASB ASC Topic 718 and FASB ASC Topic 505-50. FASB ASC Topic 718-10 and FASB ASC Topic 505-50 address the accounting for shared based payment transactions in which an enterprise receives employee services for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. FASB ASC Topic 718-10 and FASB ASC Topic 505-50 require that such transactions be accounted for using a fair value based method.

In considering the fair value of the underlying stock when the Company grants options or restricted stock, the Company considers several factors including the fair values established by market transactions. Stock-based compensation includes significant estimates and judgments of when stock options might be exercised, forfeiture rates and stock price volatility. The timing of option exercises is out of the Company's control and depends upon a number of factors including the Company's market value and the financial objectives of the holders of the options. These estimates can have a material impact on the Company's stock compensation expense but will have no impact on the Company's cash flows.

The Company accounts for equity awards of the Company issued to non-employees providing services on behalf of the Company in accordance with FASB ASC Topic 505-50. FASB ASC Topic 505-50 requires the Company to measure the fair value of equity instruments using the stock prices and other measurement assumptions as of the earlier of either the date at which a performance commitment by the counterparty is reached or the date at which the counterparty's performance is complete.

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*Defined Contribution Plans*

The Company has a 401(k) Plan (“Plan”) to provide retirement and incidental benefits for its employees. Employees may contribute from 1% to 15% of their annual compensation to the Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Service. The rate at which the Company matches employee contributions is discretionary, and may change each year. All matching contributions vest 25% after 1 year of service, 50% after 2 years of service, and 100% after 3 years of service.

Company matching contributions to the Plan for the three months ended June 30, 2013 and 2012 totaled \$7,379 and \$0, respectively, and for the six months ended June 30, 2013 and 2012 totaled \$49,502 and \$0, respectively.

*Earnings (loss) per Common Share*

Basic net earnings (loss) per common share is calculated using the weighted-average number of common shares outstanding during the period. Diluted net earnings (loss) per common share is calculated using the weighted-average number of common shares plus dilutive potential common shares outstanding during the period. There are 2,500,000 options outstanding at June 30, 2013 which are potentially dilutive and thus, were added to the basic common shares outstanding to calculate the dilutive common shares outstanding for the three months ended June 30, 2013. These shares were not potentially dilutive for the six months ended June 30, 2013 due to the loss.

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three and six month ended June 30, 2013 and 2012, are as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b><u>June 30, 2013</u></b>	<b><u>June 30, 2012</u></b>	<b><u>June 30, 2013</u></b>	<b><u>June 30, 2012</u></b>
Weighted average shares outstanding-basic	24,257,097	23,184,834	24,253,397	11,528,421
Plus: Common share equivalents				
Options	1,944,075	1,406,632	-	699,430
Weighted average shares outstanding-dilutive	<u>26,201,172</u>	<u>24,591,466</u>	<u>24,253,397</u>	<u>12,227,851</u>

*Fair Value Measurements*

The Company measures fair value in accordance with FASB ASC Topic 820, Fair Value Measurements (“ASC 820”). ASC 820 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, there exists a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

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- Level 1 - unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access as of the measurement date.
- Level 2 - inputs other than quoted prices included within Level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data.
- Level 3 - unobservable inputs for the asset or liability only used when there is little, if any, market activity for the asset or liability at the measurement date.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value (see Note 4 - Fair Value Measurements).

**3. Discontinued Operations**

At the end of December 2008, the Company's business operations related to previously operated licensed footwear departments in various department stores, have been classified as discontinued operations, for all periods presented. Therefore, all related operations, impairment losses and disposal costs, gains and losses on disposition attributable to these licensed footwear departments have been aggregated in a single caption entitled "Earnings From Discontinued Operations" on the accompanying Condensed Consolidated Statements of Income and Comprehensive Income.

Assets of discontinued operations are summarized as follows (in thousands):

	<b>June 30, 2013</b>	<b>December 31, 2012</b>
Account Receivable - Other	\$ -	\$ 512
Prepaid expenses, primarily cash collateral for worker's compensation obligations	403	421
	<u>\$ 403</u>	<u>\$ 933</u>

Liabilities of discontinued operations are summarized as follows (in thousands):

	<b>June 30, 2013</b>	<b>December 31, 2012</b>
Accrued expenses	\$ 340	\$ 341
Income taxes payable	11	11
Worker's compensation liability	403	421
	<u>\$ 754</u>	<u>\$ 773</u>

Summarized statements of income for discontinued operations are as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Total revenue	\$ -	\$ -	\$ -	\$ -
Selling, general and administrative expense	(13)	(231)	(24)	(395)
Operating income	231	231	24	395
Interest income (expense)	-	(1)	-	(1)
Earnings from discontinuing operations before income taxes	13	230	24	394
Income tax expense (benefit)	-	(16)	-	4
Earnings from discontinued operations	<u>\$ 13</u>	<u>\$ 246</u>	<u>\$ 24</u>	<u>\$ 390</u>

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Discontinued operations resulted in earnings primarily as a result of miscellaneous refunds and reversals of liabilities which were no longer required by the Company.

**4. Fair Value Measurements**

The following table summarizes the basis used to measure certain financial assets and liabilities at fair value on a recurring basis in the condensed consolidated balance sheets in accordance with FASB ASC 820 (in thousands):

**Fair Value Measurements at June 30, 2013**

Description	Balance at June 30, 2013	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable Security – common stock	\$ 584	\$ 584	—	—

**Fair Value Measurements at December 31, 2012**

Description	Balance at December 31, 2012	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable Security – common stock	\$ 1,441	\$ 1,441	—	—

Money Market Funds – money market funds are valued using quoted market prices. Accordingly, money market funds are categorized in Level 1 of the fair value hierarchy.

**5. Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets consisted of the following (in thousands):

	June 30, 2013	December 31, 2012
Insurance	\$ 33	\$ 53
Interest	328	371
Other current assets	12	-
	<u>\$ 373</u>	<u>\$ 424</u>

**6. Intangible Assets**

Intangible assets consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Patents, trademarks, and license agreement	\$ 59,434	\$ 59,434
Less - accumulated amortization	(9,031)	(7,024)
	<u>\$ 50,403</u>	<u>\$ 52,410</u>

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Amortization expense for patents and related patent costs of approximately \$2.0 million has been recorded in depreciation and amortization expense in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income (Loss) for the six month periods ended June 30, 2013 and 2012, respectively. The Company expects to incur approximately \$4.0 million of amortization expense for each of the next 13 years.

**7. Long Term Debt**

As further discussed in Note 1 - CPEX Pharmaceuticals, Inc. Acquisition, on April 5, 2011, in connection with the CPEX Transaction, the Borrower borrowed approximately \$64 million under the Term Loan Agreement by and among Borrower, The Bank of New York Mellon, as Agent, and certain Lenders from time to time party thereto, in the form of a secured term loan to Borrower. The term loan under the Term Loan Agreement bears interest at "LIBOR" plus 16% per annum, with a minimum LIBOR rate of 1%, and matures on the earlier of January 3, 2026 or the date any of CPEX's patents that are associated with Testim®, a topical testosterone gel, expire, and contains customary events of default for loans of such nature. Repayment of the loan is made through a waterfall arrangement whereby, if certain conditions are met, the Testim® royalty stream is distributed on a quarterly basis as follows: first to pay certain fees and expenses of Agent and FCB LLC, second to pay fees of the banks maintaining the accounts associated with the loan, third to pay any expenses of Agent used to protect the loan collateral and any other unreimbursed fees or expenses of Agent or any Lender, fourth to replenish any shortfall in the interest reserve (which is \$2.5 million), fifth to pay interest due, sixth to pay 65% of the remaining royalty funds to Agent for the benefit of the Lenders as payment toward loan principal, and finally to FCB LLC for its benefit.

