Ideal Power Inc.
Form 10-Q
May 15, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2018

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 001-36216

IDEAL POWER INC.

(Exact name of registrant as specified in its charter)

Delaware	**14-1999058**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4120 Freidrich Lane, Suite 100

Austin, Texas 78744

(Address of principal executive offices)

(Zip Code)

(512) 264-1542

(Registrant's telephone number, including area code)

(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. Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer," and "large accelerated filer" and "smaller reporting 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 x

If an emerging growth company, indicate by check mark whether 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 issuer is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of May 11, 2018, the issuer had 13,996,121 shares of common stock, par value $.001, outstanding.

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PART I-FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

IDEAL POWER INC.

Balance Sheets

	March 31, 2018 **(unaudited)**	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,153,268	$ 10,022,247
Accounts receivable, net	152,716	221,084
Inventories, net	227,005	251,363
Prepayments and other current assets	251,146	283,208
Total current assets	8,784,135	10,777,902
Property and equipment, net	573,026	669,571
Intangible assets, net	2,088,428	2,082,014
Other assets	37,500	37,500
Total assets	$ 11,483,089	$ 13,566,987
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 299,730	$ 449,475
Accrued expenses	1,008,149	1,081,155
Total current liabilities	1,307,879	1,530,630
Other long-term liabilities	459,216	456,234
Total liabilities	1,767,095	1,986,864
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized; 1,518,430 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	1,518	1,518
Common stock, $0.001 par value; 50,000,000 shares authorized; 13,998,465 shares issued and 13,996,121 shares outstanding at March 31, 2018 and	13,998	13,998

December 31, 2017, respectively		
Additional paid-in capital	67,273,392	67,081,359
Treasury stock, at cost, 2,344 shares at March 31, 2018 and December 31, 2017, respectively	(7,489)	(7,489)
Accumulated deficit	(57,565,425)	(55,509,263)
Total stockholders' equity	9,715,994	11,580,123
Total liabilities and stockholders' equity	$ 11,483,089	$ 13,566,987

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

IDEAL POWER INC.

Statements of Operations

(unaudited)

	Three Months Ended March 31, 2018		2017	
Product revenue	$	181,500	$	275,670
Cost of product revenue		334,963		710,930
Gross loss		(153,463)		(435,260)
Operating expenses:				
Research and development		757,783		1,190,169
General and administrative		891,988		905,963
Sales and marketing		254,243		541,533
Total operating expenses		1,904,014		2,637,665
Loss from operations		(2,057,477)		(3,072,925)
Interest income, net		1,315		4,541
Net loss	$	(2,056,162)	$	(3,068,384)
Net loss per share – basic and fully diluted	$	(0.15)	$	(0.28)
Weighted average number of shares outstanding – basic and fully diluted		13,991,121		10,879,690

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

IDEAL POWER INC.

Statements of Cash Flows

(unaudited)

	Three Months Ended March 31, 2018	2017
Cash flows from operating activities:		
Net loss	$(2,056,162)	$(3,068,384)
Adjustments to reconcile net loss to net cash used in operating activities:		
Allowance for doubtful accounts	18,235	60,703
Write-down of inventory	(883)	348,793
Depreciation and amortization	113,808	113,068
Write-off of capitalized patents	10,873	559
Write-off of fixed assets	7,056	10,534
Stock-based compensation	192,033	384,329
Decrease (increase) in operating assets:		
Accounts receivable	50,133	(247,512)
Inventories	25,241	44,491
Prepayments and other current assets	32,062	7,780
Increase (decrease) in operating liabilities:		
Accounts payable	(149,745)	16,566
Accrued expenses	(70,024)	(116,648)
Net cash used in operating activities	(1,827,373)	(2,445,721)
Cash flows from investing activities:		
Purchase of property and equipment	–	(4,378)
Acquisition of intangible assets	(41,606)	(72,376)
Net cash used in investing activities	(41,606)	(76,754)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	–	13,657,331
Exercise of options and warrants	–	11,143
Net cash provided by financing activities	–	13,668,474
Net increase (decrease) in cash and cash equivalents	(1,868,979)	11,145,999
Cash and cash equivalents at beginning of period	10,022,247	4,204,916
Cash and cash equivalents at end of period	$8,153,268	$15,350,915

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

Ideal Power Inc.

