

NEPHROS INC
Form 424B3
November 13, 2017

Prospectus Supplement Filed Pursuant to Rule 424(b)(3)

Registration No. 333-206344

PROSPECTUS SUPPLEMENT NO. 3 DATED November 13, 2017

(To Prospectus Dated April 20, 2017)

NEPHROS, INC.

This is a supplement ('Prospectus Supplement No. 3') to our prospectus, dated April 20, 2017 (the 'Prospectus'), relating to up to 5,150,000 shares of our common stock.

This Prospectus Supplement No. 3 is not complete without, and may not be delivered or utilized except in connection with, the Prospectus, including any amendments or supplements thereto.

Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2017

On November 9, 2017, we filed with the Securities and Exchange Commission a quarterly report on Form 10-Q for the quarter ended September 30, 2017 (the 'Form 10-Q'). The Form 10-Q, as filed (but without the exhibits filed with the Form 10-Q), is set forth below.

The information contained in this Prospectus Supplement No. 3 supplements and supersedes, in relevant part, the information contained in the Prospectus, as amended and supplemented. This Prospectus Supplement No. 3 is incorporated by reference into, and should be read in conjunction with, the Prospectus, as amended and supplemented, and is not complete without, and may not be delivered or utilized except in connection with, the Prospectus, as amended and supplemented.

All references in the Prospectus to 'this prospectus' are amended to read 'this prospectus (as supplemented and amended).'

Investing in our common stock involves substantial risks. See 'Risk Factors' beginning on page 9 of the Prospectus to read about important factors you should consider before purchasing our common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus SUPPLEMENT NO. 3. Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement No. 3 is November 13, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: **September 30, 2017**

OR

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

For the transition period from: _____ to _____

Commission File Number: 001-32288

NEPHROS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of
incorporation or organization)

13-3971809

(I.R.S. Employer

Identification No.)

41 Grand Avenue

07661

River Edge, NJ

(Address of principal executive offices) (Zip Code)

(201) 343-5202

Registrant's telephone number, including area code

N/A

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

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. [X] YES [] NO

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer []

Accelerated filer []

Non-accelerated filer [] (Do not check if a smaller reporting company) Smaller reporting company [X]

Emerging growth company []

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. []

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). []
YES [X] NO

As of November 5, 2017, 54,327,213 shares of the registrant's common stock, \$0.001 par value per share, were outstanding.

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PART I - FINANCIAL INFORMATION**Item 1. Financial Statements.****NEPHROS, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share amounts)**

| | (Unaudited) September 30, 2017 | (Audited) December 31, 2016 |
|---|--------------------------------------|-----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 150 | \$275 |
| Accounts receivable, net | 751 | 388 |
| Investment in lease, net-current portion | 20 | 27 |
| Inventory, net | 581 | 479 |
| Prepaid expenses and other current assets | 107 | 95 |
| Total current assets | 1,609 | 1,264 |
| Property and equipment, net | 49 | 70 |
| Investment in lease, net-less current portion | 50 | 61 |
| License and supply agreement, net | 1,105 | 1,262 |
| Other asset | 11 | 21 |
| Total assets | \$ 2,824 | \$2,678 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Secured revolving credit facility | \$ 563 | \$- |
| Accounts payable | 436 | 585 |
| Accrued expenses | 343 | 240 |
| Deferred revenue, current portion | 70 | 70 |
| Total current liabilities | 1,412 | 895 |
| Unsecured long-term note payable, net of debt issuance costs and debt discount of \$265 and \$349, respectively | 922 | 838 |
| Long-term portion of deferred revenue | 225 | 278 |
| Total liabilities | 2,559 | 2,011 |

Commitments and Contingencies (Note 14)

Stockholders' equity:

| | | |
|---|------------|-----------|
| Preferred stock, \$.001 par value; 5,000,000 shares authorized at September 30, 2017 and December 31, 2016; no shares issued and outstanding at September 30, 2017 and December 31, 2016 | - | - |
| Common stock, \$.001 par value; 90,000,000 shares authorized at September 30, 2017 and December 31, 2016; 54,160,547 and 49,782,797 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively | 54 | 50 |
| Additional paid-in capital | 122,530 | 120,835 |
| Accumulated other comprehensive income | 76 | 67 |
| Accumulated deficit | (122,395) | (120,285) |
| Total stockholders' equity | 265 | 667 |
| Total liabilities and stockholders' equity | \$ 2,824 | \$2,678 |