The balance of the loan at June 30, 2013 and December 31, 2012 was approximately \$43.9 million and \$49.5 million, respectively, with an original issue discount ("OID") balance of approximately \$1.0 million and \$1.2 million, respectively. Interest totaling approximately \$2.0 million and \$2.5 million was expensed in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income for the three months ended June 30, 2013 and 2012, respectively. Interest totaling \$4.1 million and \$5.2 million was expensed in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income for the six months ended June 30, 2013 and 2012, respectively. The rate applicable to this loan was 17.0% at June 30, 2013 and 2012. Current maturities of long term debt represent amounts expected to be payable in the next twelve months subsequent to June 30, 2013 in accordance with the repayment waterfall arrangement based on management's forecast. Future maturities are subject to change based on future cash flows and the terms of the loan agreement.

The \$64 million loan was issued at a discount of 2.34%, for total net proceeds of \$62.5 million, with an effective interest rate of 18%. The OID was \$1.5 million. The OID is equal to the difference between the stated face amount of the loan and actual cash received. This OID is being accreted over the estimated life of the loan, approximately 6 years, using the effective interest rate method, and is recorded as a component within non-cash interest expense. Accretion of approximately \$75,000 and \$43,000 was expensed for the three months ended June 30, 2013 and 2012, respectively, and accretion of approximately \$146,000 and \$83,000 was expensed for the six month ended June 30, 2013 and 2012, respectively, leaving an OID balance of approximately \$1.0 million as June 30, 2013.

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The \$64 million loan is collateralized by patents and a license agreement associated with Testim®, that were acquired in the CPEX transaction. The loan agreement requires certain financial reporting and non financial covenants. The Company was in compliance with these covenants as of June 30, 2013.

**8. Income Taxes**

The Company has available for federal income tax purposes net operating loss carryforwards (“NOLs”), subject to review by the authorities, aggregating approximately \$102.2 million and \$106.8 million, respectively, as of June 30, 2013 and December 31, 2012 that, if not utilized, will begin expiring for federal purposes in 2025. Utilization of the net operating loss carry forwards may be subject to an annual limitation in the event of a change in ownership in future years as defined by Section 382 of the Internal Revenue Code and similar state provisions. It should be noted that there may be certain limitations other than those potentially imposed by Section 382 of the Code on the Company’s ability to use its NOLs to offset certain taxable income, including, potentially, income generated in respect of the CPEX business. In assessing the realizability of deferred taxes, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized based on projections of our future taxable earnings. The ultimate realization of deferred tax assets is dependent upon several factors, including the generation of future taxable income during the periods in which those temporary differences become deductible.

As a result of the 2011 CPEX acquisition, the Company recorded an approximately \$19.5 million net deferred tax liability, and reduced approximately \$19.5 million of the valuation allowance against its NOL carryforward tax asset, which was reflected as an income tax benefit for the year ended December 31, 2011.

The Company also has available approximately \$20.0 million of net operating losses for New Jersey state income tax purposes, none of which they expect to utilize due to the fact that the Company no longer has nexus in the state of New Jersey and thus is not currently filing New Jersey state income tax returns.

Significant components of the Company’s deferred tax assets and liabilities are as follows (in thousands):

	June 30, 2013	December 31, 2012
Deferred tax assets		
NOL	\$ 35,783	\$ 37,386
Employee benefits	141	147
Alternative minimum tax	393	301
Other noncurrent liabilities	271	167
Other noncurrent assets	182	172
Unrealized capital losses	65	41
Property and equipment	73	147
	36,908	38,361
Less: valuation allowance	-	-
Deferred tax liability	(17,641)	(18,343)
Net deferred tax asset	\$ 19,267	\$ 20,018



**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
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Amounts included in the consolidated balance sheet are as follows at June 30, (in thousands):

	June 30, 2013	December 31, 2012
Current deferred tax asset	\$ 2,201	\$ 3,956
Long term deferred tax asset	17,066	16,062
	<u>\$ 19,267</u>	<u>\$ 20,018</u>

Tax Rate Reconciliation	For the Three Months Ended		For the Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Federal statutory rate	35.0%	35.0%	35.0%	35.0%
State income taxes, net of the federal tax benefit	2.8	0.2	3.2	0.2
Other	(0.1)	(34.8)	0.6	(34.4)
Personal Holding Company	36.9	-	46.4	-
Effective tax rate	<u>74.6%</u>	<u>0.4%</u>	<u>85.2%</u>	<u>0.8%</u>

**Provision for Income Taxes**

Current:				
Federal, including PHC	\$ 832	\$ 17	\$ 1,264	\$ 78
State / City	58	22	78	23
Total current	<u>890</u>	<u>39</u>	<u>1,342</u>	<u>101</u>
Deferred:				
Federal	660	-	750	-
Total deferred	<u>660</u>	<u>-</u>	<u>750</u>	<u>-</u>
Total provision	<u>\$ 1,550</u>	<u>\$ 39</u>	<u>\$ 2,092</u>	<u>\$ 101</u>

**9. Stock Based Compensation Plans**

The Company records stock based compensation in accordance with FASB ASC Topic 718 "Compensation – Stock Compensation," which requires all companies to measure and recognize compensation expense at fair value for all stock-based payments to employees and directors. The Company uses the Black-Scholes option-pricing model to estimate fair value of grants of employee and director stock options.

The Company calculates expected volatility for a share-based grant based on historic daily stock price observations of our common stock during the period immediately preceding the grant that is equal in length to the expected term of the grant. FASB ASC Topic 718 also requires that estimated forfeitures be included as a part of the estimate of expense as of the grant date. The Company has used historical data to estimate expected employee behaviors related to option term, exercises and forfeitures. With respect to both grants of options and awards of restricted stock, the risk free rate of interest is based on the U.S. Treasury rates appropriate for the expected term of the grant or award. A summary of option activity as of June 30, 2013 and changes during the twelve months ended December 31, 2012 is presented below.

	Shares	Weighted Average Exercise Price
Balance : January 1, 2012	2,562,640	\$ 1.03
Granted	-	-
Exercised	-	-
Forfeited	(62,640)	26.10
Balance : December 31, 2012	<u>2,500,000</u>	<u>\$ 0.35</u>
Granted	-	-
Exercised	-	-
Forfeited	-	-
Balance – June 30, 2013	<u>2,500,000</u>	<u>0.35</u>
Options Exercisable: June 30, 2013	<u>2,500,000</u>	<u>\$ 0.35</u>

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
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On March 15, 2010, Mr. Couchman was awarded a stock option to purchase up to 2,500,000 shares of Footstar's common stock at an exercise price of \$0.40 per share (after giving effect to the liquidating cash dividend of \$0.10 paid on March 12, 2010). The exercise price was adjusted in accordance with the terms of the initial grant from \$0.40 to \$0.35 due to a \$0.05 dividend paid to the stockholders of Footstar on October 7, 2010. On the date of the grant, the closing stock price Footstar's stock was \$0.23. The stock option was fully vested at the time of the grant. Included in Mr. Couchman's original stock option agreement, is a provision that the Board of Directors is required to adjust the agreement to reflect certain changes, including the declaration of cash dividends. On November 21, 2011, based on the Board of Directors declaration of a special cash distribution of \$0.05 per share of the Company's common stock on October 7, 2010, the Company's Board of Directors reduced Mr. Couchman's exercise price by \$0.05 in accordance with the terms of the initial grant, from \$0.40 to \$0.35. No other terms of the options were modified. Due to this modification, and in accordance with FASB ASC Topic 718, an incremental expense of \$104,507 was recognized on November 21, 2011. The modification valuation used an expected holding period of 0.48 years, an expected volatility of 72.22%, a risk free interest rate of 2% and a 0% dividend yield.

