

BIOLARGO, INC.  
Form 10-Q  
May 16, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended March 31, 2016.

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 000-19709

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BIOLARGO, INC.

*(Exact name of registrant as specified in its charter)*

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Delaware                      65-0159115  
*(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)*

**3500 W. Garry Avenue**

**Santa Ana, California 92704**

*(Address, including zip code, of principal executive offices)*

**(949) 643-9540**

*(Registrant's telephone number, including area code)*

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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 No

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

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

Large accelerated filer    Accelerated filer

Non-accelerated filer    Smaller reporting company

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

The number of shares of the Registrant's Common Stock outstanding as of May 13, 2016 was 86,268,517 shares.



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**BIOLARGO, INC.**

**FORM 10-Q**

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Exhibit 31.1  
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Exhibit 32

4.1	Form of Convertible Promissory Note issued in 2015 Unit Offering (1)
4.2	Form of Series A Stock Purchase Warrant issued in 2015 Unit Offering (1)
101.INS**	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.DEF**	XBRL Taxonomy Extension Definition
101.LAB**	XBRL Taxonomy Extension Labels
101.PRE**	XBRL Taxonomy Extension Presentation

\*Filed herewith

\*\*Furnished herewith

(1) Incorporated herein by reference from the Form 10-K filed by the Company for the year ended December 31, 2015.

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**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements****BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2015 AND MARCH 31, 2016**

	<b>DECEMBER 31, 2015</b>	<b>MARCH 31, 2016 (Unaudited)</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,763,114	\$ 1,022,290
Accounts receivable	41,431	27,049
Inventories	37,435	31,973
Prepaid expenses and other current assets	49,167	92,533
Total current assets	1,891,147	1,173,845
Other non-current assets, net of amortization	19,157	16,427
Total assets	\$ 1,910,304	\$ 1,190,272
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 324,983	\$ 257,468
Deposits	135,000	100,000
Total current liabilities	459,983	357,468
Long-term liabilities:		
Convertible notes payable	3,245,972	3,500,972
Discount on convertible notes payable	(2,937,019 )	(2,885,814 )
Total liabilities	768,936	972,626

COMMITMENTS, CONTINGENCIES (Note 7)

STOCKHOLDERS' EQUITY:

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Convertible Preferred Series A, \$.00067 Par Value, 50,000,000 Shares Authorized,  
-0- Shares Issued and Outstanding, at December 31, 2015 and March 31, 2016,  
respectively.

Common stock, \$.00067 Par Value, 200,000,000 Shares Authorized, 85,788,153 and  
86,268,517 Shares Issued, at December 31, 2015 and March 31, 2016, respectively.

	57,236	57,553
Additional paid-in capital	84,410,821	85,140,493
Accumulated deficit	(84,075,695 )	(85,653,116)
Accumulated other comprehensive loss	(40,567 )	(49,885 )
Non-controlling interest (Note 8)	789,573	722,601
Total stockholders' equity	1,141,368	217,646
Total liabilities and stockholders' equity	\$ 1,910,304	\$ 1,190,272

*See accompanying notes to unaudited consolidated financial statements.*

**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****FOR THE THREE-MONTHS ENDED MARCH 31, 2015 AND 2016****(UNAUDITED)**

	<b>MARCH</b>	<b>MARCH</b>
	<b>31, 2015</b>	<b>31, 2016</b>
Revenues	\$13,875	\$13,942
Cost of revenues	6,381	6,081
Gross profit	7,494	7,861
Selling, general and administrative expenses	560,525	930,907
Research and development	137,999	351,050
Amortization	2,730	2,730
Operating loss	(680,964 )	(1,276,826 )
Other (expense) income:		
Interest expense	(105,224 )	(406,325 )
Grant income	12,796	38,758
Net loss	(786,188 )	(1,644,393 )
Net loss attributable to noncontrolling interest	(5,756 )	(66,972 )
Net loss attributable to common shareholders	\$(780,432 )	\$(1,577,421 )
Net loss per share attributable to common shareholders:		
Loss per share attributable to shareholders – basic and diluted	\$(0.01 )	\$(0.02 )
Weighted average number of common shares outstanding:	82,973,744	85,847,219
Comprehensive loss attributable to common shareholders		
Net loss	\$(786,188 )	\$(1,644,393 )
Foreign currency translation	—	(9,318 )
Comprehensive loss	(786,188 )	(1,653,711 )
Comprehensive loss attributable to noncontrolling interest	(5,756 )	(66,972 )
Comprehensive loss attributable to common shareholders	\$(780,432 )	\$(1,586,739 )

*See accompanying notes to unaudited consolidated financial statements.*



**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****FOR THE THREE-MONTHS ENDED MARCH 31, 2016****(UNAUDITED)**

	Common stock		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Non- controlling interest	Total
	Shares	Amount					
Balance, December 31, 2015	85,648,015	\$57,236	\$84,410,821	\$(84,075,695)	\$ (40,567 )	\$ 789,573	\$1,141,368
Issuance of common stock to vendors and interest to noteholders	620,502	317	172,833	—	—	—	173,150
Stock option compensation expense	—	—	301,839	—	—	—	301,839
Fair value of warrants and conversion feature issued as discount on convertible notes payable	—	—	255,000	—	—	—	255,000
Net loss	—	—	—	(1,577,421 )	—	(66,972 )	(1,644,393)
Foreign currency translation	—	—	—	—	(9,318 )	—	(9,318 )
Balance, March 31, 2016	86,268,517	\$57,553	\$85,140,493	\$(85,653,116)	\$ (49,885 )	\$ 722,601	\$217,646

*See accompanying notes to unaudited consolidated financial statements.*

**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE-MONTHS ENDED MARCH 31, 2015 AND 2016****(UNAUDITED)**

	<b>March</b>	<b>March</b>
	<b>31, 2015</b>	<b>31, 2016</b>
Cash flows from operating activities		
Net loss	\$(786,188)	\$(1,644,393)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock option compensation expense	255,625	301,839
Common stock issued for interest and in lieu of salary to officers and fees for services from consultants	110,827	173,150
Interest expense related to amortization of the discount on convertible notes payable	72,578	298,771
Amortization expense	2,730	2,730
Changes in assets and liabilities:		
Accounts receivable	(1,814 )	14,382
Inventories	4,999	5,462
Prepaid expenses and other current assets	—	(43,366 )
Deposits	50,000	(35,000 )
Accounts payable and accrued expenses	12,596	(60,081 )
Deferred revenue	4,141	—
Net cash used in operating activities	(274,506)	(986,506 )
Cash flows from financing activities		
Proceeds from convertible notes	363,000	255,000
Payment of financing costs	(15,513 )	—
Net cash provided by financing activities	347,487	255,000
Effect of foreign currency translation	—	(9,318 )
Net change in cash	72,981	(740,824 )
Cash at beginning of year	154,460	1,763,114
Cash at end of period	\$227,411	\$1,022,290
Supplemental disclosures of cash flow information		
Cash paid during the year for:		
Interest	\$4,683	\$—
Income taxes	\$—	\$4,000
Non-cash investing and financing activities		
Conversion of accounts payable into stock options	\$247,773	\$206,934
Fair value of warrants issued in conjunction with convertible notes payable	\$404,360	\$255,000
Settlement of accounts payable and interest in shares of common stock	\$10,725	\$173,150

*See accompanying notes to unaudited consolidated financial statements*

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BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 1. Business and Organization**