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

NEPHROS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except share and per share amounts)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2017 | 2016 | 2017 | 2016 |
| Net revenues: | | | | |
| Product revenues | \$841 | \$407 | \$2,316 | \$1,405 |
| License, royalty and other revenues | 75 | 68 | 193 | 170 |
| Total net revenues | 916 | 475 | 2,509 | 1,575 |
| Cost of goods sold | 384 | 159 | 1,005 | 667 |
| Gross margin | 532 | 316 | 1,504 | 908 |
| Operating expenses: | | | | |
| Research and development | 237 | 241 | 744 | 763 |
| Depreciation and amortization | 60 | 60 | 178 | 171 |
| Selling, general and administrative | 753 | 652 | 2,405 | 2,234 |
| Total operating expenses | 1,050 | 953 | 3,327 | 3,168 |
| Loss from operations | (518) | (637) | (1,823) | (2,260) |
| Interest expense | (88) | (65) | (218) | (109) |
| Interest income | 1 | 1 | 3 | 4 |
| Other expense | (27) | (5) | (60) | (12) |
| Net loss | (632) | (706) | (2,098) | (2,377) |
| Other comprehensive income, foreign currency translation adjustments | 1 | 1 | 9 | 1 |
| Total comprehensive loss | \$(631) | \$(705) | \$(2,089) | \$(2,376) |
| Net loss per common share, basic and diluted | \$(0.01) | \$(0.01) | \$(0.04) | \$(0.05) |
| Weighted average common shares outstanding, basic and diluted | 54,142,791 | 48,783,097 | 52,473,518 | 48,501,810 |

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

NEPHROS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

(Unaudited)

| | Common Stock | | Additional Paid-in Capital | Accumulated Other Comprehensive Income | | Accumulated Deficit | Total Stockholders' Equity |
|---|--------------|--------|----------------------------------|---|---------------|------------------------|---|
| | Shares | Amount | | Income | Deficit | | |
| Balance, December 31, 2016 (audited) | 49,782,797 | \$ 50 | \$ 120,835 | \$ 67 | \$ (120,285) | \$ 667 | |
| Net loss | | | | | (2,098) | (2,098) | |
| Cumulative effect of change in accounting principle | | | 12 | | (12) | - | |
| Net unrealized gains on foreign currency translation, net of tax | | | | 9 | | 9 | |
| Issuance of common stock, net of equity issuance costs of \$152 | 4,059,994 | 4 | 1,062 | | | 1,066 | |
| Issuance of common stock | 300,000 | - | 113 | | | 113 | |
| Issuance of restricted stock | 17,756 | - | | | | - | |
| Noncash stock-based compensation | | | 508 | | | 508 | |
| Balance, September 30, 2017 | 54,160,547 | \$ 54 | \$ 122,530 | \$ 76 | \$ (122,395) | \$ 265 | |

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

NEPHROS, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Nine Months Ended September 30, | |
|---|---------------------------------------|-----------|
| | 2017 | 2016 |
| Operating activities: | | |
| Net loss | \$(2,098) | \$(2,377) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation of property and equipment | 21 | 13 |
| Amortization of license and supply agreement, net | 157 | 158 |
| Non-cash stock-based compensation, including stock options and restricted stock | 508 | 442 |
| Non-employee stock-based compensation | - | 46 |
| Non-cash interest expense | 84 | 29 |
| Inventory reserve | - | 27 |
| Allowance for doubtful accounts reserve | - | 33 |
| Loss on foreign currency transactions | 16 | 5 |
| (Increase) decrease in operating assets: | | |
| Accounts receivable | (341) | 62 |
| Inventory | (102) | 241 |
| Prepaid expenses and other current assets | (12) | 33 |
| Other assets | 10 | - |
| Increase (decrease) in operating liabilities: | | |
| Accounts payable | (166) | (226) |
| Accrued expenses | 105 | (18) |
| Deferred revenue | (53) | (52) |
| Net cash used in operating activities | (1,871) | (1,584) |
| Investing activities: | | |
| Purchase of property and equipment | - | (45) |
| Net cash used in investing activities | - | (45) |
| Financing activities: | | |
| Proceeds from issuance of common stock, net of equity issuance costs | 1,179 | - |
| Net proceeds from secured revolving credit facility | 563 | - |
| Proceeds from issuance of unsecured note | - | 1,187 |
| Proceeds from exercise of warrants | - | 1 |
| Net cash provided by financing activities | 1,742 | 1,188 |
| Effect of exchange rates on cash | 4 | - |
| Net decrease in cash | (125) | (441) |
| Cash, beginning of period | 275 | 1,248 |

