

BIOLARGO, INC.  
Form 10-Q  
August 10, 2015

**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 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 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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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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 August 6, 2015 was 84,469,125 shares.

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**BIOLARGO, INC.**

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**Exhibit Index**

<b><u>Exhibit No.</u></b>	<b><u>Description of Exhibit</u></b>
Exhibit 31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and Rules 13(a)-14 and 15(d)-14 under the Securities Exchange Act of 1934
Exhibit 31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and Rules 13(a)-14 and 15(d)-14 under the Securities Exchange Act of 1934
Exhibit 32*	

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Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.

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

† Management contract or compensatory plan, contract or arrangement

\* Filed herewith

\*\* Furnished herewith

(1) Incorporated herein by reference from the Form 8-K filed by the Company on June 23, 2014.

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**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements****BIOLARGO, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2014 AND JUNE 30, 2015**

	<b>December 31, 2014</b>	<b>June 30, 2015  (unaudited)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 154,460	\$ 96,948
Accounts receivable	5,617	7,556
Inventory	25,514	14,601
Prepaid expense	45,000	45,000
Total current assets	230,591	164,105
Other asset, net of amortization	30,077	24,617
Deferred financing fees, net	—	75,370
<b>TOTAL ASSETS</b>	<b>\$ 260,668</b>	<b>\$ 264,092</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued expenses (Note 10)	\$ 494,938	\$ 443,964
Convertible notes payable (Note 5)	250,000	283,000
Discount on convertible notes payable (Note 5)	(192,000)	(117,342)
Customer deposit	100,000	100,000
Total current liabilities	652,938	709,622
<b>LONG-TERM LIABILITIES</b>		
Convertible notes payable, net of current (Note 5)	—	759,919
Discount on convertible notes payable, net of current (Note 5)	—	(720,229)
Total long-term liabilities	—	39,690
<b>TOTAL LIABILITIES</b>	<b>652,938</b>	<b>749,312</b>

COMMITMENTS AND CONTINGENCIES (Note 8-10)

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STOCKHOLDERS' EQUITY (DEFICIT)

Convertible Preferred Series A, \$.00067 Par Value, 50,000,000 Shares Authorized, -0- Shares Issued and Outstanding, at December 31, 2014 and June 30, 2015, respectively	—	—
Common Stock, \$.00067 Par Value, 200,000,000 Shares Authorized, 82,909,300 and 84,109,125 Shares Issued, at December 31, 2014 and June 30, 2015, respectively	55,293	56,098
Additional paid-in capital	78,511,529	80,412,860
Accumulated deficit	(79,019,719)	(81,003,461)
Non-controlling interest	60,627	49,283
Total stockholders' equity (deficit)	(392,270 )	(485,220 )
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	\$260,668	\$264,092

See accompanying notes to unaudited condensed consolidated financial statements

**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****FOR THE THREE AND SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2015**

	<b>For the three-month periods</b>		<b>For the six-month periods</b>	
	<b>ended June 30, 2014</b>	<b>2015</b>	<b>ended June 30, 2014</b>	<b>2015</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>
Revenue				
Grant revenue	\$—	\$ 24,232	\$ —	\$ 37,028
Product revenue	21,086	15,611	30,373	29,486
Total revenue	21,086	39,843	30,373	66,514
Cost of goods sold	8,933	7,683	11,463	14,064
Gross profit	12,153	32,160	18,910	52,450
Costs and expenses				
Selling, general and administrative	948,663	859,268	1,556,029	1,419,793
Research and development	129,376	167,211	292,981	305,210
Amortization and depreciation	2,730	2,730	5,460	5,460
Total costs and expenses	1,080,769	1,029,209	1,854,470	1,730,463
Loss from operations	(1,068,616 )	(997,049 )	(1,835,560 )	(1,678,013 )
Interest expense, net	(3,326 )	(302,919 )	(309,452 )	(317,073 )
Net loss	(1,071,942 )	(1,299,968 )	(2,145,012 )	(1,995,086 )
Net loss (non-controlling interests)	(14,122 )	(5,588 )	(24,205 )	(11,344 )
Net loss (controlling interests)	\$(1,057,820 )	\$(1,294,380 )	\$(2,120,807 )	\$(1,983,742 )
Loss per common share – basic and diluted	\$(0.01 )	\$(0.02 )	\$(0.03 )	\$(0.02 )
Weighted average common share equivalents outstanding	76,693,189	83,400,950	78,275,663	83,188,527

