APPLIED ENERGETICS, INC.
Form 10-K
April 14, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

**xAnnual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2014

**¨Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _____ to _____

**Commission File Number 001-14015**

**Applied Energetics, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

| **Delaware** | **77-0262908** |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (IRS Employer Identification Number) |

| **4585 South Palo Verde Road, Suite 405** | |
|---|---|
| **Tucson, Arizona** | **85714** |
| (Address of Principal Executive Offices) | (Zip Code) |

**Registrant's telephone number, including area code (520) 628-7415**

**Securities registered pursuant to Section 12(b) of the Exchange Act:**

| **Title of Each Class** | **Name of Each Exchange on Which Registered** |
|---|---|
| **Common Stock, $.001 par value** | **Over the Counter Bulletin Board** |

**Securities registered pursuant to Section 12(g) of the Exchange Act:**

**None**

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer ¨ Smaller reporting company x

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the last reported sales price at which the stock was sold on June 30, 2014 (the last day of the registrant's most recently completed second quarter) was approximately $1,722,000.

The number of outstanding shares of the registrant's Common Stock, $.001 par value, as of April 6, 2015 was 91,785,520.

**APPLIED ENERGETICS, INC.**

**ANNUAL REPORT ON FORM 10-K**

**FOR THE YEAR ENDED DECEMBER 31, 2014**

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PART I

**ITEM 1. BUSINESS**

**Cautionary Note Concerning Forward-Looking Statements**

Certain statements in this Form 10-K constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include all statements that do not relate solely to the historical or current facts, and can be identified by the use of forward looking words such as "may", "believe", "will", "expect", "project", "anticipate", “estimates", "plans", "strategy", "target", "prospects" or "continue", and words of similar meaning. These forward looking statements are based on the current plans and expectations of our management and are subject to a number of uncertainties and risks that could significantly affect our current plans and expectations, as well as future results of operations and financial condition and may cause our actual results, performances or achievements to be materially different from any future results, performances or achievements expressed or implied by such forward-looking statements. This Form 10-K contains important information as to risk factors under Item 1A. Although we believe that the expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to have been correct. We do not assume any obligation to update these forward-looking statements to reflect actual results, changes in assumptions, or changes in other factors affecting such forward-looking statements.

**Available Information**

Applied Energetics, Inc. makes available free of charge on its website at www.appliedenergetics.com its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practical after electronically filing or furnishing such material to the Securities and Exchange Commission (“SEC”).

This report may be read or copied at the SEC’s Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549 or at www.sec.gov. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

**General**

Applied Energetics, Inc. is a corporation organized and existing under the laws of the State of Delaware. Our executive office is located at 4585 South Palo Verde Road, Suite 405, Tucson, Arizona, 85714 and our telephone number is (520) 628-7415.

The company is a “shell company” as such term is defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended. As of October 3, 2014, the company suspended its previous business activities.

Prior to October 3, 2014, the company engaged in the design, development and manufacture of applied energy systems for military and commercial applications and Ultra Short Pulse lasers and high voltage lasers for commercial applications. This technology is currently available to potential users.

The U.S. Government has significantly reduced defense spending over the past few years and we do not anticipate receiving any meaningful additional Government funding in the near future. We have completed all of our Government contracts and do not have any funded Government contracts for future work. We have also developed our USP laser technologies and systems for commercial markets.

The company is continuing to consider strategic alternatives, including mergers, the acquisitions of one or more business or technologies and/or the disposition of one or more of our technologies or our previous business.

**Employees**

As of March 31, 2015, we had no employees, and we retain three consultants who are paid on an hourly basis.

**ITEM 1A. RISK FACTORS**

Future results of operations of Applied Energetics involve a number of known and unknown risks and uncertainties. Factors that could affect future operating results and cash flows and cause actual results to vary materially from historical results include, but are not limited to those risks set forth below:

**Risk Related to Our Company**

**We are exploring strategic alternatives which may change the nature of our business.**

Because of the lack of government funding have received, we have significantly reduced our work force and are seeking strategic alternatives. As a result, we may acquire one or more businesses or technologies which may or may not be related to our existing businesses and may dispose of one or more of our technologies or our existing businesses. As a result, the nature of our business may change and such change may occur without stockholder approval.

**Our independent auditors have expressed substantial doubt about our ability to continue as a going concern, which may hinder our ability to obtain future financing.**

In their report accompanying our financial statements, our independent auditors stated that our financial statements for the year ended December 31, 2014 were prepared assuming that we would continue as a going concern, and that they have substantial doubt as to our ability to continue as a going concern. Our auditors have noted that our recurring losses from operations and negative cash flow from operations and the concern that we may incur additional losses due to the reduction in Government contract activity raise substantial doubt about our ability to continue as a going concern.

**Risk Related to Our Previous Business Activities**

**We may be unable to adequately protect our intellectual property rights, which could affect our ability to sustain the value of such assets.**

We may seek to sell all or a portion of our intellectual property. Protecting our intellectual property rights is critical to our ability to maintain the value of our intellectual property. We hold a number of United States patents and patent applications, as well as trademark, and registrations which are necessary and contribute significantly to the preservation of our competitive position in the market. There can be no assurance that any of these patents or future patent applications and other intellectual property will not be challenged, invalidated or circumvented by third parties. In some instances, we have augmented our technology base by licensing the proprietary intellectual property of others. In the future, we may not be able to obtain necessary licenses on commercially reasonable terms. While we have entered into confidentiality and invention assignment agreements with our employees, and entered into nondisclosure agreements with suppliers and appropriate customers so as to limit access to and disclosure of our proprietary information. These measures may not suffice to deter misappropriation or independent third party development of similar technologies. Based on our current financial condition, we may not have the funds available to enforce and protect our intellectual properties.

**We may face claims of infringement of proprietary rights.**

There is a risk that a third party may claim our products and technologies infringe on their proprietary rights. Whether or not our products infringe on proprietary rights of third parties, infringement or invalidity claims may be asserted or prosecuted against us and we could incur significant expense in defending them. If any claims or actions are asserted against us, we may not have the funds necessary to defend against such claims. Our failure to do so could adversely affect the value of our intellectual property.

**We are subject to the penny stock rules adopted by the Securities and Exchange Commission that require brokers to provide extensive disclosure to their customers prior to executing trades in penny stocks. These disclosure requirements may cause a reduction in the trading activity of our common stock, which in all likelihood would make it difficult for our stockholders to sell their securities.**

Rule 3a51-1 of the Securities Exchange Act of 1934 establishes the definition of a “penny stock,” for purposes relevant to us, as any equity security that has a minimum bid price of less than $5.00 per share or with an exercise price of less than $5.00 per share, subject to a limited number of exceptions which are not available to us. This classification would severely and adversely affect any market liquidity for our common stock.

For any transaction involving a penny stock, unless exempt, the penny stock rules require that a broker or dealer approve a person's account for transactions in penny stocks and the broker or dealer receive from the investor a written agreement to the transaction setting forth the identity and quantity of the penny stock to be purchased. In order to approve a person's account for transactions in penny stocks, the broker or dealer must obtain financial information and investment experience and objectives of the person and make a reasonable determination that the transactions in penny stocks are suitable for that person and that that person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.

The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prepared by the SEC relating to the penny stock market, which, in highlight form, sets forth:

- The basis on which the broker or dealer made the suitability determination; and
- That the broker or dealer received a signed, written agreement from the investor prior to the transaction

Disclosure also has to be made about the risks of investing in penny stocks in both public offerings and in secondary trading and commission payable to both the broker-dealer and the registered representative, current quotations for the securities and the rights and remedies available to an investor in cases of fraud in penny stock transactions. Finally, monthly statements have to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

Because of these regulations, broker-dealers may not wish to engage in the above-referenced necessary paperwork and disclosures and/or may encounter difficulties in their attempt to sell shares of our common stock, which may affect the ability of selling stockholders or other holders to sell their shares in any secondary market and have the effect of reducing the level of trading activity in any secondary market. These additional sales practice and disclosure requirements could impede the sale of our common stock, if and when our common stock becomes publicly traded. In addition, the liquidity for our common stock may decrease, with a corresponding decrease in the price of our common stock. Our common stock, in all probability, will be subject to such penny stock rules for the foreseeable future and our stockholders will, in all likelihood, find it difficult to sell their shares of common stock.

**A large number of shares of our common stock could be sold in the market in the near future, which could depress our stock price.**

As of April 6, 2015, we had outstanding approximately 92 million shares of common stock. A substantial portion of our shares are currently freely trading without restriction under the Securities Act of 1933, having been held by their holders for over one year and are eligible for sale under Rule 144(k) of the Securities Act

**Provisions of our corporate charter documents could delay or prevent change of control.**

Our Certificate of Incorporation authorizes our Board of Directors to issue up to 2,000,000 shares of "blank check" preferred stock without stockholder approval, in one or more series and to fix the dividend rights, terms, conversion rights, voting rights, redemption rights and terms, liquidation preferences, and any other rights, preferences, privileges, and restrictions applicable to each new series of preferred stock. In addition, our Certificate of Incorporation divides our board of directors into three classes, serving staggered three-year terms. At least two annual meetings, instead of one, will be required to effect a change in a majority of our board of directors. The designation of preferred stock in the future, the classification of our Board of Directors, its three classes and the rights agreement could make it difficult for third parties to gain control of our company, prevent or substantially delay a change in control, discourage bids for our common stock at a premium, or otherwise adversely affect the market price of our common stock. Moreover, the holders of our outstanding Series A Preferred Stock have a right to put their shares to the company for an amount equal to the liquidation preference of approximately $2.7 million plus unpaid dividends (approximately $402,000 as of December 31, 2014), in the event of a change of control. Such right could hinder our ability to sell our assets or merge with another company.

**The redemption and dividend provisions of our outstanding preferred stock are onerous due to our current financial condition.**

As of December 31, 2014, the liquidation preference of our outstanding preferred stock plus unpaid dividends thereon was approximately $3.1 million which represents approximately 738% of our total assets. If an event occurs that would require us to redeem the preferred stock, we may not have the required cash to do so.

In addition, our annual dividend payment on the preferred stock is approximately $268,000, which will further deplete our cash or significantly dilute our common stockholders if we pay the dividend in shares of common stock. We have not made the last three quarterly payments in 2013 nor any in 2014 and, as a result, the dividend rate has increased to 10% per annum and will remain at that level until such failure no longer continues. Dividends in arrears as of February 28, 2015 was approximately $469,000. These terms may also make it more difficult for us to sell equity securities or complete an acquisition.

**We may require additional financing to maintain our reporting requirements and administrative expenses**

We have no meaningful revenues and are dependent on our cash on hand to fund the costs associated with the reporting obligations under the Securities Exchange Act of 1934, as amended, and other administrative costs associated with our corporate existence. For the years ended December 31, 2014, 2013 and 2012, we incurred net losses of $718,826, $1,417,420 and $3,503,477, respectively. General and administrative expenses include salaries, accounting fees other professional fees and other miscellaneous expenses. We do not expect to generate any revenues unless and until the commencement of business operations. In the event that our available funds prove to be insufficient, we will be required to seek additional financing. Our failure to secure additional financing could have a material adverse effect on our ability to pay the accounting and other fees in order to continue to fulfill our reporting obligations and pursue our business plan. We do not have any arrangements with any bank or financial institution to secure additional financing and such financing may not be available on terms acceptable and in our best interests. We do not have any written agreement with our affiliates to provide funds for our operating expenses.

