

14 September 2016

Contains price sensitive information

## **MYCELX TECHNOLOGIES CORPORATION (AIM: MYX)**

### **Half Year Results Statement**

**For the six months ended 30 June 2016**

*Increasing industry recognition that MYCELX systems bring greater operational efficiency and attractive cost savings*

MYCELX Technologies Corporation ("MYCELX" or the "Company"), the clean water technology company providing patented solutions for commercial industrial markets worldwide, is pleased to announce its interim unaudited results for the six months ended 30 June 2016 for which highlights are set out below.

#### **Financial**

- Gross profit margin remained strong at 53.5% (2015 H1: 51.9%)
- Revenue of \$3.9 million (2015 H1: \$8.7 million)
- Adjusted EBITDA of negative \$0.6 million (2015 H1: negative \$0.5 million)
- Cash provided by operating activities of \$0.2 million (2015 H1: cash used by operating activities \$2.2 million)
- Net cash of \$3.7 million (2015 H1: \$3.9 million)

#### **Strategic Agreement**

- Entered exclusive sales and marketing agreement with Schlumberger for the Upstream market. Schlumberger will promote MYCELX products as the method of choice for water treatment to their upstream oil and gas customers.

#### **Operational**

- H1 contract awards highlight increasing industry recognition that MYCELX systems bring greater operational efficiency and attractive cost savings:
  - Saudi Arabia: Awarded two year contract with SABIC for total value of \$5 million
  - US: Third MYCELX system commissioned at terminal operator to treat water from operations for discharge into the Houston Ship Channel
  - US: Equipment lease secured for treatment of process water at Oklahoma refinery
  - US: Added experienced Business Development personnel with oilfield services and water treatment background to drive sales and strategic alliance formation
  - Nigeria: Successful trial offshore platform with local oil producer. First deployment of RE-GEN system offshore
  - Oman: Successful trial resulted in lease and media sales for downstream process water
- Sales initiative for a new fast-to-market product – the MYCELX Oil Recovery System

#### **Outlook**

- Rigorous cost control measures will enable the Company to be at least cash neutral from operations in 2016
- Utilise Schlumberger's global sales and marketing platform to accelerate adoption by global EOR producers of the MYCELX RE-GEN media, and broader MYCELX products

- Leverage current customer relationships and installations in the Middle East to continue to grow downstream business in MENA and North America
- Continued focus on establishing strategic alliances to accelerate sales growth globally

**Commenting on these results, Connie Mixon, CEO, said:**

*“During the first half of the year the Company met key milestones in its cost reduction program, converted new business development opportunities into revenue generating installations and made significant progress on its goal of strategic alliances.*

*At its core, the Company is a technology company with exceptional expertise gained through onsite, real-time water treatment experience. As such, the Company will continue to use its knowledge to innovate and commercialise next generation technology to meet our customers’ current and future needs more reliably and cost effectively than outdated conventional methods. The oil and gas and petrochemical industries continue to integrate MYCELX® technology into their critical, real-time processes. This is confirmation that our technology has its role in achieving sustainable water treatment for years to come.*

*Now with the support of Schlumberger in upstream and leveraging off our existing footprint with leading downstream operators, MYCELX is well on its way towards its ultimate goal of becoming the industry standard for water treatment.”*

**For further information please contact:**

**MYCELX Technologies Corporation**

Connie Mixon, CEO  
Kimberly Slayton, CFO

**Tel: 1 888 306 6843**

**RFC Ambrian Limited**

*Corporate Finance*  
Jonathan Stephens  
Oliver Morse

**Tel: 44 20 3440 6800**

*Corporate Broking*

Jonathan Williams  
Kim Eckhof

**Numis Securities Limited**

*Corporate Broking*  
James Black  
Ben Stoop

**Tel: 44 20 7260 1000**

**Celicourt Communications**

Mark Antelme  
Joanna Boon

**Tel: 44 20 7520 9266**

## **Chairman's and Chief Executive Officer's Statement**

### Summary

Last year the Company implemented expense control measures in response to the challenging oil price environment. The Company has now met its goal of being cash neutral from operations for twelve months, cash positive in H1 2016 and is on track to deliver the next milestone of being cash positive from operations for the full year. The Company will continue to be a prudent steward of its cash with monitoring in place to ensure specific measures are taken in the event of a revenue shortfall or contract delay during the year and any additional equipment purchased will be supported by a sales contract. Our cost reduction program has been targeted to ensure that it does not adversely affect the Company's continuing ability to win contracts and grow. Our recent wins in new markets and with new customers serve to show that whilst our selling, general and administrative costs have reduced by 47% our ability to convert business development opportunities into cash generation has not diminished. For example, the Company is pleased to report that a successful upstream trial was completed offshore Nigeria, which we believe will lead to future sales in a market that is actively seeking effective technology to manage water for compliant overboard discharge.

Our steadfast goal of widespread industry adoption of MYCELX relies on our ability to retain and leverage our existing customer relationships as well as explore strategic alliances to leverage sales and marketing channels globally. So far this year we have made substantial progress on both fronts.

The current year started out with the award of a two-year contract in the amount of \$5 million with a SABIC company in Saudi Arabia. The contract is a result of the recognition that MYCELX systems bring greater operational efficiency which led to higher production and attractive cost savings for the plant. Growing recognition of our successful performance throughout the GCC region has led to paid trial requests from new customers, such as the recent Oman downstream trial that led to a lease, which we are able to respond quickly to by utilising equipment from our rental fleet. During the period the Company also undertook a sales initiative for a new fast-to-market product – the MYCELX Oil Recovery System which offers customers a system that treats water onsite charged on a volume treated basis which reduces truck haul off and produces high quality sales oil in the process. The Company expects the first installation of this new product will be installed during H2 2016. Elsewhere in downstream, we have strengthened our Houston Business Development and Engineering team to focus on the markets in Texas and Louisiana. Recent wins in these markets include a third installation in the Houston Ship Channel and an equipment lease at a refinery in Oklahoma.

The highlight of the first half of the year was the establishment of an exclusive upstream sales and marketing agreement with Schlumberger, the world's largest oil field services company. The Agreement will help to expedite the industry adoption of MYCELX's new RE-GEN product line as Schlumberger will market it as the water treatment method of choice in the upstream market. We continue to pursue strategic partnerships to leverage sales and marketing platforms that value differentiated technology. It is clear that the oil and gas industry wants and needs technology to support cost effective operations.

We continue to focus our growth strategy in the Middle East, India and Americas regions. Although the Company's primary market remains in distress, operators are increasingly keen to seek out new technology that offers better performance and most importantly cost savings. While the tough environment has created opportunity for MYCELX, the Board of Directors and the Company are well aware of the challenges the Company faces. We continue to believe long-term success and building a global brand will be achieved by engaging in large scale projects as well as smaller scale, fast-to-market

opportunities. The Company will remain in the turnaround market, but primarily with current customers where we have installed equipment and operators onsite. We have identified lower cost, lower risk projects with faster execution that will bridge the gap of lengthy project timelines and will be additive to annual recurring revenue.

## H1 Review

Market conditions during the first half of 2016 continued to be challenging for the oil and gas industry and the associated service sector, with many of the operators consistently exercising stringent capital discipline. In the face of the difficult market, business sales in H1 were as expected and on track to meet the full year forecast. Our technology continues to deliver value in an industry that is struggling with significant price dislocation. This is evidenced by continued contract renewals and sales to our core customers, new prosecuted projects, ongoing paid trials, and the recent progress made into the hydraulic fracturing market.