**Outlook**

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. As reflected in the accompanying financial statements, we had a net loss of \$1,644,393, and cash used in operations of \$986,506, for the three-months ended March 31, 2016, and at March 31, 2016, we had working capital of \$816,377, current assets of \$1,173,845, and an accumulated stockholders' deficit of \$85,653,116. The foregoing factors raise substantial doubt about our ability to continue as a going concern. Ultimately, our ability to continue as a going concern is dependent upon our ability to attract significant new sources of capital, attain a reasonable threshold of operating efficiencies and achieve profitable operations by licensing or otherwise commercializing products incorporating our technologies. The financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

We have been, and anticipate that we will continue to be, limited in terms of our capital resources. Our total cash balance was \$1,022,290 at March 31, 2016. We had revenues of \$13,942 in the three-months ended March 31, 2016, which amount was not sufficient to fund our operations. We generally have not had enough cash or sources of capital to pay our accounts payable and expenses as they arise, and have relied on the issuance of stock options and common stock, as well as extended payment terms with our vendors, to continue to operate. We will be required to raise substantial additional capital to expand our operations, including without limitation, hiring additional personnel, additional scientific and third-party testing, costs associated with obtaining regulatory approvals and filing additional patent applications to protect our intellectual property, and possible strategic acquisitions or alliances, as well as to meet our liabilities as they become due for the next 12 months.

As of March 31, 2016, we had \$3,513,724 principal and interest amount outstanding due on convertible notes payable (see Note 4) that are payable into shares of our common stock at our option on the June 1, 2018 maturity date. Additionally, we had \$257,468 of accounts payable and accrued expenses (see Note 7).

The unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to Rule 8-03 of Regulation S-X under the Securities Act of 1933, as amended. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. For some of our activities, we are still operating in the early stages of the sales and distribution process, and therefore our operating results for the three-months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016, or for any other period. These unaudited consolidated financial statements and notes should be read in conjunction with the Company's audited financial statements and accompanying notes included in the Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission (the "SEC") on March 30, 2016.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 2. Summary of Significant Accounting Policies**

**Other Assets**

Other Assets consists of payments made to purchase patents related to our efforts in commercializing the ISAN system. For each of the three-months ended March 31, 2015 and 2016, we recorded amortization expense totaling \$2,730.

Long-lived and definite lived intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the sum of the expected future undiscounted cash flows from the use of the asset and its eventual disposition is less than the carrying amount of the asset, then an impairment loss is recognized. The impairment loss is measured based on the fair value of the asset. Any resulting impairment is recorded as a reduction in the carrying value of the related asset in excess of fair value and a charge to operating results. Management has not identified any impairment indicators at December 31, 2015 or March 31, 2016.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ from those estimates. Estimates are used when accounting for stock-based compensation and financing transactions, uncollectible accounts receivable, asset impairment and amortization, and taxes, among others.

The methods, estimates and judgments we use in applying these most critical accounting policies have a significant impact on the results of our financial statements.

**Share-based Payments**

All share-based payments to employees, including grants of employee stock options, are recognized in the financial statements based on their fair values.

For stock issued to consultants and other non-employees for services, we record the expense based on the fair market value of the securities as of the date of the stock issuance. The issuance of fully vested stock warrants or options to non-employees are valued at the time of issuance utilizing the Black Scholes calculation and the amount is charged to expense. The issuance of stock warrants or options to non-employees that vest over time are revalued each reporting period until vested to determine the amount to be recorded as an expense in the respective period. As the warrants or options vest, they are valued on each vesting date and an adjustment is recorded for the difference between the value already recorded and the then current value on the date of vesting.

**Non-Cash Transactions**

We have established a policy relative to the methodology to determine the value assigned to each intangible we acquire, and/or services or products received for non-cash consideration of our common stock. The value is based on the market price of our common stock issued as consideration, at the date of the agreement of each transaction or when the service is rendered or product is received.

**Foreign Currency**

The Company has designated the functional currency of Biolargo Water, Inc., our Canadian subsidiary, to be the Canadian dollar. Therefore, translation gains and losses resulting from differences in exchange rates are recorded in accumulated other comprehensive income.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Revenue Recognition**

Revenues are recognized as risk and title to products transfers to the customer (which generally occurs at the time shipment is made), the sales price is fixed or determinable, and collectability is reasonably assured. We also may generate revenues from royalties and license fees from our intellectual property. Licensees typically pay a license fee in one or more installments and ongoing royalties based on their sales of products incorporating or using our licensed intellectual property. License fees are recognized over the estimated period of future benefit to the average licensee.

**Government Grants**

We have been awarded grants from the Canadian National Research Institute – Industrial Research Assistance Program (NRC-IRAP) and the National Science and Engineering Research Council of Canada (NSERC). The government grants received are considered other income and are included in our consolidated statements of operations. We received our first grant in 2015 and have been awarded eleven grants in the totaling approximately \$900,000. Some of the funds from these grants are given directly to third parties (such as the University of Alberta) to support research on our technology. The grants have terms generally ranging between six and eighteen months and support a majority, but not all of the related research budget costs. This cooperative research allows us to utilize (i) a depth of resources and talent to accomplish highly skilled work, (ii) financial aid to support research and development costs, (iii) independent and credible validation of our technical claims.

The grants provide for (i) recurring monthly amounts and (ii) reimbursement of costs for research talent for which we invoice to request payment and (iii) ancillary cost reimbursement for research talent travel related costs. All awarded grants have specific requirements on how the money is spent, typically to employ researchers. None of the funds may be used for general administrative expenses or overhead in the United States. These grants have substantially increased our level of research and development activities in Canada and the development of our AOS filter. We continue to apply for Canadian government and agency grants to fund research and development activities. Not all of our grant applications have been awarded, and no assurance can be made that any pending grant application, or any future grant applications, will be awarded.

**Earnings (Loss) Per Share**

We report basic and diluted earnings (loss) per share (“EPS”) for common and common share equivalents. Basic EPS is computed by dividing reported earnings by the weighted average shares outstanding. Diluted EPS is computed by adding to the weighted average shares the dilutive effect if stock options and warrants were exercised into common stock. For the three-months ended March 31, 2015 and 2016, the denominator in the diluted EPS computation is the same as the denominator for basic EPS due to the anti-dilutive effect of the warrants and stock options on the Company’s net loss.

**Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update No. 2014-09 (ASU 2014-09), Revenue from Contracts with Customers. ASU 2014-09 will eliminate transaction- and industry-specific revenue recognition guidance under current GAAP and replace it with a principle based approach for determining revenue recognition. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. ASU 2014-09 also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. Based on the FASB’s Exposure Draft Update issued on April 29, 2015, and approved in July 2015, Revenue from Contracts With Customers (Topic 606): Deferral of the Effective Date, ASU 2014-09 is now effective for reporting periods beginning after December 15, 2017, with early adoption permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Entities will be able to transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. The adoption of ASU 2014-09 is not expected to have any impact on our consolidated financial statement presentation or disclosures.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 3. Deposits**

**Royalty Revenue**

In 2012, we executed a joint venture agreement with Peter Holdings Pty. Ltd., the principal developer of the Isan System, whereby we jointly purchased the intellectual property associated with the Isan System, and agreed to share any royalties from any licensing revenue generated from the Isan System on an equal 50/50 basis.