Pursuant to the Plan of reorganization, on April 19, 2012, Xstelos issued an option to purchase 2,500,000 shares of the Company to Mr. Couchman substantially on the same terms as the Footstar option. The option expires on March 15, 2020. This issuance or exchange did not result in additional compensation in 2012.

On December 24, 2012, the Company paid a dividend of \$.30 per share of the Company's common stock. The Board of Directors is evaluating an adjustment to the agreement as required and described above.

Mr. Finerman, a non-employee director of the Company, elected to receive his full retainer (\$12,500 for each quarter, totaling \$50,000) for fiscal 2012 in shares of restricted stock in lieu of cash compensation for service as a director in 2012 to which he would otherwise have been entitled. On April 2, 2012, July 2, 2012, October 1, 2012 and January 2, 2013, 10,965, 6,579, 7,576, and 7,576 shares of Company common stock, respectively, having an aggregate fair value of \$12,500 on each grant date, were issued to Mr. Finerman for service as a director in 2012 (the April 2, 2012 shares were issued as Footstar common stock). The \$12,500 value of the January 2, 2013 issuance is related to the fourth quarter of 2012 and is included in accrued expenses in the accompanying balance sheet as of December 31, 2012.

Mr. Finerman, also elected to receive his full retainer (\$12,500 for each quarter, totaling \$50,000) for fiscal 2013 in shares of fully vested restricted stock in lieu of cash compensation for service as a director in 2013 to which he would otherwise have been entitled. On each of April 2, 2013 and July 1, 2013, 7,353 and 8,621 shares, respectively, of Xstelos common stock having an aggregate fair value of \$12,500 on each grant date, were issued to Mr. Finerman for service as a director for the first quarter and second quarter of 2013, respectively. The \$12,500 value of the July 1, 2013 issuance is related to the second quarter of 2013 and is included in accrued expenses in the accompanying balance sheet as of June 30, 2013.

**XSTELOS HOLDINGS, INC. AND SUBSIDIARIES**  
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**10. Commitments and Contingencies**

*Litigation Matters*

The Company is involved in various and routine litigation matters, which arise through the normal course of business. Management believes that the resolution of these matters will not have a material adverse effect on the liquidity of the Company. While it firmly maintains that all pending claims are meritless, the Company will, however, continue to expend costs as it vigorously defends against these claims.

*Thom McAn:* In connection with the Company's discontinued operations in 1995, the Company entered into a sublease formerly occupied by its Thom McAn stores. The lease expires effective February 1, 2014. The obligation under the sublease is \$0.4 million as of the date of this filing, although the Company believes that there has been a novation of its obligations under such lease and may bring litigation to have a court finally determine such issue. At this time, the Company has not recorded a liability relating to this commitment as the probability of an unfavorable outcome is remote.

**Watson Laboratories, Inc.**

On May 23, 2012, Auxilium Pharmaceuticals, Inc. ("Auxilium") and FCB I LLC ("FCB") filed a lawsuit against Watson Laboratories, Inc.; Watson Pharmaceuticals, Inc.; and Watson Pharma, Inc. (collectively, "Watson") for infringement of FCB's ten patents listed in the U.S. Food and Drug Administration's ("FDA's") *Approved Drug Products with Therapeutic Equivalence Evaluations* (commonly known as the "Orange Book") as covering Testim<sup>®</sup> 1% testosterone gel. The lawsuit was filed in the United States District Court for the District of New Jersey.

Auxilium and FCB filed this lawsuit in response to a notice letter, dated April 12, 2012, sent by Watson Laboratories, Inc. regarding its filing with the FDA of ANDA No. 09-1073 for a generic 1% testosterone gel product. This letter also stated that ANDA No. 09-1073 contained Paragraph IV certifications, under 21 U.S.C. Section 355(j) of the Federal Food, Drug, and Cosmetic Act ("FFDCA"), with respect to the nine patents listed in the Orange Book on that date as covering Testim<sup>®</sup>: U.S. Patent Nos. 7,320,968; 7,608,605; 7,608,606; 7,608,607; 7,608,608; 7,608,609; 7,608,610; 7,935,690; and 8,063,029. On May 15, 2012, a new composition patent covering Testim<sup>®</sup> was issued. This patent is now also listed in the Orange Book and was included in the patent infringement lawsuit filed against Watson. In total, ten Testim<sup>®</sup> patents are now listed in the Orange Book and will expire at various dates ranging from July 21, 2023 through January 18, 2025.

On July 6, 2012, Watson filed its answer to the patent infringement complaint filed by Auxilium and FCB. Watson also asserted counterclaims against Auxilium and FCB, which seek declaratory judgments that each of the ten patents-in-suit are invalid or are not infringed by Watson's proposed generic 1% testosterone gel product.

This case is presently in the early stages of fact discovery. A trial date has not yet been set.

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Auxilium and FCB remain committed to protecting their intellectual property rights, including their patent protection for Testim<sup>®</sup>. Under the Hatch-Waxman Act, as a result of the patent infringement lawsuit filed against Watson, final FDA approval of Watson's ANDA for its proposed generic version of Testim<sup>®</sup> will be stayed until at least the earlier of 30 months from the date Watson's notice letter was received (*i.e.*, October 14, 2014) or final resolution of the pending patent infringement lawsuit.

**Upsher-Smith Laboratories, Inc.**

On December 4, 2008, CPEX Pharmaceuticals, Inc. ("CPEX") and Auxilium filed a lawsuit against Upsher-Smith Laboratories, Inc. ("Upsher-Smith") for infringement of U.S. Patent No. 7,320,968 ("the '968 patent"), which is listed in FDA's Orange Book as covering Testim<sup>®</sup> 1% testosterone gel and which was assigned to CPEX at that time. The lawsuit was filed in the United States District Court for the District of Delaware.

CPEX and Auxilium filed this lawsuit in response to a notice letter, dated October 22, 2008 and sent by Upsher-Smith, regarding Upsher-Smith's filing with the FDA of ANDA No. 79-178 for a generic 1% testosterone gel product. This letter also stated that Upsher-Smith's ANDA contained a Paragraph IV certification with respect to the '968 patent. On February 27, 2009, Auxilium filed a Citizen Petition with the FDA, requesting that the FDA withhold approval of Upsher-Smith's ANDA No. 79-178 and that the FDA require Upsher-Smith to conduct additional clinical studies related to the safety and efficacy of its proposed generic 1% testosterone gel product. On August 26, 2009, the FDA granted Auxilium's citizen petition in part, and stated that additional clinical testing would need to be conducted by Upsher-Smith before its proposed 1% testosterone gel product could be approved by the FDA. On December 13, 2011, the lawsuit pending in the District of Delaware was administratively closed by the court.