**Management has broad discretion over the selection of our prospective business**

Any person who invests in our securities will do so without an opportunity to evaluate the specific merits or risks of any potential new prospective business in which we may engage. As a result, investors will be entirely dependent on the broad discretion and judgment of management in connection with the selection of a prospective business. The business decisions made by our management may not be successful.

**Stockholders may not receive disclosure or information regarding a prospective business**

As of the date of this annual report, we have not yet identified any prospective business or industry in which we may seek to become involved and at present we have no information concerning any prospective business. Management is not required to and may not provide stockholders with disclosure or information regarding prospective business opportunities. Moreover, a prospective business opportunity may not result in a benefit to stockholders or prove to be more favorable to stockholders than any other investment that may be made by shareholders and investors.

**We have not specified an industry for new prospective business opportunities and accordingly risks associated with a specific business cannot be ascertained**

There is no basis for stockholders to evaluate the possible merits or risks of potential new business opportunities or the particular industry in which we may ultimately operate. To the extent that we effect a business combination with a financially unstable entity or an entity that is in its early stage of development or growth, including entities without established records of revenues or income, we will become subject to numerous risks inherent in the business and operations of that financially unstable company. In addition, to the extent that we effect a business combination with an entity in an industry characterized by a high degree of risk, we will become subject to the currently unascertainable risks of that industry. A high level of risk frequently characterizes certain industries that experience rapid growth, including internet companies. Although management will endeavor to evaluate the risks inherent in a particular new prospective business or industry, there can be no assurance that we will properly ascertain or assess all such risks or that subsequent events may not alter the risks that we perceive at the time of the consummation of any new business opportunity.

**There are many blank check companies for which we will compete to attract business opportunities**

We expect to encounter intense competition from other entities seeking to pursue new business opportunities. Many of these entities are well-established and have extensive experience in identifying new prospective business opportunities. Many of these competitors possess greater financial, technical, human and other resources than we do. Based upon our limited financial and personnel resources, we may lack the resources as compared to those of many of our potential competitors.

**We are deemed a "Shell Company" as such we are subject to additional reporting and disclosure requirements that may affect our short-term prospects to implement our business plan and could result in a loss of your entire investment.**

Shell companies are prohibited from using a Form S-8 to register securities pursuant to employee compensation plans. However, the rules do not prevent us from registering securities pursuant to registration statements. Additionally, the rule regarding Form 8-K requires shell companies to provide more detailed disclosure upon completion of a transaction that causes it to cease being a shell company. We must file a current report on Form 8-K containing the information required pursuant to Regulation S-K and in a registration statement on Form 10, within four business days following completion of a transaction together with financial information of the private operating company. In order to assist the SEC in the identification of shell companies, we are also required to check a box on Form 10-Q and Form 10-K indicating that we are a shell company. To the extent that we are required to comply with additional disclosure because we are a shell company, we may be delayed in executing any mergers or acquiring other assets that would cause us to cease being a shell company.

**Restrictions on the reliance of rule 144 by shell companies or former shell companies**

Historically, the SEC staff has taken the position that Rule 144 is not available for the resale of securities initially issued by companies that are, or previously were, blank check companies, like us. The SEC has codified and expanded this position in the amendments discussed above by prohibiting the use of Rule 144 for resale of securities issued by any shell companies (other than business combination related shell companies) or any issuer that has been at any time previously a shell company. The SEC has provided an important exception to this prohibition, however, if the following conditions are met:

- The issuer of the securities that was formerly a shell company has ceased to be a shell company;
- The issuer of the securities is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act;
- The issuer of the securities has filed all Exchange Act reports and material required to be filed, as applicable, during the preceding 12 months (or such shorter period that the issuer was required to file such reports and materials), other

than Current Reports on Form 8-K; and

- At least one year has elapsed from the time that the issuer filed current comprehensive disclosure with the SEC reflecting its status as an entity that is not a shell company.

As a result, it is likely that pursuant to Rule 144, stockholders who receive our restricted securities in a business combination will not be able to sell our shares without registration until one year after we have completed

**We most likely will issue additional securities in conjunction with a business opportunity which will result in a dilution of present stockholder ownership**

Our certificate of incorporation authorizes the issuance of 125,000,000 shares of common stock. As of December 31, 2014, we have 91,785,520 shares issued and outstanding. We may be expected to issue additional shares in connection with our pursuit of new business opportunities and new business operations. To the extent that additional shares of common stock are issued, our stockholders would experience dilution of their respective ownership interests. If we issue shares of common stock in connection with our intent to pursue new business opportunities, a change in control of our company is expected to occur. The issuance of additional shares of common stock may adversely affect the market price of our common stock, in the event that an active trading market commences

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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**ITEM 2. PROPERTIES**

In March, 2015, we have a month-to-month agreement to lease approximately 4,000 square feet of office, manufacturing and storage space in Tucson, Arizona.

Our aggregate rent expense, including common area maintenance costs, was approximately $37,000 and $48,000 for 2014 and 2013, respectively.

We believe our facilities are adequate for our currently expected level of operations.

See Note 9 to our 2014 Consolidated Financial Statements, which is incorporated herein by reference for information with respect to our lease commitments at December 31, 2014.

**ITEM 3. LEGAL PROCEEDINGS**

We may from time to time be involved in legal proceedings arising from the normal course of business.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable

PART II

**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASE OF EQUITY SECURITIES**

**Market price per share**

Our common stock is currently quoted for trading on the Over the Counter Bulletin Boards and the OTC Markets, trading under the symbol "AERG.OB". The following table sets forth information as to the price range of our common stock for the period January 1, 2012 through February 23, 2015. No dividends on common stock were declared for these periods.

| Quarterly Periods | High | Low |
|---|---|---|
| 2013 | | |
| First | 0.05 | 0.02 |
| Second | 0.05 | 0.02 |
| Third | 0.03 | 0.01 |
| Fourth | 0.02 | 0.01 |
| 2014 | | |
| First | 0.05 | 0.01 |
| Second | 0.03 | 0.01 |
| Third | 0.03 | 0.01 |
| Fourth | 0.02 | >0.01 |
| 2015 (Thru February 23, 2015) | | |
| First | 0.01 | >0.01 |

**Holders of Record**

As of March 18, 2015, there were approximately 392 holders of record of Applied Energetics' common stock.

**Unregistered Sale of Securities and Use of Proceeds**

There were no unregistered sales of securities in 2014.

**Dividends**

Dividends on our Preferred Stock are payable quarterly on the first day of February, May, August and November, in cash or shares of Common Stock. We paid dividends via the issuance shares of Common Stock on our 6.5% Series A Convertible Preferred Stock in 2011. We paid cash dividends on our 6.5% Series A Convertible Preferred Stock in 2012 and February and May 2013. The company did not pay the dividends due August 1, 2013; November 1, 2013; February 1, 2014; May 1, 2014; August 1, 2014; November 1, 2014 and February 1, 2015. Dividend arrearages as of December 31, 2014 and February 28, 2015 were approximately $402,000, and $469,000, respectively.

**Equity Compensation Plan Information**

See Item 12.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following management discussion and analysis ("MD&A") together with the risk factors set forth in Item 1A and with our audited Consolidated Financial Statements and Notes thereto included elsewhere herein.

Overview

The company is a "shell company" as such term is defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended. As of October 3, 2014, the company suspended its previous business activities.

Prior to October 3, 2014, the company engaged in the design, development and manufacture of applied energy systems for military and commercial applications and Ultra Short Pulse lasers and high voltage lasers for commercial applications.

The U.S. Government has significantly reduced defense spending over the past few years and we do not anticipate receiving any meaningful additional Government funding in the near future. We have completed all of our Government contracts and do not have any funded Government contracts for future work. We have also developed our USP laser technologies and systems for commercial markets.

The company is continuing to consider strategic alternatives, including mergers, the acquisitions of one or more business or technologies and/or the disposition of one or more of our previous business.

Critical Accounting Policies

**Use of Estimates**

The preparation of consolidated financial statements in conformity with United States generally accepted accounting principles requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management bases its assumptions on historical experiences and on

various other inputs and estimates that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. In addition, management considers the basis and methodology used in developing and selecting these estimates, the trends in and amounts of these estimates, specific matters affecting the amount of and changes in these estimates, and any other relevant matters related to these estimates, including significant issues concerning accounting principles and financial statement presentation. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein. Significant estimates include revenue recognition under the percentage of completion method of contract accounting, estimate to forecast loss on contracts under the completed contract method of accounting, the valuation of inventory, estimates of long-lived asset value, and estimate to forecast expected forfeiture rate on stock-based compensation and stock-based compensation expense.

**Revenue Recognition**

Revenue has been derived from ongoing contract work for systems development, effects testing and the design and development of demonstration systems and sub-systems for our Government and commercial customers. This work is expected to be generally performed under cost-plus contracts with Government customers.

Revenue under long-term Government contracts is generally recorded under the percentage of completion method. Revenue, billable monthly, under cost plus fixed fee contracts is recorded as costs are incurred and includes estimated earned fees in the proportion that costs incurred to date bear to total estimated costs. Costs include direct labor, direct materials, subcontractor costs and overhead. General and administrative expenses allowable under the terms of the contracts are allocated per contract depending on its direct labor and material proportion to total direct labor and material of all contracts. As contracts can extend over one or more accounting periods, revisions in earnings estimated during the course of work are reflected during the accounting period in which the facts become known. When the current contract estimate indicates a loss, a provision is made for the total anticipated loss in the period in which the facts become known. Management evaluates many variables and makes various assumptions related to the estimation of total cost of completion of long-term contracts. Management reviews the progress and performance of all contracts monthly.

The asset caption “accounts receivable” includes costs and estimated earnings in excess of billings on uncompleted contracts, which represents revenue recognized in excess of amounts billed. Such revenue is billable under the terms of the contracts at the end of the year, yet was not invoiced until January, 2013, and is generally expected to be collected within one year. The liability “billings in excess of costs and estimated earnings on uncompleted contracts” represents billings in excess of revenue recognized.

Revenue for other products and services is recognized when such products and services are delivered or performed and, in connection with certain sales to certain customers, when the products and services are accepted, which is normally negotiated as part of the initial contract. Revenue from commercial, non-Governmental customers has historically been based on fixed price contracts where the sale is recognized upon acceptance of the product or performance of the service and when payment is probable. Contract costs are accumulated in the same manner as inventory costs and are charged to operations as the related revenue from contract is recognized. When the current contract estimate indicates a loss, a provision is made for the total anticipated loss in the period in which the facts become known.

**Inventories**

Inventories include material, direct labor and related manufacturing and administrative overhead and are stated at the lower-of-cost (determined on a weighted average basis) or market for raw materials and work-in-process inventory. When actual contract cost and the estimate to complete exceed the estimated contract revenues, a loss provision is recorded. Due to the nature of our inventory, we analyze inventory on an item-by-item basis compared to future usage and sales for obsolescence quarterly.