In February 2014, we received a deposit of \$100,000 from InsulTech Manufacturing, LLC, an Arizona limited liability company d/b/a Clarion Water (“Clarion Water”) towards a worldwide, exclusive license of the Isan System. On August 12, 2014, we entered into a license agreement with Clarion Water in which we granted an exclusive license to commercialize the Isan System for a term expiring the latter of 10 years or upon the expiration of the licensed patents. The license agreement provides that the \$100,000 deposit is non-refundable, and is to be credited to future payments of royalties or sublicense fees due under the license agreement. The agreement further provides for a 10% royalty of licensee’s “net sales revenue”, and 40% of sublicensing fees. Licensee is required to make minimum payments beginning July 1, 2016, of \$50,000 per quarter, and we are obligated to share any revenues under the agreement on an equal basis with Peter Holdings Pty. Ltd. The intellectual property subject to the license agreement includes all intellectual property related to the Isan System, including all patents, trademarks, proprietary knowledge, and other similar know-how or rights relating to or arising out of the Isan System or the patents related to the Isan System. The agreement contains other terms and conditions typically found in intellectual property license agreements.

**Note 4. Notes and Convertible Notes Payable**

As of March 31, 2016, we have outstanding a total of \$3,500,972 unsecured convertible promissory notes with a maturity date of June 1, 2018, which accrue interest at a rate of 12% per annum. We may pay these notes at maturity by the issuance of common stock at the conversion rate set forth in the note. These notes include those issued to investors in the 2015 Unit Offering (see “2015 Unit Offering” immediately below), and notes that were converted into 2015 Unit Offering notes (see Note 6).

For the three-months ended March 31, 2015 and 2016, we recorded \$105,224 and \$406,325 of interest expense related to the amortization of our discount on our convertible notes payable.

**2015 Unit Offering**

On January 15, 2015, we commenced a private securities offering of “units”, each Unit consisting of a convertible promissory note and Series A stock purchase warrant (“2015 Unit Offering”). The price and availability of the Units are set forth in a “Pricing Supplement” issued from time-to-time, and priced up to a 30% discount to the market price of the Company’s common stock. Each note is convertible into the Company’s common stock at the Unit price. The Offering is subject to an over-allotment of 20%, or an additional \$1,000,000 in Units, for an aggregate total of \$6,000,000, and shall be known as the Company’s “2015 Unit Offering.” The Company has the right to register the common shares underlying the notes and warrants (“Shares”) with the Securities and Exchange Commission, and the obligation to register the Shares in the event we are successful in raising \$3,000,000 of gross proceeds. (See Note 9, “Subsequent Events”.)

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

During the three-months ended March 31, 2015 and 2016, we received \$230,000 and \$255,000, respectively, and issued unsecured convertible promissory notes with maturity dates of June 1, 2018, which accrue interest at the rate of 12% per annum, at unit prices of \$0.35. During the three-months ended March 31, 2015 and 2016, the fair value of the warrants and the intrinsic value of the beneficial conversion feature resulted in a \$230,000 and \$255,000 discount on the convertible note payables.

Interest due will be paid quarterly in arrears in cash or shares of common stock. If paid by the issuance of common stock, interest is paid at a conversion price equal to the average closing price of the Company's common stock over the 20 trading days prior to the interest payment due date. The principal amount of the note may be paid by the issuance of shares of common stock, or cash, upon maturity at the Company's election. When paid in shares, the number of shares to be issued shall be calculated by dividing the principal amount invested by the Unit price, as it is established at the time of the original investment by the applicable Pricing Supplement. The notes may be converted at any time by the investor, at maturity by the Company, or by the Company prior to maturity, so long as all of the following conditions are met: (i) the Shares issued as payment are registered with the SEC, (ii) the Company's common stock closes for ten consecutive trading days at or above three times the Unit price.

Each investor, for no additional consideration, received a Series A stock purchase warrant. (See Note 6).

Each Series A warrant allows for the purchase of the number of common shares equal to the investment amount divided by the Unit price, (e.g., one warrant share for each share of common stock which the investor is eligible to receive through conversion of his original convertible note) and, the warrant will have an exercise price as set forth in the Pricing Supplement. Each Series A warrant expires June 1, 2020. The Company may "call" the Series A warrant, requiring the investor to exercise the warrant within 30 days or forever lose the rights to do so, only if the following conditions have been met: (i) the underlying Shares are registered with the SEC, and (ii) the Company's common stock closes for 10 consecutive trading days at or above two times the exercise price.

**December/January Notes**

In January 2015, we received \$133,000 and issued unsecured convertible promissory notes each with a one-year maturity date, which accrue interest at a rate of 12% per annum. Each noteholder, for no additional consideration, received a stock purchase warrant exercisable at \$0.30 per share, which expires January 2018. (See Note 6).

The funds received as part of our December/January Notes totaled \$333,000, all of which converted into terms of the 2015 Unit Offering during the second and third quarters of 2015.

## **Note 5. Stockholders' Equity**

### **Preferred Stock**

Our certificate of incorporation authorizes our Board of Directors to issue preferred stock, from time to time, on such terms and conditions as they shall determine. As of December 31, 2015 and March 31, 2016 there were no outstanding shares of our preferred stock.

### **Common Stock**

During the three-months ended March 31, 2015 and 2016, we issued 312,739 and 338,262 shares of common stock in lieu of salary to officers and fees for service provided by consultants, resulting in a weighted-average fair value of \$110,827 and \$73,658, respectively, and recorded in selling general and administrative expense.

During the three-months ended March 31, 2016, we issued 282,240 shares of common stock resulting in a grant date fair value of \$99,492, to settle our accrued interest liability, which is recorded as interest expense in our consolidated statement of operations. There were no shares issued for interest during the three-months ended March 31, 2015.

## BIOLARGO, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Share-Based Compensation

During the three-months ended March 31, 2015 and 2016, we recorded an aggregate \$255,625 and \$301,839 in selling general and administrative expense related to the issuance of stock options. We issued options through our 2007 Equity Incentive Plan and outside of our 2007 Equity Incentive Plan.

**2007 Equity Incentive Plan**

On August 7, 2007, and as amended April 29, 2011, our Board of Directors adopted the BioLargo, Inc. 2007 Equity Incentive Plan ("2007 Plan") as a means of providing our directors, key employees and consultants additional incentive to provide services. Both stock options and stock grants may be made under this plan. The Board's Compensation Committee administers this plan. The plan allows grants of common shares or options to purchase common shares. As plan administrator, the Compensation Committee has sole discretion to set the price of the options. The Compensation Committee may at any time amend or terminate the plan.

On March 21, 2016, our Board of Directors extended by five years the expiration of options to purchase 307,777 shares of our common stock issued to our Board of Directors and vendors in March 2011. The options were originally issued in exchange for unpaid obligations and now expire on March 21, 2021. The weighted-average fair value of the options resulted in additional \$119,971 of selling, general and administrative expenses.

Activity for our stock options under the 2007 Plan for the three-months ended March 31, 2015 and 2016 is as follows:

	<b>Options Outstanding</b>	<b>Shares Available</b>	<b>Exercise Price per share</b>	<b>Weighted Average Price per share</b>
Balance, March 31, 2015:				
Balances as of December 31, 2014	8,601,086	3,398,914	\$0.23 – 1.89	\$ 0.44
Granted	—	—	—	—

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Expired	(200,000 )	200,000	0.58	0.58
Balance, March 31, 2015	8,401,086	3,598,914	\$0.23 – 1.89	\$ 0.43

	<b>Options Outstanding</b>	<b>Shares Available</b>	<b>Exercise Price per share</b>	<b>Weighted Average Price per share</b>
Balance, March 31, 2016:				
Balances as of December 31, 2015	10,241,086	1,758,914	\$0.22 – 1.89	\$ 0.44
Granted	—	—	—	—
Expired	—	—	—	—
Balance, March 31, 2016	10,241,086	1,758,914	\$0.22 – 1.89	\$ 0.44

*Options issued Outside of the 2007 Equity Incentive Plan*

On March 31, 2016, we issued options to purchase 263,523 shares of our common stock at an exercise price of \$0.33 per share to our board of directors, in lieu of \$67,500 in fees and to a vendor in lieu of accrued and unpaid fees \$12,975. The weighted-average fair value of these options totaled \$86,963 and is recorded as selling, general and administrative expenses.

