CLEARSIGN COMBUSTION CORP
Form 10-Q
August 13, 2015

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 June 30, 2015

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 001-35521

CLEARSIGN COMBUSTION CORPORATION

(Exact name of registrant as specified in its charter)

WASHINGTON **26-2056298**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

12870 Interurban Avenue South

Seattle, Washington 98168

(Address of principal executive offices)

(Zip Code)

(206) 673-4848

(Registrant's telephone number, including area code)

No change

(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

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

As of August 13, 2015 the issuer has 12,811,218 shares of common stock, par value $.0001, issued and outstanding.

TABLE OF CONTENTS

PART I-FINANCIAL INFORMATION

ITEM 1 CONDENSED FINANCIAL STATEMENTS

ClearSign Combustion Corporation

Condensed Balance Sheets

(Unaudited)

	June 30, 2015	December 31, 2014
ASSETS		
Current Assets:		
Cash and cash equivalents	$14,606,000	$1,845,000
Prepaid expenses	254,000	109,000
Total current assets	14,860,000	1,954,000
Fixed assets, net	186,000	263,000
Patents and other intangible assets, net	2,973,000	2,372,000
Other assets	10,000	10,000
Total Assets	$18,029,000	$4,599,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$427,000	$253,000
Accrued compensation and taxes	832,000	982,000
Total current liabilities	1,259,000	1,235,000
Long Term Liabilities:		
Long-term accrued compensation and taxes	182,000	372,000
Deferred rent	27,000	33,000
Total liabilities	1,468,000	1,640,000
Commitments		
Stockholders' Equity:		
Preferred stock, $0.0001 par value, zero shares issued and outstanding	-	-

Common stock, $0.0001 par value, 12,811,218 and 9,681,476 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively	1,000	1,000
Additional paid-in capital	41,199,000	24,218,000
Accumulated deficit	(24,639,000)	(21,260,000)
Total stockholders' equity	16,561,000	2,959,000
Total Liabilities and Stockholders' Equity	$ 18,029,000	$ 4,599,000

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

ClearSign Combustion Corporation

Condensed Statements of Operations

(Unaudited)

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2015	2014	2015	2014
Operating expenses:				
Research and development	$ 714,000	$ 556,000	$ 1,287,000	$ 1,163,000
General and administrative	1,096,000	1,072,000	2,115,000	2,113,000
Total operating expenses	1,810,000	1,628,000	3,402,000	3,276,000
Loss from operations	(1,810,000)	(1,628,000)	(3,402,000)	(3,276,000)
Other income:				
Interest income	14,000	2,000	23,000	3,000
Net Loss	$ (1,796,000)	$ (1,626,000)	$ (3,379,000)	$ (3,273,000)
Net Loss per share - basic and fully diluted	$ (0.14)	$ (0.17)	$ (0.28)	$ (0.35)
Weighted average number of shares outstanding - basic and fully diluted	12,799,666	9,631,972	12,085,478	9,347,647

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

ClearSign Combustion Corporation

Condensed Statement of Stockholders' Equity

(Unaudited)

For the Six Months Ended June 30, 2015

	Common Stock Shares	Amount	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity
Balances at December 31, 2014	9,681,476	$ 1,000	$ 24,218,000	$ (21,260,000)	$ 2,959,000
Shares issued in underwritten offering ($5.85 per share)	2,990,000	-	17,491,000	-	17,491,000
Issuance costs of underwritten offering	-	-	(1,212,000)	-	(1,212,000)
Shares issued for services ($5.97 per share)	10,470	-	62,000	-	62,000
Shares issued upon exercise of options ($2.20 per share)	129,062	-	284,000	-	284,000
Shares issued upon exercise of options ($4.88 per share)	210	-	1,000	-	1,000
Share based compensation	-	-	355,000	-	355,000
Net loss	-	-	-	(3,379,000)	(3,379,000)
Balances at June 30, 2015	12,811,218	$ 1,000	$ 41,199,000	$ (24,639,000)	$ 16,561,000

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

ClearSign Combustion Corporation

Condensed Statements of Cash Flows

(Unaudited)

	For the Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities:		
Net loss	$ (3,379,000)	$ (3,273,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Common stock issued for services	62,000	111,000
Share based payments	355,000	162,000
Depreciation and amortization	112,000	119,000
Abandonment of capitalized intangible assets	5,000	8,000
Deferred rent	(6,000)	7,000
Change in operating assets and liabilities:		
Prepaid expenses	(145,000)	(94,000)
Accounts payable	174,000	(81,000)
Accrued compensation	(340,000)	(70,000)
Net cash used in operating activities	(3,162,000)	(3,111,000)
Cash flows from investing activities:		
Acquisition of fixed assets	(30,000)	(63,000)
Disbursements for patents and other intangible assets	(611,000)	(579,000)
Net cash used in investing activities	(641,000)	(642,000)
Cash flows from financing activities:		
Proceeds from issuance of common stock for cash, net of offering costs	16,279,000	5,796,000
Proceeds from exercise of stock options	285,000	-
Net cash provided by financing activities	16,564,000	5,796,000
Net increase in cash and cash equivalents	12,761,000	2,043,000
Cash and cash equivalents, beginning of period	1,845,000	2,688,000
Cash and cash equivalents, end of period	$ 14,606,000	$ 4,731,000

Supplemental disclosure of non-cash operating and financing activities:

During the six months ended June 30, 2015, the Company issued 210 shares of common stock through a net settlement cashless exercise of stock options to purchase 10,500 shares at $4.88 per share in May 2015 when the closing price was $4.98 per share.