A significant development in MYCELX's progress to become the industry standard for water treatment occurred in H1 2016. Schlumberger, the world's largest oil field services company, entered into an exclusive Sales and Marketing agreement with the Company to be the sole distributor of MYCELX's entire product range in the upstream market. The agreement will help to expedite widespread industry adoption of MYCELX's new RE-GEN product line in particular which Schlumberger will market as its water treatment method of choice in the upstream market. The RE-GEN product has been proven to be highly effective in advanced enhanced oil recovery (EOR) produced water treatment and for polymer flood produced water in particular. The Company believes treating the vast amount of water that is produced during EOR operations, that can be used for re-injection and other purposes, will be a significant challenge for the upstream industry in the foreseeable future. Producers are already opting to increase production from existing fields using these advanced extraction methods in response to oil prices and their own portfolio considerations. Historically, the difficulty of treating the water during EOR operations hindered the use of several of these advanced extraction methods. RE-GEN media overcomes this obstacle. Leveraging Schlumberger's global sales and marketing platform should accelerate adoption by global EOR producers of the MYCELX RE-GEN media. Moreover, Schlumberger's ability to broadcast MYCELX's superior and cost effective performance to its global customer base should increase adoption of MYCELX entire product suite throughout the upstream sector.

The cost control measures implemented last year have enabled the Company to meet key targets during the period. The Company was cash positive from operations in H1 2016 and has been cash neutral from operations since 30 June 2015. MYCELX is on track to be at least cash neutral from operations for the full year. These cost control measures have become engrained in the Company's approach to stewarding its cash and it is this discipline that will allow the Company to navigate what it expects to be continuing volatile market conditions in 2016 and the years to come.

## **Operational Review**

### *Middle East & India*

The Company pursued its key applications in the Middle East and India; process water treatment in downstream petrochemical sector and treating produced water during Enhanced Oil Recovery.

During H1 one of the Company's existing SABIC customers renewed their operating lease for two years in the amount of \$5 million. This contract underpinned the expected lease, media and service revenues from

the downstream petrochemical sector in 2016 and 2017. The Company's strategy continues to focus on providing process improvements for production efficiency which is highly valued in this sector. This niche application and unique capability is attributable to the small footprint and highly efficient technology MYCELX provides where space is limited and performance is key to ongoing operations and consistent production. In addition, the Company will remain in the turnaround market, but primarily with current customers where we have installed equipment and operators onsite.

A new sales initiative was recently undertaken to support a fast-to-market downstream product, the MYCELX Oil Recovery System. The system treats water onsite on a volume treated basis which reduces truck haul off and produces high quality sales oil in the process. The Company believes that these applications of MYCELX technology are difficult for other water treatment companies to mimic in terms of performance or cost.

As reported previously, MYCELX continues to progress a major project in India with additional paid trials which will be undertaken in the H2 period to further refine their overall clean water solution. In addition to this project, MYCELX is pursuing further opportunities in the Middle East and India for Enhanced Oil Recovery (EOR) applications leveraging the RE-GEN media performance.

#### *North America*

MYCELX commissioned a water treatment system at a terminal operator to treat water from operations for discharge into the Houston Ship Channel. This is the third such installation for the Company in the Texas location. Water discharge into the Channel is regulated and enforced by the US Coast Guard and the Environmental Protection Agency and only operators with MYCELX systems are allowed to discharge into the Channel. There are cost savings to the operator by treating and discharging rather than having to pump water to an industrial waste water treatment plant that charges the operator by volume and contamination level.

In the refinery space the Company leased equipment for treatment of process water at an Oklahoma refinery and with the addition of an experienced business development professional the Company expects to progress its footprint in the refinery and petrochemical sector in the Gulf Coast region going forward.

The US onshore market is focused on production from wells with lower operational costs. Innovative technology such as MYCELX that enables producers to recycle and reuse water while mitigating the need for fresh water during operations is increasingly in demand. Furthermore, MYCELX continues to innovate its systems to lower the cost of operation for the end user by providing remote monitoring capability which reduces manpower costs. Continuing our efforts in 2015 we pursued opportunities to enter new segments of the US onshore market created by the departure of several oil field services companies whose water treatment options are no longer economically viable. The Company has entered into strategic agreements which it believes will accelerate this fast-to-market opportunity. The full water recycle and reuse system with remote monitoring installed last year for use in hydraulic fracturing continues to perform well and we expect to build on this success for future onshore installations for cost effective water treatment and advanced cost control in the hydraulic fracturing market

#### Financial

The decline in revenues over the period due to the continued oil price volatility and market dislocation was as expected. Equipment sales and leases decreased by 35.0% to \$1.3 million in the first half of 2016 (2015 H1: \$2.0 million). Revenue from consumable filtration media and service decreased because last

year's numbers benefited from two turnaround petrochemical plant projects which were not expected this year. Total revenue decreased by 55.2% to \$3.9 million (2015 H1: \$8.7 million) with gross profit margins slightly enhanced at 53. 5% (2015 H1: 51.9%).

Cost cutting measures resulted in total operating expenses for the first half of 2016 decreasing by 41.4% to \$3.4 million (2015 H1: \$5.8 million) with the largest component of those savings coming from reduced selling, general and administrative ("SG&A") expenses. The decrease to SG&A expenses included a reduction in staff costs of \$1.1 million, a decrease in facilities, maintenance and shipping of \$500,000, a decrease in travel expense of \$330,000, and a decrease in research and development expense of \$141,000.

Adjusted EBITDA was negative \$600,000 for the first half of 2016, compared to negative \$500,000 for the first half of 2015. Adjusted EBITDA is net income before interest expense, provision for income taxes, depreciation and amortisation of fixed and intangible assets including depreciation of leased equipment which is included in cost of goods sold. The Company uses Adjusted EBITDA as the profitability measure for making decisions regarding allocating resources and assessing performance.

The Company recorded a loss before tax of \$1.4 million in the first half of 2016 compared to a loss before tax of \$1.3 million in the first half of 2015. Basic loss per share was 8 cents for the first half of 2016, which was unchanged from the first half of 2015.

Cash preservation has been an imperative for the Company and MYCELX ended the period with \$5.7 million of cash and cash equivalents including restricted cash, compared to \$5.8 million in total at 31 December 2015. Cash provided by operations was \$200,000 for the first half of 2016, compared to \$2.2 million cash used in operations in the first half of 2015. The Company's net cash position remained at \$3.7 million. Net cash is defined as cash and cash equivalents plus restricted cash less balances on the lines of credit and the current and long term note payable.

### Summary and Outlook

MYCELX believes that the volatile market conditions are likely to continue throughout the rest of 2016 and beyond, but is well positioned to meet those challenges. The Company has adapted its business plans to enhance its prospects for new contract wins, preserve existing revenue streams and reduce costs to achieve our goal of being operationally cash positive in FY 2016. We continue to believe long-term success and building a global brand will be achieved by engaging in large scale projects as well as smaller scale, fast-to-market opportunities. We continue to progress large and complex projects by undertaking paid trials to refine the water treatment solution to meet customers' specific requirements. Given market conditions, these projects have moved at a slow pace but nevertheless continue to generate revenue for MYCELX at a time when other large scale projects elsewhere in the industry have been suspended. We have also identified lower cost, lower risk projects with faster execution that will bridge the gap of lengthy project timelines and will be additive to annual recurring revenue.