On March 31, 2015, we issued options to purchase 577,818 shares of our common stock at an exercise price of \$0.36 per share to two vendors and to our members of our board of directors, in lieu of \$136,750 in accrued and unpaid fees. The weighted-average fair value of these options totaled \$206,076 and is recorded as selling, general and administrative expenses.

## BIOLARGO, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The grant-date fair value of the previously issued options that vested during the three-months ended March 31, 2015 and 2016 was \$49,549 and \$94,905, respectively.

Activity of our stock options issued outside of the 2007 Plan for the three-months ended March 31, 2015 and 2016 is as follows:

	<b>Options Outstanding</b>	<b>Exercise Price per share</b>		<b>Weighted Average Price per share</b>
Balance, March 31, 2015:				
Balance, December 31, 2014	17,965,291	\$0.18	– 1.00	\$ 0.40
Granted	577,818		0.36	0.36
Expired	—		—	—
Balance, March 31, 2015	18,543,109	\$0.18	– 1.00	\$ 0.40

	<b>Options Outstanding</b>	<b>Exercise Price per share</b>		<b>Weighted Average Price per share</b>
Balance, March 31, 2016:				
Balance, December 31, 2015	19,394,975	\$0.18	– 1.00	\$ 0.40
Granted	263,523		\$0.33	\$ 0.33
Expired	—		—	—
Balance, March 31, 2016	19,658,498	\$0.18	– 1.00	\$ 0.40

We recognize compensation expense for stock option awards on a straight-line basis over the applicable service period of the award, which is the vesting period. Share-based compensation expense is based on the grant date fair value estimated using the Black-Scholes Option Pricing Model. The following methodology and assumptions were used to calculate share based compensation for the three-months ended March 31:

**2015****2016**

	<b>Non Plan</b>	<b>2007 Plan</b>	<b>Non Plan</b>	<b>2007 Plan</b>
Risk free interest rate	1.97%	—	1.91%	1.36%
Expected volatility	821%	—	645%	315%
Expected dividend yield	—	—	—	—
Forfeiture rate	—	—	—	—
Expected life in years	7	—	7	5

Expected price volatility is the measure by which our stock price is expected to fluctuate during the expected term of an option. Expected volatility is derived from the historical daily change in the market price of our common stock, as we believe that historical volatility is the best indicator of future volatility.

The risk-free interest rate used in the Black-Scholes calculation is based on the prevailing U.S Treasury yield as determined by the U.S. Federal Reserve. We have never paid any cash dividends on our common stock and do not anticipate paying cash dividends on our common stock in the foreseeable future.

Historically, we have not had significant forfeitures of unvested stock options granted to employees and Directors. A significant number of our stock option grants are fully vested at issuance or have short vesting provisions. Therefore, we have estimated the forfeiture rate of our outstanding stock options as zero.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 6. Warrants**

**2015 Unit Offering Warrants**

During the three-months ended March 31, 2015 and 2016, pursuant to the terms of our 2015 Unit Offering (see Note 4), we issued warrants to purchase up to an aggregate 1,023,400 and 728,571 shares of our common stock at an exercise price of \$0.40 and \$0.45 per share, respectively. These warrants were issued to investors and as commissions, and are set to expire June 1, 2020. The intrinsic and relative fair value of these warrants resulted in \$233,000 and \$255,000 recorded as a discount on our convertible notes on our consolidated balance sheet in the period issued.

**Warrants Issued Concurrently with December/January Notes**

During the three-months ended March 31, 2015 we issued warrants to purchase an aggregate 266,000 shares of our common stock. These warrants are exercisable at \$0.30 per share and expire January 2020. The intrinsic and relative fair value of warrants issued in the three-months ended March 31, 2015 resulted in \$133,000 discount on the note payables.

We recorded \$72,578 and \$298,771 of interest expense related to the amortization of the discount on convertible notes and for the extension of warrants set to expire during the three-months ended March 31, 2015 and 2016, respectively.

We have certain warrants outstanding to purchase our common stock, at various prices, as summarized in the following tables:

	<b>Number of Shares</b>	<b>Price Range</b>
Balance, March 31, 2015		
Outstanding as of December 31, 2014	8,838,122	\$0.125 – 1.00

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Issued	1,501,900	0.30	–	0.75
Expired	—		—	
Outstanding as of March 31, 2015	10,340,022	\$0.125	–	1.00

Balance, March 31, 2016	Number of Shares	Price Range		
Outstanding as of December 31, 2015	13,779,438	\$0.125	–	1.00
Issued	728,571			0.45
Expired	—			—
Outstanding as of March 31, 2016	14,508,009	\$0.125	–	1.00

The fair value of each award grant is estimated on the date of grant using the Black-Scholes option-pricing model. The determination of expense of warrants issued for services or settlement also uses the option-pricing model. The principal assumptions we used in applying this model were as follows for the three-months ended March 31:

	2015		2016	
Risk free interest rate	0.97	– 1.46%	1.36	%
Expected volatility		332%	315	%
Expected dividend yield		—	—	
Forfeiture rate		—	—	
Expected life in years		5	5	

The risk-free interest rate is based on U.S Treasury yields in effect at the time of grant. Expected volatilities are based on historical volatility of our common stock.

## BIOLARGO, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 7. Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses included the following:

	<b>December 31, 2015</b>	<b>March 31, 2016</b>
Accounts payable and accrued expenses	\$ 174,539	\$ 107,216
Uncertain tax position	137,500	137,500
Accrued interest	12,944	12,752
Total accounts payable and accrued expenses	\$ 324,983	\$ 257,468

**Note 8. Noncontrolling Interest**

In May 2012, we formed a subsidiary for the purpose of marketing and selling medical products containing our technology, Clyra Medical Technology, Inc. (“Clyra”). Until December 17, 2012, this subsidiary was wholly-owned, with 7,500 shares issued to BioLargo, Inc. On December 17, 2012, Clyra issued 1,500 shares of Clyra common stock to a three-member management team, one-third of which vested immediately, and the remaining over time. The shares granted to the three executives are restricted from transfer until a sale of the company, whether by means of a sale of its stock or substantially all of its assets, or otherwise by agreement of Clyra, BioLargo and the executives.

On December 30, 2015, Clyra sold 9,830 shares of its Series A Preferred Stock (“Preferred Shares”) to Sanatio Capital, LLC (“Sanatio”) for \$750,000. This sale was made in reliance on the exemption from registration contained in Section 4(2) of the Securities Exchange Act and Regulation D promulgated thereunder as not involving a public offering of securities. As a result of the sale, Sanatio owns 40% of Clyra’s issued and outstanding shares, BioLargo owns 54%, and the remainder is owned by management.

As set forth in Clyra's Amended and Restated Articles of Incorporation, Preferred Shares accrue an annual dividend of 8% for a period of five years. Although the dividends begin to accrue immediately, Clyra has no obligation to declare a dividend until a product of the company has received a premarket approval by the United States Federal Drug Administration ("FDA"), or for which a premarket notification pursuant to form 510(k) has been submitted and for which the FDA has given written clearance to market the product in the United States (either, "FDA Approval"). After FDA Approval, annually on December 20, and unless prohibited by California law governing distributions to shareholders, Clyra is required to declare and pay any accruing dividends to holders of Preferred Shares then accrued but unpaid. Management classifies the Preferred Shares dividend as a medium probability of occurring and as of March 31, 2016 the Preferred Shares dividend has an accrued and undeclared balance of \$15,000.