**Share-Based Payments**

Stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period.

The fair value of each option grant is estimated at the date of grant using the Black-Scholes-Merton option valuation model. We make the following assumptions relative to this model: (i) the annual dividend yield is zero as we do not pay dividends on our common stock, (ii) the weighted-average expected life is based on a midpoint scenario, where the expected life is determined to be half of the time from grant to expiration, regardless of vesting, (iii) the risk free interest rate is based on the U.S. Treasury security rate for the expected life, and (iv) the volatility is based on the level of fluctuations in our historical share price for a period equal to the weighted-average expected life. We estimate forfeitures when recognizing compensation expense and adjust this estimate over the requisite service period should actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative

adjustment, which is recognized in the period of change and which impacts the amount of unamortized compensation expense to be recognized in future periods.

**Recoverability of Property and Equipment**

We assess recoverability of property and equipment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable.

We assess the recoverability of property and equipment by determining whether the amortization of the balances over their remaining lives can be recovered through undiscounted future operating cash flows. The amount of impairment, if any, is measured based on projected discounted future operating cash flows. The assessment of the recoverability of long-lived assets will be impacted if estimated future operating cash flows are not achieved.

**Income Taxes**

Deferred tax assets and liabilities are recognized currently for the future tax consequences attributable to the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

**Results of Operations**

Our consolidated financial information for the years ending December 31, 2014, and 2013 is as follows:

| | 2014 | 2013 |
|---|---|---|
| Revenue | $30,625 | $42,686 |
| Cost of revenue | (24,606) | (35,852) |
| General and administrative | (726,718) | (1,391,590) |
| Selling and marketing | - | (37,511) |
| Interest income | 1,873 | 4,847 |
| Loss before provision for income taxes | (718,826) | (1,417,420) |
| Provision (benefit) for income taxes | - | - |
| Net loss | $(718,826) | $(1,417,420) |

**Revenue**

Revenue decreased by approximately $12,000 to $31,000 for the year ended December 31, 2014 compared to $43,000 for the year ended December 31, 2013. Revenue from the LGE product line increased by $21,000 to $25,000 and High Voltage revenue decreased by $33,000 to $6,000 for the year ended December 31, 2014 compared to the year ended December 31, 2013. We have completed all work under our Government contracts and do not have any funded Government contracts for future work due to the lack of Government funding and are not investing company funds or resources to develop or enhance our technologies or systems. We no longer have an agreement for the lease of our High Voltage equipment.

**Cost of Revenue**

Cost of revenue includes manufacturing labor, benefits and overhead, and an allocation of allowable general and administration and research and development costs in accordance with the terms of our government contracts.

Cost of revenue decreased by approximately $11,000 for the year ended December 31, 2014 compared to 2013. The decrease in cost of revenue is directly tied to the decrease in sales activity of approximately 28%. Cost of revenue as a percentage of revenue decreased to 80% from 84% last year.

**General and Administrative**

General and administrative expenses decreased approximately $665,000 to $727,000 for the year ended December 31, 2014 compared to $1.4 million for the year ended December 31, 2013. Salaries, wages and benefits decreased by approximately $438,000, which is reflective of our reduction in workforce; professional services decreased by approximately $215,000; depreciation and amortization decreased by $35,000; non-cash compensation costs decreased by approximately $14,000; travel related expenses decreased by $6,000; and insurance & miscellaneous fees decreased by $5,000. Offsetting these reductions in operating expenses totaling approximately $715,000 was a decrease in absorption of labor and overheads of approximately $21,000 previously charged to Government contracts; supplies and building related expenses increased by approximately $17,000; and miscellaneous expense increased by $15,000 reflective of gains on the sales of fixed assets in 2013. Cost saving measures were initiated in 2011 and have continued, in response to the decrease in revenue and lack of Government contracts, including reductions of our workforce and reductions in other operating expenses.

At December 31, 2014, there were no unrecognized compensation costs related to unvested restricted stock awards.

**Selling and Marketing**

Selling and marketing expenses decreased by approximately $38,000 for the year ended December 31, 2014 compared to 2013. The decrease was mostly due to the cessation of our bid and proposal activity in 2013.

Other Income (Expense)

Other income (expense) primarily consists of interest income and interest expense. Net interest income for 2014 was lower by approximately $3,000 from 2013 primarily due to interest income on our bank deposits.

**Net Loss**

Our operations in 2014 resulted in a net loss of approximately $719,000, a decrease of approximately $699,000 compared to the approximately $1.4 million net loss for 2013. Our net loss attributable to common stockholders per common share – basic and diluted decreased from approximately ($0.02) per share to ($0.01) per share due to the decrease of net loss.

**Trend Discussion**

We expect there to be no revenues in 2015.

**Liquidity and Capital Resources**

At December 31, 2014, we had approximately $364,000 of cash and cash equivalents, a decrease of approximately $715,000 from December 31, 2013. In 2014, we used approximately $724,000 in operating activities. This amount is comprised primarily of our net loss of $719,000 and a decrease in our accrued expenses and deposits of $77,000, gain

on equipment disposal of $8,000, and a decrease in accounts payable of $6,000, partially offset by a decrease in inventory of $38,000, decrease prepaid expenses and other assets of $38,000 and depreciation and amortization of $6,000. Investing activities had $9,000 proceeds from disposal of equipment, resulting in net cash outflow of approximately $715,000.

The company's Board of Directors determined that as of October 3, 2014, the company suspended its current business activities. As a result, the company considers itself to be a "shell company" as such term is defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended. The company is not expected to incur any material costs associated with the suspension of its activities. As of March 18, 2015, our backlog was $ -0-. We have ceased our operations and the board has suspended payment of director fees and all employees are to be employed part-time and paid on an hourly basis to preserve cash.

The company is continuing to consider strategic alternatives, including mergers, the acquisitions of one or more business or technologies and/or the disposition of one or more of our existing business

In their report accompanying our financial statements, our independent auditors stated that our financial statements for the year ended December 31, 2014 were prepared assuming that we would continue as a going concern, and that they have substantial doubt as to our ability to continue as a going concern. Our auditors have noted that our recurring losses from operations and negative cash flow from operations and the concern that we may incur additional losses due to the reduction in Government contract activity raise substantial doubt about our ability to continue as a going concern.

**Backlog**

At December 31, 2014 and 2013, we had a backlog (i.e., work load remaining on signed contracts) of approximately $-0- and $25,000, respectively, to be completed within the twelve months following those dates.

**Contractual Obligations:**

The following table summarizes our contractual obligations and other commercial commitments as of December 31, 2014:

| | Payment by Period | |
|---|---|---|
| | Total | Less than 1 Year |
| Operating leases | $ 2,571 | $ 2,571 |
| Total | $ 2,571 | $ 2,571 |

Not included in the above table are the dividends on our Series A Preferred Stock that are approximately $268,000 each year (approximately $67,000 each quarter), assuming no conversion of the outstanding shares of Series A Preferred Stock into shares of common stock.

**Operating Leases**

We have, in the past, operated in leased premises under operating leases. Total rent expense on premises amounted to approximately $37,000 and $48,000 for 2014 and 2013, respectively.

**Preferred Stock**

The Series A Preferred Stock has a liquidation preference of $25.00 per share. The Series A Preferred Stock bears dividends at an initial rate of 6.5% of the liquidation preference per share per annum, which accrues from the date of issuance, and is payable quarterly. We have not made the last three quarterly payments in 2013 nor any in 2014 and, as a result, the dividend rate has increased to 10% per annum and will remain at that level until such failure no longer continues. Dividends in arrears as of February 28, 2015 were $469,000.

The holders of the Series A Preferred Stock have a right to put the stock to the Company for an aggregate amount equal to the liquidation preference ($2.7 million) plus unpaid dividends of $446,000 in the event of a change in control. Dividends are payable in: (i) cash, (ii) shares of our common stock (valued for such purpose at 95% of the

weighted average of the last sales prices of our common stock for each of the trading days in the ten trading day period ending on the third trading day prior to the applicable dividend payment date), provided that the issuance and/or resale of all such shares of our common stock are then covered by an effective registration statement or (iii) any combination of the foregoing. As of December 31, 2014, there were 107,172 shares of Series A Preferred Stock outstanding.

**Recent Accounting Pronouncements**

Refer to Note 2 of Notes to Consolidated Financial Statements for a discussion of recent accounting standards and pronouncements.

**Off-Balance Sheet Arrangements**

As of December 31, 2014, we had no significant off-balance sheet arrangements other than operating leases. For a description of our operating leases, see Note 9 to the Consolidated Financial Statements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

In the normal course of business, our financial position is subject to a variety of risks, such as the ability to collect our accounts receivable and the recoverability of the carrying values of our long-term assets. We do not presently enter into any transactions involving derivative financial instruments for risk management or other purposes.

Our available cash balances are deposited in bank demand deposit accounts. Substantially all of our cash flows are derived from our operations within the United States and today we are not subject to market risk associated with changes in foreign exchange rates.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Our Consolidated Financial Statements, the related notes and the Report of Independent Registered Public Accounting Firms thereon, are included in Applied Energetics' 2014 Consolidated Financial Statements and are filed as a part of this report on page F-1 following the signatures.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

On February 23, 2015, in order to reduce costs, the Audit Committee of Applied Energetics, Inc. (the "Company") engaged Liggett, Vogt & Webb, P.A. ("Liggett") as the Company's independent registered public accounting firm to audit the Company's financial statements for the fiscal year ended December 31, 2014.

On March 3, 2015, the Company's Audit Committee advised BDO USA, LLP ("BDO") that it is dismissing BDO as the Company's registered independent public accounting firm as a cost saving measure.

BDO's reports on the financial statements of the Company for the fiscal years ended December 31, 2012 and 2013 did not contain any adverse opinion or a disclaimer of opinion and were not qualified or modified as to audit scope, or accounting principles, but were modified as to uncertainty as to the Company's ability to continue as a going concern. During the Company's two most recent fiscal years ended December 31, 2012 and 2013 and the subsequent interim periods through March 3, 2015, there were: (i) no disagreements between the Company and BDO on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of BDO, would have caused BDO to make reference to the subject matter of the disagreements in connection with its report, and (ii) no reportable events within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

The Company provided BDO a copy of the above disclosures in this Item 4.01 and requested that BDO provide the Company with a letter addressed to the Securities and Exchange Commission stating whether BDO agrees with the statements made by the Company in response to Item 304(a) of Regulation S-K. A copy of this letter dated March 3, 2015 furnished by BDO in response to that request is filed as Exhibit 16.1 to its Form 8-K filed with the SEC on

March 5, 2015.

During the Company’s two most recent fiscal years ended December 31, 2012 and 2013 and through the interim periods preceding March 3, 2015, the Company did not consult with Liggett regarding (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company’s financial statements, and Liggett did not provide either a written report or oral advice to the Company that was an important factor considered by the Company in reaching a decision as to any accounting, auditing, or financial reporting issue; or (ii) the subject of any disagreement, as defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions, or a reportable event within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

## ITEM 9A. CONTROLS AND PROCEDURES

### Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2013. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it 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. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on that evaluation our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2014.