The agreement with Schlumberger achieved one of the Company's stated goals of forming strategic relationships. It is of great value as we build our brand globally especially in the upstream market. Alignment with Schlumberger's global customer base, via their sales and marketing channels, should accelerate uptake and sales in large scale EOR projects where the RE-GEN solution has already been proven the field. We will continue to vigorously pursue this large global application.

The refinement of the evaluation process for our project pipeline to ensure all resources expended are cost efficient and geared to market conditions has kept the Company very focused. Adoption of a risk approach to our revenue outlook together with our cost cutting initiatives has the Company on track to achieve our goal of being at least operationally cash flow neutral in H2 and full year 2016.

At its core, the Company is a technology company with exceptional expertise gained through onsite, real-time water treatment experience. As such, the Company will continue to use its knowledge to innovate and commercialise next generation technology to meet our customers' current and future needs more reliably and cost effectively than outdated conventional methods. Now with the support of Schlumberger in upstream and leveraging off our existing footprint with leading downstream operators, MYCELX is well on its way towards its ultimate goal of becoming the new industry standard for water treatment.

**Tim Eggar**

Chairman

14 September 2016

**Connie Mixon**

Chief Executive Officer

**MYCELX TECHNOLOGIES CORPORATION**  
**Statements of Operations**  
**(USD, in thousands, except share data)**

	<i>Six Months Ended 30 June 2016 (unaudited)</i>	<i>Six Months Ended 30 June 2015 (unaudited)</i>	<i>Year Ended 31 December 2015</i>
<b>Revenue</b>	<b>3,945</b>	<b>8,690</b>	<b>13,592</b>
Cost of goods sold	1,834	4,178	6,343
<b>Gross profit</b>	<b>2,111</b>	<b>4,512</b>	<b>7,249</b>
<b>Operating expenses:</b>			
Research and development	-	141	172
Selling, general and administrative	3,180	5,364	9,594
Depreciation and amortisation	268	266	507
<b>Total operating expenses</b>	<b>3,448</b>	<b>5,771</b>	<b>10,273</b>
<b>Operating loss</b>	<b>(1,337)</b>	<b>(1,259)</b>	<b>(3,024)</b>
<b>Other expense</b>			
Loss on disposal of equipment	-	-	(76)
Interest expense	(47)	(78)	(144)
<b>Loss before income taxes</b>	<b>(1,384)</b>	<b>(1,337)</b>	<b>(3,244)</b>
Provision for income taxes	(116)	(225)	(405)
<b>Net loss</b>	<b>(1,500)</b>	<b>(1,562)</b>	<b>(3,649)</b>
<b>Loss per share-basic</b>	<b>(0.08)</b>	<b>(0.08)</b>	<b>(0.20)</b>
Loss per share-diluted	(0.08)	(0.08)	(0.20)
<b>Shares used to compute basic loss per share</b>	<b>18,770,117</b>	<b>18,638,929</b>	<b>18,705,244</b>
<b>Shares used to compute diluted loss per share</b>	<b>18,770,117</b>	<b>18,638,929</b>	<b>18,705,244</b>

The accompanying notes are an integral part of the financial statements.



**MYCELX TECHNOLOGIES CORPORATION**
**Balance Sheets**
**(USD, in thousands, except share data)**

	<i>As of 30 June 2016 (unaudited)</i>	<i>As of 30 June 2015 (unaudited)</i>	<i>As of 31 December 2015</i>
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and cash equivalents	5,246	7,240	5,296
Restricted cash	500	500	500
Accounts receivable - net	2,502	3,970	2,855
Unbilled accounts receivable	57	32	20
Inventory	3,269	4,385	3,790
Prepaid expenses	205	508	204
Other assets	76	150	109
<b>Total Current Assets</b>	<b>11,855</b>	<b>16,785</b>	<b>12,774</b>
Property and equipment – net	11,213	12,300	11,714
Intangible assets – net	811	773	809
<b>Total Assets</b>	<b>23,879</b>	<b>29,858</b>	<b>25,297</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>Current Liabilities</b>			
Accounts payable	531	489	485
Payroll and accrued expenses	629	1,381	577
Deferred revenue	-	-	42
Lines of credit	-	1,762	-
Note payable – current	83	79	75
Warrant liability	-	63	-
Other current liabilities	119	42	115
<b>Total Current Liabilities</b>	<b>1,362</b>	<b>3,816</b>	<b>1,294</b>
Note payable – long-term	1,964	2,041	2,006
<b>Total Liabilities</b>	<b>3,326</b>	<b>5,857</b>	<b>3,300</b>

**Stockholders' Equity**

Common stock, \$0.025 par value, 100,000,000 shares authorised, 18,770,117 shares issued and outstanding at 30 June 2016 and 2015, and 31 December 2015.

	469	469	469
Additional paid-in capital	40,258	40,119	40,202
Accumulated deficit	(20,174)	(16,587)	(18,674)
<b>Total Stockholders' Equity</b>	<b>20,553</b>	<b>24,001</b>	<b>21,997</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>23,879</b>	<b>29,858</b>	<b>25,297</b>

The accompanying notes are an integral part of the financial statements.

	<b>Common Stock</b>		<b>Additional Paid-in Capital</b>	<b>Accumulated Deficit</b>	<b>Stock Subscription Receivable</b>	<b>Total</b>
	<b>Shares</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Balances at 31 December 2014</b>	<b>18,553</b>	<b>464</b>	<b>39,820</b>	<b>(15,025)</b>	<b>(235)</b>	<b>25,024</b>
Issuance of common stock, net of offering costs	217	5	259	-	235	499
Stock-based compensation expense	-	-	40	-	-	40
Net loss for the period	-	-	-	(1,562)	-	(1,562)
<b>Balances at 30 June 2015 (unaudited)</b>	<b>18,770</b>	<b>469</b>	<b>40,119</b>	<b>(16,587)</b>	<b>-</b>	<b>24,001</b>
Stock-based compensation expense	-	-	83	-	-	83
Net loss for the period	-	-	-	(2,087)	-	(2,087)
<b>Balances at 31 December 2015</b>	<b>18,770</b>	<b>469</b>	<b>40,202</b>	<b>(18,674)</b>	<b>-</b>	<b>21,997</b>
Stock-based compensation expense	-	-	56	-	-	56
Net loss for the period	-	-	-	(1,500)	-	(1,500)
<b>Balances at 30 June 2016 (unaudited)</b>	<b>18,770</b>	<b>469</b>	<b>40,258</b>	<b>(20,174)</b>	<b>-</b>	<b>20,553</b>

The accompanying notes are an integral part of the financial statements.