Holders of Preferred Shares are entitled to preferential payments in the event of a liquidation, dissolution or winding up of the company, in an amount equal to any accrued and unpaid dividends. After such preference, any remaining assets are distributed pro-rata between holders of Clyra common stock and Preferred Shares as if the Preferred Shares had converted to Clyra common stock. Holders of Preferred Shares may convert the shares to Clyra common stock initially on a one-to-one basis. The conversion formula is subject to change in the event Clyra sells stock at a lower price than the price paid by Sanatio.

In addition to the foregoing, Clyra entered into a consulting agreement with Beach House Consulting, LLC, through which Jack B. Strommen will be providing consulting services to the company. Mr. Strommen is the founder of Beach House Consulting, LLC. Mr. Strommen will be assisting the company in its sales and marketing activities once it has FDA Approval on a product, at which point the agreement provides that Mr. Strommen is to receive \$23,438 per month for a period of four years. As of March 31, 2016, the Company has not presented any products to the FDA for FDA Approval.

From inception, Clyra has generated no revenues and the financial impact of Clyra's operations for the three-months ended March 31, 2016, resulted in a net loss of \$115,859.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 9. Subsequent Events.**

Management has evaluated subsequent events through the date of the filing of this Quarterly Report and management noted the following for disclosure.

**2015 Unit Offering**

Subsequent to March 31, 2016, we received \$180,000 and issued convertible promissory notes with a maturity date of June 1, 2018 to three accredited investors in our 2015 Unit Offering (see Note 4). The Unit price was \$0.35, and thus the notes are convertible at \$0.35 per share. Each investor, for no additional consideration, received a stock purchase warrant exercisable at \$0.45 per share, which expires June 1, 2020. We issued warrants to purchase an aggregate 514,286 shares.

With these investments, an aggregate \$3,106,713 has been invested in our 2015 Unit Offering. The terms of the offering require that we register the shares underlying the notes and warrants in the event aggregate investments exceed \$3,000,000. We intend to begin the process of registering the shares shortly.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Quarterly Report on Form 10-Q of BioLargo, Inc. (the "Company") contains forward-looking statements. These forward-looking statements include predictions regarding, among other things:

- our business plan;
- the commercial viability of our technologies and products incorporating our technologies;
- the effects of competitive factors on our technologies and products incorporating our technologies;
- expenses we will incur in operating our business;
- our ability to end persistent operating losses and generate positive cash flow and operating income;
- our ability to identify potential applications of our technologies in industries other than the animal health industry and to bring viable products to market in such industries;
- the application of our technologies in the food and beverage industry;
- the willingness of other companies to incorporate our technologies into new or existing products or services and provide continued support for such products or services;
- the ability of our licensees to successfully produce, advertise and market products incorporating our technologies;
- the continued success and viability of our licensees holding the exclusive right to exploit our technologies in particular fields;
- the sufficiency of our liquidity and working capital;
- our ability to finance product field testing, hiring of personnel, required regulatory approvals, and needed patent applications;
- continued availability and affordability of resources used in our technologies and the production of our products and services; and
- whether we are able to complete additional capital or debt financings in order to continue to fund operations and continue as a going concern.

You can identify these and other forward-looking statements by the use of words such as "may", "will", "expects", "anticipates", "believes", "estimates", "continues", or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

Such statements, which include statements concerning future revenue sources and concentrations, selling, general and administrative expenses, research and development expenses, capital resources, additional financings and additional losses, are subject to risks and uncertainties, including, but not limited to, those discussed elsewhere in this Form 10-Q, that could cause actual results to differ materially from those projected.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015. Unless otherwise expressly stated herein, all statements, including forward-looking statements, set forth in this Form 10-Q are as of March 31, 2016, unless expressly stated otherwise, and we undertake

no duty to update this information.

As used in this Report, the term Company refers to BioLargo, Inc., a Delaware corporation, and its wholly-owned subsidiaries, BioLargo Life Technologies, Inc., a California corporation, Odor-No-More, Inc., a California corporation, BioLargo Water USA, Inc., a California corporation, BioLargo Development Corp., a California corporation, a Canadian subsidiary BioLargo Water, Inc., and its majority owned subsidiary Clyra Medical Technologies, Inc.

The following discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and the related notes to the consolidated financial statements included elsewhere in this report.

## **Our Business**

We make life better delivering sustainable technology-based products that help solve some of the most widespread problems threatening the world's supply of water, food, agriculture, healthcare and energy. We create and refine intellectual property that forms a foundation from which to build and create break-through products and technology for licensure to commercial partners. Our products harness the power of iodine – “Nature's Best Solution” – to eliminate contaminants that threaten our water, our health and our quality of life.

We **invent, patent, prove and partner** – to create best-of-class products and technology for commercialization as we build value for our shareholders and deliver benefits to our world.

### *Invent – Three Platform Technologies*

We feature three patent protected platform technologies with diverse product opportunities across multiple industries – the AOS Filter, CupriDyne, and Isan. Each features the use of the all-natural iodine molecule. While they all use iodine, they are quite different in terms of the methods by which they exploit the use of iodine, the form and composition of iodine used, and therefore their function and value proposition can be quite different for each commercial application.

#### *AOS Filter*

The AOS Filter is our invention that combines iodine, water filter materials and electrolysis within a water filter device. Our filter generates extremely high oxidation potential in order to oxidize and break-down, or otherwise eliminate, soluble organic contaminants like acids, solvents, sulfurs, oil and gas by-products, and pharmaceutical by-products which are commonly found in all sorts of contaminated water. It also achieves extremely high rates of disinfection to eliminate infectious biological pathogens like salmonella, listeria and E.coli.

Extremely high oxidation potential is the key. The term ‘oxidation potential’ refers to the measure of the performance in which an oxidant is able to ‘break down’ a material through, in simple terms, the addition of oxygen and the transfer of

electrons. Two commonly understood examples of oxidation are, as salt air rusts a shipyard anchor, or as fire is able to dismantle wood and turn it into ash. The key to our AOS Filter is its ability to generate extremely high oxidation potential in a continuous flow device that attacks contaminants in water that flow through the AOS Filter. The extremely high oxidation potential enables the AOS Filter to achieve performance results that researchers at the University of Alberta refer to as, '**unprecedented**'. Our AOS Filter embodies a break-through in science which led to BioLargo's co-founding of an ongoing research chair to solve the contaminated water issues associated with the Canadian Oil Sands at the University of Alberta Department of Engineering with the top five oil companies in Canada, the regional water district, and various environmental agencies of the Canadian government. Our work is continually expanding into a number of commercial applications with a key focus on food processing, agriculture and oil and gas. We are also evaluating opportunities in the maritime industry, mining, storm drain recapture / recycling, and drinking water. It is an award-winning invention that is supported with science and engineering financial support and grants from various federal and provincial agencies in Canada. The financial support is expanding along with the work to develop commercially available designs. We believe the AOS Filter has an important and substantial commercial opportunity in every segment of the water treatment industry.

Following extensive validation testing and refinement of the basic operating system, we have begun a commercial prototype development project, the next step leading to a product ready for commercial markets. The project will be executed in collaboration with technical personnel at the Northern Alberta Institute of Technology (NAIT)'s Center for Sensors and Systems Integration and with NAIT's Applied Bio/Nanotechnology Industrial Research Chair. With financial support provided by the Alberta Innovates nanoPDP program, this project will focus on the development of a first generation prototype system that incorporates a sensor platform to monitor various water parameters through online real-time data acquisition. This platform will be integrated with BioLargo's pre-commercial AOS reactor, and will enable further scale up and testing in industrial settings. Once this prototype development phase is complete, we intend to focus on producing multiple commercial ready pilot units for testing with various interested industrial clients and on securing regulatory approvals where required.