See accompanying notes to unaudited condensed consolidated financial statements





**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)  
FOR THE SIX-MONTH PERIOD ENDED JUNE 30, 2015****(unaudited)**

	Common Stock			Accumulated Deficit	Noncontrolling Interest	Total
	Number of shares	Par Value \$.00067	Additional Paid-in Capital			
Balance, December 31, 2014	82,909,300	\$55,293	\$78,511,529	\$(79,019,719)	\$ 60,627	\$(392,270 )
Issuance of stock in exchange of Clyra shares	400,000	268	(268 )	—	—	—
Issuance of stock to vendor	238,904	161	94,549	—	—	94,710
Fair value of options issued for accrued and unpaid obligations to vendors	—	—	405,955	—	—	405,955
Issuance of stock to satisfy accrued and unpaid obligations to officers	560,921	376	197,356	—	—	197,732
Fair value of options issued to board of directors and officer	—	—	249,700	—	—	294,700
Fair value of warrants issued as discount on convertible notes payable	—	—	892,919	—	—	892,919
Fair value of warrants issued as fees for convertible notes payable	—	—	61,120	—	—	61,120
Net loss	—	—	—	(1,983,742 )	(11,344 )	(1,995,086)
Balance, June 30, 2015	84,109,125	\$56,098	\$80,412,860	\$(81,003,461)	\$ 49,283	\$(485,220 )

See accompanying notes to unaudited condensed consolidated financial statements

**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2014 AND 2015****(unaudited)**

	For the six-month periods ended June 30,	
	<b>2014</b>	<b>2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Loss	\$(2,145,012)	\$(1,995,086)
Adjustments to Reconcile Net Loss to Net Cash Used in Operating Activities:		
Non-cash expense related to options issued to board of directors	253,911	249,700
Non-cash expense related to common stock issued to officers in exchange for unpaid obligations	141,425	197,732
Non-cash expense related to options and warrants issued to vendors	188,463	405,955
Non-cash expense related to common stock issued to consultants	221,187	83,137
Non-cash expense related to common stock issued to convert interest related to our convertible notes	291,574	11,573
Expense related to amortization of the fair value of the warrants issued as part of the convertible debt	—	262,267
Amortization and depreciation expense	5,460	5,460
Increase (decrease) in cash from change in:		
Accounts receivable	1,027	(1,939 )
Inventory	5,100	10,913
Prepaid expenses	(45,000 )	—
Customer deposit	100,000	—
Accounts payable and accrued expenses	(26,898 )	(43,074 )
Net Cash Used In Operating Activities	(1,008,763)	(813,362 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from sale of stock	1,014,644	—
Proceeds from sale of convertible notes payable	—	778,000
Proceeds from sale of stock in subsidiary	220,000	—
Payment of financing costs	—	(22,150 )
Net cash provided by financing activities	1,234,644	755,850
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>225,881</b>	<b>(57,512 )</b>
<b>CASH AND CASH EQUIVALENTS — BEGINNING</b>	<b>92,437</b>	<b>154,460</b>
<b>CASH AND CASH EQUIVALENTS — ENDING</b>	<b>\$318,318</b>	<b>\$96,948</b>

SUPPLEMENTAL DISCLOSURES OF CASHFLOW INFORMATION

Cash Paid During the Period for:		
Interest	\$6,733	\$9,400
Taxes	\$2,400	\$4,000

SUPPLEMENTAL DISCLOSURES OF NON-CASH FINANCING AND INVESTING ACTIVITIES:

Fair value of warrants issued in conjunction with convertible notes payable	\$584,800	\$892,919
Fair value of warrants issued in conjunction convertible notes payable for fees	\$—	\$61,120

See accompanying notes to unaudited condensed consolidated financial statements

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 1. Business and Organization**

**Liquidity**

The accompanying condensed 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 \$1,995,086 for the six-month period ended June 30, 2015, and at June 30, 2015, we had negative working capital of \$545,517, current assets of \$164,105, and an accumulated stockholders' deficit of \$81,003,461. 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 technology. 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 and cash equivalents were \$96,948 at June 30, 2015. We recorded revenues of \$66,514 in the six-month period ended June 30, 2015, 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 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 June 30, 2015, we had \$1,042,919 principal amount outstanding on our convertible note payables (see Note 5), and \$443,964 of outstanding accounts payable and accrued expenses. (See Note 10.)