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| | | |
|---|--------|--------|
| Cash, end of period | \$ 150 | \$ 807 |
| Supplemental disclosure of cash flow information | | |
| Cash paid for interest | \$ 79 | \$ 39 |
| Cash paid for income taxes | \$ 6 | \$ 2 |
| Supplemental disclosure of noncash investing and financing activities | | |
| Fair value of warrants issued with unsecured note payable | \$- | \$ 393 |
| Investment in lease receivable, net | \$- | \$ 92 |
| Cost of equipment in sales-type lease | \$- | \$ 92 |
| Restricted stock issued to settle liability | \$- | \$ 51 |
| Deposit on inventory reclassified from prepaid expenses and other current assets to inventory | \$- | \$ 18 |
| Deposit on property and equipment reclassified from prepaid expenses and other current assets to property and equipment | \$- | \$ 124 |

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

NEPHROS, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Note 1 - Organization and Nature of Operations

Nephros, Inc. (“Nephros” or the “Company”) was incorporated under the laws of the State of Delaware on April 3, 1997. Nephros was founded by health professionals, scientists and engineers affiliated with Columbia University to develop advanced End Stage Renal Disease (“ESRD”) therapy technology and products. The Company has two products in the hemodiafiltration (“HDF”) modality to deliver therapy for ESRD patients. These are the OLpūr mid-dilution HDF filter or “dialyzer,” designed expressly for HDF therapy, and the OLpūr H2H HDF module, an add-on module designed to allow the most common types of hemodialysis machines to be used for HDF therapy.

In 2009, the Company expanded into ultrapure water filtration products as a complement to the ESRD therapy business, introducing its proprietary dual stage ultrafilter architecture. The company has since introduced a variety of ultrafiltration and microfiltration products that address water quality and infection control in both medical and commercial applications.

The Company is currently headquartered at 41 Grand Avenue, River Edge, New Jersey 07661, which houses the Company’s executive offices and research facilities, and has a subsidiary, Nephros International Limited, in Dublin, Ireland.

Note 2 - Basis of Presentation and Going Concern

Interim Financial Information

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. Results for the period ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December

31, 2017.

The condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2016 included in the Company's Annual Report on Form 10-K.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amount of revenues and expenses, during the reporting period. Actual results could differ materially from those estimates. Included in these estimates are assumptions about the collection of accounts receivable, value of inventories, useful life of fixed assets and intangible assets, assumptions used in determining stock compensation such as expected volatility and risk-free interest rate and the ability of the Company to continue as a going concern.

Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company's recurring losses and inability to generate sufficient cash flow to meet its obligations and sustain its operations raise substantial doubt about its ability to continue as a going concern. The Company's consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

To support the Company's cash needs, management entered into a \$1,000,000 secured revolving credit facility with a commercial lender. In addition, the Company has received approval to sell a portion of its New Jersey net operating loss and research and development tax credits through a program administered by the New Jersey Economic Development Authority ("NJEDA"), which the Company anticipates will result in cash proceeds of over \$1.75 million during the fourth quarter of 2017. Based on the Company's existing cash balances, its current cash flow projections, including projected increases in product sales from the launch of new products, and the anticipated proceeds from the NJEDA tax credit program, the Company believes it will have sufficient cash resources to fund its operations through the first half of 2018, if not longer. The Company's financial projections are subject to a number of uncertainties, including the timing and market acceptance of the Company's new products and the Company's ability to obtain the planned proceeds from the NJEDA tax credit program. There can be no assurance that any of such events will occur, or that the Company's future cash flow will be sufficient to meet its obligations and commitments. If the Company is unable to generate sufficient cash flow from operations in the future to meet its operating requirements and other commitments or obtain the anticipated proceeds from the NJEDA tax credit program, the Company will be required to adopt alternatives, such as seeking to raise debt or equity capital, curtailing its planned activities or ceasing its operations. There can be no assurance that any such actions could be effected on a timely basis or on satisfactory

terms or at all, or that these actions would enable the Company to continue to satisfy its capital requirements.