During the six months ended June 30, 2014, the Company issued warrants to purchase 20,313 shares of common stock valued at $92,000 as part of a placement agent fee related to the March 2014 registered direct offering of common stock.

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

ClearSign Combustion Corporation

Notes to Unaudited Condensed Financial Statements

Note 1 – Organization and Description of Business

ClearSign Combustion Corporation (ClearSign or the Company) designs, develops and markets technologies for the purpose of improving key performance characteristics of combustion systems, including emission and operational performance, energy efficiency and overall cost-effectiveness. The Company's primary technologies include its Duplex™ technology, which achieves very low emissions without the need of external flue gas recirculation, selective catalytic reduction, or higher excess air operation, and its Electrodynamic Combustion Control™ or ECC™ technology, which introduces a computer-controlled electric field into the combustion region which may better control gas-phase chemical reactions and improve system performance and cost-effectiveness. The Company is located in Seattle, Washington and was incorporated in the State of Washington in 2008.

The Company has generated limited revenues from operations to date to meet its operating expenses, and has historically financed its operations primarily through issuances of equity securities. The Company has incurred losses since its inception totaling $24,639,000 and expects to experience operating losses and negative cash flows for the foreseeable future. Management believes that the successful growth and operation of the Company's business is dependent upon its ability to obtain adequate sources of funding through co-development agreements, strategic partnering agreements, or equity or debt financing to adequately support research and development efforts, protect intellectual property, form relationships with strategic partners, and provide for working capital and general corporate purposes. There can be no assurance that the Company will be successful in achieving its long-term plans as set forth above, or that such plans, if consummated, will enable the Company to achieve profitable operations or continue in the long-term as a going concern.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed 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 condensed balance sheet at December 31, 2014 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 our Annual Report on Form 10-K for the year ended December 31, 2014. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year or any other future periods.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes revenue on co-development agreements using the percentage of completion method. Under this method, the completion percentage is determined by dividing costs incurred to date by total estimated project costs. Since these projects will require technological development to complete, which by its nature is difficult to predict, the actual cost required to complete contracted work may vary from estimates. Estimated project costs are revised regularly which can alter the reported level of project profitability. Any estimated project losses are recognized in the current reporting period. Customer billings are recorded when cash receipts are probable and in accordance with the underlying co-development contract. If billings exceed recognized revenue, the difference is recorded as a current liability, while any recognized revenues exceeding billings are recorded as a current asset. Recognized revenues are subject to revisions as the contract progresses to completion and actual revenue and cost become certain. Revisions in revenue estimates are reflected in the period in which the facts that give rise to the revision become known. There were no revenues for the six months ended June 30, 2015 and 2014.

Cost of Revenue

Cost of co-development revenue includes both direct and allocated indirect costs of completing the scope of work of co-development agreements. Direct costs include labor, materials and other costs incurred directly in fulfilling co-development agreements. Indirect costs include labor, rent, depreciation and other costs associated with operating the Company. Due to the nature of the work involved, the cost of co-development projects may fluctuate substantially from period to period.

Cash and Cash Equivalents

Highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents. Cash is maintained with a commercial bank where accounts are generally guaranteed by the Federal Deposit Insurance Corporation up to $250,000. The Company's deposits may at times exceed this limit. The Company has not experienced losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Fixed Assets

Fixed assets are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are depreciated over the life of the lease or their useful life, whichever is shorter. All other fixed assets are depreciated over two to four years. Maintenance and repairs are expensed as incurred.

Patents and Trademarks

Patents and trademarks are recorded at cost. Amortization is computed using the straight-line method over the estimated useful lives of the assets once they are issued.

Impairment of Long-Lived Assets

The Company tests long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable through the estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair values are reduced for the cost of disposal.

Fair Value of Financial Instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are categorized based on whether or not the inputs are observable in the market and the degree that the inputs are observable. The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The Company's financial instruments primarily consist of cash and cash equivalents, accounts payable and accrued expenses. As of the balance sheet dates, the estimated fair values of the financial instruments were not materially different from their carrying values as presented on the balance sheets. This is primarily attributed to the short maturities of these instruments. The Company did not identify any other non-recurring assets and liabilities that are required to be presented in the balance sheets at fair value.

Research and Development

The cost of research and development is expensed as incurred. Research and development costs consist of salaries, benefits, share based compensation, consulting fees, rent, utilities, depreciation, and consumables used in laboratory and field testing.

Deferred Rent

Operating lease agreements which contain provisions for future rent increases or periods in which rent payments are reduced or abated are recorded in monthly rent expense in the amount of the total payments over the lease term divided by the number of months of the lease term. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent which is reflected on the accompanying balance sheets.