**Management’s Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act. Internal control over financial reporting is a process designed by, or under the supervision of, our principal executive and principal financial officers and affected by our Board of Directors, management and other personnel, 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. Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the company's assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of the management and directors of the company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, including our Principal Executive Officer (”PEO”)and Principal Financial Officer (“PFO”), has conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2014, based on the framework established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). This assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of those controls. Based on our assessment under the criteria described above, the PEO and PFO has concluded that our internal control over financial reporting was effective as of December 31, 2014.

This Annual Report on Form 10-K does not include an attestation report of our registered public accounting firm regarding internal controls over financial reporting. Management’s report was not subject to attestation by our registered public accounting firm pursuant to the SEC rules that permit smaller reporting companies to provide only management attestation in annual report on Form 10-K.

**Changes in Internal Control Over Financial Reporting**

There has been no change in Applied Energetics' internal control over financial reporting for the quarter ended December 31, 2014 that materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

Not Applicable

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The following is information with respect to our executive officers and directors:

| Name | Age | Principal Position |
|---|---|---|
| George P. Farley | 76 | Principal Executive Officer, Principal Financial Officer and Director |
| John F. Levy | 59 | Independent Director |

**George P. Farley:** George P. Farley was designated as our principal executive officer and principal financial officer on March 2, 2015. Mr. Farley, a certified public accountant, has been a member of our Board of Directors since March 2004. Mr. Farley is Chairman of our Audit Committee and also serves as a member of our Compensation Committee. Since 1999, Mr. Farley has operated a consulting practice in which he assists and advises public and private companies in complex financial transactions, on complex accounting and reporting issues and at time providing Chief Financial Officer services. Mr. Farley has been providing financial consulting services since 1999. Through 2007, Mr. Farley served as a Director and a member of the Audit Committee of iCad, Inc. He has also served as a Director and member of the Audit Committee of Preserver Insurance Company, Inc. and Acorn Holdings Corp and as a Director for Olympia Leather Company, Inc. From November 1997 to August 1999, Mr. Farley was a Chief Financial Officer of Talk.com, Inc., which provides telecommunication services. Mr. Farley was also a director of Talk.com, Inc. Mr. Farley joined BDO USA, LLP in 1962 and was a partner at BDO USA, LLP from 1972 to 1995, where he served as the managing partner of BDO's Philadelphia Office, National Director of Mergers and Acquisition and established BDO's valuation practice.

**John F. Levy:** John F. Levy has been a director of the company since June 2009. Mr. Levy serves as Chairman of our Nominating and Corporate Governance Committee and as a member of our Audit and Strategic Planning Committee. Since May 2005, Mr. Levy has served as the Chief Executive Officer of Board Advisory, a consulting firm that advises public companies in the areas of corporate governance, corporate compliance, financial reporting and financial strategies. Mr. Levy served as the Interim Chief Financial Officer from November 2005 to March 2006 of Universal Food & Beverage Company, which filed a voluntary petition under the provisions of Chapter 11 of the United States Bankruptcy Act on August 31, 2007. From November 1997 to May 2005, Mr. Levy served as Chief Financial Officer of MediaBay, Inc., a NASDAQ listed company and provider of spoken word audio content. While at MediaBay, he also served for a period as its Vice Chairman. Mr. Levy is a certified public accountant with nine years of experience with the national public accounting firms of Ernst & Young, Laventhol & Horwath and Grant Thornton. Mr. Levy is a director and non-executive Chairman of the Board of Applied Minerals, Inc., a natural resource and mining company and a director of China Commercial Credit, Inc., a privately held micro credit company that provides direct loans and loan guarantee services in China. Mr. Levy was formerly a director of Brightpoint, Inc., Take-Two Interactive

Software, Inc., PNG Ventures, Inc. and Gilman & Ciocia, Inc. Mr. Levy has authored numerous courses including “The 21st Century Director: Legal and Ethical Responsibilities of Board Members”, a course on the ethical and legal responsibilities of board members initially presented to various state accounting societies. Mr. Levy has a B.S. degree in Economics from the Wharton School of the University of Pennsylvania and received his M.B.A. from St. Joseph's University in Philadelphia.

**Director Qualifications, Experience and Skills**

All of our directors bring to our Board a wealth of executive leadership experience derived from their service as senior executives and, in many cases, founders of industry or knowledge specific consulting firms or operational businesses. They also offer extensive public company board experience. Each of our board members has demonstrated strong business acumen and an ability to exercise sound judgment and has a reputation for integrity, honesty and adherence to ethical standards. When considering whether directors and nominees have the experience, qualifications, attributes and skills, taken as a whole, to enable the Board of Directors to satisfy its oversight responsibilities effectively in light of the company’s business and structure, the Corporate Governance and Nominating Committee and the Board of Directors focused primarily on the information discussed in each of the Directors’ individual biographies set forth above and the specific individual qualifications, experience and skills as described below:

- Mr. Farley's extensive knowledge of accounting, the capital markets, financial reporting and financial strategies from his extensive public accounting experience, and prior services as a chief financial officer of a public company and as audit committee member of several public companies. Mr. Farley specialized in "Transactional Accounting" managing the accounting and auditing function for numerous public financings, mergers, acquisitions, reorganizations and business dispositions. In 1993, Mr. Farley was part of the team that created a new financing vehicle, the Specified Purpose Acquisition Company "SPAC".
- Mr. Levy's extensive knowledge of accounting, the capital markets, corporate governance, corporate compliance, financial reporting and financial strategies from his public accounting firm experience and service as chief financial officer and audit committee member of several public companies, as well as through the services he provides to public companies through Board Advisory a consulting firm he founded.

**Section 16(A) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires certain officers and directors of Applied Energetics, and any persons who own more than ten percent of the common stock outstanding to file forms reporting their initial beneficial ownership of shares and subsequent changes in that ownership with the SEC and the NASDAQ Stock Market. Officers and directors of Applied Energetics, and greater than ten percent beneficial owners are also required to furnish us with copies of all such Section 16(a) forms they file. None of our officers or directors failed to file any Section 16(a) forms, nor were any such persons late in making any such filings.

**Code of Ethics**

Applied Energetics has adopted a Code of Business Conduct and Ethics that applies to all of Applied Energetics' employees and directors, including its principal executive officer, principal financial officer and principal accounting officer. Applied Energetics' Code of Business Conduct and Ethics covers all areas of professional conduct including, but not limited to, conflicts of interest, disclosure obligations, insider trading, confidential information, as well as compliance with all laws, rules and regulations applicable to Applied Energetics' business.

Our Code of Ethics and Business Conduct is available at our website at www.appliedenergetics.com/default.aspx/investor-relations, or upon request made to us in writing at the following address, will be provided without charge:

Applied Energetics, Inc.

Attention: Compliance Officer

4585 South Palo Verde Road, Suite 405

Tucson, AZ 85714

**Committees of the Board of Directors**

**Audit Committee**

The Audit Committee of the Board of Directors is comprised of Messrs. Farley (Chairman) and Levy. The Audit Committee makes recommendations concerning the engagement of independent public accountants, reviews the scope and results of the audit engagement with the independent public accountants, approves professional services provided by the independent public accountants, reviews the independence of the independent public accountants, considers the range of audit and non-audit fees and reviews the adequacy of our internal accounting controls. Our Board of Directors has determined that Mr. Farley is an “audit committee financial expert” as defined under Item 407 of Regulation S-K of the SEC. Refer to Item 10 above for Mr. Farley's qualifications.

**Compensation Committee**

The Compensation Committee of the Board of Directors is comprised of Mr. Farley. The committee is responsible for establishing and maintaining executive compensation practices designed to encourage company profitability and enhance long-term shareholder value.

**Nominating and Corporate Governance Committee**

The Nominating and Corporate Governance Committee is comprised of Mr. Levy. The Committee is responsible for establishing and maintaining corporate governance practices designed to aid the long-term success of Applied Energetics and effectively enhance and protect shareholder value.

**Strategic Planning Committee**

The Strategic Planning Committee is comprised of Mr. Levy. The Committee is responsible for providing oversight to establish strategic direction for the Company, develop with Company management and recommend to the Board a short and long-term strategic plan for the Company, periodically review and update the plan, investigate and review merger, acquisition, joint venture and other business combination and strategic opportunities and to provide oversight for monitoring and executing strategies.

**ITEM 11. EXECUTIVE COMPENSATION**

**Summary Compensation Table**

The following table discloses, for the periods presented, the compensation for the person who served as our Principal Executive Officer, our Chief Financial Officer and our Chief Operating Officer for the years ended December 31, 2014, and 2013 (the “Named Executive”).

**SUMMARY COMPENSATION TABLE**

| Name and Principal Position | Year | Salary (1) | All Other Compensation (2) | Total |
|---|---|---|---|---|
| Joseph C Hayden, Former Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer | 2014 | $107,500 | $ - | $107,500 |
| | 2013 | $133,913 | $ 10 | $133,923 |

(1) On April 12, 2013, we entered into a consulting agreement effective April 1, 2013 with SVJ Enterprises LLC ("SVJ"), an affiliate of Mr. Hayden, where Mr. Hayden served as the company's principal executive officer, principal financial officer and principal accounting officer and SVJ was compensated at the rate of $250 per hour, up to a maximum of 10 hours per week, for Mr. Hayden's services. Joseph C. Hayden resigned from his positions as principal executive officer, principal financial officer and principal accounting officer effective February 13, 2015.

(2) The amounts shown in the "All Other Compensation" column are attributable the dollar value of life insurance premiums paid by us for all named executive officers. The amount reported for 2013 represents this benefit paid on Mr. Hayden's behalf prior to entering into a contracting agreement with SVJ.

**Employment Agreements for Named Executive Officers**

None

**Director Compensation**

The following table discloses our director compensation for the year ended December 31, 2014:

| Name | Fees Earned or Paid in Cash | Stock Awards (1) | Total |
|---|---|---|---|
| George P. Farley | $ 16,667 | $ - | $16,667 |
| John F. Levy | $ 13,333 | $ - | $13,333 |
| Mark J. Lister (2) | $ 16,667 | $ - | $16,667 |

(1) The amounts shown in the "Stock Awards" column represent the aggregate grant date fair value in 2013 related to stock awards, computed in accordance with FASB ASC Topic 718. For a discussion of valuation assumptions, see Note 7 to our 2014 Consolidated Financial Statements.

(2) Effective March 2, 2015, Mr. Lister resigned as a director of the company.

As of January of 2014, the annual cash compensation for independent directors was as follows: $25,000 for Messrs. Lister and Farley and to $20,000 for Mr. Levy. Effective September 1, 2014, the directors of the company agreed to stop receiving director compensation.

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION:**

During the fiscal year ended December 31, 2014, none of our executive officers served on the Board of Directors or the Compensation Committee of any other company whose executive officers also serve on our Board of Directors or our Compensation Committee.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS:**

The following table sets forth information regarding the beneficial ownership of our Common Stock, based on information provided by the persons named below in publicly available filings, as of March 18, 2015:

- each of our directors and executive officers;
- all directors and executive officers of ours as a group; and
- each person who is known by us to beneficially own more than five percent of the outstanding shares of our Common Stock.