Notes to Financial Statements

(unaudited)

Note 1 – Organization and Description of Business

Ideal Power Inc. (the "Company") was incorporated in Texas on May 17, 2007 under the name Ideal Power Converters, Inc. The Company changed its name to Ideal Power Inc. on July 8, 2013 and re-incorporated in Delaware on July 15, 2013. With headquarters in Austin, Texas, it develops power conversion solutions with an initial focus on solar + storage, microgrid and stand-alone energy storage applications. The principal products of the Company are 30-kilowatt power conversion systems, including 2-port and multi-port products.

Since its inception, the Company has generated limited revenues from the sale of products and has financed its research and development efforts and operations through the sale of common stock and, prior to its initial public offering, the issuance of convertible debt. The Company's continued operations are dependent upon its ability to obtain adequate sources of funding through future revenues, follow-on stock offerings, debt financing, co-development agreements, sale or licensing of developed intellectual property or other alternatives.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission for Form 10-Q. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The Balance Sheet at December 31, 2017 has been derived from the Company's audited financial statements.

In the opinion of management, these financial statements reflect all normal recurring, and other adjustments, necessary for a fair presentation. These financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year or any other future periods.

Recently Adopted Standards

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The FASB issued several amendments to the standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. The standard replaced most existing revenue recognition guidance in U.S. GAAP when it became effective on January 1, 2018. The adoption of this standard did not have a material effect on the Company's financial statements, nor required an adjustment to the opening balance of accumulated deficit at January 1, 2018, the date of initial adoption. See Note 12 for a discussion of the Company's revenue recognition policy.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), in order to address eight specific cash flow issues with the objective of reducing the existing diversity in practice. The updated standard is effective for financial statements issued for annual periods beginning after December 15, 2017 and interim periods within those fiscal years. The adoption of the standard did not have a significant effect on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU provides clarity and reduces both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718 to a change to the terms or conditions of a share-based payment award. The amendments in this ASU are effective for public entities for fiscal years and interim periods beginning after December 15, 2017. The ASU is applied prospectively on and after the effective date. The standard did not have a material effect on the Company's financial statements.

In July 2017, the FASB issued ASU 2017-11, Accounting for Certain Financial Instruments with Down Round Features and Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception. Part I of this ASU addresses the complexity of accounting for certain financial instruments with down round features. Per the ASU, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down round feature. The ASU is effective for public entities for fiscal years beginning after December 15, 2018 and early adoption is permitted. The Company has elected to early adopt the ASU and will recognize the value of the effect of the down round provision, if and/or when triggered. The provision is associated with stock warrants issued as part of the Company's 2017 definitive securities purchase agreement, or the Private Placement. For more details regarding the 2017 Private Placement, see Note 9 and Note 11.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet. Most prominent among the amendments is the recognition of assets and liabilities by lessees for those leases classified as operating leases under previous U.S. GAAP. Under the new standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The new standard will be effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. While the Company is continuing to assess the potential impact of this standard, it expects its lease commitment will be subject to the updated standard and recognized as a lease liability and right-of-use asset upon adoption.

Management does not believe that any other recently issued, but not yet effective, accounting standard, if adopted, would have a material impact on the Company’s financial statements.

Note 3 – Accounts Receivable

Accounts receivable, net consisted of the following:

	March 31, 2018 **(unaudited)**	December 31, 2017
Trade receivables	$307,892	$ 378,894

Other receivables	25,059	20,589
	332,951	399,483
Allowance for doubtful accounts	(180,235)	(178,399)
	$152,716	$221,084

The Company had receivable balances from four customers that accounted for 73% of net trade receivables at March 31, 2018.