Income Taxes

The Company accounts for income taxes using an asset and liability approach which allows for the recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain. Tax benefits from an uncertain tax position are recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate resolution.

Stock-Based Compensation

The costs of all employee stock options, as well as other equity-based compensation arrangements, are reflected in the financial statements based on the estimated fair value of the awards on the grant date. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. Stock compensation for stock granted to non-employees is determined as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

Net Loss per Common Share

Basic loss per share is computed by dividing loss available to common stockholders by the weighted-average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include additional common shares available upon exercise of stock options and warrants using the treasury stock method, except for periods for which no common share equivalents are included because their effect would be anti-dilutive. At June 30, 2015 and 2014, potentially dilutive shares outstanding amounted to 1,392,352 and 1,249,582, respectively.

Recently Issued Accounting Pronouncements

Management does not believe that any recently issued, but not yet effective standards, if adopted, will have a material effect on the financial statements.

Emerging Growth Company

The Company is an emerging growth company as defined under the Jumpstart Our Business Startups Act of 2012 (JOBS Act). An emerging growth company may delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. The Company will remain an emerging growth company until December 31, 2017, although it will lose that status sooner if its revenues exceed $1 billion, if it issues more than $1 billion in non-convertible debt in a three year period, or if the market value of its common stock that is held by non-affiliates exceeds $700 million as of any June 30. At June 30, 2015, the market value of the Company’s common stock held by non-affiliates totaled $61 million.

Note 3 – Fixed Assets

Fixed assets are summarized as follows:

	June 30, 2015 (unaudited)	December 31, 2014
Machinery and equipment	$ 647,000	$ 646,000
Office furniture and equipment	121,000	98,000
Leasehold improvements	130,000	124,000
Accumulated depreciation	(712,000)	(605,000)
	$ 186,000	$ 263,000

Note 4 – Patents and Other Intangible Assets

Patents and other intangible assets are summarized as follows:

	June 30, 2015 (unaudited)	December 31, 2014
Patents		
Patents pending	$ 2,867,000	$ 2,262,000
Issued patents	67,000	67,000
	2,934,000	2,329,000
Trademarks		
Trademarks pending	15,000	36,000
Registered trademarks	22,000	-
	37,000	36,000
Other	8,000	8,000
	2,979,000	2,373,000
Accumulated amortization	(6,000)	(1,000)
	$ 2,973,000	$ 2,372,000

Future amortization expense associated with issued patents as of June 30, 2015 is estimated as follows:

2015	$4,000
2016	9,000
2017	9,000
2018	9,000
2019	9,000
Thereafter	43,000
	$83,000

During the three and six months ended June 30, 2015 and 2014, the Company recorded an impairment loss of $5,000, $5,000, $0, and $8,000, respectively, from abandonment of capitalized patents and trademarks pending.

Note 5 – Termination of Employment Agreement

The Company and its former Chief Executive Officer, Richard F. Rutkowski, entered into an agreement in December 2014 terminating a prior employment agreement. Under this agreement, Mr. Rutkowski will be paid his annual salary of $359,000 through December 31, 2016, provided employee benefits through December 2015, and receive a bonus of $60,000, which was paid in March 2015, as well as accelerated vesting on 15,625 stock options with an exercise price of $4.88 per share and 14,219 stock options with an exercise price of $9.90 per share which terminated in March 2015.

The liability incurred under this agreement totaled $943,000 which was recognized in general and administrative expense in December 2014. At June 30, 2015, the remaining liability totaled $576,000 and is payable through December 2016.

Note 6 – Stockholders' Equity

Common Stock and Preferred Stock

The Company is authorized to issue 62,500,000 shares of common stock and 2,000,000 shares of preferred stock. Preferences, limitations, voting powers and relative rights of any preferred stock to be issued may be determined by the Company's Board of Directors. The Company has not issued any shares of preferred stock.

In February 2015, the Company completed an underwritten public offering of common stock whereby 2,990,000 shares were issued at $5.85 per share. Gross proceeds from the offering totaled $17.5 million and net cash proceeds approximated $16.3 million. Expenses of the offering approximated $1.2 million, including underwriting fees of $1,049,000, underwriter legal fees and other costs of $55,000, and other costs of $110,000.

In March 2014, the Company completed a registered direct offering of common stock whereby 812,500 shares were issued at $8.00 per share. Gross proceeds from the offering totaled $6.5 million and net cash proceeds approximated $5.8 million. Expenses of the offering approximated $0.8 million. Cash expenses included placement agent fees of $488,000, placement agent legal and other fees of $75,000, issuer legal fees of $113,000, and other costs of $44,000. Non-cash expenses consisted of a warrant to purchase 20,313 shares of the Company's common stock at $10.00 per share exercisable until March 2019 valued at $92,000.