**MYCELX TECHNOLOGIES CORPORATION**  
**Statements of Cash Flows**  
**(USD, in thousands)**

	<i>Six Months Ended 30 June 2016 (unaudited)</i>	<i>Six Months Ended 30 June 2015 (unaudited)</i>	<i>Year Ended 31 December 2015</i>
<b>Cash flow from operating activities</b>			
Net loss	(1,500)	(1,562)	(3,649)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortisation	728	709	1,441
Loss from disposition of equipment	-	-	76
Stock compensation	56	40	123
Non-cash change in warrant liability	-	-	(63)
Change in operating assets and liabilities:			
Accounts receivable	353	(1,360)	(245)
Unbilled accounts receivable	(37)	58	71
Inventory	521	595	1,190
Prepaid expenses	(1)	20	324
Other assets	33	(10)	31
Accounts payable	46	(712)	(716)
Payroll and accrued expenses	52	493	(309)
Deferred revenue	(42)	(282)	(240)
Other current liabilities	4	(192)	(119)
<b>Net cash provided by (used in) operating activities</b>	<b>213</b>	<b>(2,203)</b>	<b>(2,085)</b>
<b>Cash flow from investing activities</b>			
Payments for purchases of property and equipment	(207)	(598)	(806)
Proceeds from sale of property and equipment	-	-	3
Payments for purchases of intangible assets	(22)	(36)	(92)
<b>Net cash used in investing activities</b>	<b>(229)</b>	<b>(634)</b>	<b>(895)</b>
<b>Cash flows from financing activities</b>			
Net proceeds from stock issuance	-	499	499
Payments on notes payable	(34)	(46)	(85)
Payments on lines of credit	-	(1,665)	(3,427)
<b>Net cash used in financing activities</b>	<b>(34)</b>	<b>(1,212)</b>	<b>(3,013)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(50)</b>	<b>(4,049)</b>	<b>(5,993)</b>
Cash and cash equivalents, beginning of period	5,296	11,289	11,289
<b>Cash and cash equivalents, end of period</b>	<b>5,246</b>	<b>7,240</b>	<b>5,296</b>

**Supplemental disclosures of cash flow information:**

Cash payments for interest	39	88	153
Cash and non cash payments for income taxes	164	233	403
Property and equipment remaining in accounts payable and other current liabilities	77	6	-

Management considered the effect of exchange rate changes on cash and cash equivalents held or due in foreign currency and deemed it immaterial to the statement of cash flows.

The accompanying notes are an integral part of the financial statements.

## NOTES TO THE FINANCIAL STATEMENTS

### 1. Nature of business and basis of presentation

**Basis of presentation** – These interim financial statements have been prepared using recognition and measurement principles of Generally Accepted Accounting Principles in the United States of America (“U.S. GAAP”).

The interim financial statements for the six months ended 30 June 2016 and 2015 have not been audited.

**Nature of business** – MYCELX Technologies Corporation (“MYCELX” or the “Company”) was incorporated in the State of Georgia on 24 March 1994. The Company is headquartered in Duluth, Georgia with operations in Houston, Texas, Saudi Arabia, India and the United Kingdom. The Company provides clean water technology equipment and related services to the oil and gas, power, marine and heavy manufacturing sectors and the majority of its revenue is derived from the Middle East and United States.

### 2. Summary of significant accounting policies

**Use of estimates** – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. The primary estimates and assumptions made relate to depreciation and amortisation, share-based compensation, deferred taxes and stock warrant valuation. Actual results could differ from these estimates and the differences may be material to the financial statements.

**Cash and cash equivalents** – Cash and cash equivalents consist of short-term, highly liquid investments which are readily convertible into cash within ninety (90) days of purchase. At 30 June 2016, all of the Company’s cash and cash equivalent balances were held in non interest-bearing transaction accounts. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. At 30 June 2016 and 2015, and 31 December 2015, cash in non-U.S. institutions was \$139,802. The Company has not experienced any losses in such accounts.

**Restricted cash** – The Company classifies as restricted cash all cash whose use is limited by contractual provisions. At 30 June 2016 and 2015, and 31 December 2015, restricted cash included \$500,000 cash on deposit in a money market account as required by a lender (see Note 8).

**Trade accounts receivable** – Trade accounts receivable are stated at the amount management expects to collect from outstanding balances. The Company provides credit in the normal course of business to its customers and performs ongoing credit evaluations of those customers and maintains allowances for doubtful accounts, as necessary. Accounts are considered past due based on the contractual terms of the transaction. Credit losses, when realised, have been within the range of the Company’s expectations and, historically, have not been significant. There was no allowance for doubtful accounts for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015.

**Inventories** – Inventories consist primarily of raw materials and filter media finished goods as well as equipment to house the filter media and are stated at the lower of cost or market value. Equipment that is in the process of being constructed for sale or lease to customers is also included in inventory (work-in-progress). The Company applies the FIFO method (first in; first out) to account for inventory. Manufacturing work-in-progress and finished products inventory include all direct costs, such as labor and material, and

those indirect costs which are related to production, such as indirect labor, rents, supplies, repairs and depreciation costs. A valuation reserve is recorded for slow moving or obsolete inventory items to reduce the cost of inventory to its net realisable value.

**Prepaid expenses and other current assets** – Prepaid expenses and other current assets include non-trade receivables that are collectible in less than twelve months, security deposits on leased space and various prepaid amounts that will be charged to expenses within twelve months. Non-trade receivables that are collectible in twelve months or more are included in long-term assets.

**Property and equipment** – All property and equipment are valued at cost. Depreciation is computed using the straight-line method for financial reporting over the following useful lives:

Buildings	39 years
Leasehold improvements	1-5 years
Office equipment	3-10 years
Manufacturing equipment	5-15 years
Research and development equipment	5-10 years
Purchased software	1-5 years
Equipment leased to customers	3-10 years

Expenditures for major renewals and betterments that extend the useful lives of property and equipment are capitalised. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation expense includes depreciation on equipment leased to customers and is included in cost of goods sold.

**Intangible assets** – Intangible assets consist of the costs incurred to purchase patent rights and legal and registration costs incurred to internally develop patents. Intangible assets are reported net of accumulated amortisation. Patents are amortised using the straight-line method over a period based on their contractual lives which approximates their estimated useful lives.

**Revenue recognition** – The Company's revenue consists of media product and equipment sales. Revenues from media sales are recognised, net of sales allowances and sales tax, when products are shipped and risk of loss has transferred to customers, collection is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable. The Company offers customers the option to lease or purchase their equipment. Lease agreements range from one to twenty-four months in length and are renewed at the end of each agreement, if necessary. The lease agreements meet the criteria for classification as operating leases; accordingly, revenue on lease agreements is recognised as income over the lease term. Revenues on long-term contracts related to construction of equipment are recognised, net of sales tax, on the percentage-of-completion basis using costs incurred compared to total estimated costs. Costs are recognised and considered for percentage-of-completion as they are incurred in the manufacture of the equipment. Therefore, revenues may not be related to the progress billings to customers. Revenues are based on estimates, and the uncertainty inherent in estimates initially is reduced progressively as work on the contract nears completion. Revenues on sales in which equipment is pre-fabricated and stocked in inventory are recognised, net of sales tax, upon shipment of the equipment to the customer.

Contract costs include all direct labor and benefits, materials unique to or installed to the project, subcontractor costs, as well as costs relative to contract performance such as travel to a customer site and shipping charges. Provision for estimated losses on uncompleted contracts is recorded in the period

in which such losses are probable and estimable. No such provisions have been recognised as of 30 June 2016 and 2015, and 31 December 2015. Changes in job performance, job conditions, and estimated profitability may result in revisions to costs and income, which are recognised in the period in which the revisions are determined. Actual results could vary from estimates used in the financial statements.

Unbilled accounts receivable represents revenues recognised in excess of amounts billed. Deferred revenue represents billings in excess of revenues recognised. Contract retentions are recorded as a component of accounts receivable.