Unless otherwise indicated, the address of each beneficial owner is care of Applied Energetics, 4585 South Palo Verde Road, Suite 405, Tucson, Arizona 85714. Unless otherwise indicated, the company believes that all persons named in the following table have sole voting and investment power with respect to all shares of common stock that they beneficially own.

For purposes of this table, a person is deemed to be the beneficial owner of the securities if that person has the right to acquire such securities within 60 days of March 18, 2015 upon the exercise of options or warrants. In determining the percentage ownership of the persons in the table below, we assumed in each case that the person exercised all options which are currently held by that person and which are exercisable within such 60 day period, but that options and warrants held by all other persons were not exercised, and based the percentage ownership on 91,785,520 shares outstanding on March 18, 2015.

| Name of Beneficial Owner | Number of Shares Beneficially Owned (1) | | Percentage of Shares Beneficially Owned (1) | |
|---|---|---|---|---|
| Superius Securities Group Inc. Profit Sharing Plan | 8,535,997 | (2) | 9.3 | % |
| Joseph C. Hayden | 5,631,700 | (3) | 6.1 | % |
| John F. Levy | 37,500 | | * | |
| George P. Farley | - | (4) | * | |
| All directors and executive officers as a group (1 person) | 37,500 | | * | |

* Less than 1%

(1) Computed based upon the total number of shares of common stock, restricted shares of common stock and shares of common stock underlying options held by that person that are exercisable within 60 days of the Record Date.

(2) Based on information contained in a report on Schedule 13G filed with the SEC on October 29, 2009. The address of Superius Securities Group Inc. Profit Sharing Plan is 94 Grand Ave., Englewood, NJ 07631.

(3) Based on information contained in a Form 4 filed with the SEC on March 1, 2011. The address of Mr. Hayden is 6525 N. Longfellow Dr., Tucson, AZ 85718

(4) Mr. Farley denies beneficial ownership of the common shares and common shares issuable upon exercise of options he transferred to various LLCs.

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table details information regarding our existing equity compensation plans as of December 31, 2014:

**Equity Compensation Plan Information**

| Plan category | Number of securities to be issued upon exercise of outstanding options | Weighted-average exercise price of outstanding options | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 32,000 | $ 0.51 | 8,343,067 |
| Equity compensation plans not approved by security holders | - | $ - | - |
| Total | 32,000 | $ 0.51 | 8,343,067 |

The following is a description of currently open stock option and equity plans.

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The 2004 Stock Incentive Plan (“2004 Plan”), which provides for the grant of any or all of the following types of awards: (1) stock options, which may be either incentive stock options or non-qualified stock options, (2) restricted stock, (3) deferred stock and (4) other stock-based awards. A total of 3,000,000 shares of common stock were originally reserved for distribution pursuant to the 2004 Plan. On June 28, 2005, the stockholders approved an amendment to the 2004 Plan to (i) increase the number of shares of the company's common stock, $.001 par value, authorized for issuance under the 2004 Plan by 2,000,000 shares from 3,000,000 shares to 5,000,000 shares, and (ii) set the maximum number of shares of common stock which may be issued upon the exercise of incentive stock options at 3,000,000 shares. As of December 31, 2014, options to purchase no shares were outstanding under this plan. Additionally, as of December 31, 2014, there were no unvested restricted stock units outstanding under this plan. As of April 29, 2014, the tenth anniversary of the 2004 Plan’s effective date, awards can no longer be made from this plan.

The 2007 Stock Incentive Plan (“2007 Plan”), which provides for the grant of any or all of the following types of awards: (1) stock options, which may be either incentive stock options or non-qualified stock options, (2) restricted stock, (3) deferred stock, (4) stock appreciation rights, and (5) other stock-based awards. A total of 10,000,000 shares of common stock have been reserved for distribution pursuant to the 2007 Plan provided, however, that the maximum number of shares available for award or grant during the first five years of the 2007 Plan shall be an aggregate of 5,000,000 shares; and provided further that the maximum number of shares available for award or grant during any consecutive twelve month period shall be 1,000,000 shares during the first two years of the 2007 Plan and 2,000,000 shares during the third through fifth years of the 2007 Plan. The five-year limitation period ended September 10, 2012. As of December 31, 2013, options to purchase 32,000 shares were outstanding under this plan. As of December 31, 2014, no restricted stock grants remain outstanding under the plan. As of December 31, 2014, approximately 8.3 million shares were available for grant from this plan.

We have, from time to time, also granted non-plan options and other equity-based awards to certain officers, directors, employees and consultants. No inducement grants as defined were made during 2014, nor are any outstanding from previous years.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

### Transactions with Related Parties

Except as disclosed herein, no director, executive officer, stockholder holding at least 5% of shares of our common stock, or any family member thereof, had any material interest, direct or indirect, in any transaction, or proposed transaction since the year ended December 31, 2014.

**Review, Approval or Ratification of Transactions with Related Persons**

Pursuant to our Code of Business Conduct, all officers and directors of the company who have, or whose immediate family members have, any direct or indirect financial or other participation in any business that supplies goods or services to Applied Energetics, are required to notify our Compliance Officer, who will review the proposed transaction and notify the Audit Committee of our Board of Directors for review and action as it sees fit, including, if necessary, approval by our Board of Directors.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES:**

The following is a summary of the fees billed to the company by its independent registered Public Accounting firm, Liggett, Vogt & Webb P.A. for professional services rendered for the year ended December 31, 2014.

| | 2014 |
|---|---|
| Audit Fees | $8,500 |
| Tax Fees | - |
| | $8,500 |

The following is a summary of the fees billed to the company by BDO USA, LLP for professional services rendered for the years ended December 31, 2014 and 2013.

| | 2014 | 2013 |
|---|---|---|
| Audit Fees | $44,074 | $67,029 |
| Tax Fees | $3,000 | $15,000 |

Fees for audit services include fees associated with the annual audit of the company and its subsidiaries, the review of our quarterly reports on Form 10-Q. Tax fees include tax compliance, tax advice, research and development credits and tax planning related to federal and state tax matters.

**Pre-Approval Policies and Procedures**

Consistent with the SEC requirements regarding auditor independence, our Audit Committee has adopted a policy to pre-approve all audit and permissible non-audit services provided by our independent registered public accounting firm. Under the policy, the Audit Committee must approve non-audit services prior to the commencement of the specified service. Our independent registered public accounting firm, Liggett, Vogt & Webb P.A., have verified to our Audit Committee that they have not performed, and will not perform any prohibited non-audit service.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

The following documents are filed or incorporated by reference as part of this report:

(a) (1) The Consolidated Financial Statements of Applied Energetics, Inc. are filed as part of this report on page F-1 following the signatures.

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Exhibits:

| EXHIBIT NUMBER | DESCRIPTION |
|---|---|
| 2.1 | Amended and Restated Plan and Agreement of Merger entered into as of March 17, 2004, by and among U.S. Home & Garden, Inc. (“USHG”), Ionatron Acquisition Corp., a wholly-owned subsidiary of USHG, Robert Kassel (for purposes of Sections 5.9, 6.2(d), 6.2(j), 9.4 and 10.10 only), Fred Heiden (for purposes of Section 9.4 only), and Ionatron, Inc. and Robert Howard, Stephen W. McCahon, Thomas C. Dearmin and Joseph C. Hayden (incorporated by reference to the comparable exhibit filed with the Registrant’s Form 8-K filed with the SEC on March 24, 2004). |
| 3.1 | Certificate of Incorporation, as amended, (incorporated by reference to the comparable exhibit filed with the Registrant’s Form 10-KSB for the fiscal year ended June 30, 1995). |
| 3.2 | Certificate of Amendment of Certificate of Incorporation of the Registrant filed with the Secretary of State of the State of Delaware on April 29, 2004 (incorporated by reference to the comparable exhibit filed with the Registrant’s Form 10-Q for the quarterly period ended March 31, 2004). |
| 3.3 | Certificate of Elimination of the 10% Series A Convertible Preferred Stock of the Registrant (incorporated by reference to the comparable exhibit filed with the Registrant’s Form 8-K filed with the SEC on October 28, 2005). |
| 3.4 | Certificate of Designation of the 6.5% Series A Redeemable Convertible Preferred Stock of the Registrant (incorporated by reference to the comparable exhibit filed with the Registrant’s 8-K filed with the SEC on October 28, 2005). |
| 3.5 | Certificate of Ownership and Merger of Applied Energetics, Inc. into Ionatron, Inc. (incorporated by reference to the comparable exhibit filed with the Registrant’s Form 8-K filed with the SEC on February 20, 2008). |
| 3.6 | Amended and Restated By-laws of the Registrant (incorporated by reference to Exhibit 3 of the Registrant’s Form 10-Q for the Quarter ended June 30, 2007. |
| 3.7 | Certificate of Amendment to Certificate of Incorporation filed with the Secretary of State of the State of Delaware on September 10, 2007. |
| 4.1 | Form of certificate evidencing Common Stock, $.001 par value, of the Registrant (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form S-1 (Registration No. 333-38483)). |
| 10.1 | 2004 Stock Incentive Plan (incorporated by reference to Appendix B to the Registrant’s Proxy Statement on Schedule 14A filed with the SEC on May 25, 2005). |
| 10.2 | 2007 Stock Incentive Plan (as amended) (incorporated by reference to the comparable exhibit filed with the Registrant's Form 10-K for the year ended December 31, 2007). |
| 10.3 | Applied Energetics, Inc. consulting agreement with SVJ Enterprises LLC effective April 1, 2013 (incorporated by reference to the comparable exhibit filed with the Registrant’s Form 8-K filed with the SEC on April 17, 2013) |
| 21 | Subsidiaries (incorporated by reference to the comparable exhibit filed with the Registrant’s Form 10-K for the year ended December 31, 2006) |
| 23.1 | Consent of Liggett, Vogt & Webb, P.A. |
| 23.2 | Consent of BDO USA, LLP |
| 31.1 | Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley |

| | |
|---|---|
| | Act of 2002. |
| 32.1 | Principal Executive Officer and Principal Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 99.1 | Compensation Committee Charter (incorporated by reference to the comparable exhibit filed with the Registrant's Form 10-K for the year ended December 31, 2010) |
| 99.2 | Corporate Governance and Nominating Committee Charter (incorporated by reference to the comparable exhibit filed with the Registrant's Form 10-K for the year ended December 31, 2009) |
| 99.3 | Audit Committee Charter (incorporated by reference to the comparable exhibit filed with the Registrant's Form 10-K for the year ended December 31, 2009 |

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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 on the 10th day of April 2015.

**APPLIED ENERGETICS, INC.**

**By** /s/ George P Farley
George P Farley
Principal Executive Officer and Principal Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on the 10th day of April, 2015 by the following persons on behalf of the registrant and in the capacities indicated.

| Name | Title |
|---|---|
| /s/ John F. Levy<br>John F. Levy | Director |
| /s/ George P. Farley<br>George P. Farley | Director |

**APPLIED ENERGETICS, INC.**

**FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED DECEMBER 31, 2014 and 2013**

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**Report of the Independent Registered Public Accounting Firm**

To the Board of Directors and shareholders

Applied Energetics, Inc.