Equity Incentive Plan

The Company has an Equity Incentive Plan (the Plan) which provides for the granting of options to purchase shares of common stock, stock awards to purchase shares at no less than 85% of the value of the shares, and stock bonuses to officers, employees, board members, consultants, and advisors. The Compensation Committee of the Board of Directors is authorized to administer the Plan and establish the grant terms, including the grant price, vesting period and exercise date. As of June 30, 2015, the number of shares reserved for issuance under the Plan totaled 1,389,297 shares. The Plan provides for quarterly increases in the available number of authorized shares equal to the lesser of 10% of any new shares issued by the Company during the quarter immediately prior to the adjustment date or such lesser amount as the Board of Directors shall determine.

In the six months ended June 30, 2015, the Company granted 405,200 stock options under the Plan to employees and a consultant, including 300,000 stock options granted to its Chief Executive Officer, Stephen E. Pirnat. The stock options have exercise prices at the grant date fair values which range from $5.07 to $5.97 per share, contractual lives of 10 years, and vest over 1-2 years in the case of Mr. Pirnat's stock options and over 4 years in the case of all other stock options. The fair value of stock options granted estimated on the date of grant using the Black-Scholes option valuation model was $1,232,000, which includes $923,000 for Mr. Pirnat's stock options. The recognized compensation expense associated with these grants for the six months ended June 30, 2015 was $230,000. The following weighted-average assumptions were utilized in the calculation of the fair value of the stock options:

Expected life	5.81	years
Weighted average volatility	72	%
Forfeiture rate	11	%
Weighted average risk-free interest rate	1.46	%
Expected dividend rate	0	%

In February 2015, the Company authorized 23,034 shares of common stock to be issued under the Plan to its three independent directors in accordance with board agreements and which will be earned quarterly for service in 2015. The fair value of the stock at the time of grant was $5.97 per share for a total value of $138,000. The Company recognized $37,000 and $62,000 in general and administrative expense for the three and six months ended June 30, 2015, respectively, and will recognize the remaining $76,000 on a pro-rated quarterly basis in the remainder of 2015.

In the six months ended June 30, 2015, 129,062 shares of common stock were issued through the exercise of stock options with a strike price of $2.20 per share and 210 shares of common stock were issued through the exercise of stock options with a strike price of $4.88 per share for proceeds of $285,000.

Stock options may be exercised prior to vesting where the resulting shares of common stock are issued with a declining repurchase right in favor of the Company at the exercise price should the employee terminate employment or upon other related circumstances prior to the previous vesting date. At June 30, 2015, there are 5,837 shares outstanding subject to a repurchase right at $4.88 per share through December 31, 2016.

Outstanding stock option grants at June 30, 2015 and December 31, 2014 totaled 817,790 and 643,817 with 290,651 and 441,958 being vested and exercisable at June 30, 2015 and December 31, 2014, respectively. Stock grants made to date through June 30, 2015 and December 31, 2014 totaled 200,894 shares and 190,424 shares, respectively. Of these amounts, 20,000 and 28,000 at June 30, 2015 and December 31, 2014, respectively, are subject to declining repurchase rights by the Company at $0.0001 per share through September 30, 2016. The recognized compensation expense associated with these grants for the three and six months ended June 30, 2015 and 2014 totaled $276,000, $417,000, $81,000 and $162,000, respectively. At June 30, 2015, the number of shares reserved under the Plan but unissued totaled 370,613. At June 30, 2015, there was $1,433,000 of total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted average period of 2.1 years.

Consultant Stock Plan

The Company has a 2013 Consultant Stock Plan (the Consultant Plan) which provides for the granting of shares of common stock to consultants who provide services related to capital raising, investor relations, and making a market in or promoting the Company’s securities. The Company’s officers, employees, and board members are not entitled to receive grants from the Consultant Plan. The Compensation Committee of the Board of Directors is authorized to administer the Consultant Plan and establish the grant terms. The number of shares reserved for issuance under the Consultant Plan on June 30, 2015 totaled 115,087 with 96,837 of those shares unissued. The Consultant Plan provides for quarterly increases in the available number of authorized shares equal to the lesser of 1% of any new shares issued by the Company during the quarter immediately prior to the adjustment date or such lesser amount as the Board of Directors shall determine.

Warrants

The Company has the following warrants outstanding at June 30, 2015:

	Total Outstanding Warrants		
Exercise Price	Warrants	Weighted Average Exercise Price	Life (in years)
$1.80	80,000	$ 1.80	5.64
$2.20	118,959	$ 2.20	0.86
$5.00	345,000	$ 5.00	1.82
$10.00	20,313	$ 10.00	3.68
	564,272	$ 4.14	

Note 7 – Related Party Transactions

In connection with the February 2015 underwritten public offering described in Note 6, the Company paid the underwriter, MDB Capital Group, LLC (MDB), underwriting fees of $1,049,000 and underwriter legal fees and other costs of $55,000. As of March 2015, MDB and its chief executive officer beneficially own, in the aggregate, approximately 8.1% of the Company's common stock.