On September 10, 2012, Upsher-Smith filed a complaint in the United States District Court for the District of New Jersey against Auxilium and FCB, seeking a declaratory judgment that its ANDA No. 79-178 does not infringe eight of the ten patents listed in the Orange Book as covering Testim<sup>®</sup>: U.S. Patent Nos. 7,608,605; 7,608,606; 7,608,607; 7,608,608; 7,608,609; 7,608,610; 7,935,690; and 8,063,029. On October 12, 2012, Auxilium and FCB filed a motion to dismiss Upsher-Smith's declaratory judgment complaint for lack of subject matter jurisdiction, or alternately to transfer that case to the District of Delaware. On January 29, 2013, in response to the parties' submission of letters regarding subsequent factual developments relevant to the pending motion to dismiss, the Court terminated the motion without prejudice and set forth a schedule for revised briefing to include the subsequent factual developments. Auxilium and FCB's revised motion to dismiss or transfer was filed, and the parties completed briefing on March 4, 2013. On March 27, 2013, the Court granted Auxilium and FCB's motion to dismiss without prejudice and the New Jersey action was terminated. On April 26, 2013, Upsher-Smith filed a notice of appeal to the United States Court of Appeals for the Federal Circuit. On June 14, 2013, following agreement of the parties, the Court dismissed Upsher-Smith's Appeal.

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On January 28, 2013, Auxilium and FCB I filed a complaint in the United States District Court for the District of Delaware against Upsher-Smith for infringement of U.S. Patent Nos. 7,320,968; 7,608,605; 7,608,606; 7,608,607; 7,608,608; 7,608,609; 7,608,610; 7,935,690; 8,063,029; and 8,178,518. Auxilium and FCB I filed this lawsuit in response to a notice letter, dated December 21, 2012, and sent by Upsher-Smith, regarding Upsher-Smith's filing with the FDA of NDA No. 204399 for a generic 1% testosterone gel product. On January 30, 2013, Upsher-Smith counterclaimed for a declaration that these patents are invalid and/or unenforceable and that Upsher-Smith's marketing of a prescription topical gel containing testosterone would not infringe the patent. Under the Hatch-Waxman Act, as a result of the patent infringement lawsuit filed against Upsher-Smith, final FDA approval of Upsher-Smith's NDA for its proposed generic version of Testim<sup>®</sup> will be stayed until at least the earlier of 30 months from the date Upsher-Smith's notice letter was received (*i.e.*, June 24, 2015) or final resolution of the pending patent infringement lawsuit. On June 28, 2013, a Hearing on Upsher-Smith's Motion for Summary Judgment was held and the Court's Decision is Pending. The trial on this matter is expected to occur in the second quarter of 2014. As in the litigation discussed above, Auxilium and FCB remain committed to protecting their intellectual property rights, including their patent protection for Testim<sup>®</sup>.

*Development and License Agreement with Serenity*

On June 13, 2013, Black Horse Capital, LP ("Black Horse Capital"), Black Horse Capital Master Fund Ltd. ("Black Horse Capital Master Fund"), Ouray Holdings I AG ("Ouray") and Cheval Holdings, Ltd. ("Cheval Holdings," and together with Black Horse Capital, Black Horse Capital Master Fund and Ouray, the "Plaintiffs") filed a lawsuit against Xstelos, Xstelos Corp, FCB Holdings and Jonathan Couchman, the Company's President, Chief Executive Officer and Chief Financial Officer ("Couchman" and collectively with the Company, Xstelos Corp. and FCB Holdings, the "Defendants"), claiming that the Defendants are monetarily liable to the Plaintiffs for various claims and Plaintiffs are entitled to specific performance with respect to certain claims, including for alleged breaches of the Claimed Serenity Agreement (as defined below), claimed unpaid amounts due under the Consulting Agreement, claimed breaches of the alleged contractual duties under the Stockholders' Agreement (as defined below), and certain related matters. One of the Plaintiffs is the 19.5% owner of FCB Holdings and various Plaintiffs are a party to multiple agreements with one or more of the Defendants, including a stockholders' agreement (the "Stockholders' Agreement") with Xstelos Corp and FCB Holdings and a Consulting Agreement with Xstelos Corp. Certain of the Plaintiffs had previously raised claims with the Company that they were entitled to an 80% interest (the "Claimed Serenity Agreement") in certain rights owned by CPEX underlying the Serenity License Agreement, 80% of all revenue that may be received by CPEX pursuant to the Serenity License Agreement, unpaid amounts under the Consulting Agreement, as well as certain related matters.

In February 2008, CPEX had entered into a Development and License Agreement ("Serenity License Agreement") with Serenity Pharmaceuticals Corporation, to develop Ser-120, a product candidate for the treatment of nocturia that utilizes CPEX's patented intranasal drug delivery technology. Nocturia is a condition which causes an individual to wake one or more times at night to urinate. Serenity granted CPEX a non-exclusive license to its technology and patents rights to conduct initial formulation activities under the Agreement. CPEX granted Serenity an exclusive, sublicensable, worldwide license under United States Patent No. 7,244,703 and foreign equivalents and CPEX's proprietary CPE-215 drug delivery technology to conduct research activities related to the development of Ser-120 and to make and sell the product. On April 1, 2010, CPEX announced that Serenity entered into a global agreement with Allergan, Inc. ("Allergan") under which Allergan assumed the development and license agreement with Serenity. In return, CPEX is entitled to sales milestones and low single digit royalties on worldwide net sales following commercialization of Ser-120. Allergan has recently reported positive Phase 3 data for Ser-120, as well as that it will fund a confirmatory Phase 3 trial.

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The Defendants intend to vigorously defend against such claims.

**11. Charter restriction**

Subject to certain exceptions, including prior exemption by Xstelos's board of directors, Xstelos's Certificate of Incorporation prohibits and makes void certain transfers of its common stock, to the extent that after giving effect to such purported transfer (i) the purported transferee would become a 4.75% or greater holder of its common stock, (ii) the ownership of a 4.75% stockholder's common stock, prior to giving effect to the purported transfer, would be increased or (iii) the transfer creates a new "public group" under Treasury rules.

**12. Investment in Myrexis**

*Purchase of shares in Myrexis*

On February 27, 2013, Xstelos Corp and Myrexis entered into a stock purchase agreement (the "Stock Purchase Agreement"). Pursuant to terms of such stock purchase agreement, Xstelos agreed to purchase from Myrexis 7,000,000 newly issued shares of Myrexis common stock, par value \$0.01 per share, representing approximately 20% of all outstanding Myrexis Common Stock after giving effect to such purchase (the "Purchase"). The shares were purchased for an aggregate purchase price of \$250,000. The Company has accounted for this transaction under the equity method. The equity in loss of investment in affiliate for Myrexis for the period April 1, 2013 through June 30, 2013 was \$31,000, which decreased the investment in affiliate balance to \$219,000 and has been reflected in the accompanying condensed consolidated balance sheet as of June 30, 2013. Xstelos Corp. also agreed to provide to Myrexis services pursuant to the terms of an Intercompany Services Agreement (described below) as well as consent to Mr. Couchman serving as Myrexis's Chief Financial Officer. (Mr. Couchman also serves as Myrexis's Chief Executive Officer.) Steven D. Scheiwe, a member of the Company's Board of Directors, serves on the Board of Directors of Myrexis.