Activity in the allowance for doubtful accounts was as follows:

Balance at December 31, 2017	$(178,399)
Write offs	16,399
Provisions	(18,235)
Balance at March 31, 2018	$(180,235)

Note 4 – Inventories

Inventories, net consisted of the following:

	March 31, 2018 **(unaudited)**	December 31, 2017
Raw materials	$ 193,445	$ 222,436
Finished goods	153,120	149,370
	346,565	371,806
Reserve for obsolescence	(119,560)	(120,443)
	$ 227,005	$ 251,363

Note 5 – Property and Equipment

Property and equipment, net consisted of the following:

	March 31, 2018 **(unaudited)**	December 31, 2017
Machinery and equipment	$ 1,005,621	$ 1,013,133
Building leasehold improvements	395,335	395,335
Furniture, fixtures, software and computers	218,571	218,571
	1,619,527	1,627,039
Accumulated depreciation and amortization	(1,046,501)	(957,468)
	$ 573,026	$ 669,571

Note 6 – Intangible Assets

Intangible assets, net consisted of the following:

	March 31, 2018 **(unaudited)**	December 31, 2017
Patents	$ 1,585,001	$ 1,554,268

Other intangible assets	732,175	732,175
	2,317,176	2,286,443
Accumulated amortization	(228,748)	(204,429)
	$ 2,088,428	$ 2,082,014

Amortization expense amounted to $24,319 and $17,875 for the three months ended March 31, 2018 and 2017, respectively. Amortization expense for the succeeding five years and thereafter is $74,140 (2018), $98,853 (2019-2022) and $1,162,567 (thereafter).

At March 31, 2018 and December 31, 2017, the Company had capitalized $456,309 and $472,928, respectively, for costs related to patents that have not been awarded.

Note 7 – Accrued Expenses

Accrued expenses consisted of the following:

	March 31, 2018 **(unaudited)**	December 31, 2017
Accrued compensation	$ 268,768	$ 247,343
Warranty reserve	478,521	426,115
Other	260,860	407,697
	$ 1,008,149	$ 1,081,155

Note 8 – Commitments and Contingencies

<u>Lease</u>

The Company has entered into a lease for 14,782 square feet of office and laboratory space located in Austin, Texas. The triple net lease has a term of 48 months and commenced on June 1, 2014. The annual base rent in the first year of the lease was $154,324 and increases by $3,548 in each succeeding year of the lease. In addition, the Company is required to pay its proportionate share of operating costs for the building. At March 31, 2018, the remaining annual base rent commitments under the lease are $27,495. The Company incurred rent expense of $57,802 and $57,656 for the three months ended March 31, 2018 and 2017, respectively.

<u>License Agreement</u>

In 2015, the Company entered into licensing agreements which expire on February 7, 2033. Per the agreements, the Company has an exclusive royalty-free license which enhances its intellectual property portfolio related to semiconductor power switches. The agreements include both fixed and variable payments. The variable payments are a function of the number of associated patent filings pending and patents issued under the agreements. The Company will pay $10,000 for each patent filing pending and $20,000 for each patent issued within 20 days of December 21, 2017 and each subsequent year of the agreement, up to a maximum of $100,000 per year (i.e. five issued patents). At March 31, 2018, two patents associated with the agreements had been issued and the corresponding long-term liability for the estimated present value of future payments under the licensing agreement is $459,216. The Company is accruing interest for future payments related to the issued patent associated with the agreement.

Legal Proceedings

The Company is in arbitration with Libra Industries, Inc.(Libra), its prior contract manufacturer, with both parties asserting claims against the other party. The arbitration hearing is April 23, 2018 to April 25, 2018 in Travis County, Texas. At this time, the Company is unable to estimate the possible loss, if any, associated with this proceeding. At March 31, 2018 and December 31, 2017, the Company recorded a $100,000 accrual based on an expired settlement offer made by the Company to Libra.