Note 8 – Commitments

On February 3, 2015, the Company and its newly-appointed Chief Executive Officer, Stephen E. Pirnat entered into an employment agreement (the Agreement) which terminates on December 31, 2017, unless earlier terminated. Compensation under the Agreement includes an annual salary of $350,000 with annual cost-of-living adjustments, a grant of stock options as described in Note 6, annual cash bonuses of 30% to 60% of his annual salary and equity bonuses based on performance standards established by the Compensation Committee of the Board of Directors, medical and dental benefits for Mr. Pirnat and his family, and relocation expenses up to approximately $100,000. The Agreement may be terminated by the Company without cause under certain circumstances, as defined in the Agreement whereby a severance payment would be due in the amount of compensation that would have been due had employment not been terminated or one year of the current annual compensation, whichever is greater. In the event of a change in control, Mr. Pirnat would receive one year’s compensation and all previously granted stock options would vest in full.

The Company has agreements with its three independent directors to compensate them annually. The obligation totals $300,000 per year of which $150,000 is to be paid with the Company’s common stock at fair value. Directors are elected annually.

The Company has a triple net lease for office and laboratory space through February 2017. Under the terms of the lease, the Company paid no rent for the period November 2011 to February 2012 and for February 2014. Rent escalates annually by 3%. The Company records monthly rent expense equal to the total of the payments over the lease term divided by the number of months of the lease term. Therefore, the deferred rent was reduced by $6,000 for the six months ended June 30, 2015 and rent expense of $7,000 was accrued for the six months ended June 30, 2014. Under the terms of the lease, the Company will also pay monthly triple net operating costs which currently approximate $3,000 per month. Minimum future payments under this lease at June 30, 2015 are as follows:

2015	$69,000
2016	141,000

2017	24,000
	$234,000

For the three and six months ended June 30, 2015 and 2014, rent expense amounted to $40,000, $82,000, $41,000 and $79,000, respectively.

The Company has a Field Test Agreement with Southern California-based Aera Energy LLC to demonstrate and test the Duplex technology in a once through steam generator (OTSG) used to facilitate the production of heavy oil in California's San Joaquin Valley. Under the terms of the agreement, the Company has retrofitted an OTSG unit in order to achieve certain performance criteria. The agreement also includes time-sensitive pricing, delivery and installation terms, if elected, that will apply to future purchases by Aera Energy LLC of this Duplex application.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION

CONTAINED IN THIS REPORT

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and the provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. You can find many (but not all) of these statements by looking for words such as “approximates,” “believes,” “hopes,” “expects,” “anticipates,” “estimates,” “projects,” “intends,” “plans,” “would,” “should,” “could,” “may,” or other similar expressions in th In particular, these include statements relating to future actions, prospective products, applications, customers, technologies, future performance or results of anticipated products, expenses, and financial results. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- our limited cash and our history of losses;
- our ability to achieve profitability;
- our limited operating history;
- emerging competition and rapidly advancing technology in our industry that may outpace our technology;
- our ability to develop commercially viable products based upon our technology;
- customer demand for the products and services we develop;
- the impact of competitive or alternative products, technologies and pricing;
- our ability to manufacture any products we develop;
- general economic conditions and events and the impact they may have on us and our potential customers;
- our ability to obtain adequate financing in the future;
- our ability to continue as a going concern;
- our success at managing the risks involved in the foregoing items; and
- other factors discussed in this report.

The forward-looking statements are based upon management’s beliefs and assumptions and are made as of the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements included in this report. You should not place undue reliance on these forward-looking statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q as well as our audited financial statements and related notes included in our Annual Report on Form 10-K. In addition to historical information, this discussion and analysis here and throughout this Form 10-Q contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements.

OVERVIEW

We design and develop technologies that aim to improve both the emission performance and operational efficiency characteristics of combustion systems. Our core technologies include our Duplex™ and Electrodynamic Combustion Control™ (ECC™) technologies. Our Duplex technology uses a unique refractory tile to homogenize the flame temperature and achieve very low emissions without the need of external flue gas recirculation, selective catalytic reduction, or higher excess air operation. Our ECC technology introduces a computer-controlled electric field into a combustion system in order to better control gas-phase chemical reactions and improve system performance and cost-effectiveness. To date, our operations have been funded primarily through sales of our common stock. We have earned no significant revenue since inception on January 23, 2008. We are located in Seattle, Washington.

Plan of Operation

We are pursuing development of our technologies to enable future sales. These activities entail (i) field development projects in the case of our Duplex technology where we have successfully demonstrated our proprietary technology operating in our field testing with thermal output of up to 52 million BTU/hr, (ii) laboratory research in the case of our ECC technology where we have demonstrated certain attributes of our proprietary technology operating in our research facility with thermal output of up to 2 million BTU/hr, and (iii) business development and marketing activities with established entities that use steam generators, process heaters, boilers, solid fuel burners, and other combustion systems as well as original equipment manufacturers. We intend to continue to enter into collaborative arrangements which would enable us to work closely with established companies in targeted industries to apply solutions developed in our laboratory and field settings.