In connection with the Purchase, Xstelos entered into a letter agreement (the "Letter Agreement") dated February 27, 2013 with Myrexis, pursuant to which Myrexis granted to Xstelos Corp an exemption under Section 29 of Myrexis's Tax Benefits Shareholder Rights Agreement, embodying a shareholder rights plan adopted on March 29, 2012 to protect the use of Myrexis's net operating losses and certain other tax attributes. Under the exemption, Xstelos Corp must not at any time represent more than the lesser of (i) 30% of the Common Stock and (ii) the maximum percentage ownership of Common Shares from time to time such that an ownership change would not have occurred for purposes of Section 382 of the Internal Revenue Code of 1986, as amended, and the Treasury Regulations thereunder.

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*Intercompany services agreement with Myrexis*

On February 27, 2013, Xstelos Corp. and Myrexis entered into an Intercompany Services Agreement. Pursuant to the Intercompany Services Agreement, Xstelos Corp. agreed to provide Myrexis with certain administrative, management, accounting and information services for one year in exchange for a fee of \$25,000. The Intercompany Services Agreement will terminate upon 30 days upon written notice given to the other party. Intercompany service fees of \$6,250 were received for the period ended June 30, 2013 and were recorded as selling, general and administrative expense in the accompanying Statements of Income and Comprehensive Income (Loss).

## **ITEM 2. Management’s Discussion and Analysis of Financial Condition and**

### **Results of Operations**

#### **Forward-Looking Statements**

This report contains forward-looking statements made in reliance upon the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These statements may be identified by the use of words such as “anticipate,” “estimates,” “should,” “expect,” “project,” “intend,” “plan,” “believe” and other words and terms of similar meaning, in connection with any discussion of our financial statements, business, results of operations, liquidity, future operating or financial performance and other future events and circumstances. Factors that could affect our forward-looking statements include, among other things:

- the expectation that our business and operations will continue as presently conducted;
- competition from existing products or new products that may emerge;
- regulatory difficulties relating to products that have already received regulatory approval;
- potential product liability claims;
- our dependency on third-party manufacturers to supply or manufacture our products;
- our ability to establish or maintain collaborations, licensing or other arrangements;
- our ability and third parties’ abilities to protect intellectual property rights;
- limitations of our ability to utilize its net operating losses;
- compliance with obligations under intellectual property licenses with third parties; and
- our ability to successfully invest for future growth.

Because the information in this Quarterly Report on Form 10-Q is based solely on data currently available, it is subject to change and should not be viewed as providing any assurance regarding our future. Actual results, operations, performance, events, plans and expectations may differ materially from our current expectations and the differences may be material, individually or in the aggregate, to our business, financial condition, results of operations, liquidity and prospects. Additionally, we do not plan to update any of our forward looking statements based on changes in assumptions, changes in results or other events subsequent to the date of this Quarterly Report on Form 10-Q, other than as included in our future required SEC filings, or as may otherwise be legally required.



## Results of Operations – Three months ended June 30, 2013 versus Three months ended June 30, 2012

The following is a discussion of the results of operations for Xstelos Corp for the three months ended June 30, 2013 compared with the three months ended June 30, 2012 (in thousands) (inflation and changing prices have not had a material impact on revenues or results from operations in the two periods):

	Three Months Ended June 30,			
	2013	2012	<i>Change</i>	<i>% (+/-)</i>
<b>ROYALTY REVENUE</b>	\$ 6,554	\$ 7,650	\$ (1,096)	-14.3%
<b>Operating Expenses</b>				
Selling, general and administrative expense	1,255	1,174	81	-6.9%
Depreciation and amortization	1,016	1,066	(50)	-4.7%
Total operating expenses	2,271	2,240	31	1.4%
<b>OPERATING INCOME</b>	4,283	5,410	(1,127)	-20.8%
Interest expense, net	(2,165)	(2,632)	467	-17.7%
Rental revenue	41	13	28	215.4%
Loss on marketable securities and investment in affiliate	(95)	(533)	438	82.2%
Gain on sale of real estate	-	7,652	(7,652)	-100.0%
Loss on disposal of non-operating assets	-	(116)	116	-100.0%
<b>EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	2,064	9,794	(7,730)	-78.9%
Income tax expense	1,550	39	1,511	3,874.4%
<b>EARNINGS FROM CONTINUING OPERATIONS</b>	\$ 514	\$ 9,755	\$ (9,241)	-94.7%

### Royalty Revenue

Royalty revenue decreased \$1.1 million, or 14.3%, to \$6.6 million for three months ended June 30, 2013 compared with \$7.6 million for three months ended June 30, 2012 due to decreased sales volume by Auxilium of Testim®, on which royalty revenue is earned.

### SG&A Expenses

SG&A expenses increased \$0.1 million, or 6.9%, to \$1.3 million for three months ended June 30, 2013 compared with \$1.2 million for three months June 30, 2012. The increase is due to higher legal expenses in 2013, primarily related to increased litigation expense relating to the Watson Laboratories and Upsher-Smith cases (see note 10) offset by lower headcount, professional fees, insurance expenses and real estate expenses.

### Depreciation and Amortization

Depreciation and amortization expense decreased \$0.05 million, or 4.7%, to \$1.02 million for the three months ended June 30, 2013 compared with \$1.07 million for the three months ended June 30, 2012. This decrease is solely due to depreciation expense adjustment in 2012 for assets held for use that were, previously not depreciated, as they were classified as assets held for sale, prior to the second quarter 2012.

#### Operating Income

Operating income decreased \$1.1 million, or 20.8% to \$4.3 million for three months ended June 30, 2013 compared with a \$5.4 million for three months ended June 30, 2012, primarily due to the decreased royalty revenue and higher selling, general and administrative expenses, as described above.

#### Interest Expense

Interest expense decreased \$0.5 million, or 17.7%, to \$2.2 million for three months ended June 30, 2013 compared with \$2.7 million for three months ended June 30, 2012. The decrease is exclusively due to a lower principal loan balance in 2013.

#### Marketable Securities and Investment in Affiliate

The Company recognized a realized gain of approximately \$39,000 on sales of marketable securities and unrealized loss in market value of approximately \$103,000 due to a decrease in the stock price per share of the marketable securities and loss from equity method investment of \$31,000.

#### Sale of Real Estate

On April 27, 2012, the Company sold its Mahwah Real Estate for approximately \$14.6 million less selling and other costs of approximately \$0.8 million, and recognized a gain of approximately \$7.7 million.

#### Disposal of Non-Operating Assets

In June 2012, the Company signed a five year lease of its Exeter real estate. As a result of preparing the building for this lease, management disposed of approximately \$134,000 of furniture and equipment that were store in the Exeter building, and recorded a loss. This loss was offset by a gain from the sale of equipment of approximately \$18,000.

## Results of Operations – Six months ended June 30, 2013 versus Six months ended June 30, 2012

The following is a discussion of the results of operations for Xstelos Corp for the six months ended June 30, 2013 compared with the six months ended June 30, 2012 (in thousands) (inflation and changing prices have not had a material impact on revenues or results from operations in the two periods):

	Six Months Ended June 30,			
	2013	2012	<i>Change</i>	<i>% (+/-)</i>
<b>ROYALTY REVENUE</b>	\$ 12,187	\$ 14,791	\$ (2,604)	-17.6%
<b>Operating Expenses</b>				
Selling, general and administrative expense	3,260	2,584	676	26.2%
Depreciation and amortization	2,032	2,070	(38)	-1.8%
Total operating expenses	5,292	4,654	638	13.7%
<b>OPERATING INCOME</b>	6,895	10,137	(3,242)	-32.0%
Interest expense, net	(4,436)	(5,381)	945	17.6%
Rental revenue	81	13	68	523.1%
Loss on marketable securities and investment in affiliate	(69)	(527)	458	86.9%
Gain on sale of real estate	-	7,652	(7,652)	-100.0%
Loss on disposal of non-operating assets	(38)	(116)	78	-67.2%
<b>EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	2,433	11,778	(9,345)	-79.3%
Income tax expense	2,092	101	1,991	1,971.3%
<b>EARNINGS FROM CONTINUING OPERATIONS</b>	\$ 341	\$ 11,677	\$ (11,336)	-97.1%

### Royalty Revenue

Royalty revenue decreased \$2.6 million, or 17.6%, to \$12.2 million for six months ended June 30, 2013 compared with \$14.8 million for six months ended June 30, 2012 due to decreased sales volume by Auxilium of Testim®, on which royalty revenue is earned.