We have audited the accompanying consolidated balance sheet of Applied Energetics, Inc. (the "Company") as of December 31, 2014 and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2014 and the results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles in the United States.

The accompanying consolidated financial statements have been prepared assuming that the Applied Energetics, Inc. will continue as a going concern. As more fully described in Note 1 to the consolidated financial statements, the Company has incurred recurring operating losses and will have to obtain additional capital to sustain operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments to reflect the possible effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

/s/Liggett, Vogt & Webb, P.A.

Liggett, Vogt & Webb, P.A.

Certified Public Accountants

New York, New York

April 10, 2015

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders

Applied Energetics, Inc.

Tucson, Arizona

We have audited the accompanying consolidated balance sheet of Applied Energetics, Inc. as of December 31, 2013 and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Applied Energetics, Inc. at December 31, 2013, and the results of its operations and its cash flows for the year then ended**,** in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring losses from operations and expects losses from operations to continue in 2014 due to the reduction of government contract activity that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ BDO USA, LLP

Phoenix, Arizona

April 14, 2015

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APPLIED ENERGETICS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31,

| | 2014 | 2013 |
|---|---|---|
| Revenue | $30,625 | $42,686 |
| Cost of revenue | 24,606 | 35,852 |
| Gross profit | 6,019 | 6,834 |
| Operating expenses: | | |
| General and administrative | 726,718 | 1,391,590 |
| Selling and marketing | - | 37,511 |
| Total operating expenses | 726,718 | 1,429,101 |
| Operating loss | (720,699) | (1,422,267) |
| Other income | | |
| Interest income | 1,873 | 4,847 |
| Total other income | 1,873 | 4,847 |
| Loss before provision for income taxes | (718,826) | (1,417,420) |
| Provision for income taxes | - | - |
| Net loss | (718,826) | (1,417,420) |
| Preferred stock dividends | (267,930) | (236,411) |
| Net loss attributable to common stockholders | $(986,756) | $(1,653,831) |
| Net loss attributable to common stockholders per common share – basic and diluted | $(0.01) | $(0.02) |
| Weighted average number of common shares outstanding, basic and diluted | 91,761,915 | 91,735,662 |

See accompanying notes to consolidated financial statements.

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APPLIED ENERGETICS, INC.

CONSOLIDATED BALANCE SHEETS

| | DECEMBER 31, | |
|---|---|---|
| | 2014 | 2013 |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | $364,232 | $1,079,336 |
| Accounts receivable | - | 1,875 |
| Inventory - net | - | 37,953 |
| Prepaid expenses | 59,305 | 97,274 |
| Total current assets | 423,537 | 1,216,438 |
| Property and equipment - net | - | 6,984 |
| TOTAL ASSETS | $423,537 | $1,223,422 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable | $4,967 | $11,359 |
| Accrued expenses | 386,265 | 217,138 |
| Accrued compensation | - | 44,990 |
| Total current liabilities | 391,232 | 273,487 |
| | | |
| Total liabilities | 391,232 | 273,487 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' equity | | |
| Series A convertible preferred stock, $.001 par value, 2,000,000 shares authorized and 107,172 shares issued and outstanding at December 31, 2014 and 2013 (Liquidation preference $2,679,300) | 107 | 107 |
| Common stock, $.001 par value, 125,000,000 shares authorized; 91,785,520 shares issued and outstanding at December 31, 2014 and 91,735,662 shares issued and outstanding at December 31, 2013 | 91,785 | 91,736 |
| Additional paid-in capital | 79,236,839 | 79,234,745 |
| Accumulated deficit | (79,296,426) | (78,376,653) |
| Total stockholders' equity | 32,305 | 949,935 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $423,537 | $1,223,422 |

See accompanying notes to consolidated financial statements.

APPLIED ENERGETICS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

| | Preferred Stock | | Common Stock | | Additional Paid-in | Accumulated | Total Stockholders' |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Capital | Deficit | Equity |
| Balance as of December 31, 2012 | 107,172 | $ 107 | 91,735,662 | $91,736 | $79,218,301 | $(76,722,822) | $ 2,587,322 |
| Sale of common stock | - | - | - | - | 14 | - | 14 |
| Stock-based compensation expense | - | - | - | - | 16,430 | - | 16,430 |
| Preferred stock dividends | - | - | - | - | - | (236,411) | (236,411) |
| Net loss for the year ended December 31, 2013 | - | - | - | - | - | (1,417,420) | (1,417,420) |
| Balance as of December 31, 2013 | 107,172 | $ 107 | 91,735,662 | $91,736 | $79,234,745 | $(78,376,653) | $ 949,935 |
| Stock-based compensation expense | - | - | 49,858 | 49 | 2,094 | - | 2,143 |
| Preferred stock dividends | - | - | - | - | - | (200,947) | (200,947) |
| Net loss for the year ended December 31, 2014 | - | - | - | - | - | (718,826) | (718,826) |
| Balance as of December 31, 2014 | 107,172 | $ 107 | 91,785,520 | $91,785 | $79,236,839 | $(79,296,426) | $ 32,305 |

See accompanying notes to consolidated financial statements.

APPLIED ENERGETICS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31,

| | 2014 | 2013 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | $(718,826) | $(1,417,420) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 5,770 | 40,831 |
| Gain on equipment disposal | (7,736) | (13,392) |
| Contractor cost settled in disposal of fixed assets | - | 42,000 |
| Noncash inventory impairment | 32,000 | - |
| Noncash stock based compensation expense | 2,143 | 16,430 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 1,875 | 46,089 |
| Inventory | 5,953 | 28,931 |
| Prepaid expenses and other assets | 37,969 | 5,337 |
| Accounts payable | (6,392) | (105,571) |
| Accrued expenses and deposits | (76,810) | (104,178) |
| Net cash used in operating activities | (724,054) | (1,460,943) |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from disposal of building and equipment | 8,950 | 5,200 |
| Net cash provided by investing activities | 8,950 | 5,200 |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from sale of common stock | - | 14 |
| Payment of cash dividends | - | (87,077) |
| Net cash used in financing activities | - | (87,063) |
| Net decrease in cash and cash equivalents | (715,104) | (1,542,806) |
| Cash and cash equivalents, beginning of period | 1,079,336 | 2,622,142 |
| Cash and cash equivalents, end of period | $364,232 | $1,079,336 |
| Supplemental Cash Flow Information | | |
| Cash paid for interest | $- | $- |
| Cash paid for income taxes | $- | $- |
| Preferred dividends accrued and unpaid | $200,948 | $149,334 |

See accompanying notes to consolidated financial statements.

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**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1 - ORGANIZATION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

The consolidated financial statements include the accounts of Applied Energetics, Inc. and its wholly owned subsidiaries, Ionatron Technologies, Inc. and North Star Power Engineering, Inc. (“North Star”) (collectively, "company," "Applied Energetics," "we," "our" or "us"). All intercompany balances and transactions have been eliminated. Certain reclassifications have been made to prior period financial statement amounts to conform to the current presentation.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. For the year ended December 31, 2014, the company incurred a net loss of approximately $719,000, had negative cash flows from operations of $724,000 and may incur additional future losses due to the reduction in Government contract activity. These matters raise substantial doubt as to the company’s ability to continue as a going concern.

Although there can be no assurance, management believes it will be successful in the development and sales of their USP laser systems and high voltage systems, securing new contracts from Department of Defense customers and obtaining additional financing necessary to fund operating shortfalls. The financial statements do not include any adjustments relating to the recoverability of assets and the amount or classification of liabilities that might be necessary should the company be unable to continue as a going concern.

### Nature of Business

Applied Energetics, Inc. is a corporation organized and existing under the laws of the State of Delaware. Our executive office is located at 4585 South Palo Verde Road, Suite 405, Tucson, Arizona, 85714 and our telephone number is (520) 628-7415.

The company is a “shell company” as such term is defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended. As of October 3, 2014, the company suspended its previous business activities.

Prior to October 3, 2014, the company engaged in the design, development and manufacture of applied energy systems for military and commercial applications and Ultra Short Pulse lasers and high voltage lasers for commercial applications. The Company is currently seeking to sell or license its technology.

**Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management bases its assumptions on historical experiences and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. In addition, management considers the basis and methodology used in developing and selecting these estimates, the trends in and amounts of these estimates, specific matters affecting the amount of and changes in these estimates, and any other relevant matters related to these estimates, including significant issues concerning accounting principles and financial statement presentation. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein. Significant estimates include revenue recognition under the percentage of completion method of contract accounting, the valuation of inventory, carrying amounts of long-lived assets, valuation assumptions for share-based payments and measurements of income tax assets and liabilities.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**Revenue Recognition**

A majority of revenue under long-term government contracts is recorded under the percentage of completion method. Revenue, billable monthly under cost plus fixed fee contracts, is recorded as costs are incurred and includes estimated earned fees in the proportion that costs incurred to date bear to total estimated costs. Costs include direct labor, direct materials, subcontractor costs and manufacturing and administrative overhead allowable under the contract. General and administrative expenses allowable under the terms of contracts are allocated per contract, depending on its direct labor and material proportion to total direct labor and material of all contracts. As contracts can extend over one or more accounting periods, revisions in earnings estimated during the course of work are reflected during the accounting period in which the facts become known. When the current contract estimate indicates a loss, a provision is made for the total anticipated loss in the current period. We do not generally provide an allowance for returns from our government customers because our customer agreements do not provide for a right of return.

The asset caption “accounts receivable” includes costs and estimated earnings in excess of billings on uncompleted contracts, which represents revenue recognized in excess of amounts billed. Such revenue is billable under the terms of contracts at the end of the year, but was not invoiced until the following year and is generally expected to be collected within one year.

Revenue for other products and services is recognized when such products and services are delivered or performed and, in connection with certain sales to Government agencies, when the products and services are accepted, which is normally negotiated as part of the initial contract. Revenue from commercial, non-Governmental, customers is based on fixed price contracts where the sale is recognized upon acceptance of the product or performance of the service and when payment is probable. Contract costs are deferred in the same manner as inventory costs and are charged to operations as the related revenue from contracts is recognized. When a current contract estimate indicates a loss, a provision is made for the total anticipated loss in the period in which such facts become evident.

**Net Loss Attributable to Common Stockholders**

Basic loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding for the period before giving effect to stock options, stock warrants, restricted stock units and convertible securities outstanding, which are considered to be dilutive common stock equivalents. Diluted net loss per common share is calculated based on the weighted average number of common and

potentially dilutive shares outstanding during the period after giving effect to dilutive common stock equivalents. Contingently issuable shares are included in the computation of basic loss per share when issuance of the shares is no longer contingent. The number of options, restricted stock units and our Series A Convertible Preferred Stock, which were not included in the computation of earnings per share because the effect was antidilutive, was 139,172 and 564,097 for the years ended December 31, 2014 and 2013, respectively.

**Fair Value of Current Assets and Liabilities**

The carrying amount of accounts receivable and accounts payable approximate fair value due to the short maturity of these instruments.