After performing testing on our Duplex technology in our laboratory furnace with thermal output up to 5 million BTU/hr, we commenced field development work in the fourth quarter of 2014 with Southern California-based Aera Energy LLC (Aera Energy) to demonstrate and test the Duplex technology in a once-through steam generator (OTSG) with a thermal output ranging from 40 to 62.5 million BTU/hr used to facilitate the production of heavy oil through enhanced oil recovery in California's San Joaquin Valley. To date, we have tested an OTSG located in Aera Energy's Belridge field outside Bakersfield, California at a rate of 52 million BTU/hr and met the San Joaquin Valley Air Pollution Control District's regulations under Rule 4320 requiring NOx emissions not to exceed 5 ppm (corrected at 3% O_2). These results were achieved without major modifications to the burner or the need for flue gas recirculation (FGR). Further, we observed a thermal efficiency improvement of approximately 1% when compared to a baseline case with a conventional low NOx burner without FGR. OTSG systems typically operate with FGR to lower NOx emissions. FGR, however, penalizes thermal efficiency, increasing fuel and electricity costs. We estimate that Duplex, compared to systems operating with FGR, will provide an overall energy savings of as much as 3-4% which could represent a reduction in annual operating expense of up to $90,000 to $100,000, depending on variables such as the market price for natural gas and electricity. During testing, Aera's OTSG unit continued to supply steam at the capacity and quality required for oil field operations. We continue to conduct testing to address additional performance criteria in order to continue to validate the environmental and operational benefits of our Duplex technology. Assuming continued successful completion of the demonstration and testing, our agreement with Aera Energy includes time-sensitive pricing, delivery and installation terms, if elected, that will apply to future purchases of this Duplex application. In May 2015, we received an order from an independent Southern California oil producer to retrofit a 25 million BTU/hr OTSG with our Duplex technology. In accordance with the terms of the order, the installation is expected to be completed in the second half of 2015.

We recently executed an agreement with Tesoro Refining & Marketing Company LLC, a subsidiary of Tesoro Corporation, to evaluate our Duplex technology in a multiple-burner process heater located in Tesoro’s Los Angeles area refinery. The Duplex technology performance will be evaluated based on several performance criteria, including NOx emission criteria determined by California’s South Coast Air Quality Management District (SCAQMD). The first phase of the project will be completed under a fixed price agreement in the second half of 2015.

We previously executed agreements regarding two further field tests with prospective customers at two separate petroleum refineries in the San Joaquin Valley related to process heaters with a thermal output ranging from 12 to 15 million BTU/hr. Pursuant to each agreement, if we are able to retrofit the prospective customer’s process heater in accordance with the specifications set forth in the agreement, the prospective customer will purchase a Duplex system from us. These prospective customers have no other financial obligations under the agreements. We have commenced field testing in one of the refineries and expect to complete the projects in the second half of 2015. We intend to continue field validation of our Duplex technology in order to produce sufficient data to demonstrate product attributes and dependability.

Regarding our ECC technology, we continue to conduct solid fuel laboratory testing in conjunction with six parties who contributed $110,000 in 2014 to our research. If successful, this would create a basis for further focused laboratory studies prior to any field demonstrations. There is no assurance that additional revenues will be realized, terms will be reached, or a final agreement executed between us and any of these companies.

In April and May 2012, we completed an initial public offering (IPO) of our common stock whereby we sold 3,450,000 shares of common stock at $4.00 per share, which included the exercise of the underwriter’s overallotment option, resulting in gross proceeds of $13.8 million and, after deducting certain costs paid with common stock, net proceeds of $11.6 million.

In March 2014, we completed a registered direct offering of our common stock whereby we sold 812,500 shares of common stock at $8.00 per share resulting in gross proceeds of $6.5 million and net proceeds of approximately $5.8 million.

In February 2015, we completed an underwritten public offering of our common stock whereby we sold 2,990,000 shares of common stock at $5.85 per share resulting in gross proceeds of $17.5 million and net proceeds of approximately $16.3 million.

Our anticipated costs include employee salaries and benefits, compensation paid to consultants, capital costs for research and other equipment, costs associated with development activities including travel and administration, legal expenses, sales and marketing costs, general and administrative expenses, and other costs associated with an early stage, publicly-traded technology company. We currently have 13 full-time employees and 2 part-time employees. We anticipate increasing the number of employees required to support our activities in the areas of research and development, sales and marketing, and general and administrative functions. We expect to incur consulting expenses related to technology development commensurate with our current levels and we expect to incur increasing expenses to protect our intellectual property.

The amount that we spend for any specific purpose may vary significantly, and could depend on a number of factors including, but not limited to, the pace of progress of our commercialization and development efforts, actual needs with respect to product testing, development and research, market conditions, and changes in or revisions to our marketing strategies.

Research, development, and commercial acceptance of new technologies are, by their nature, unpredictable. Although we will undertake development and commercialization efforts with reasonable diligence, there can be no assurance that the net proceeds from our securities offerings will be sufficient to enable us to develop our technology to the extent needed to create future sales to sustain operations. If the net proceeds from these offerings are insufficient for this purpose, we will consider other options to continue our path to commercialization, including, but not limited to: additional financing through follow-on equity offerings, debt financing, co-development agreements, sale or licensing of developed intellectual or other property, or other alternatives.