NEPHROS, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Note 3 - Major Customers and Concentration of Credit Risk

For the three months ended September 30, 2017 and 2016, the following customers accounted for the following percentages of the Company's revenues, respectively:

| Customer | 2017 | 2016 |
|----------|------|------|
| A | 14 % | 11 % |
| B | 14 % | 11 % |
| C | 12 % | 17 % |
| D | 8 % | 16 % |

For the nine months ended September 30, 2017 and 2016, the following customers accounted for the following percentages of the Company's revenues, respectively:

| Customer | 2017 | 2016 |
|----------|------|------|
| A | 18 % | 14 % |
| B | 13 % | 20 % |
| C | 12 % | 9 % |

As of September 30, 2017 and December 31, 2016, the following customers accounted for the following percentages of the Company's accounts receivable, respectively:

| Customer | 2017 | 2016 |
|----------|------|------|
| A | 16 % | 6 % |
| B | 13 % | 36 % |
| C | 1 % | 12 % |

The Company provides credit terms to customers in connection with purchases of the Company's products. Management periodically reviews customer account activity in order to assess the adequacy of the allowances provided for potential collection issues and returns. Adjustments, if any, are made to reserve balances following the completion of these reviews to reflect management's best estimate of potential losses. The allowance for doubtful accounts was approximately \$2,000 and \$50,000 as of September 30, 2017 and December 31, 2016, respectively.

Note 4 - Revenue Recognition

Revenue is recognized in accordance with Accounting Standards Codification ("ASC") Topic 605. Four basic criteria must be met before revenue can be recognized: (i) persuasive evidence that an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the fee is fixed or determinable; and (iv) collectability is reasonably assured.

The Company recognizes revenue related to product sales when product is shipped via external logistics provider and the other criteria of ASC Topic 605 are met. Product revenue is recorded net of returns and allowances. Shipments for all products are currently received directly by the Company's customers.

License Agreement Revenue

Deferred revenue was approximately \$295,000 and \$348,000 on the accompanying condensed consolidated balance sheets as of September 30, 2017 and December 31, 2016, respectively, and is related to the Company's License Agreement with Bellco (see Note 14, below), which is being deferred over the remainder of the expected obligation period. The Company has recognized approximately \$2,781,000 of revenue related to the Bellco License Agreement to date and approximately \$18,000 and \$53,000 for the three and nine months ended September 30, 2017, respectively. The Company recognized approximately \$17,000 and \$52,000 of revenue related to this License Agreement for the three and nine months ended September 30, 2016, respectively. Approximately \$17,000 of revenue will be recognized in the remaining three months of fiscal 2017 and approximately \$69,500 of revenue will be recognized in each of the years ended December 31, 2018 through 2021.

NEPHROS, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

For the three months ended September 30, 2017 and 2016, the Company recognized royalty revenue from Bellco of approximately \$57,000 and \$27,000, respectively. For the nine months ended September 30, 2017 and 2016, the Company recognized royalty revenue from Bellco of approximately \$115,000 and \$84,000, respectively.

See Note 14, Commitments and Contingencies, for further discussion of the Bellco License Agreement.

7.600%

Baa2

20,092,464

Total Multi-Utilities

34,677,797

Oil, Gas & Consumable Fuels 2.1%

803,273

Nexen Inc.

7.350%

BB+

18,427,083

Pharmaceuticals 0.0%

| | |
|--|---------|
| | 4,600 |
| Bristol-Myers Squibb Company (CORTS) | |
| | 6.250% |
| | A+ |
| | 114,218 |
| | 3,100 |
| Bristol-Myers Squibb Company Trust (CORTS) | |
| | 6.800% |
| | A+ |
| | 20 |

79,546

Total Pharmaceuticals

193,764

Real Estate/Mortgage 17.4%

514,503

Developers Diversified Realty Corporation, Series G

8.000%

Ba1

9,775,557

19,908

Developers Diversified Realty Corporation, Series H

7.375%

Ba1

349,385

23,767

Developers Diversified Realty Corporation

7.500%

Ba1

22

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| | |
|--|-----------|
| | 418,299 |
| | 3,001 |
| Duke Realty Corpoation, Series O | |
| | 8.375% |
| | Baa3 |
| | 72,834 |
| | 162,167 |
| Duke Realty Corporation, Series L | |
| | 6.600% |
| | Baa3 |
| | 3,244,962 |
| | 4,800 |
| Harris Preferred Capital Corporation, Series A | |