**Cash and Cash Equivalents**

Cash equivalents are investments in money market funds or securities with an initial maturity of three months or less. These money market funds are invested in government and US treasury based securities.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**Accounts Receivable and Allowance for Doubtful Accounts**

Our accounts receivable balance includes contract receivables related to completed and in-progress contracts, retainers and costs and estimated earnings in excess of billings on uncompleted contracts.

We do not generally provide an allowance for receivables from the Government. We have non-Government customers for which we provide for potentially uncollectible accounts receivable by use of the allowance method. The allowance is provided based upon a review of the individual accounts outstanding, and the company's prior history of uncollectible accounts receivable. As of December 31, 2014 there are no accounts receivable. As of December 31, 2013, we believe all receivable balances to be fully collectible and accordingly, have no allowance for doubtful accounts at such dates.

**Inventory**

Inventories include material, direct labor and related manufacturing overhead and are stated at the lower-of-cost (determined on a weighted average basis) or market for raw materials and work-in-process inventory. When actual contract cost and the estimate to complete exceed the estimated contract revenues, a loss provision is recorded. Due to the nature of our inventory, we analyze inventory on an item-by-item basis compared to future usage and sales for obsolescence quarterly.

**Property and Equipment**

Property and equipment are recorded at cost. Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the assets from three to five years. Leasehold improvements are depreciated over the life of the related lease (including expected extensions) or asset, whichever is shorter. Amortization of assets acquired under capital leases is included in depreciation and amortization expense. Significant improvements extending the useful life of property are capitalized. When equipment is retired or otherwise disposed of, the cost of the equipment and the related accumulated depreciation are removed from the accounts, and any resulting gains or losses are reflected in the consolidated statements of operations. Repair and maintenance costs are expensed as incurred.

**Computer Software Development Costs**

In general, direct development costs associated with internal-use computer software are capitalized as fixed assets and include external direct costs of material and services and payroll costs for employees devoting time to the software projects, where applicable. Costs incurred during the preliminary project stage, as well as for maintenance and training, are expensed as incurred. Depreciation expense relative to capitalized computer software development costs was approximately $-0- for both 2014 and 2013, respectively.

**Long-Lived Assets**

We review long-lived assets, including intangible assets subject to amortization, for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable.

We assess the recoverability of such long-lived assets by determining whether the amortization of the balances over their remaining lives can be recovered through undiscounted future operating cash flows. The amount of impairment, if any, is measured based on projected discounted future operating cash flows. The assessment of the recoverability of long-lived assets will be impacted if estimated future operating cash flows are not achieved.

**Income Taxes**

Deferred tax assets and liabilities are recognized currently for the future tax consequences attributable to the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized. Our valuation allowance is currently 100% of our assets.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

We consider all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance is needed for some portion or all of a net deferred tax asset. Judgment is used in considering the relative impact of negative and positive evidence. In arriving at these judgments, the weight given to the potential effect of negative and positive evidence is commensurate with the extent to which it can be objectively verified. We record a valuation allowance to reduce our deferred tax assets and review the amount of such allowance annually. When we determine certain deferred tax assets are more likely than not to be utilized, we will reduce our valuation allowance accordingly.

**Share-Based Payments**

Employee stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period. The fair value of each option grant is estimated at the date of grant using the Black-Scholes-Merton option valuation model. We make the following assumptions relative to this model: (i) the annual dividend yield is zero as we do not pay dividends on common stock, (ii) the weighted-average expected life is based on a midpoint scenario, where the expected life is determined to be half of the time from grant to expiration, regardless of vesting, (iii) the risk free interest rate is based on the U.S. Treasury security rate for the expected life, and (iv) the volatility is based on the level of fluctuations in our historical share price for a period equal to the weighted-average expected life. We estimate forfeitures when recognizing compensation expense and adjust this estimate over the requisite service period should actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative adjustment, which is recognized in the period of change and which impacts the amount of unamortized compensation expense to be recognized in future periods.

**Significant Concentrations and Risks**

We maintain cash balances at a commercial bank and, at times, balances exceed FDIC limits. Substantially all of our accounts receivable are with agents or departments of the US Federal Government which, although concentrated in one group of common entities, does not expose us to significant credit risk.

**Research and Development Costs**

Research and development costs include experimentation, design, and enhancement of proprietary technologies and products and are expensed as incurred.

**NOTE 2 – NEW ACCOUNTING STANDARDS**

In August 2014, the FASB issued Accounting Standards Update "ASU" 2014-15 on "Presentation of Financial Statements Going Concern (Subtopic 205-40) – Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern". Currently, there is no guidance in U.S. GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern or to provide related footnote disclosures. The amendments in this ASU provide that guidance. In doing so, the amendments are intended to reduce diversity in the timing and content of footnote disclosures. The amendments require management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (1) provide a definition of the term substantial doubt, (2) require an evaluation every reporting period including interim periods, (3) provide principles for considering the mitigating effect of management's plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (5) require an express statement and other disclosures when substantial doubt is not alleviated, and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). The amendments in this ASU are effective for public and nonpublic entities for annual periods ending after December 15, 2016. Early adoption is permitted.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

The company has reviewed all other issued accounting pronouncements and plans to adopt those that are applicable to it. The company does not expect the adoption of any other pronouncements to have an impact on its results of operations or financial position.

**NOTE 3 – INVENTORIES**

Our inventories consist of the following at:

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Raw materials | $32,900 | $37,953 |
| Work-in-process | | |
| Provision for loss | (32,900) | - |
| Total inventory | $- | $37,953 |

Inventories include material, direct labor and related manufacturing administrative overhead and are stated at the lower-of-cost (determined on a weighted average basis) or market for raw materials and work-in-process inventory. When actual contract cost and the estimate to complete exceed the estimated contract revenues, a loss provision is recorded. Due to the nature of our inventory, we analyze inventory on an item-by-item basis compared to future usage and sales for obsolescence quarterly. As of December 31, 2014, management believed a 100% obsolescence reserve was necessary based on this analysis.

**NOTE 4 – PROPERTY AND EQUIPMENT**

Property and equipment consist of the following as of:

| | December 31, 2014 | 2013 |
|---|---|---|
| Leasehold improvements | $15,141 | $15,141 |
| Equipment | 500,821 | 1,728,270 |
| Furniture | - | 5,333 |
| Software | 758,441 | 778,379 |
| Total | 1,274,403 | 2,527,123 |
| Less accumulated depreciation and amortization | (1,274,403) | (2,520,139) |
| Property and equipment - net | $- | $6,984 |

Property and equipment are depreciated over 3 to 5 years using the straight line, half year convention. The number of years is dependent upon the useful life of the equipment. Depreciation expense was approximately $6,000 and $41,000 for the years ended December 31, 2014 and 2013, respectively. Depreciation expense is included in general and administrative expense.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 5 – ACCRUED EXPENSES**

Accrued expenses consist of the following as of:

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Accrued professional fees | $5,000 | $31,144 |
| Dividends payable | 378,823 | 177,876 |
| Other | 2,442 | 8,118 |
| Total accrued expenses | $386,265 | $217,138 |

**NOTE 6 – STOCKHOLDERS' EQUITY**

**Authorized Capital Stock**

Our authorized capital stock consists of 125,000,000 shares of common stock at a par value of $.001 per share and 2,000,000 shares of preferred stock at a par value of $.001 per share. On April 10, 2012, our stockholders approved an amendment to our certificate of incorporation to increase our authorized common stock from 125,000,000 to 500,000,000 shares at such time as our Board of Directors determined that effecting such amendment will be in the best interests of our company and our stockholders. Any such amendment will become effective when the filing of a certificate of amendment to our certificate of incorporation is accepted and recorded by the Secretary of State of the State of Delaware.

**Preferred Stock**

As of December 31, 2014 and 2013 there were 107,172 shares of Series A Redeemable Convertible Preferred Stock (the "Series A Preferred Stock") outstanding. The company did not pay the dividends due August 1, 2013, November 1, 2013, February 1, 2014, May 1, 2014, August 1, 2014, and November 1, 2014. Dividend arrearages as of December

31, 2014 including previously accrued dividends included in our balance sheet are approximately $402,000. Our Board of Directors suspended the declaration of the dividend, commencing with the dividend payable as of February 1, 2015 since we did not have a surplus (as such term is defined in the Delaware general corporation Law) as of December 31, 2014, until such time as we have a surplus or net profits for a fiscal year.

Our Series A Preferred Stock has a liquidation preference of $25.00 per Share. The Series A Preferred Stock bears dividends at the rate of 6.5% of the liquidation preference per share per annum, which accrues from the date of issuance, and is payable quarterly. Dividends may be paid in: (i) cash, (ii) shares of our common stock (valued for such purpose at 95% of the weighted average of the last sales prices of our common stock for each of the trading days in the ten trading day period ending on the third trading day prior to the applicable dividend payment date), provided that the issuance and/or resale of all such shares of our common stock are then covered by an effective registration statement or (iii) any combination of the foregoing. If the Company fails to make a dividend payment within five business days following a dividend payment date, the dividend rate shall immediately and automatically increase by 1% from 6.5% of the liquidation preference per offered share of Series A preferred stock to 7.5% of such liquidation preference. If a payment default shall occur on two consecutive dividend payment dates, the dividend rate shall immediately and automatically increase to 10% of the liquidation preference for as long as such payment default continues and shall immediately and automatically return to the Initial dividend rate at such time as the payment default is no longer continuing.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Each share of Series A Preferred Stock is convertible at any time at the option of the holder into a number of shares of common stock equal to the liquidation preference (plus any unpaid dividends for periods prior to the dividend payment date immediately preceding the date of conversion by the holder) divided by the conversion price (initially $12.00 per share, subject to adjustment in the event of a stock dividend or split, reorganization, recapitalization or similar event.) If the closing sale price of the common stock is greater than 140% of the conversion price on 20 out of 30 trading days, the company may redeem the Series A Preferred Stock in whole or in part at any time through October 31, 2010, upon at least 30 days' notice, at a redemption price, payable in cash, equal to 100% of the liquidation preference of the shares to be redeemed, plus unpaid dividends thereon to, but excluding, the redemption date, subject to certain conditions. In addition, beginning November 1, 2010, the company may redeem the Series A Preferred Stock in whole or in part, upon at least 30 days' notice, at a redemption price, payable in cash, equal to 100% of the liquidation preference of the Series A Preferred Stock to be redeemed, plus unpaid dividends thereon to, but excluding, the redemption date, under certain conditions.

If a change of control occurs, each holder of shares of Series A Convertible Preferred Stock that are outstanding immediately prior to the change of control shall have the right to require the corporation to purchase, out of legally available funds, any outstanding shares of Series A Convertible Preferred Stock at the defined purchase price. The purchase price is defined as: per share of Preferred Stock, 101% of the liquidation preference thereof, plus all unpaid and accumulated dividends, if any, to the date of purchase thereof. The purchase price is payable, at the corporation's option, (x) in cash, (y) in shares of the common stock at a discount of 5% from the fair market value of Common Stock on the Purchase Date (i.e. valued at a 95% discount of the Common Stock on the Purchase Date), or (z) any combination thereof.