### *CupriDyne®*

Our CupriDyne formula is used to deliver iodine within products. It can be delivered in any physical form, and can be combined with other ingredients, like fragrances in our odor control products, and primitive surfactants in our stain and odor products. Additional ingredients can often be added without sacrificing its practical and safe antimicrobial functions as well its oxidation potential. Our product designs include liquids, sprays, gels, powders, coatings and absorbents.

Safe and effective is the key. Each of our product designs delivers iodine safely, and precisely, to achieve effective broad-spectrum disinfection or odor control, depending on product design. Our primary ingredients, as well as reaction by-products, are “generally recognized as safe” (G.R.A.S) by the U.S. Food and Drug Administration as food additives in their basic forms. Its commercial product opportunities are diverse and we have an extensive menu of product designs in various stages of commercialization and licensure development, discussed in detail below in the “Commercial, Household and Personal Care Products” section. We specialize in delivering iodine, nature’s broadest spectrum and most potent disinfectant, oxidizer, catalyst, and essential nutrient, in safe, environmentally friendly, non-staining, non-toxic and effective product designs.

CupriDyne is unique. The iodine most of us are familiar with, sold in pharmacies and used by hospitals, has severe limitations – it is considered toxic, causes staining, and contains a limited dose of the active oxidizing ingredient. Our CupriDyne technology, on the other hand, directly addresses many of these shortcomings – it delivers iodine’s oxidizing ingredient (“free iodine”) with precision, ranging from very small doses up to very large doses with more than 20 times the power of traditional iodine. We can deliver iodine so that it is both non-toxic and non-staining, thus extending its usefulness well beyond historical product applications. Our formulations expand the functionality of our products well beyond simple disinfection.

### *Isan System*

The Isan System is an automated iodine dosing system. It is the winner of a Top 50 Water Technology Award by the Artemis Project and a Dupont Innovation Award. Precise dosing combined with a straight-forward ‘set-it-and-forget-it’ automated computer controlled system is the key. The system features controlled measuring, flow control, dosing and iodine extraction/removal technology as well as an automatic tracking system that precisely delivers iodine in calibrated doses into a water stream or container of water. The Isan system has been proven to substantially reduce the incidence of fungal growth, spoilage, organisms and pathogens in water and on food. The system is able to operate at high flow rates.

First developed in Australia, the Isan system was initially registered with the APVMA (Australian Pesticides and Veterinary Medicines Authority) and FSANZ (Food Standards Australia and New Zealand) in Australia and New Zealand. The system has meaningful use and commercial value in any industry that can benefit from a precise use of iodine in water, like; agriculture, food production and processing, manufacturing, industrial water processes, irrigation supply.

***Patent - an Expanding Intellectual Property Estate***

We have 16 patents issued and multiple pending. We believe these patents provide a foundation from which to continue building our patent portfolio and we have reasonable basis upon which to rely on our patent protections in the field of art in which we practice. We also rely on trade secrets and technical know-how to establish and maintain additional protection of our intellectual property. As our capital resources permit, we expect to expand our patent protection as we continue to refine our inventions as well as make new discoveries. See the detailed discussion below of our patent portfolio.

*Prove - a Continual Process*

We have invested time and money in a wide array of third party testing, side-by-side comparisons and third party verifications to support our most important technical claims. The basic attributes of iodine are well understood by science and industry. We have evidence and experience to substantiate the following bold claims:

o AOS Filter- when compared to the best of class competition we are

100 times more effective

less than 1/20<sup>th</sup> the cost

more than 10 times faster

o CupriDyne

Generally Accepted As Safe (G.R.A.S.) – ingredients and by products are GRAS according to the FDA.

Potent oxidizer

Total odor elimination

Non-toxic and gentle

Increases holding power of absorbents by up to six times

Promotes rapid healing (animal care products)

De-scaling

Eliminates Sulfur, Ammonia, Fatty Acids, Mercaptans

Enhanced flocculation

Nutritive

oIsan System

Precise iodine dosing

Anti-bacterial, anti-fungal, anti-viral

Effective against top five plant pathogens

Promotes extended shelf-life

Enhances root growth and foliage growth for healthier plants

***Partner – a Smart Strategic Decision***

We seek to develop commercial partnerships with other companies who will partner with us and pay us for a negotiated contractual right to use our intellectual property (patents, formulas, designs, claims, know-how, secrets), in order to expand their business for their own commercial purposes. In those instances, we seek a reasonable deposit, a minimum commitment to volume, some territorial rights, and a percentage of sales for a mutually agreeable term and territory. We believe this licensing model will prove successful and meaningful for our company.

We have chosen to focus on business opportunities that we believe have some combination of the following attributes: a compelling commercial advantage, our products out-perform competing products, market segments in which we have the talent and resources or opportunity to succeed in executing our business plans; and uses where we can identify a compelling cost savings or value offering to increase market share.

We choose to pursue a licensing strategy for its obvious and well-understood high margins, potential for explosive revenue potential and capital conserving features. While this business model can also be highly dependent upon macro-economic factors like the relative stability of the national and international economy as well as cyclical nature of business, politics and climate for innovation and competing technical advances, we believe this is the most appropriate strategy for our company. We have learned from difficult and real life experience. When our commercial licensing partners are under financial pressure from macro-economic and political circumstances, including reorganizations, recapitalization, or consolidation, they hold on to capital and are less likely to take any risk for new product offerings. Timing is critically important. Companies facing circumstances beyond their management's control are less likely to embrace any risk of innovation. Therefore, our time delays have negatively impacted our company by causing us to invest more capital, do more work, and advance our technology with nominal cash flow to support our work. However, while these delays have occurred and they were difficult, we have been able to maintain our operations, advance our scientific assets, build on our proven claims, refine our designs and we have continued to build a portfolio of both products and technology that we believe will ultimately enjoy meaningful commercial success.

While we have waited out many of the uncertainties of the macro-economic marketplace, we have advanced our commercial purposes and made investments in various aspects of product design, marketing and distribution, but only at an early stage and small level. In those instances, we consider these efforts to be a prelude to an ultimate licensing strategy. This strategy has been slower than we prefer. However, it has created a substantial level of diversification and breadth of potential revenue streams that we believe can and will generate meaningful revenues as they find traction in the marketplace. As we improve our access to capital, strengthen our balance sheet and can begin to generate meaningful cash flow, we believe those commercial opportunities will generate revenue for years to come as our products find their way into the marketplace.

In many situations, our potential licensing partners would prefer that we advance products all the way through proof of claim, manufacturing, market acceptance, well-established distribution and commercial success. While this is obvious, can be intriguing, and the relative benefits that would accrue to our valuation are clear, the risks of failure are equally high and this strategy would require substantially more capital than we have been able to secure during what many believe has been one of the most economically uncertain times in modern history. Therefore, we have chosen to invest our time and resources where we find leverage to move forward, knowing that our technical claims are proven, they are patented and that each product design has a high probability of success to find a partner and generate meaningful returns on our invested capital as our targeted licensing partners seek to deploy capital assets and begin taking advantage of our offering for their own commercial advancements.

Although our technology has commercial applications within many industries, we are focusing our efforts in four areas: water treatment; industrial odor control applications; commercial, household and personal care products (“CHAPP”); and “advanced wound care.”

Within these broad categories, we also narrow our product focus to exploit opportunities that we believe are of high-value to potential customers and that present commercially significant opportunities.