7.375%

A1

112,272

1,022,865

HRPT Properties Trust, Series B

8.750%

Baa3

24,139,614

42,480

HRPT Properties Trust, Series C

7.125%

Baa3

| | |
|------------------------------------|------------|
| | 850,874 |
| | 73,300 |
| Kimco Realty Corporation, Series F | |
| | 6.650% |
| | Baa2 |
| | 1,556,159 |
| | 735,530 |
| Kimco Realty Corporation, Series G | |
| | 7.750% |
| | Baa2 |
| | 17,910,156 |
| | 89,050 |
| Prologis Trust, Series G | |

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6.750%

Baa3

1,754,285

41,400

Public Storage, Inc., Series E

6.750%

Baa1

927,360

17,530

Public Storage, Inc., Series H

6.950%

Baa1

| | |
|--------------------------------|-----------|
| | 403,015 |
| | 67,600 |
| Public Storage, Inc., Series Y | |
| | 6.850% |
| | Baa1 |
| | 1,546,350 |
| | 123,700 |
| Realty Income Corporation | |
| | 7.375% |
| | Baa2 |
| | 3,085,078 |
| | 447,758 |
| Realty Income Corporation | |

6.750%

Baa2

10,790,968

190,545

Regency Centers Corporation

7.450%

BBB-

4,325,372

221,836

Regency Centers Corporation

7.250%

BBB-

| | |
|--|------------|
| | 4,924,759 |
| | 701,321 |
| Vornado Realty LP | |
| | 7.875% |
| | BBB |
| | 17,533,025 |
| | 1,932,592 |
| Wachovia Preferred Funding Corporation | |
| | 7.250% |
| | A- |
| | 39,308,919 |
| | 160,100 |
| Weingarten Realty Trust | |

8.100%

BBB

3,314,070

149,245

Weingarten Realty Trust

6.950%

Baa3

3,104,296

198,268

Weingarten Realty Trust

6.500%

Baa3

30

3,965,360

Total Real Estate/Mortgage

153,412,969

Wireless Telecommunication Services 2.4%

2,000

Telephone and Data Systems Inc.

7.600%

Baa2

46,000

830,959

United States Cellular Corporation

8.750%

Baa2

20,981,715

2,200

United States Cellular Corporation

7.500%

Baa2

32

52,052

Total Wireless Telecommunication Services

21,079,767

Total \$25 Par (or similar) Preferred Securities (cost \$722,139,284)

647,462,209

Principal

Amount (000)

Description (1)

Coupon

Maturity

Ratings (2)

Value

Corporate Bonds 0.9% (0.7% of Total Investments)

Commercial Banks 0.4%

\$ 4,400

Swedbank ForeningsSparbanken AB, 144A

7.500%

9/11/12

Baa2

\$ 3,669,098

Food Products 0.5%

5,000

FPL Group Capital Inc., (MMB)

6.650%

6/15/67

A3

4,606,720

\$ 9,400

Total Corporate Bonds (cost \$9,469,473)

8,275,818

Principal

Amount (000)/

| Description (1) | Shares | Coupon | Maturity | Ratings (2) | Value |
|---|--------|--------|----------|-------------|-------|
| Capital Preferred Securities 46.2% (36.1% of Total Investments) | | | | | |

Capital Markets 1.3%

3,600

MUFG Capital Finance

4.850%

7/25/56

A2

\$ 4,346,515

7,900

UBS Preferred Funding Trust I

8.622%

10/01/51

A1

7,277,630

Total Capital Markets

11,624,145

Commercial Banks 27.5%

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| | |
|------------------------------|------------|
| | 5,500 |
| AB Svensk Exportkredit, 144A | |
| | 6.375% |
| | 10/27/49 |
| | Aa3 |
| | 4,302,859 |
| | 23,400 |
| AgFirst Farm Credit Bank | |
| | 8.393% |
| | 12/15/16 |
| | A |
| | 17,623,733 |
| | 6,800 |
| AgFirst Farm Credit Bank | |

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7.300%

12/15/53

A

4,845,619

15,724

Banco Santander Finance

10.500%

9/29/49

A2

16,903,300

34,700

Barclays Bank PLC, 144A

8.550%

6/15/15

BBB+

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| | |
|--------------------------------|------------|
| | 31,924,000 |
| | 5,000 |
| Barclays Bank PLC, (4) | |
| | 6.278% |
| | 12/15/34 |
| | A+ |
| | 3,875,000 |
| | 6,000 |
| BBVA International Unipersonal | |
| | 5.919% |
| | 4/18/58 |
| | A2 |
| | 4,506,348 |
| | 6,250 |
| Credit Agricole, S.A, 144A | |