**Impairment of long-lived assets** – Long-lived assets to be held and used, including property and equipment and intangible assets with definite useful lives, are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss, if any, is recognised for the difference between the fair value and carrying value of the assets. Impairment analyses, when performed, are based on the Company's business and technology strategy, management's views of growth rates for the Company's business, anticipated future economic and regulatory conditions, and expected technological availability. For purposes of recognition and measurement, the Company groups its long-lived assets at the lowest level for which there are identifiable cash flows, which are largely independent of the cash flows of other assets and liabilities. No impairment charges were recorded in the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015.

**Shipping and handling costs** – Consistent with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 605-45-50 Shipping and Handling Fees and Costs, the Company classifies shipping and handling amounts billed to customers as revenue, and shipping and handling costs as a component of costs of goods sold.

**Research and development costs** – Research and development costs are expensed as incurred. Research and development expense for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was approximately \$nil, \$141,000 and \$172,000, respectively.

**Advertising costs** – The Company expenses advertising costs as incurred. Advertising expense for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was approximately \$nil, \$7,000 and \$7,000, respectively, and is recorded in selling, general and administrative expenses.

**Rent expense** – The Company records rent expense on a straight-line basis for operating lease agreements that contain escalating rent clauses. The deferred rent liability included in other current liabilities in the accompanying balance sheet represents the cumulative difference between rent expense recognised on the straight-line basis and the actual rent paid.

**Income taxes** – The provision for income taxes for interim and annual periods is determined using the asset and liability method, under which deferred tax assets and liabilities are calculated based on the temporary differences between the financial statement carrying amounts and income tax bases of assets and liabilities using currently enacted tax rates. The deferred tax assets are recorded net of a valuation allowance when, based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realised in future periods. Decreases to the valuation allowance are recorded as reductions to the provision for income taxes and increases to the valuation allowance result in additional provision for income taxes. The realisation of the deferred tax assets, net of a valuation allowance, is primarily dependent on the ability to generate taxable income. A change in the Company's estimate of future taxable income may require an addition or reduction to the valuation allowance.

The benefit from an uncertain income tax position is not recognised if it has less than a 50 percent likelihood of being sustained upon audit by the relevant authority. For positions that are more than 50 percent likely to be sustained, the benefit is recognised at the largest amount that is more-likely-than-not to be sustained. An uncertain income tax position is not recognised if it has less than a 50 percent likelihood of being sustained. Where a net operating loss carried forward, a similar tax loss or a tax credit carry forward exists, an unrecognised tax benefit is presented as a reduction to a deferred tax asset. Otherwise, the Company classifies its obligations for uncertain tax positions as other non-current liabilities unless expected to be paid within one year. Liabilities expected to be paid within one year are included in the accrued expenses account.

The Company recognises interest accrued related to tax in interest expense and penalties in selling, general and administrative expenses. During the six months ending 30 June 2016 and 2015, and the year ended 31 December 2015 the Company recognised no interest or penalties.

**Earnings per share** – Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and potentially dilutive shares outstanding during the period. Potentially dilutive shares consist of the incremental common shares issuable upon conversion of the exercise of common stock options and warrants. Potentially dilutive shares are excluded from the computation if their effect is antidilutive. Total common stock equivalents that were excluded from computing diluted net loss per share were approximately 1,106,645, 1,193,324, and 1,150,201 for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015, respectively.

**Fair value of financial instruments** – The Company uses the framework in ASC 820, Fair Value Measurements and Disclosures, to determine the fair value of its financial assets. ASC 820 establishes a fair value hierarchy that prioritises the inputs to valuation techniques used to measure fair value and expands financial statement disclosures about fair value measurements.

The hierarchy established by ASC 820 gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under ASC 820 are described below:

- **Level 1:** Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- **Level 2:** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- **Level 3:** Unobservable inputs for the asset or liability.

There were no significant transfers into or out of each level of the fair value hierarchy for assets measured at the fair value for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015.

All transfers are recognised by the Company at the end of each reporting period.



Transfers between Levels 1 and 2 generally relate to whether a market becomes active or inactive. Transfers between Levels 2 and 3 generally relate to whether significant relevant observable inputs are available for the fair value measurement in their entirety.

The Company's financial instruments as of 30 June 2016 and 2015, and 31 December 2015 include cash and cash equivalents, accounts receivable, accounts payable, the lines of credit, the note payable, and the warrant liability. The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and the lines of credit approximate fair value due to the short-term nature of those assets and liabilities. The Company believes it is impractical to disclose the fair value of the note payable as it is an illiquid financial instrument.

The Company uses Level 3 inputs for its valuation methodology for the warrant liability. The estimated fair value was determined using a Monte Carlo pricing model based on various assumptions (see Note 10). The Company's warrant liability is adjusted to reflect estimated fair value at each period end, with any decrease or increase in the estimated fair value being recorded in selling, general and administrative expenses in the statements of operations.

The following table presents the activity for liabilities measured at estimated fair value using unobservable inputs for 30 June 2016 and 2015, and 31 December 2015:

	<b>Warrant Liability</b> <i>US\$000</i>
<b>Balance at 30 June 2015</b>	<b>63</b>
Adjustments to estimated fair value	(63)
<b>Balance at 31 December 2015</b>	<b>0</b>
Adjustments to estimated fair value	-
<b>Balance at 30 June 2016</b>	<b>0</b>

**Foreign currency transactions** – From time to time the Company transacts business in foreign currencies (currencies other than the United States Dollar). These transactions are recorded at the rates of exchange prevailing on the dates of the transactions. Foreign currency transaction gains or losses are included in selling, general and administrative expenses.

**Share-based compensation** – The Company issues equity-settled share-based awards to certain employees, which are measured at fair value at the date of grant. The fair value determined at the grant date is expensed, based on the Company's estimate of shares that will eventually vest, on a straight-line basis over the vesting period. Fair value for the share awards representing equity interests identical to those associated with shares traded in the open market is determined using the market price at the date of grant. Fair value is measured by use of the Black Scholes valuation model (see Note 10).

**Recently issued accounting standards** – In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)", as subsequently amended, which is the new comprehensive revenue recognition standard that will supersede all existing revenue recognition guidance under U.S. GAAP. The standards' core principle is that a company will recognise revenue when it transfers promised goods or services to a customer in an amount that reflects the

consideration to which the company expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 for all entities by one year. Accordingly, public companies should apply the guidance in ASU 2014-09, as amended, to annual and interim periods beginning on or after 15 December 2017. Early adoption is permitted but not before annual periods beginning after 15 December 2016. Entities will have the option of using either a full retrospective approach or a modified approach to adopt the guidance. The Company is currently evaluating the impact of adopting this guidance.

In July 2015, the FASB issued ASU 2015-11, “Simplifying the Measurement of Inventory”, which simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realisable value. The standard applies only to inventories for which cost is determined by methods other than last-in first-out and the retail inventory method and is effective for annual reporting periods beginning after 15 December 2016, and interim periods within those fiscal years, with early application permitted. The Company is currently evaluating the impact of adopting this guidance.

In November 2015, the FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes”, which will require entities to present deferred tax assets (DTAs) and deferred tax liabilities (DTLs) as noncurrent in a classified balance sheet. The new standard simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet. The standard is effective for interim and annual periods beginning after 15 December 2016, with early application permitted. The Company elected to early adopt this standard as of 31 December 2015 to simplify the presentation of its deferred income taxes.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”, which requires lessees to recognise on the balance sheet the assets and liabilities for the rights and obligations created by the leases with lease terms of more than twelve months. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will continue to primarily depend on its classification as a finance or operating lease. However, unlike current U.S. GAAP, which requires only capital leases be recognised on the balance sheet, the new standard will require both types of leases to be recognised on the balance sheet. The new standard also requires disclosures about the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The new standard is effective for fiscal years beginning after 15 December 2019, and for interim and annual periods thereafter, with early application permitted. The Company is currently evaluating the impact of adopting this guidance.