We have a number of examples of strategic alliance or partnering initiatives whereby we are advancing both our science, our patents, our proof of claims, field trials and our commercial opportunities. There are a number of noteworthy examples:

*The University of Alberta*

We are engaged in a cooperative research relationship with the University of Alberta and its researchers in Edmonton, Canada. The offices and lab of our Canadian subsidiary, and our staff researchers, are located within the University of Alberta research center at Discovery Place. We are able to utilize the extensive resources of the University and its researchers on a contract for hire basis as needed. We work closely with the Department of Agricultural, Food and Nutritional Science at the University of Alberta and its Department of Engineering, and partner with the University professors on government and industry sponsored financial awards and grants to support our ongoing research and development as we refine the AOS Filter in preparation of commercial pilots and commercial designs. Generally, the financial awards take on two common themes: first, science and engineering grants in which the University of Alberta is the primary recipient and contracting party with the grant agency to support work on and around our technology; and second, direct grants in which our Canadian subsidiary is the contracting party to support ongoing science and engineering to advance our AOS Filter towards commercialization, sometimes supporting the work of PhD students at the University. In both cases, the financial awards support much, but not all, of the research budget and related costs. Our research arrangement with the University has three high value propositions for BioLargo: (i) a depth of resources and talent to accomplish highly skilled work, (ii) financial aid to support research and development costs, and (iii) independent and credible validation of our technical claims.

### *Clarion Water*

On August 18, 2014, we entered into a manufacturing and distribution license agreement for our Isan® system with Clarion Water, a new operating division of InsulTech Manufacturing, LLC ([www.insultech.com](http://www.insultech.com)), the latter of which has over 20 years of commercial success around the globe representing hundreds of millions in sales of technical products to Fortune 100 companies.

Owned in equal parts by BioLargo, Inc. and Peter Holdings, Ltd. through a joint venture agreement, the Isan system leverages the power of iodine to provide the world's most effective disinfection dosing systems. It has been referred to as one of the most important technical advancements in food safety in the past 20 years. It won a 'top 50 water company award' by the Artemis Project in 2010 and a DuPont Innovation Award for its excellence in science and innovation in 2004.

The Isan system delivers Iodine as a powerful, broad-spectrum biocide that is a logical replacement for chlorine in applications involving irrigation supply and post-harvest sanitation. Through its automated and precise dosing system, the Isan system can help increase the quality and shelf life of fruits, vegetables, and other produce, is effective against a host of bacteria and fungi, and helps producers conform to increasingly stringent food safety regulations such as the Hazard Analysis and Critical Control Points (HACCP), which addresses food safety through the analysis and control of raw material hazards.

The Isan system has been validated through early stage commercialization and comprehensive testing conducted in Australia and New Zealand. Clarion intends to leverage this early work and focus initial commercialization efforts on the vast opportunities for the technology in improving plant quality and shelf life as well as explore additional opportunities for use in select industrial applications.

Per the terms of our license agreement, Clarion receives the exclusive global manufacturing and distribution rights to the Isan system and use of all historical data to support its commercial focus. Clarion will pay BioLargo royalties on revenue equal to 10% paid quarterly in arrears. As we jointly own the Isan System with Peter Holdings, Ltd., all royalties are shared equally with Peter Holdings. There are no minimum royalty payments for the first two years, but at year three (beginning July 1, 2016) the minimum royalties are \$50,000 per quarter, at year four \$75,000 per quarter, and at year five and onward \$100,000 per quarter. The intellectual property subject to the license agreement includes all intellectual property related to the Isan System, including all patents, trademarks, proprietary knowledge, and other similar know-how or rights relating to or arising out of the Isan System or the patents related to the Isan System. The agreement contains other terms and conditions typically found in intellectual property license agreements.

BioLargo received a royalty advance of \$100,000 upon execution of a letter of intent in February of 2014, which will be applied to royalties received during the first two years of the agreement. Of this advance, \$45,000 was paid to Peter Holdings under our joint venture agreement. BioLargo retains certain marketing rights to help develop clients for Clarion.

Since licensing the technology from BioLargo in August 2014, Clarion has completed a comprehensive technical and engineering update to the Isan System, featuring a new automated touch screen user interface, enhanced security, enhanced control features for increased monitoring and sensing, and adding automated functionality providing users unmatched flexibility, reliability and control over this state-of-the-art disinfectant delivery system, and begun commercial trials. In 2015, it filed application with the U.S. Environmental Protection Agency, which application is pending as of the date of this report.

### ***Downeast Logistics***

In late 2013, we entered into a cooperative selling and distribution agreement with Downeast Logistics, a certified “Service-Disabled Veteran-Owned Small Business” (SDVOSB), as our distribution partner to facilitate our first order to the US Government. Downeast has been instrumental in developing ongoing sales to the United States Military. We have six products with National Stocking Numbers. In March 2015 we secured a \$150,000 “Indefinite Delivery Purchase Order” (IDPO) for the purchase of our Specimen Transport Solidifier pouches by the U.S. Defense Logistics Agency (DLA). The purchase order allows the DLA to purchase the product at agreed-upon prices for the following 12 months. In exchange, the company is awarded the contract to be the exclusive supplier of the designated product under the IDPO. During the period of the contract, approximately \$30,000 in product was ordered.

In March 2016 two of our product lines (consisting of 9 SKUs) of Nature’s Best Science products were awarded a five year U.S. General Services Administration (GSA) supply contract, under schedule 65IIA for medical equipment and supplies. The award opens up access to these products through “GSA Advantage”, the online shopping and ordering system that provides government agencies access to thousands of contractors and millions of supplies (products) and services. We intend to apply for inclusion of additional existing and future products into GSA Advantage.

Downeast Logistics has operated for more than thirteen years, and will continue to offer our products through multiple channels of the US Government. Its designation as a SDVOSB places Downeast Logistics within a group of highly sought after vendors to the US government. Odor-No-More has registered, and is in the process of registering, itself as well as its products with several procurement agencies of the US Government.

### ***Industrial Odor Control - CupriDyne Clean***

In 2015, we were invited by a number of potential customers to design a product for the industrial odor control industry segment and to begin trials for an odor control product in large scale operations. As a result of these efforts, we have branded a liquid product “CupriDyne Clean”, a non-staining and colorless blend of micronutrients. It is available in various sizes for industrial uses and is ideal for waste transfer stations, composting facilities, landfill operations, sewage plants and lift stations, food processing plants and animal enclosures. It is dispensed through atomization systems, portable sprayers and water trucks, and is safe and effective on a host of surfaces including soils, metals, concrete and asphalt docks, floors, walls, feed and water receptacles, waste receptacles, tanks, bins, liners and dumpsters.

Since 2015, we have and continue to refine the product design, its claims and marketing and selling plans. Our product web site can be seen at [www.cupridyne.com](http://www.cupridyne.com). Based on our test marketing and trials, we believe that many industries that must contend with odors that include hydrogen sulfide, ammonia, fatty acids, sulfur compounds, or

mercaptans, are dissatisfied with the current competing odor control products, place a high value on odor control solutions that actually work, and are anxious to test and trial new products like our CupriDyne Clean as they search for a solution to these common and troublesome odor problems. We have been told by prospective customers and experts from these markets that effective odor control for these prospective customer groups is in among the top on a list of priorities in their daily operations and their commitment to serve their local communities where they operate. We intend to further develop our products, refine our free trial program that can be combined with a highly motivated customer service and sales program to help break open this market. We plan to attend industry conferences, join trade associations, advertise, and recruit leaders from these industries to help us refine, focus and break through to commercial success. While the success of these efforts cannot be assured, we are confident and highly encouraged to focus and invest time, energy, staff and capital in this area as resources permit.