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6.637%

5/30/49

Aa3

4,531,250

13,500

Credit Agricole, S.A

9.750%

12/26/54

Aa3

14,006,250

1,500

First Empire Capital Trust I

8.234%

2/01/27

Baa1

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| | |
|--|------------|
| | 1,012,140 |
| | 17,095 |
| First Union Capital Trust II, Series A | |
| | 7.950% |
| | 11/15/29 |
| | A- |
| | 16,234,643 |
| | 6,800 |
| Fulton Capital Trust I | |
| | 6.290% |
| | 2/01/36 |
| | Baa2 |
| | 4,159,098 |
| | 4,650 |
| HSBC Capital Funding LP, Debt | |

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10.176%

6/30/50

A-

5,359,125

6,000

KeyCorp Capital III

7.750%

7/15/29

Baa2

5,324,562

10,900

Lloyd s Banking Group PLC, 144A

0.000%

10/01/49

B3

47

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| | |
|--|-----------|
| | 6,336,344 |
| | 8,000 |
| North Fork Capital Trust II | |
| | 8.000% |
| | 12/15/27 |
| | Baa1 |
| | 7,480,000 |
| | 10,000 |
| Northgroup Preferred Capital Corporation, 144A | |
| | 6.378% |
| | 10/15/57 |
| | A1 |
| | 8,304,200 |
| | 26,200 |
| Rabobank Nederland, 144A | |

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11.000%

12/31/49

Aa2

32,184,604

8,000

Reliance Capital Trust I, Series B

8.170%

5/01/28

N/R

6,169,136

12,000

Royal Bank of Scotland Group PLC

9.118%

3/31/49

B-

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11,101,188

5,000

Sparebanken Rogaland, Notes, 144A

6.443%

5/01/49

A3

4,344,630

650

Standard Chartered PLC, 144A

7.014%

7/30/37

BBB

534,435

3,000

Swedbank ForeningsSparbanken AB, 144A

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9.000%

9/17/50

Ba1

2,891,556

9,000

Unicredito Italiano Capital Trust, 144A

9.200%

4/05/51

A2

8,370,000

1,500

Union Bank of Norway

7.068%

11/19/49

A2

51

2,129,173

(3)

Union Planters Preferred Fund, 144A

7.750%

7/15/53

BB+

18,225,000

Total Commercial Banks

242,678,193

Diversified Financial Services 1.9%

| | |
|---|------------|
| | 12,811 |
| Countrywide Capital Trust III, Series B | |
| | 8.050% |
| | 6/15/27 |
| | Baa3 |
| | 12,198,288 |
| | 1,775 |
| JP Morgan Chase Capital Trust XX Ser T | |
| | 6.550% |
| | 9/29/36 |
| | A1 |
| | 53 |

1,653,524

3,000

JPMorgan Chase Capital Trust XVIII

6.950%

8/17/66

A1

2,885,580

Total Diversified Financial Services

16,737,392

Diversified Telecommunication Services 3.7%

32

Centaur Funding Corporation, Series B, 144A

9.080%

4/21/20

BBB

32,350,781

Insurance 10.0%

| | |
|--------------|-----------|
| | 2,200 |
| AXA SA, 144A | |
| | 6.463% |
| | 12/14/49 |
| | BBB+ |
| | 1,738,000 |
| | 8,000 |
| AXA SA, 144A | |
| | 6.379% |
| | 6/14/57 |
| | BBB+ |
| | 6,480,000 |
| | 6,750 |
| AXA-UAP | |

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8.600%

12/15/30

A-

7,035,998

6,600

Great West Life and Annuity Insurance Company, 144A

7.153%

5/16/46

A-

5,511,000

800

Hartford Financial Services Group Inc.

8.125%

6/15/18

BB+

720,000

57

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| | |
|---|-----------|
| | 3,500 |
| MetLife Capital Trust IV, 144A | |
| | 7.875% |
| | 12/15/37 |
| | Baa1 |
| | 3,342,500 |
| | 6,400 |
| National Financial Services Inc. | |
| | 6.750% |
| | 5/15/37 |
| | Baa2 |
| | 4,829,965 |
| | 1,200 |
| Nationwide Financial Services Capital Trust | |
| | 7.899% |
| | 58 |