Note 9 — Common Stock

On March 3, 2017, the Company closed on a definitive securities purchase agreement, or Private Placement, to sell the Company’s common stock and preferred stock together with warrants to purchase shares of common stock. In the Private Placement, each share of common stock or preferred stock was sold together with a warrant to purchase one share of common stock at a collective price of $2.535. Investors purchased an aggregate of 5,220,826 shares of common stock and 708,430 shares of preferred stock together with warrants to purchase 5,929,256 shares of common stock in the Private Placement for aggregate gross proceeds of $15 million. Net cash proceeds were $13.7 million after offering fees and expenses, including the placement agent fee of $1.1 million.

Note 10 — Equity Incentive Plan

On May 17, 2013, the Company adopted the 2013 Equity Incentive Plan (the "Plan") and reserved shares of common stock for issuance under the Plan. The Plan is administered by the Compensation Committee of the Company's Board of Directors. At March 31, 2018, 860,544 shares of common stock were available for issuance under the Plan.

During the three months ended March 31, 2018, the Company granted 95,358 stock options to Board members under the Plan. The estimated fair value of these stock options, calculated using the Black-Scholes option valuation model, was $90,000, of which $22,500 was recognized during the three months ended March 31, 2018.

A summary of the Company's stock option activity and related information is as follows:

	Stock Options	**Weighted Average Exercise Price**	**Weighted Average Remaining Life (in years)**
Outstanding at December 31, 2017	1,232,236	$ 6.44	6.8
Granted	95,358	$ 1.56	
Forfeited/Expired/Exchanged	(104,128)	$ 5.20	
Outstanding at March 31, 2018	1,223,466	$ 6.16	6.9
Exercisable at March 31, 2018	928,196	$ 6.53	6.6

At March 31, 2018, there was $764,494 of unrecognized compensation cost related to non-vested equity awards granted under the Plan. That cost is expected to be recognized over a weighted average period of 0.7 years.

Note 11 — Warrants

In connection with the Private Placement, investors received warrants to purchase 5,929,256 shares of common stock. The warrants have an exercise price of $2.41 per share and will expire three years from the date of issuance. The placement agent also received 237,170 warrants to purchase shares of common stock as part of its placement agent fee. The placement agent warrant has an exercise price of $2.89 per share and also has a three-year term. The warrants contain a provision to protect investors from potential future dilutive events, or a down-round provision. The Company elected to early adopt ASU 2017-11 and will recognize the value of the effect of the down-round provision if and/or when triggered. The Company had 7,481,079 warrants outstanding at both March 31, 2018 and December 31, 2017 with a weighted average exercise price of $2.79 per share. At March 31, 2018 all warrants are exercisable, although for the Company's two largest beneficial owners their warrants may be exercised only to the extent that the total number of shares of common stock then beneficially owned by these shareholders does not exceed 9.99% of the outstanding shares of the Company's common stock.

Note 12 — Revenue

Revenue Recognition

Revenue is recognized in accordance with ASC Topic 606 upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that typically are for products only although contracts could include various combinations of products and services, which are generally distinct and accounted for as separate performance obligations. Revenue is recognized net of taxes collected from customers, which are subsequently remitted to governmental authorities. The Company generally sells its products FOB shipping and recognizes revenue when products are shipped. Revenue from services, which consist of commissioning services, if any, is recognized as services are performed.

The Company had revenue from three customers which accounted for 31%, 19% and 15% of net revenue for the three months ended March 31, 2018 and revenue from three customers which accounted for 25%, 19% and 16% of net revenue for the three months ended March 31, 2017.

Deferred Revenues

We record deferred revenues when cash payments are received in advance of our performance. Based on our review of customer credit, we may require full or partial payment before the products or services are delivered to the customer.

Activity in the deferred revenue account was as follows:

Balance at December 31, 2017	$-
Deferral of revenue	17,350
Recognition of revenue	&nbs