We intend to further develop our products, refine our free trial program, attend industry conferences, join trade associations, advertise, and recruit leaders from these industries to help us refine, focus and break through to commercial success. We are highly encouraged by this early work and the welcome response from new prospects from industry. In May 2016, we secured our first orders for CupriDyne Clean for the use at a Southern California waste handling facility. While the success of these efforts cannot be assured, we are confident and highly encouraged to focus and invest time, energy, staff and capital in this area as resources permit.

**Multinationals and Mid-Level Industry Participants**

We began discussions about our AOS Filter with a number of multi-nationals as well as regional companies in 2014 and 2015 that are continuing. We held our first technical symposium in August 2015 where we had more than 30 attendees representing industry, academia and funding agencies. We are planning another technical symposium this August of 2016 to showcase the refinements, data showing efficacy and the first commercial prototype being designed and assembled by the Northern Alberta Institute of Technology. We have entered into technical non-disclosure agreements with a wide variety of companies to evaluate our AOS Filter and discuss potential strategic alliances. Many of these continue to monitor our technical progress and have expressed interest in the technology and potential strategic alliances as we finalize our commercially ready design. The claims we have put forth are well received. The focus of discussions in most cases has moved from efficacy, which is accepted, to a business case discussion relative to capital and time to market and the potential return on investment. While these discussions are ongoing, we continue to advance our science and proven claims. We are highly encouraged that our AOS Filter has an important role in commerce.

We believe there are a number of potential partners interested in working with us to exploit the commercial opportunities associated with the AOS Filter technology. These opportunities are limited by common and obvious limitations, capital, the relative state of development and market readiness and, adoption rates in the marketplace. Given the significant value offerings, namely enhanced performance and lower cost, we believe we will be able to find industry partners to assist in commercialization of the AOS Filter and are committed to pursue success in these markets.

**Commercial, Household and Personal Care Products**

CHAPP includes broad product categories and many opportunities for the application of our technology. It is defined by the ability to utilize similar, if not identical, consumption products in multiple market segments. Detergents, single use absorbents, wipes, products that provide odor or disinfection control, and stain removal all fall within this category. Packaging ranges from consumer sizes of a few ounces to bulk packaging for commercial or industrial use. We are currently marketing products in this category under four brands – Odor-No-More, Nature’s Best Solution, Deodorall, and NBS - direct to consumers, through retail stores, and most recently, to the U.S. Government.

We are continuing our efforts to generate “private label” clients. We have fulfilled some small orders for various products that we produced under a third party’s private brand. We are meeting with new potential customers for private label opportunities. We also are in discussions with potential strategic alliance partners to provide large scale manufacturing and distribution should we secure orders for the private label business opportunities. We have a few opportunities that could expand to become large customers for our company. Success in these markets is highly dependent upon the willingness of the potential partners to invest in product support to continue marketing and expanding customer awareness.

Our sales in the CHAPP product category are nominal. Product development, sales, and marketing require significant financial resources that we currently do not have. As such, our progress in this area has been slower than we had hoped. We are marketing the technology for licensure to established companies in this industry segment, as the opportunities present themselves through our various independent agents and our key industry contacts, and we are continuing to expand our proof of claims and product designs for various odor and moisture control applications.

**Advanced Wound Care – Clyra Medical Technologies Subsidiary**

In 2012 we formed a subsidiary Clyra Medical Technologies, Inc. (“Clyra”) to commercialize our technology in the medical products industry, with an initial focus on advanced wound care. Our advanced wound care products combine broad-spectrum antimicrobial capabilities with iodine’s natural and well-understood metabolic pathway to promote healing. Our products are highly differentiated by the gentle nature in which they can perform. We believe these benefits, along with reduced product costs as compared with other antimicrobials, give our products a competitive advantage in the marketplace.

In December 2015, we completed a financing transaction through which \$750,000 was invested into Clyra in exchange for preferred stock comprising 40% of the total issued and outstanding shares. The investor committed to fund a \$5,000,000 operating line of credit once Clyra’s initial products receive FDA Approval.

With new funding in place, Clyra re-initiated product development and testing for its wound gel and wound cleaner products with experts and well established contract manufacturing companies from industry. It intends to apply for FDA 510(k) approval for these two products to be sold into the advanced wound care industry. While no assurances can be made about the ultimate success any FDA applications once filed, given the forward looking nature of such events, Clyra has retained and engaged a team of experts in the area to guide it through the process. Given the timing of the FDA process, and the requirement for approval before product can be sold, we do not anticipate product sales until 2017. In the interim, we will continue to refine our products, their roll out, marketing, and distribution plans. A U.S. patent was recently issued for these products under development and we intend to continue expanding patent coverage as we refine our products, as available. We are also evaluating potential product designs where our current product designs can be used or slightly modified/ enhanced to create new products for new medial related markets like dental, veterinary medicine, over the counter applications and the like.

## **Results of Operations—Comparison of the three-months ended March 31, 2016 and 2015**

### **Revenue**

Our revenue from product sales totaled \$13,942 in the three-months ended March 31, 2016, compared with \$13,875 for the three-months ended March 31, 2015, and \$54,761 for the three-months ended December 31, 2015. Our product revenue consisted primarily of sales of our Suction Canister Solidifiers to military hospitals, our Specimen Transport Solidifier pouches to the U.S. Defense Logistics Agency, and our Odor-No-More branded animal bedding additive to horse stables and a farming retailer.

After the end of the period covered by this Report, we received our first orders for our CupriDyne Clean Industrial Odor Eliminator for use at a waste handling facility. We have multiple customer trials ongoing and are focused on expanding our customer base and trial program, and increasing our revenues for this product.

### **Other Income**

During the three-months ended March 31, 2016, income received from Canadian grant agencies increased \$25,962 (to \$38,758) over the three-months ended March 31, 2015. We anticipate income received from grants to increase at this same rate for 2016. Our wholly owned Canadian subsidiary has been awarded a total of 11 research grants, from the Canadian National Research Institute – Industrial Research Assistance Program (NRC-IRAP) and the National Science and Engineering Research Council of Canada (NSERC). The government grants received are considered reimbursement grants related to costs we incur and therefore are included as Other Income on our income statement.

The total value of grants previously awarded as of the date of this Report is approximately \$900,000, although not all of the grant funds are to be paid directly to us nor will all the funds be considered as income in our financial statements.

**Cost of Goods Sold**

Our cost of goods sold includes costs of raw materials, contract manufacturing, and proportions of salaries and expenses related to the sales and marketing efforts of our products. Because we have not achieved a meaningful product revenue base, and our number of products is increasing, the inclusion of the fixed costs related to the product development and manufacturing increases our cost of goods disproportionately, resulting in high percentage fluctuations.

**Selling, General and Administrative Expense**

Our Selling, General and Administrative (“SG&A”) expenses include both cash and non-cash expenses. Our total SG&A increased by \$370,382 (66%) in the three-months ended March 31, 2016 due primarily to a non-cash expense associated with the extension of the expiration dates of stock options issued in 2011 in lieu of salary and consultant/vendor payables.

The largest components of our selling, general and administrative expenses for the three-months ended March 31, 2015 and 2016 were:

	<b>MARCH</b>	<b>MARCH</b>
	<b>31, 2015</b>	<b>31, 2016</b>
Officer salaries and payroll-related expenses	\$ 131,098	\$ 160,269
Consulting expense	104,996	285,239
Professional fees	111,445	143,403
Board of director expense		