If management is unable to implement its proposed business plan or employ alternative financing strategies, it does not presently have any alternative proposals. In that case, we may be required to scale back our development plans by reducing expenditures for employees, consultants, business development and marketing efforts, and other envisioned expenditures or curtail or even suspend our operations.

We cannot assure that our technology will be accepted, that we will ever earn revenues sufficient to support our operations, or that we will ever be profitable. Furthermore, we have no committed source of financing and we cannot assure that we will be able to raise money as and when we need it to continue our operations. If we cannot raise funds as and when we need them, we may be required to severely curtail, or even to cease, our operations.

CRITICAL ACCOUNTING POLICIES

The following discussion and analysis of financial condition and results of operations is based upon our financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Certain accounting policies and estimates are particularly important to the understanding of our financial position and results of operations and require the application of significant judgment by our management or can be materially affected by changes from period to period in economic factors or conditions that are outside of our control. As a result, they are subject to an inherent degree of uncertainty. In applying these policies, our management uses their judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical operations, our future business plans and projected financial results, the terms of existing contracts, our observance of trends in the industry, information provided by our customers and information available from other outside sources, as appropriate. See Note 2 to our unaudited condensed financial statements for a more complete description of our significant accounting policies.

Revenue Recognition. The Company recognizes revenue on co-development agreements using the percentage of completion method. Under this method, the completion percentage is determined by dividing costs incurred to date by total estimated project costs. Since our projects will require technological development to complete, which by its nature is difficult to predict, the actual cost required to complete contracted work may vary from estimates. Estimated project costs are revised regularly which can alter the reported level of project profitability. Any estimated project losses are recognized in the current reporting period. Customer billings are recorded when cash receipts are probable and in accordance with the underlying co-development contract. If billings exceed recognized revenue, the difference is recorded as a current liability, while any recognized revenues exceeding billings are recorded as a current asset. Recognized revenues are subject to revisions as the contract progresses to completion and actual revenue and cost become certain. Revisions in revenue estimates are reflected in the period in which the facts that give rise to the revision become known.

Cost of Revenue. Cost of co-development revenue includes both direct and allocated indirect costs of completing the scope of work of co-development agreements. Direct costs include labor, materials and other costs incurred directly in fulfilling co-development agreements. Indirect costs include labor, rent, depreciation and other costs associated with operating the Company. Due to the nature of the work involved, the cost of co-development projects may fluctuate substantially from period to period.

Research and Development. The cost of research and development is expensed as incurred. Research and development costs consist of salaries, benefits, share based compensation, consulting fees, rent, utilities, depreciation, and consumables used in laboratory and field testing.

Patents and Trademarks. Patents and trademarks are recorded at cost. Amortization is computed using the straight-line method over the estimated useful lives of the assets once they are issued.

Stock-Based Compensation. The costs of all employee stock options, as well as other equity-based compensation arrangements, are reflected in the financial statements based on the estimated fair value of the awards on the grant date. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. Stock compensation for stock granted to non-employees is determined as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

17

Fair Value of Financial Instruments. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are categorized based on whether or not the inputs are observable in the market and the degree that the inputs are observable. The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The Company's financial instruments primarily consist of cash and cash equivalents, accounts payable and accrued expenses. As of the balance sheet dates, the estimated fair values of the financial instruments were not materially different from their carrying values as presented on the balance sheets. This is primarily attributed to the short maturities of these instruments. The Company did not identify any other non-recurring assets and liabilities that are required to be presented in the balance sheets at fair value.

RESULTS OF OPERATIONS

Comparison of the Three and Six Months Ending June 30, 2015 and 2014

Operating Expenses. Operating expenses, consisting of research and development (R&D) and general and administrative (G&A) expenses, increased by approximately $182,000 to $1,810,000 for the three months ended June 30, 2015, referred to herein as Q2 2015, compared to the same period in 2014 (Q2 2014). The Company increased its R&D expenses by $158,000 to $714,000 for Q2 2015 primarily due to increased field testing costs of our Duplex technology. G&A expenses increased by $24,000 to $1,096,000 in Q2 2015 resulting primarily from $193,000 of stock option and relocation costs associated with our CEO’s employment agreement offset by a $172,000 reduction in consulting fees and travel costs.

Operating expenses increased by $126,000 to $3,402,000 for the six months ended June 30, 2015 compared to the same period in 2014. The Company increased its R&D expenses by $124,000 to $1,287,000 for the six months ended June 30, 2015 primarily due to increased field testing costs of our Duplex technology. G&A expenses increased by $2,000 to $2,115,000 for the six months ended June 30, 2015. G&A expenses rose primarily due to $245,000 of stock option and relocation costs associated with our CEO’s employment agreement offset by a $220,000 reduction in consulting fees and travel costs.

Loss from Operations. Due to the increase in operating expenses, our loss from operations increased during Q2 2015 by $182,000 to $1,810,000 and increased for the six months ended June 30, 2015 by $126,000 to $3,402,000.