### SG&A Expenses

SG&A expenses increased \$0.7 million, or 26.2%, to \$3.3 million for six months ended June 30, 2013 compared with \$2.6 million for six months June 30, 2012. The increase is due to higher legal expenses in 2013, primarily related to increased litigation expense relating to the Watson Laboratories and Upsher-Smith cases that accrued during Q1 (see note 10), which is offset by lower headcount, professional fees, insurance expenses and real estate expenses.

### Depreciation and Amortization

Depreciation and amortization expense decreased \$0.01 million, or 1.8%, to \$2.03 million for six months ended June 30, 2013 compared with \$2.07 million for six months ended June 30, 2012. This decrease is solely due to depreciation expense adjustment in 2012 for assets held for use that were, previously not depreciated, as they were classified as assets held for sale, prior to the second quarter 2012.

## Operating Income

Operating income decreased \$3.2 million, or 32.0% to \$6.9 million for six months ended June 30, 2013 compared with a \$10.1 million for six months ended June 30, 2012, primarily due to the decreased royalty revenue and higher legal expenses, as described above.

## Interest Expense

Interest expense decreased \$1.0 million, or 17.6%, to \$4.4 million for six months ended June 30, 2013 compared with \$5.4 million for six months ended June 30, 2012. The decrease is exclusively due to a lower principal loan balance in 2013.

## Marketable Securities and Investment in Affiliate

The Company recognized a realized gain of approximately \$53,000 on sales of marketable securities and unrealized loss in market value of approximately \$91,000 due to a decrease in the stock price per share of the marketable securities and loss from equity method investment of \$31,000.

## Sale of Real Estate

On April 27, 2012, the Company sold its Mahwah Real Estate for approximately \$14.6 million less selling and other costs of approximately \$0.8 million, and recognized a gain of approximately \$7.7 million.

## Disposal of Non-Operating Assets

In June 2012, the Company signed a five year lease of its Exeter real estate. As a result of preparing the building for this lease, management disposed of approximately \$134,000 of furniture and equipment that were stored in the Exeter building, and recorded a loss. This loss was offset by a gain from the sale of equipment of approximately \$18,000.

## Liquidity and Capital Resources

At June 30, 2013, the Company had cash and cash equivalents of approximately \$17.1 million, which, along with the royalties from Testim® pursuant to the licensing agreement with Auxilium, we believe will be sufficient to fund our operations and our cash requirements for the next twelve months, and beyond. Our cash includes balances maintained in commercial bank accounts. There can be no assurance that changes in our research and development plans or other events affecting our revenues or operating expenses will not result in the earlier depletion of our funds. In appropriate situations, which will be strategically determined, we may seek funding from other sources, including, but not limited to, contribution by others to joint ventures and other collaborative or licensing arrangements for the development, testing, manufacturing and marketing of products currently under development or sales of debt or equity securities.

On April 5, 2011, in connection with the acquisition of CPEX, FCB LLC, a wholly owned subsidiary of FCB Acquisition, which became a wholly owned subsidiary of CPEX upon FCB Acquisition's merger with and into CPEX, borrowed approximately \$64 million under the Term Loan Agreement. The term loan under the Term Loan Agreement bears interest at "LIBOR" plus 16% per annum, with a minimum LIBOR rate of 1%, and matures on the earlier of January 3, 2026 or the date any of CPEX's patents that are associated with Testim®, a topical testosterone gel, expire, and contains customary events of default for loans of such nature. As part of the Term Loan Agreement, CPEX contributed to FCB LLC all of its intellectual property rights in Testim® and rights to the royalty stream pursuant to the license agreement with Auxilium, and the loan is secured by FCB LLC's interest in all such rights. Repayment of the loan is made through a waterfall arrangement whereby, if certain conditions are met, the Testim® royalty stream is distributed on a quarterly basis as follows: first to pay certain fees and expenses of Agent and FCB LLC, second to pay fees of the banks maintaining the accounts associated with the loan, third to pay any expenses of Agent used to protect the loan collateral and any other unreimbursed fees or expenses of Agent or any Lender, fourth to replenish any shortfall in the interest reserve (which is \$2.5 million), fifth to pay interest due, sixth to pay 65% of the remaining royalty funds to Agent for the benefit of the Lenders as payment toward loan principal, and finally to FCB LLC for its benefit. As of June 30, 2013, the outstanding principal amount due under the term Loan Agreement was approximately \$43.9 million.

Our largest source and use of cash were financing and investing related to the CPEX acquisition. The Company generated positive cash flow from operations due to our acquisition of CPEX.

As of June 30, 2013 accounts receivable, consisting of a royalty receivable, totaled \$6.6 million. These receivables are generally collected within three months after the respective calendar quarter.

Net cash provided by operating activities for six months ended June 30, 2013 was \$5.4 million, directly related to net earnings of \$0.4 million, adding \$2.0 million of depreciation and amortization, and increased by \$0.6 million due to the decrease in accounts receivable and \$2.4 million due to other miscellaneous items consisting principally of an decrease in prepaid expenses and other current assets of \$0.6 million.

Cash used in investing activities was \$0.6 million for the six months ended June 30, 2013, which was primarily due to the proceeds from sale of marketable securities.

Cash used in financing activities was \$5.6 million for the six months ended June 30, 2013, which was used to repay debt under the term loan agreement related to the CPEX Transaction.

Factors that could affect our short and long term liquidity include, among other items, the amount of royalties received from Auxilium and the payment of any further dividends or distributions.

#### *Long term debt*

The term loan under the Term Loan Agreement bears interest at "LIBOR" plus 16% per annum, with a minimum LIBOR rate of 1%, and matures on the earlier of January 3, 2026 or the date any of CPEX's patents that are associated with Testim®, a topical testosterone gel, expire, and contains customary events of default for loans of such nature. The loan was issued at a discount of 2.34%. The original issue discount (OID) was \$1.5 million. The OID is equal to the difference between the stated face amount of the loan and actual cash received. This OID is being accreted over the estimated life of the loan, approximately 6 years, using the effective interest rate method, and is recorded as a component within non-cash interest expense. The loan is collateralized by patents and a license agreement associated with Testim®, that were acquired in the CPEX transaction. The loan agreement requires certain financial reporting and non financial covenants.

## **Critical Accounting Policies, Estimates and Judgments**

The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, as well as the reported revenues and expenses during the reporting periods. We evaluate these estimates and judgments on an ongoing basis. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions.

### *Cash equivalents*

Cash and cash equivalents consist of highly liquid instruments with maturities of three months or less from the date acquired and stated at cost which approximates their fair market value. At times the Company has cash and cash equivalents balances in excess of the FDIC and SIPC insured limits.