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| | |
|-----------------------------------|------------|
| | 3/01/37 |
| | Baa2 |
| | 797,558 |
| | 12,300 |
| Oil Insurance Limited, 144A | |
| | 7.558% |
| | 12/30/49 |
| | Baa1 |
| | 7,415,658 |
| | 17,600 |
| Old Mutual Capital Funding, Notes | |
| | 8.000% |
| | 6/22/53 |
| | Baa3 |
| | 14,432,000 |
| | 59 |

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| | |
|---------------------------|-----------|
| | 6,300 |
| Progressive Corporation | |
| | 6.700% |
| | 6/15/67 |
| | A2 |
| | 5,423,859 |
| | 6,600 |
| Prudential Financial Inc. | |
| | 8.875% |
| | 6/15/18 |
| | BBB+ |
| | 6,567,000 |
| | 2,850 |
| Prudential PLC | |
| | 6.500% |
| | 60 |

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| | |
|-------------------------|------------|
| | 6/29/49 |
| | A- |
| | 2,337,000 |
| | 28,900 |
| XL Capital, Limited | |
| | 6.500% |
| | 10/15/57 |
| | BBB- |
| | 21,097,000 |
| | 957 |
| ZFS Finance USA Trust V | |
| | 6.500% |
| | 5/09/67 |
| | A |
| | 794,310 |
| | 61 |

Total Insurance

88,521,848

Real Estate 1.3%

11

Sovereign Real Estate Investment Trust, 144A

12.000%

62

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10/31/50

BBB+

11,041,250

Road & Rail 0.5%

4,400

Burlington Northern Santa Fe Funding Trust I

6.613%

12/15/55

BBB-

4,102,146

63

Total Capital Preferred Securities (cost \$471,157,904)

407,055,755

Shares

Description (1)

Value

Investment Companies 3.5% (2.8% of Total Investments)

838,654

Blackrock Preferred Income Strategies Fund

\$ 7,556,273

1,025,979

Flaherty and Crumrine/Claymore Preferred Securities Income Fund Inc.

13,276,168

728,065

John Hancock Preferred Income Fund III

10,367,646

Total Investment Companies (cost \$51,148,059)

31,200,087

Principal

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| Amount (000) | Description (1) | Coupon | Maturity | Ratings (2) | Value |
|-----------------|--|--------|----------|----------------|-----------------------|
| | Short-Term Investments 3.9% (3.0% of Total Investments) | | | | |
| | U.S. Government and Agency Obligations 0.8% (0.6% of Total Investments) | | | | |
| \$ 7,000 | U.S Treasury Notes | 1.500% | 10/31/10 | AAA | \$ 7,080,395 |
| 7,000 | Total U.S. Government and Agency Obligations | | | | 7,080,395 |
| | Repurchase Agreement 3.1% (2.4% of Total Investments) | | | | |
| 27,301 | Repurchase Agreement with Fixed Income Clearing Corporation, dated 9/30/09, repurchase price \$27,301,388, collateralized by \$25,665,000 U.S. Treasury Notes, 4.625%, due 2/29/12, value \$27,849,092 | 0.010% | 10/01/09 | N/A | 27,301,380 |
| | Total Short-Term Investments (cost \$34,316,009) | | | | 34,381,775 |
| | Total Investments (cost \$1,288,230,729) 127.9% | | | | 1,128,375,644 |
| | Borrowings (27.6)% (5), (6) | | | | (244,000,000) |
| | Other Assets Less Liabilities (0.3)% | | | | (2,370,727) |
| | Net Assets Applicable to Common Shares 100% | | | | \$ 882,004,917 |

Fair Value Measurements

In determining the value of the Fund's investments various inputs are used. These inputs are summarized in the three broad levels listed below:

Level 1 - Quoted prices in active markets for identical securities.

Level 2 - Other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.).

Level 3 - Significant unobservable inputs (including management's assumptions in determining the fair value of investments).

The inputs or methodology used for valuing securities are not an indication of the risk associated with investing in those securities. The following is a summary of the Fund's fair value measurements as of September 30, 2009:

| | Level 1 | Level 2 | Level 3 | Total |
|------------------------|---------------|---------------|-------------|-----------------|
| Investments: | | | | |
| Preferred Securities* | \$590,533,341 | \$460,109,623 | \$3,875,000 | \$1,054,517,964 |
| Corporate Bonds | | 8,275,818 | | 8,275,818 |
| Investment Companies | 31,200,087 | | | 31,200,087 |
| Short-Term Investments | 34,381,775 | | | 34,381,775 |
| Total | \$656,115,203 | \$468,385,441 | \$3,875,000 | \$1,128,375,644 |

*Preferred Securities includes Convertible Preferred Securities, \$25 Par (or similar) Preferred Securities and Capital Preferred Securities held by the Fund at the end of the reporting period, if any.