**Reclassifications** – Certain reclassifications have been made to prior years’ financial statements to conform to current year presentation. These reclassifications had no effect on previously reported results of operations or accumulated deficit.

### 3. Inventories

Inventories consist of the following at 30 June 2016 and 2015, and 31 December 2015:

	30 June 2016 <i>US\$000</i>	30 June 2015 <i>US\$000</i>	31 December 2015 <i>US\$000</i>
Raw materials	797	1,093	929
Work-in-progress	1	8	-
Finished goods	<u>2,471</u>	<u>3,284</u>	<u>2,861</u>
Total inventory - net	<u><u>3,269</u></u>	<u><u>4,385</u></u>	<u><u>3,790</u></u>

### 4. Property and equipment

Property and equipment consists of the following at 30 June 2016 and 2015, and 31 December 2015:

	30 June 2016 <i>US\$000</i>	30 June 2015 <i>US\$000</i>	31 December 2015 <i>US\$000</i>
Land	709	709	709
Building	2,724	2,724	2,724
Leasehold improvements	340	315	325
Office equipment	745	741	745
Manufacturing equipment	917	907	917
Research and development equipment	514	644	644
Purchased software	222	222	222
Equipment leased to customers	8,884	8,548	8,610
Equipment available for lease to customers	<u>826</u>	<u>826</u>	<u>826</u>
	15,881	15,636	15,722
Less: accumulated depreciation	<u>(4,668)</u>	<u>(3,336)</u>	<u>(4,008)</u>
Property and equipment – net	<u><u>11,213</u></u>	<u><u>12,300</u></u>	<u><u>11,714</u></u>

During the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015, the Company removed property, plant and equipment and the associated accumulated depreciation of approximately \$48,000, \$nil and \$41,000, respectively, to reflect the disposal of property, plant and equipment.

Depreciation expense for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was approximately \$708,000, \$690,000 and \$1,403,000, respectively, and includes depreciation on equipment leased to customers. Depreciation expense on equipment leased to customers included in cost of goods sold for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was \$460,000, \$443,000 and \$934,000, respectively.

## 5. Intangible assets

During 2009, the Company entered into a patent rights purchase agreement with a shareholder. The agreement provided for the immediate payment of \$28,000 in 2009 with the possibility of an additional \$72,000 based on profits on the sales of a particular product. During 2010, the Company paid \$22,000 based on profits on the sales of the product and paid the remaining \$50,000 in 2011. The patent is amortised utilising the straight-line method over a useful life of 17 years which represents the legal life of the patent from inception. Accumulated amortisation on the patent was approximately \$36,000, \$29,000 and \$32,000 as of 30 June 2016 and 2015, and 31 December 2015, respectively.

In addition to the purchased patent, the Company has internally developed patents. Internally developed patents include legal and registration costs incurred to obtain the respective patents. The Company currently holds various patents and numerous pending patent applications in the United States, as well as numerous foreign jurisdiction outside of the United States.

Intangible assets as of 30 June 2016 and 2015, and 31 December 2015 consist of the following:

	<i>Weighted Average Useful lives</i>	30 June 2016 <i>US\$000</i>	30 June 2015 <i>US\$000</i>	31 December 2015 <i>US\$000</i>
Internally developed patents	15 years	1,177	1,100	1,155
Purchased patents	17 years	100	100	100
		<u>1,277</u>	<u>1,200</u>	<u>1,255</u>
Less accumulated amortisation		(466)	(427)	(446)
Intangible assets – net		<u>811</u>	<u>773</u>	<u>809</u>

Approximate aggregate future amortisation expense is as follows:

### Year ending 31 December (USD, in thousands)

2016	19
2017	33
2018	33
2019	29
2020	28
Thereafter	146

Amortisation expense for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was approximately \$20,000, \$19,000 and \$38,000, respectively.

## 6. Income taxes

The components of income taxes shown in the consolidated statements of operations are as follows:

	30 June 2016 <i>US\$000</i>	30 June 2015 <i>US\$000</i>	31 December 2015 <i>US\$000</i>
Current:			
Federal	-	-	-
Foreign	116	225	392
State	-	-	13
Total current provision	<u>116</u>	<u>225</u>	<u>405</u>
Deferred:			
Federal	-	-	-
Foreign	-	-	-
State	-	-	-
Total deferred provision	<u>-</u>	<u>-</u>	<u>-</u>
Total provision for income taxes	<u><u>116</u></u>	<u><u>225</u></u>	<u><u>405</u></u>

The provision for income tax varies from the amount computed by applying the statutory corporate federal tax rate of 34 percent, primarily due to the effect of certain nondeductible expenses, foreign withholding tax, and changes in valuation allowances.

A reconciliation of the differences between the effective tax rate and the federal statutory tax rate is as follows:

	30 June 2016	30 June 2015	31 December 2015
Federal statutory income tax rate	<u>34.0%</u>	<u>34.0%</u>	<u>34.0%</u>
State tax rate, net of federal benefit	0.7%	(1.4%)	0.4%
Valuation allowance	(37.5%)	(37.9%)	(25.1%)
Other	(0.1%)	(.5%)	(13.8%)
Foreign withholding tax	(5.5%)	(11.1%)	(8.0%)
Effective income tax rate	<u>(8.4%)</u>	<u>(16.9%)</u>	<u>(12.5%)</u>

The significant components of deferred income taxes included in the balance sheets are as follows:

	30 June 2016 <i>US\$000</i>	30 June 2015 <i>US\$000</i>	31 December 2015 <i>US\$000</i>
Deferred tax assets			
Net operating loss	6,586	5,494	6,056
Equity compensation	424	452	404
Research and development credits	159	159	159
Accrued liability	8	10	44
Charitable contributions	9	9	9
Other	24	170	25
Total gross deferred tax asset	<u>7,210</u>	<u>6,294</u>	<u>6,697</u>

Deferred tax liabilities			
Property and equipment	(962)	(949)	(968)
Warrants	-	(3)	-
Total gross deferred tax liability	<u>(962)</u>	<u>(952)</u>	<u>(968)</u>
Net deferred tax asset before valuation allowance	6,248	5,342	5,729
Valuation allowance	<u>(6,248)</u>	<u>(5,342)</u>	<u>(5,729)</u>
Net deferred tax asset (liability)	<u>-</u>	<u>-</u>	<u>-</u>

Deferred tax assets and liabilities are recorded based on the difference between an asset or liability's financial statement value and its tax reporting value using enacted rates in effect for the year in which the differences are expected to reverse, and for other temporary differences as defined by ASC-740, Income Taxes. At 30 June 2016, the Company has recorded a valuation allowance of \$6.2 million for which it is more likely than not that the Company will not receive future tax benefits due to the uncertainty regarding the realisation of such deferred tax assets.

As of 30 June 2016, the Company has approximately \$18.6 million of gross U.S. federal net operating loss carry forwards and \$5.3 million of gross state net operating loss carry forwards that will begin to expire in the 2019 tax year.