At June 30, 2013, restricted cash of \$2,500,000 pledged to support a bank credit facility, is classified as a non-current asset. The restricted cash serves as collateral for the loan in connection with the CPEX Transaction that provides financial assurance that the Company has the ability to service the loan, as discussed in Note 7 – Long Term Debt. The cash is held in custody by the loan agent, is restricted as to withdrawal or use, and is currently not invested and does not bear interest.

### *Royalties Receivable and Allowances for Doubtful Accounts*

When necessary, receivable balances are reported net of an estimated allowance for uncollectible accounts. Estimated uncollectible receivables are based on the amount and status of past due accounts, contractual terms with customers, the credit worthiness of customers and the history of uncollectible accounts. Royalties receivable as of June 30, 2013, are royalties due from its licensee, Auxilium for sales of Testim®. All receivables are uncollateralized and therefore are subject to credit risk.

### *Intangible Assets*

Costs incurred in connection with acquiring licenses, patents, and other proprietary rights are capitalized as intangible assets. These assets are amortized on a straight-line basis over the applicable useful life from the dates of acquisition. Such assets are reviewed whenever events or changes in circumstances indicate that the assets may be impaired, by comparing the carrying amounts to their estimated future undiscounted cash flows, and adjustments are made for any diminution in value below the carrying value.

### *Income Taxes*

The Company records deferred tax assets and liabilities based on the differences between the book and tax bases of assets and liabilities and on operating loss carryforwards using enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. These amounts are adjusted, as appropriate, to reflect enacted changes in tax rates expected to be in effect when the temporary differences reverse.

The Company determined the deferred tax provision under the liability method, whereby deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using currently enacted tax rates.

The Company reviews the valuation of deferred tax assets based on positive evidence, such as projections of future taxable earnings along with negative evidence, such as operational uncertainties. As a result, the Company concluded that it is more likely than not that certain deferred tax assets will be realized as of June 30, 2013, based primarily on the actual earnings from CPEX operations since the date of acquisition in April 2011, and the forecasted performance of CPEX.

### *Revenue Recognition*

CPEX recognizes revenue from royalties on Auxilium's sales of Testim in accordance with The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605-10-S99-1, which requires sales to be recorded upon delivery, provided that there is evidence of a final arrangement, there are no uncertainties surrounding acceptance, title has passed, collectability is reasonably assured and the price is fixed or determinable. Since 2003, Auxilium has sold Testim to pharmaceutical wholesalers and chain drug stores, which have the right to return purchased products prior to the units being dispensed through patient prescriptions.

### **Contingencies and Litigation**

The information set forth under the caption "Litigation Matters" in Note 10 to the condensed consolidated financial statements is incorporated herein by reference.

### **Off-Balance Sheet Arrangements**

None.

## **Impact of Inflation**

The condensed consolidated financial statements included in this document have been prepared in accordance with accounting principles generally accepted in the United States of America. These principles require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Our interest obligations for our long term debt, representing 50% of total assets as of June 30, 2013, are primarily market driven. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Interest rates, however, do not necessarily move in the same direction or with the same magnitude as the price of goods and services, since such prices are affected by inflation. In a period of rapidly rising interest rates, the ability to pay interest and current maturities on our long-term debt is critical. The principal effect of inflation on earnings, as distinct from levels of interest rates, is in the area of non-interest expense. Expense items such as employee compensation, employee benefits and occupancy costs may be subject to increases as a result of inflation. An additional effect of inflation is the possible increase in the interest due on our long-term debt. We are unable to determine the inflationary impact on interest to the extent, if any, to which we owe on our long-term debt.

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

Not Applicable.

## **ITEM 4. Controls and Procedures**

The Company has established controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and is accumulated and communicated to management, including our President and Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. With the participation of our President and Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report (the "Evaluation Date"). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based on such evaluation, our President and Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective.

No changes in the Company's internal control over financial reporting have occurred during the quarterly period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.



## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

The information set forth under the caption “Litigation Matters” in Note 10 to the condensed consolidated financial statements is incorporated herein by reference.

#### ITEM 1A. Risk Factors

Please review our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, for a complete statement of “Risk Factors” that pertain to our business. The following paragraphs set forth additional risk factors.

**Our products and any of our product candidates, if approved, and our competitors’ branded products may face competition from lower cost generic, branded generic or follow-on products and such generic competition could have a material adverse effect on our business.**

Testim® was approved under the provisions of the U.S. Food, Drug and Cosmetic Act that renders it susceptible to potential competition from generic manufacturers via the Abbreviated New Drug Application (“ANDA”) procedure or the 505(b)(2) New Drug Application (“505(b)(2)NDA”) procedure. Generic manufacturers can sell their products at prices much lower than those charged by the innovative pharmaceutical companies who have incurred substantial expenses associated with the research and development of the drug product.

The ANDA procedure and the 505(b)(2) NDA procedure include provisions allowing generic manufacturers to challenge the effectiveness of the innovator’s patent protection long before the generic manufacturer actually commercializes their products through the paragraph IV certification procedure. In recent years, generic manufacturers have used paragraph IV certifications extensively to challenge patents on a wide array of innovative pharmaceuticals, and we expect this trend to continue and to implicate drug products with even relatively small total revenues.

#### Upsher-Smith Litigations

We are currently engaged in separate litigations with Upsher-Smith in Federal court in Delaware regarding Upsher-Smith’s attempts to bring a testosterone gel product to market via an ANDA or 505(b)(2) NDA using Testim® as its reference listed drug. Upsher-Smith will not be able to lawfully launch a generic or branded generic version of Testim® in the U.S. without the necessary approval from the FDA. The previously pending ANDA litigation in Federal court in New Jersey was dismissed in March 2013, and, although Upsher-Smith initially appealed, FCB, Auxilium and Upsher-Smith have since jointly agreed to dismiss the appeal. We refer to the ANDA litigation in Delaware as the “Delaware Upsher-Smith ANDA Litigation”, the 505(b)(2) NDA litigation in Delaware as the “Delaware Upsher-Smith 505(b)(2) NDA Litigation”, the litigation in New Jersey as the “New Jersey Upsher-Smith ANDA Litigation”, and all three of them collectively as the “Upsher-Smith Litigations”.

### Delaware ANDA

In October 2008, CPEX and AuxiliumTestim®, received notice that Upsher-Smith filed an ANDA containing a paragraph IV certification seeking approval from the FDA to market a generic version of Testim® prior to the January 2025 expiration of the '968 Patent. Shortly after, CPEX and Auxilium commenced the Delaware Upsher-Smith ANDA Litigation. Although it would seem unlikely based on (i) the FDA's public statements in its responses to the Citizen's Petitions submitted by each of Auxilium and AbbVie Inc. ("AbbVie") and (ii) Upsher-Smith's public stance that its generic product has different penetration enhancers than Testim®, the FDA could approve the generic product proposed in Upsher-Smith's ANDA. With FDA approval, even if the Delaware Upsher-Smith ANDA Litigation remains pending, Upsher-Smith may nevertheless choose to launch this generic product at risk of infringing the '968 patent. Although administratively closed in December 2011, the Delaware Upsher-Smith ANDA Litigation has not been dismissed or finally resolved and could also result in a finding that Upsher-Smith's proposed testosterone product does not infringe the '968 Patent or that the '968 Patent is invalid and/or unenforceable. All discovery obligations of the parties continue to be in effect. In April 2012, FCB and Auxilium received a notice from Upsher-Smith in connection with its ANDA advising FCB and Auxilium of Upsher-Smith's Paragraph IV certification relating to the eight additional patents listed in the Orange Book in addition to the '968 patent-in-suit, and asserting that Upsher-Smith does not believe that the product for which it is seeking approval infringes any of the Orange Book listed Testim® patents and that those patents are invalid. A tenth U.S. patent issued to FCB on May 15, 2012 and was listed in the Orange Book.