The following is a reconciliation of the Fund's Level 3 investments held at the beginning and end of the measurement period:

| | Level 3 Investments \$ |
|--|------------------------------|
| Balance at beginning of period | |
| Gains (losses): | |
| Net realized gains (losses) | |
| Net change in unrealized appreciation (depreciation) | 149,936 |
| Net purchases at cost (sales at proceeds) | 3,725,000 |
| Net discounts (premiums) | 64 |
| Net transfers in to (out of) at end of period fair value | |
| Balance at end of period | \$3,875,000 |

Income Tax Information

The following information is presented on an income tax basis based on the information currently available to the Fund. Differences between amounts for financial statement and federal income tax purposes are primarily due to recognition of premium amortization, timing differences in the recognition of income and timing differences in recognizing certain gains and losses on investment transactions. To the extent that differences arise that are permanent in nature, such amounts are reclassified within the capital accounts on the Statement of Assets and Liabilities presented in the annual report, based on their federal tax basis treatment; temporary

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differences do not require reclassification. Temporary and permanent differences do not impact the net asset value of the Fund.

At September 30, 2009, the cost of investments was \$1,290,486,176.

Gross unrealized appreciation and gross unrealized depreciation of investments at September 30, 2009, were as follows:

| | |
|---|------------------|
| Gross unrealized: | |
| Appreciation | \$ 21,415,973 |
| Depreciation | (183,526,505) |
| Net unrealized appreciation (depreciation) of investments | \$ (162,110,532) |

- (1) All percentages shown in the Portfolio of Investments are based on net assets applicable to Common shares unless otherwise noted.
 - (2) Ratings: Using the higher of Standard & Poor's Group (Standard & Poor's) or Moody's Investor Service, Inc. (Moody's) rating. Ratings below BBB by Standard & Poor's or Baa by Moody's are considered to be below investment grade.
 - (3) Principal Amount (000) rounds to less than \$1,000.
 - (4) For fair value measurement disclosure purposes, investment categorized as Level 3.
 - (5) Borrowings as a percentage of Total Investments is 21.6%.
 - (6) The Fund may pledge up to 100% of its eligible investments in the Portfolio of Investments as collateral for Borrowings. As of September 30, 2009, investments with a value of \$959,416,039 have been pledged as collateral for Borrowings.
- N/A Not applicable.
N/R Not rated.
(MMB) Middle Market Bank.
144A Investment is exempt from registration under Rule 144A of the Securities Act of 1933, as amended. These investments may only be resold in transactions exempt from registration which are normally those transactions with qualified institutional buyers.
CORTS Corporate Backed Trust Securities
PPLUS PreferredPlus Trust
SATURNS Structured Asset Trust Unit Repackaging

Item 2. Controls and Procedures.

a. The registrant's principal executive and principal financial officers, or persons performing similar functions, have concluded that the registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended (the "1940 Act") (17 CFR 270.30a-3(c))) are effective, as of a date within 90 days of the filing date of this report that includes the disclosure required by this paragraph, based on their evaluation of the controls and procedures required by Rule 30a-3(b) under the 1940 Act (17 CFR 270.30a-3(b)) and Rule 13a-15(b) or 15d-15(b) under the Securities Exchange Act of 1934 (17 CFR 240.13a-15(b) or 240.15d-15(b)).

b. There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act (17 CFR 270.30a-3(d))) that occurred during the registrant's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting.

Item 3. Exhibits.

File as exhibits as part of this Form a separate certification for each principal executive officer and principal financial officer of the registrant as required by Rule 30a-2(a) under the 1940 Act (17 CFR 270.30a-2(a)), exactly as set forth below: EX-99 CERT Attached hereto.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

(Registrant) Nuveen Quality Preferred Income Fund 2

By (Signature and Title)* /s/ Kevin J. McCarthy
Kevin J. McCarthy
Vice President and Secretary

Date November 27, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By (Signature and Title)* /s/ Gifford R. Zimmerman
Gifford R. Zimmerman
Chief Administrative Officer (principal executive officer)

Date November 27, 2009

By (Signature and Title)* /s/ Stephen D. Foy
Stephen D. Foy
Vice President and Controller (principal financial officer)

Date November 27, 2009

* Print the name and title of each signing officer under his or her signature.