The FASB issued Interpretation ASC-740-10-25, Income Taxes, an interpretation of ASC-740 which clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognised in the financial statements. Under ASC-740, the impact of an uncertain income tax position on the income tax return must be recognised at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. ASC-740 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. ASC-740 applies to all tax positions related to income taxes.

As a result of the adoption and implementation of ASC-740, a tax position is recognised as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognised is the largest amount of tax benefit that has a greater than 50 percent likelihood of being realised on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Company recognises interest and penalties related to tax positions in income tax expense. At 30 June 2016 and 2015, and 31 December 2015, there was no accrual for uncertain tax positions or related interest.

The Company's tax years 2012 through 2016 remain subject to examination by federal, state and foreign income tax jurisdictions.

## 7. Lines of credit

In August 2013, the Company entered into a revolving credit facility with a bank that permitted it to borrow up to 90 percent of eligible accounts receivable and 75 percent of its eligible inventory with a maximum borrowing capacity of \$5 million. In April 2014, the maximum borrowing capacity was increased to \$10 million. Borrowings bear interest at a rate per annum equal to the base rate, which is the greater of the Prime Rate in effect on a given day, a rate determined by the lender to be one and one-half percent (1.5%) above Daily One Month LIBOR, or the Federal Funds Rate plus one and one-half percent (1.5%). The facility renewed annually and was secured by a first security interest in all of the Company's accounts

receivable, general intangibles and inventory. Under terms of the line of credit, the Company was required to maintain a specified fixed charge coverage ratio and debt to intangible net worth ratio, as those terms are defined. During the year ended 31 December 2015 the Company repaid the full amount outstanding and closed the credit facility. The balance on the line of credit at 30 June 2016 and 2015, and 31 December 2015 was \$nil, \$1,762,000 and \$nil, respectively. Interest expense related to this loan for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was \$nil, \$30,000, and \$47,000, respectively.

In October 2014, the Company entered into a bank line of credit that allows for borrowings up to \$500,000. The line of credit is revolving and is payable on demand. The balance on the line of credit at 30 June 2016 and 2015, and 31 December 2015 was \$nil. The facility matures in October 2017 and is secured by the assignment of a deposit account held by the lender. The line of credit carries a variable interest rate of 0.5 percentage points under an independent index which is the Wall Street Journal Prime and is calculated by applying the ratio of the interest rate over a year of 360 days multiplied by the outstanding principal balance multiplied by the actual number of days the principal balance is outstanding. The interest rate on 30 June 2016 and 2015, and 31 December 2015 was 3.00 percent, 2.75 percent and 3.00 percent, respectively. Interest expense related to this loan for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was \$nil.

## 8. Notes payable

On 27 March 2013, the Company entered into a term loan agreement with a lender for the purchase of property and a building for its manufacturing operations and corporate offices. The note is secured by the property and building. The Company borrowed proceeds of \$2,285,908 at a fixed interest rate of 4.45 percent. The loan has a ten year term with monthly payments based on a twenty year amortisation. There is a one-time payment at the end of the term of the note of approximately \$1,400,000. In accordance with the terms of the agreement, the Company is required to keep \$500,000 in a deposit account with the lending bank. As of 30 June 2016 and 2015, and 31 December 2015, the Company had restricted cash of \$500,000 related to the loan agreement. Future maturities of long-term debt are as follows as of 30 June 2016:

### Year ending 31 December (USD, in thousands)

2016	41
2017	85
2018	89
2019	93
2020	97
Thereafter	1,642
	<u>2,047</u>

## 9. Public Offering of Common Stock

### *Authorised shares and shares issuance*

In December 2014, the Company issued an additional 5,295,069 shares of common stock for \$2.35 per share. The Company incurred costs in the issuance of these shares of approximately \$657,000. The Company received net proceeds of approximately \$11,786,000. In January 2015, the Company completed the final closing of the share offering and issued 78,977 shares of common stock for \$2.35 per share raising approximately \$186,000.

## 10. Stock compensation

### *Stock options*

In July 2011, the Company's shareholders approved the Conversion Shares and the Directors' Shares, as well as the Plan Shares and Omnibus Performance Incentive Plan ("Plan"). This included the termination of all outstanding stock incentive plans, cancellation of all outstanding stock incentive agreements, and the awarding of stock incentives to Directors and certain employees and consultants. The Company established the Plan to attract and retain Directors, officers, employees and consultants. The Company reserved an amount equal to 10 percent of the Common Shares issued and outstanding immediately following completion of the issuance of additional shares in 2011.

Upon the issuance of these additional shares, an award of share options was made to the Directors and certain employees and consultants, and a single award of restricted shares was made to a former Chief Financial Officer. In addition, additional stock options were awarded in each year subsequent. The awards of stock options and restricted shares made upon issuance were in respect of 85 percent of the Common Shares available under the Plan, equivalent to 8.5 percent of the Public Offering. The total number of shares reserved for stock awards and options under this Plan is 1,877,011 with 1,160,556 shares allocated as of 30 June 2016. The shares are allocated as 26,000 shares to a Non-Executive Director and 1,134,556 shares to employees, executives and consultants.

The options granted to Non-Executive Directors unless otherwise agreed vest contingent on continuing service with the Company at the vesting date and compliance with the covenants applicable to such service and have a ten year life.

Employee options either vest over three years with a third vesting ratably each year, or partially on issuance and partially over the following 24 month period. Vesting accelerates in the event of a change of control. Options granted to Non-Executive Directors and one executive vest partially on issuance and will vest partially one to two years later. The remaining Non-Executive Director options must be exercised during the course of the 2016 calendar year or they will expire and vesting accelerates in the event of a change of control.

As discussed in Note 2, the Company uses the Black Scholes valuation model to measure the fair value of options granted. Since the Company does not have a sufficient trading history from which to calculate its historical volatility, the Company's expected volatility is based on a basket of comparable companies' historical volatility. As the Company's initial options were granted in 2011, the Company does not have sufficient history of option exercise behavior from which to calculate the expected term. Accordingly, the expected terms of options are calculated based on the short-cut method commonly utilised by newly public companies. The risk free interest rate is based on a blended average yield of two and five year United States Treasury Bills at the time of grant. The assumptions used in the Black Scholes option pricing model for options granted in 2015 and 2016 were as follows:

	Number of Options Granted	Grant Date	Risk-Free Interest Rate	Expected Term	Volatility	Exercise Price	Fair Value Per Option
2015	299,000	05/20/2015	1.29%	6 years	58.00%	\$2.15	\$1.16
2016	345,000	03/14/2016	1.70%	5.75 years	54.50%	\$0.40	\$0.20



The Company assumes a dividend yield of 0.0%.

The following table summarises the Company's stock option activity for the six months ended 30 June 2016:

<b>Stock Options</b>	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Weighted-Average Remaining Contractual Term (in years)</b>	<b>Average Grant Date Fair Value</b>
Outstanding at 31 December 2015	825,556	\$3.48	5.8	\$1,476,970
Granted	345,000	\$0.40	5.8	\$69,000
Forfeited	(10,000)	\$2.15		
Outstanding at 30 June 2016	1,160,556	\$2.69	5.9	\$1,466,552
Exercisable at 30 June 2016	656,223			

A summary of the status of unvested options as of 30 June 2016 and changes during the six months ended 30 June 2016 is presented below:

<b>Unvested Options</b>	<b>Shares</b>	<b>Weighted-Average Fair Value at Grant Date</b>
Unvested at 31 December 2015	249,000	\$1.16
Granted	345,000	\$0.20
Vested	(79,667)	\$1.16
Forfeited	(10,000)	
Unvested at 30 June 2016	504,333	\$0.50

As of 30 June 2016, total unrecognised compensation cost of \$235,000 was related to unvested share-based compensation arrangements awarded under the Plan.