If the Corporation pays all or a portion of the Purchase Price in Common Stock, no fractional shares of Common Stock will be issued; instead, the Company will round the applicable number of shares of Common Stock up to the nearest whole number of shares; provided that the Corporation may pay the Purchase Price (or a portion thereof), whether in cash or in shares of Common Stock, only if the Corporation has funds legally available for such payment and may pay the Purchase Price (or a portion thereof) in shares of its Common Stock only if (i) the Common Stock is listed on a U.S. national securities exchange or the Nasdaq Stock Market at the time of issuance and (ii) a shelf registration statement covering the issuance by the Corporation and/or resales of the Common Stock issuable as payment of the Purchase Price is effective on the Payment Date unless such shares are eligible for immediate resale in the public market by non-affiliates of the Corporation.

Dividends on our Preferred Stock are payable quarterly on the first day of February, May, August and November, in cash or shares of Common Stock, at our discretion. We paid cash dividends on our 6.5% Series A Preferred Stock in February and May, 2013.

**Share-Based Payments**

Applied Energetics adopted an Amended and Restated 2007 Stock Incentive Plan (“2007 Plan”) and a 2004 Stock Incentive Plan as amended (“2004 Plan”) both of which provides for the grant of any or all of the following types of awards: (1) stock options, (2) restricted stock, (3) deferred stock, (4) stock appreciation rights, and (5) other stock-based awards, including restricted stock units, for periods up to 10 years. Stock options granted under the plans are generally for a fixed number of shares to employees and directors with an exercise price equal to the fair market value of the shares at the date of grant. Options granted to employees will generally vest over two to four years. Most options granted have a contractual life of 5 years from the grant date. Restricted stock granted under the plans to employees generally vest immediately and/or over a period of up to four years. Some restricted stock granted under the plans vest only upon meeting certain departmental or company-wide performance goals. Both restricted stock and options granted to non-employee directors generally vest immediately on the date of grant. We have, from time to time, also granted non-plan options to certain officers, directors and employees. As of April 29, 2014, the tenth anniversary of the 2004 Plan’s effective date, awards can no longer be made from this plan. Total stock-based compensation expense for grants to officers, employees and consultants was approximately $2,000 and $16,000 for the years ended December 31, 2014 and 2013, respectively, which was charged to general and administrative expense.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

At December 31, 2014 and 2013, there were outstanding options to purchase 32,000 and 520,000, respectively, of common stock. There were -0- and 7,425 unvested restricted stock units outstanding as of December 31, 2014 and December 31, 2013, respectively. As of December 31, 2014 and 2013, there were no unvested restricted stock awards outstanding.

The following table sets forth information regarding awards under our 2007 Stock Incentive Plan:

As of December 31, 2014

| | Share Grants Approved | Options Outstanding | Restricted Stock Awards Outstanding | Restricted Stock Units Outstanding | Shares Available for Award |
|---|---|---|---|---|---|
| 2007 Stock Incentive Plan | 10,000,000 | 32,000 | - | - | 8,343,067 |
| Total | | 32,000 | - | - | 8,343,067 |

On September 10, 2007, the stockholders of Applied Energetics approved the adoption of the company's 2007 Plan. A total of 10,000,000 shares of common stock have been reserved for distribution pursuant to the 2007 Plan; provided, however, that the maximum number of shares available for award or grant during the first five years of the 2007 Plan shall be an aggregate of 5,000,000 shares; and provided further that the maximum number of shares available for award or grant during any consecutive twelve month period shall be 1,000,000 shares during the first two years of the 2007 Plan and 2,000,000 shares during the third through fifth years of the 2007 Plan. The five-year limitation period ended September 10, 2012. As of December 31, 2014 and 2013, options to purchase 32,000 and 132,000 shares, respectively, were outstanding under this plan. There were -0- and 7,425 unvested restricted stock units outstanding as of December 31, 2014 and 2013, respectively. As of December 31, 2014 and 2013 there were no restricted stock awards outstanding. Grants from the 2007 Plan can be either service based, where the grant vests with the passage of time, or performance based, where the grant vests based on the attainment of a pre-defined company or departmental goal.

There are 8,343,067 aggregate shares available for grant from the Stock Incentive Plans as of December 31, 2014.

The fair value of restricted stock and restricted stock units was estimated using the closing price of our common stock on the date of award and fully recognized upon vesting.

No options were granted in 2014 or 2013.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

The following table summarizes the activity of our stock options for the years ended December 31, 2014, and 2013:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at December 31, 2012 | 1,172,166 | $ 0.51 |
| Granted | - | $ - |
| Exercised | - | $ - |
| Forfeited or expired | (652,666 ) | $ 0.55 |
| Outstanding at December 31, 2013 | 519,500 | $ 0.47 |
| Granted | - | $ - |
| Exercised | - | $ - |
| Forfeited or expired | (487,500 ) | $ 0.46 |
| Outstanding at December 31, 2014 | 32,000 | $ 0.51 |
| Exercisable at December 31, 2014 | 32,000 | $ 0.51 |

As of December 31, 2014 and December 31, 2013, the aggregate intrinsic value (amount by which Applied Energetics' closing stock price on the last trading day of the year exceeds the exercise price of the option) of options outstanding was $0, as the exercise price was greater than the market price. As of December 31, 2014 and 2013, the weighted average remaining contractual life of options outstanding and options exercisable was 1.45 and 1.45 years, respectively. At December 31, 2014, there was $0 of unrecognized compensation costs related to unvested stock options, net of estimated forfeitures.

The following table summarizes the activity of our restricted stock units and restricted stock grants for the years ended December 31, 2014 and 2013:

| | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Unvested at December 31, 2012 | 76,458 | $ 0.83 |

| | | |
|---|---|---|
| Granted | - | $ - |
| Vested | (38,228) | $ 0.83 |
| Forfeited | (30,805) | $ 0.83 |
| Unvested at December 31, 2013 | 7,425 | $ 0.83 |
| | | |
| Granted | - | $ - |
| Vested | (7,425 ) | $ 0.83 |
| Forfeited | - | $ - |
| Unvested at December 31, 2014 | - | $ - |

As of December 31, 2014, there was no unrecognized stock-based compensation related to unvested restricted stock, net of estimated forfeitures

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Compensation expense recorded for shares and options delivered to non-employee consultants for the years ended December 31, 2014 and 2013 was approximately $0 and $0, respectively.

**NOTE 7– SIGNIFICANT CUSTOMERS**

The majority of our customers are either the Government or contractors to the Government and represent 82% and 61% of our revenue for 2014 and 2013, respectively.

**NOTE 8 – COMMITMENTS AND CONTINGENCIES**

**Operating Leases**

In August 2012, we entered into two 1-year lease agreements to lease office and manufacturing space and to lease storage space in Tucson, Arizona. In May 2013, these leases were changed to month-to-month.

Rent expense was approximately $37,000 and $48,000 for 2014 and 2013, respectively.

At December 31, 2014, we had approximately $2,600 in future minimum lease payments due in less than a year.

**Guarantees**

We agree to indemnify our officers and directors for certain events or occurrences arising as a result of the officers or directors serving in such capacity. The maximum amount of future payments that we could be required to make under these indemnification agreements is unlimited. However, we maintain a director's and officer’s liability insurance

policy that limits our exposure and enables us to recover a portion of any future amounts paid. As a result, we believe the estimated fair value of these indemnification agreements is minimal because of our insurance coverage and we have not recognized any liabilities for these agreements as of December 31, 2014 and 2013.

**Litigation**

We may from time to time be involved in legal proceedings arising from the normal course of business.

**NOTE 9 – INCOME TAXES**

The reconciliation of the difference between income taxes at the statutory rate and the income tax provision for the years ended:

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Computed tax at statutory rate | $(244,401) | $(481,923) |
| State taxes | (49,884) | (98,365) |
| Change in valuation allowance | 294,285 | 574,520 |
| Other | - | 5,768 |
| Provision (benefit) for taxes | $- | $- |

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**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Deferred tax assets (liabilities) consist of the following:

| | December 31 , | |
|---|---|---|
| | 2014 | 2013 |
| Deferred Tax Assets: | | |
| Accruals and reserves | $- | $11,003 |
| Depreciation and amortization | - | 139,045 |
| Tax credit carryforwards | 579,497 | 579,497 |
| Net operating loss | 21,632,884 | 20,910,696 |
| Goodwill amortization | - | 233,485 |
| ASC 718 stock compensation | - | 44,370 |
| Valuation allowance | (22,212,381) | (21,918,096) |
| Total deferred tax assets | $- | $- |

We believe that sufficient uncertainty exists regarding the future realization of our deferred tax assets and thus a full valuation allowance is required. The valuation allowance for the year ended December 31, 2014 increased by approximately $294,000 due to changes in deferred tax assets.

As of December 31, 2014, we have cumulative federal and Arizona net operating loss carryforwards of approximately $57.7 million and $16 million, respectively, which can be used to offset future income subject to taxes. Federal net operating loss carryforwards begin to expire in 2020. Arizona net operating loss carryforwards begin to expire in 2015. In addition there are federal net operating loss carryforwards is approximately $27.1 million from USHG related to pre-merger losses. We also have pre-merger federal capital loss carryforwards of approximately $520,000.

As of December 31, 2014, we had cumulative unused research and development tax credits of approximately $239,000 and $340,000, which can be used to reduce future federal and Arizona income taxes, respectively. As of December 31, 2012, we have cumulative unused federal minimum tax credit carryforwards from USHG of approximately $244,000. The federal minimum tax credit carryforwards are not subject to expiration under current federal tax law.

Utilization of our USHG pre-merger net operating loss carryforwards and tax credits is subject to substantial annual limitations due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards and tax

credit carryforwards before utilization.

We have unrecognized tax benefits attributable to losses and minimum tax credit carryforwards that were incurred by USHG prior to the merger in March 2004 as follows:

| | |
|---|---|
| Balance at December 31, 2012 | $9,635,824 |
| Additions related to prior year tax positions | - |
| Additions related to current year tax positions | - |
| Reductions related to prior year tax positions and settlements | - |
| Balance at December 31, 2013 | $9,635,824 |
| | |
| Additions related to prior year tax positions | - |
| Additions related to current year tax positions | - |
| Reductions related to prior year tax positions and settlements | (261,078 ) |
| Balance at December 31, 2014 | $9,374,746 |

These benefits are not recognized as a result of uncertainty regarding the utilization of the loss carryforwards and minimum tax credits. If in the future we utilize the attributes and resolve the uncertainty in our favor, the full amount will favorably impact our effective income tax rate.

**APPLIED ENERGETICS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

The company considers the U.S. and Arizona to be major tax jurisdictions. As of December 31, 2014, for federal tax purposes the tax years 2012, 2013 and 2014 and for Arizona the tax years 2011 through 2014 remain open to examination. The company currently does not expect any material changes to unrecognized tax positions within the next twelve months.

We recognize interest and penalties related to unrecognized tax benefits in income tax expense. As of December 31, 2014 and 2013, we had no accrued interest or penalties related to our unrecognized tax benefits.

**NOTE 10 – SUBSEQUENT EVENT**

The Company’s management has evaluated subsequent events occurring after December 31, 2014, the date of our most recent balance sheet, through the date our financial statements were issued.