### New Jersey ANDA

On March 27, 2013, FCB and Auxilium learned that Judge Linares of the United States District Court for the District of New Jersey ruled in favor of FCB and Auxilium on their motion to dismiss the lawsuit previously filed by Upsher-Smith on September 10, 2012. On April 25, 2013, Upsher-Smith filed a Notice of Appeal, appealing the dismissal to the United States Court of Appeals for the Federal Circuit. On June 14, 2013, the Court dismissed the appeal pursuant to a joint motion filed by the parties, thereby terminating the lawsuit. The lawsuit had sought a declaration of non-infringement and/or invalidity of FCB's U.S. Patent Nos.: 7,608,605; 7,608,606; 7,608,607; 7,608,608; 7,608,609; 7,608,610; 7,935,690; and 8,063,029. All of the eight referenced patents cover Testim® 1% testosterone gel, and the eight referenced patents are among the ten FCB patents covering Testim® that are currently listed in the Orange Book. The referenced patents will expire between 2023 and 2025.

### Delaware 505(b)(2) NDA

On or about December 28, 2012, FCB and Auxilium became aware of a notice from Upsher-Smith that advised FCB and Auxilium of Upsher-Smith's filing of a 505(b)(2) NDA containing a Paragraph IV certification under 21 U.S.C. Section 314.52(c) for testosterone gel (the "Upsher-Smith NDA"). This Paragraph IV certification notice refers to the ten U.S. patents, covering Testim®, that are listed in the Orange Book. These ten patents are owned by FCB and are exclusively licensed to Auxilium and will expire between 2023 and 2025. Upsher-Smith may seek to have any drug approved under the Upsher-Smith NDA as a generic or branded generic version of Testim®. On January 28, 2013, FCB and Auxilium filed a lawsuit in the United States District Court for the District of Delaware against Upsher-Smith for infringement of FCB's ten patents listed in the Orange Book as covering Testim® 1% testosterone gel. A hearing on Upsher-Smith's previously filed motion for summary judgment was held on June 28, 2013, and, by request of the Court, the parties submitted additional briefing in the weeks following the hearing. FCB and Auxilium are currently awaiting a ruling from the Court which we believe could come as early as during the third quarter of 2013. If summary judgment is granted, Upsher-Smith could launch a 1% testosterone gel product using Testim® as the reference drug immediately after such ruling, if it receives approval by the FDA. If summary judgment is not granted, the trial is currently scheduled to commence during the second quarter of 2014.

On March 26, 2013, Auxilium submitted a Citizen Petition to the FDA with respect to Upsher-Smith's 505(b)(2) NDA referencing Testim®. Auxilium requested that, in the event of FDA approval of the Upsher-Smith 505(b)(2) NDA, the FDA: (i) refrain from designating Upsher-Smith's testosterone gel as therapeutically equivalent to Testim® and (ii) require that the label for the Upsher-Smith testosterone gel state that the product is not interchangeable with other testosterone transdermal gels. Since any such approval by the FDA would be pursuant to a 505(b)(2) NDA and not pursuant to an ANDA, it is unclear at this time whether such an Upsher-Smith product would receive a therapeutically equivalent rating to Testim® or a different rating.

#### Watson Litigation

##### ANDA Litigation with Watson

On May 24, 2012, FCB and Auxilium filed a lawsuit against Watson for infringement of FCB's ten patents listed in the Orange Book as covering Testim® 1% testosterone gel. The lawsuit was filed in the United States District Court for the District of New Jersey on May 23, 2012 in response to a notice letter, dated April 12, 2012, sent by Watson Laboratories, Inc. (NV) regarding its filing with the FDA of an ANDA for a generic 1% testosterone gel product. This letter also stated that the ANDA contained Paragraph IV certifications with respect to the nine patents listed in the Orange Book on that date as covering Testim®. The lawsuit filed against Watson involves those nine patents, as well as a tenth patent covering Testim® that was issued on May 15, 2012 and is listed in the Orange Book.

An adverse outcome in any of the Upsher-Smith Litigations (including a ruling granting Upsher-Smith's pending summary judgment motion in the Delaware Upsher-Smith 505(b)(2) NDA Litigation), the Watson Litigation, or any other such legal action, could result in one or more generic or branded generic versions of Testim® being launched in the U.S. immediately after such adverse outcome and before the expiration of the last to expire of the ten Orange Book patents relating to Testim® in January 2025. If Upsher-Smith prevails in the Upsher-Smith Litigation (including as a result of a ruling granting its pending summary judgment motion in the Delaware Upsher-Smith 505(b)(2) NDA Litigation), it could launch a 1% testosterone gel product using Testim® as the reference drug immediately, if approved by the FDA. It is unclear whether any such potentially approved Upsher-Smith product would receive a therapeutically equivalent rating to, and thus be freely substitutable for, Testim®, or if it would receive a different rating to, and perhaps not be freely substitutable for, Testim®. Any such Upsher-Smith product, whatever the rating, could have a materially adverse impact on our Testim® revenues, but we believe that a product with a therapeutically equivalent rating could likely have a more severe materially adverse impact on our Testim® revenues. The introduction of a generic or different version of Testim® at any time, whatever the rating, or the introduction of a generic or different version of AbbVie's AndroGel franchise (which could be on or before August 2015) could significantly and potentially permanently reduce the royalty revenue from Auxilium which we derive from Testim®. A significant reduction in our Testim® royalty revenue from Auxilium could have a material adverse effect on our business, results of operations and financial condition, including without limitation, our liquidity and net working capital and could materially and adversely affect our ability to execute on our short and long-term business plans.

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

Mr. Finerman, a non-employee director of the Company, elected to receive his full retainer (\$12,500 for each quarter, totaling \$50,000) for fiscal 2013 in shares of restricted stock in lieu of cash compensation for service as a director in 2013 to which he would otherwise have been entitled. On July 1, 2013, 8,621 shares of Xstelos common stock having an aggregate fair value of \$12,500 on such grant date were issued to Mr. Finerman for service as a director for the second quarter of 2013.

The Company relied on Section 4(2) of the Securities Act of 1933, as amended, in connection with all such issuances to Mr. Finerman, as such issuances were not in connection with a public offering.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not Applicable.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

- 31.1 Certification of President, Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

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

XSTELOS HOLDINGS, INC.

Date: August 14, 2013

By: /s/ Jonathan M. Couchman

Jonathan M. Couchman

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President and Chief Executive Officer and Chief Financial Officer  
(Principal Executive Officer and Principal Financial Officer)

I, Jonathan M. Couchman, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2013 of Xstelos Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2013

By: /s/ Jonathan M. Couchman  
Jonathan M. Couchman  
President and Chief Executive Officer  
(Principal Executive Officer)

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CERTIFICATIONS PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with this Quarterly Report on Form 10-Q of Xstelos Holdings, Inc. (the "Company") for the quarterly period ended June 30, 2013, as filed with the Securities and Exchange Commission on the date hereof, (the "Report"), each of the undersigned officers of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2013

By: /s/ Jonathan M. Couchman  
Jonathan M. Couchman  
President and Chief Executive Officer and Chief Financial Officer  
(Principal Executive Officer and Principal Financial Officer)

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