Net Loss. Primarily as a result of the increase in operating expenses, our net loss for Q2 2015 was $1,796,000 as compared to a net loss of $1,626,000 for Q2 2014, resulting in an increased net loss of $170,000, and our net loss for the six months ended June 30, 2015 was $3,379,000 as compared to a net loss of $3,273,000 for Q2 2014, resulting in an increased net loss of $106,000.

Liquidity and Capital Resources

At June 30, 2015, our cash and cash equivalent balance totaled $14,606,000 compared to $1,845,000 at December 31, 2014. This increase resulted primarily from our underwritten public offering of 2,990,000 shares of common stock in February 2015 which resulted in net proceeds of approximately $16.3 million. This was offset by the operating costs for the six months ended June 30, 2015 supporting our ongoing research and development of our technology to enable future sales. Although we are pursuing co-development agreements, there is no assurance that they will be adequate to fund our operations and to commercialize our technology. To the extent co-development agreement funding is insufficient for these purposes, we may undertake offerings of our securities, debt financing, selling or licensing our developed intellectual or other property, or other alternatives. The Company filed a Form S-3 shelf registration statement with the Securities and Exchange Commission (SEC) on May 6, 2013 that was declared effective on May 30, 2013. Following the offering that closed in February 2015, the registration statement allows the Company to offer up to an aggregate of $6,009,000 of common stock, preferred stock or warrants from time to time as market conditions permit. This equity funding would be used to enable further investment in our technology and product development and to maintain a strong balance sheet as we pursue strategic joint development and marketing relationships and prepare to pursue significant opportunities in various segments of the market. This information does not constitute an offer of any securities for sale.

At June 30, 2015, our current assets were in excess of current liabilities resulting in working capital of $13,601,000 compared to $719,000 at December 31, 2014. The increase in working capital resulted primarily from the $16.3 million of net proceeds from our February 2015 common stock offering offset by funds used in operations and invested in intangible and fixed assets.

Operating activities for the six months ended June 30, 2015 resulted in cash outflows of $3,162,000, which were due primarily to the loss for the period of $3,379,000 and net changes in working capital, exclusive of cash, which reduced cash flow by $311,000. These were offset by services paid with common stock and stock options of $417,000, and other non-cash expenses of $111,000. Operating activities for the six months ended June 30, 2014 resulted in cash outflows of $3,111,000 which were due primarily to the loss for the period of $3,273,000 and net changes in working capital, exclusive of cash, which reduced cash flow by $245,000. These were offset by services paid with common stock and stock options of $273,000, and other non-cash expenses of $134,000.

Investing activities for the six months ended June 30, 2015 resulted in cash outflows of $611,000 for development of patents and other intangible assets and $30,000 for acquisition of fixed assets. Investing activities for the six months ended June 30, 2014 resulted in cash outflows of $579,000 for development of patents and other intangible assets and $63,000 for acquisition of fixed assets.

Financing activities for the six months ended June 30, 2015 resulted in $16,564,000 of cash inflows, which came primarily from the issuance of 2,990,000 shares of common stock at $5.85 per share resulting in gross proceeds of $17,491,000 and net cash proceeds of approximately $16,279,000. Additionally, we raised $285,000 through exercises of stock options. Financing activities for the six months ended June 30, 2014 resulted in $5,796,000 of cash inflows, which came primarily from the issuance of 812,500 shares of common stock at $8.00 per share resulting in gross proceeds of $6,500,000 and net cash proceeds of approximately $5,780,000.

Off-Balance Sheet Transactions

We do not have any off-balance sheet transactions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company we are not required to provide this information.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the “Act”) is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has concluded that, as of June 30, 2015, our disclosure controls and procedures are effective.

There have been no material changes in our internal controls over financial reporting that occurred during the quarter ended June 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II-OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 1A. RISK FACTORS

We incorporate herein by reference the risk factors included under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014 which we filed with the Securities and Exchange Commission on February 26, 2015.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Exhibit Number	Document
3.1	Articles of Incorporation of ClearSign Combustion Corporation, amended on February 2, 2011 (1)
3.1.1	Articles of Amendment to Articles of Incorporation of ClearSign Combustion Corporation filed on December 22, 2011 (1)
3.2	Bylaws (1)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer*
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer*
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer*
101	The following financial statements from the registrant's Quarterly Report on Form 10-Q for the six months ended June 30, 2015, formatted in XBRL: (i) Condensed Balance Sheets (Unaudited); (ii) Condensed Statements of Operations (Unaudited); (iii) Condensed Statement of Stockholders' Equity (Unaudited); (iv) Condensed Statements of Cash Flows (Unaudited); (v) Notes to Unaudited Condensed Financial Statements.*

*Filed herewith

(1) Incorporated by reference from the registrant's registration statement on Form S-1, as amended, file number 333-177946, originally filed with the Securities and Exchange Commission on November 14, 2011.

SIGNATURES

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

	CLEARSIGN COMBUSTION CORPORATION (Registrant)
Date: August 13, 2015	By: /s/ Stephen E. Pirnat Stephen E. Pirnat Chief Executive Officer
	By: /s/ James N. Harmon James N. Harmon Chief Financial Officer

22