#### *Stock warrants*

On 29 July 2011, the Company and one of its consultants entered into a warrant agreement for the consultant's assistance in connection with the Company's initial public offering on 4 August 2011. Pursuant to this agreement, the Company agreed to grant to the consultant warrants to subscribe for Common Shares representing 1.5 percent of the total shares outstanding immediately following the initial public offering, or 193,843 warrant shares. The warrant vested upon the August 2011 issuance of the shares. The exercise price of the warrants is 210 pence per share. The warrants are exercisable in whole or in part at any time in the period between 5 August 2011 and 5 August 2016. In May 2013, the consultant exercised 113,843 warrants for consideration paid to the Company and proceeds of approximately \$371,000 were received.

The warrants are exercisable, at the election of the consultant, without payment of the exercise price, for such number of Common Shares as is calculated in accordance with a formula set out in the warrant agreement. In summary, that formula operates by calculating the notional net gain that the shareholder would have made if it had exercised its warrants at the exercise price and then sold its shares at the current market value. The formula then uses the notional net gain to calculate such lesser number of

Common Shares that the shareholder would need to acquire (at \$nil acquisition cost) in order to achieve the same notional net gain. In the event that the shareholder exercises the warrants (or any part) in this manner, the warrants are deemed to have been exercised in respect of such number of Common Shares as would have been required in order to achieve the same notional net gain had the warrants been exercised at the exercise price.

In addition, either the consultant or the Company may elect, in certain circumstances, including a merger or sale of substantially all of the assets of the Company, to receive or provide (as the case may be) a cash payment, in substitution for the warrants, calculated in accordance with a formula set out in the warrant agreement. As a result, the fair value of the outstanding warrants is classified as a liability in accordance with ASC 480 - Distinguishing Liabilities from Equity. As discussed in Note 2, the fair value of the warrants is measured utilising a Monte Carlo valuation model with the following assumptions:

	30 June 2016	30 June 2015	31 December 2015
Closing price per share of common stock	\$0.38	\$2.06	\$0.37
Exercise price per share	\$2.81	\$3.30	\$2.15
Expected volatility	49.0%	51.0%	49.0%
Risk-free interest rate	0.74%	0.74%	0.74%
Remaining expected term of underlying securities (years)	0.1	1.1	0.6

In addition, as of the valuation dates, management assessed the probabilities of future financing assumptions in the Monte Carlo valuation model.

## 11. Employee benefit plan

The Company maintains an active defined contribution retirement plan for its employees (the “Benefit Plan”). All employees satisfying certain service requirements are eligible to participate in the Benefit Plan. The Company makes cash contributions each payroll period up to specified percentages of employees’ contributions as approved by the Board of Directors. In September 2015, the Company changed its policy of making contributions under which it chose not to contribute to the plan. The Company may elect to change its policy in the future. The Company’s contributions to the Benefit Plan were approximately \$nil, \$52,000, and \$72,000 for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015, respectively.

## 12. Commitments and contingencies

**Operating leases** – The Company leases certain facilities and equipment under non-cancelable operating leases which expire at varying times between August 2015 and May 2019. Certain of these leases have escalating rent payments which result in the Company recording a deferred rent liability.

Future minimum lease payments under the operating leases, together with the present value of minimum lease payments as of 30 June 2016 are as follows:

	<i>Future Lease Payments US\$000</i>
Year Ending 31 December	
2016	95
2017	314
2018	116
2019	49
2020	-
Thereafter	-
Total future lease payments	<u>574</u>

Rent expense for the six months ended 30 June 2016 and 2015, and the year ended 31 December 2015 was approximately \$172,000, \$317,000 and \$613,000, respectively.

### 13. Related party transactions

The Company has held a patent rights purchase agreement since 2009 with a shareholder as described in Note 5.

### 14. Segment and geographic information

ASC 280-10, *Disclosures About Segments of an Enterprise and Related Information* (ASC 280-10), establishes standards for reporting information about operating segments. ASC 280-10 requires that the Company report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker ("CODM") in deciding how to allocate resources and in assessing performance. The Company's CODM is the Chief Executive Officer (CEO). While the CEO is apprised of a variety of financial metrics and information, the business is principally managed on an aggregate basis as of 30 June 2016. For the six months ended 30 June 2016, the Company's revenues were generated primarily in the Middle East and the United States (U.S.). Additionally, the majority of the Company's expenditures and personnel either directly supported its efforts in the Middle East and the U.S., or cannot be specifically attributed to a geography. Therefore, the Company has only one reportable operating segment.

Revenues from customers by geography are as follows:

(USD, in thousands)	Six months ended 30 June 2016	Six months ended 30 June 2015	Year ended 31 December 2015
Middle East	2,609	7,210	10,604
United States	811	1,060	1,897
Other	525	420	1,091
Total	<u>3,945</u>	<u>8,690</u>	<u>13,592</u>

Equipment leased to customers by geography is as follows:

(USD, in thousands)	Six months ended 30 June 2016	Six months ended 30 June 2015	Year ended 31 December 2015
Middle East	6,391	6,589	6,301
United States	2,118	1,610	1,813
Other	375	349	496
Total	<u>8,884</u>	<u>8,548</u>	<u>8,610</u>

## 15. Concentrations

At 30 June 2016, two customers, one with three contracts with three separate plants represented 78 percent of accounts receivable. During the six months ended 30 June 2016, the Company received 62 percent of its gross revenue from one customer with three contracts with three separate plants.

At 31 December 2015, two customers, one with three contracts with three separate plants, represented 74 percent of accounts receivable. During the year ended 31 December 2015, the Company received 78 percent of its gross revenue from two customers, one with three separate plants.

At 30 June 2015, two customers, one with three contracts with three separate plants represented 81 percent of accounts receivable. During the six months ended 30 June 2015, the Company received 82 percent of its gross revenue from two customers, one with four contracts with three separate plants.

## 16. Subsequent events

The Company discloses material events that occur after the balance sheet date but before the financials are issued. In general, these events are recognised in the financial statements if the conditions existed at the date of the balance sheet, but are not recognised if the conditions did not exist at the balance sheet date. Management has evaluated subsequent events through 14 September 2016, the date the interim results were available to be issued, and no events have occurred which require further disclosure.

## **Forward Looking Statements**

This release contains certain statements that are or may be "forward-looking statements". These statements typically contain words such as "intends", "expects", "anticipates", "estimates" and words of similar import. All the statements other than statements of historical facts included in this announcement, including, without limitation, those regarding the Company's financial position, business strategy, plans and objectives of management for future operations (including development plans and objectives relating to the Company's products and services) are forward-looking statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future and therefore undue reliance should not be placed on such forward-looking statements. There are a number of factors that could cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Such forward-looking statements are based on numerous assumptions regarding the Company's present and future business strategies and the environment in which the Company will operate in the future and such assumptions may or may not prove to be correct. Forward-looking statements speak only as at the date they are made. Neither the Company nor any other person undertakes any obligation (other than, in the case of the Company, pursuant to the AIM Rules for Companies) to update publicly any of the information contained in this announcement, including any forward-looking statements, in the light of new information, change in circumstances or future events.