The unaudited condensed 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. We are still operating in the early stages of the sales and distribution process, and therefore our operating results for the six-month period ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015, or for any other period. These unaudited condensed 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, 2014 filed with the Securities and Exchange Commission (the "SEC") on March 30, 2015.

## Note 2. Summary of Significant Accounting Policies

### Inventory

Inventories are stated at the lower of cost or net realizable value using the average cost method. Inventories consisted of:

	<b>December 31, 2014</b>	<b>June 30, 2015</b>
Raw materials	\$ 18,816	\$12,605
Finished goods	6,698	1,996
Total inventory	\$ 25,514	\$ 14,601

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Other Assets**

Other Assets consists of payments made to purchase patents related to our efforts in commercializing the Isan system.

For the six-month periods ended June 30, 2014 and 2015, we recorded amortization expense totaling \$5,460 and \$5,460, respectively.

We review intangible assets for potential impairment using our best estimates based on reasonable assumptions and projections. An impairment loss to write such assets down to their estimated fair values is necessary if the carrying values of the assets exceed their related undiscounted expected future cash flows. We also determine impairment whenever events or changes in circumstances indicate that their carrying values may not be recoverable. Management has not identified any impairment indicators at June 30, 2015.

**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 and financing transactions, uncollectible accounts receivable, asset impairment, depreciation and amortization, and taxes, among others.

**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 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.

During the six-month periods ended June 30, 2014 and 2015, we recorded an aggregate \$442,374 and \$655,655 in selling general and administrative expense related to options issued as part of our 2007 Equity Incentive Plan and outside of our 2007 Equity Incentive Plan (see Note 9).

During the six-month periods ended June 30, 2014 and 2015, we issued an aggregate 284,491 and 560,921 shares of our common stock to our officers in lieu of accrued and unpaid compensation and unreimbursed expenses totaling \$166,607 and \$197,732, respectively.

During the six-month periods ended June 30, 2014 and 2015, we issued an aggregate 313,209 and 238,904 shares of our common stock to third party vendors in lieu of accrued and unpaid obligations totaling \$229,527 and \$94,710, respectively. (See Note 9).

On March 28, 2014, we issued an aggregate 1,360,000 shares of our common stock to note payable holders in lieu of \$584,800 note payable principal balance and related accrued interest. (See Note 5).



BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**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.

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.

**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. Grants received are recognized as revenue when the terms and conditions of the grant are met on a periodic basis over the life of the grant.

**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 six-month periods ended June 30, 2014 and 2015, 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 (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers.” ASU 2014-09 creates a new, principle-based revenue recognition framework that will affect all revenue-generating activities. In addition to superseding and replacing nearly all existing revenue recognition guidance under U.S. GAAP, including industry-specific guidance, the new standard:

changes the basis for deciding when revenue is recognized over time or at a point in time;

provides new guidance on specific aspects of revenue recognition; and

expands and improves disclosures about revenue.

Entities are required to apply the standard for annual periods beginning after December 15, 2018, and for interim periods therein. The standard permits the use of either the retrospective method, where prior period results are reflected on a comparable basis, or cumulative effect method. Management is currently evaluating the effect of this pronouncement on its financial reporting.

In August 2014, the FASB issued ASU No. 2014-15 (“ASU 2014-15”), “Presentation of Financial Statements-Going Concern (Subtopic 205-40) - Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern.” ASU 2014-15 requires a Company’s management to evaluate, at each reporting period, whether there are conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date the financial statements are issued and provide related disclosures. ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The Company is currently evaluating the impact of the adoption of ASU 2014-15 on its consolidated financial statements.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In July 2015, the FASB issued ASU No. 2015-11, “Simplifying the Measurement of Inventory, Topic 330, Inventory.” An entity should measure inventory within the scope of this Update at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of ASU 2015-11 on its consolidated financial statements.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02 (ASU 2015-02), “Consolidation” (Topic 810). ASU 2015-02 changes the guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. All legal entities are subject to reevaluation under the revised consolidation mode. ASU 2015-02 affects the following areas: (1) Limited partnerships and similar legal entities. (2) Evaluating fees paid to a decision maker or a service provider as a variable interest. (3) The effect of fee arrangements on the primary beneficiary determination. (4) The effect of related parties on the primary beneficiary determination. (5) Certain investment funds. ASU 2015-02 is effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the guidance in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. A reporting entity may apply the amendments in this guidance using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. A reporting entity also may apply the amendments retrospectively. The adoption of ASU 2015-02 is not expected to have any impact on the Company’s financial statement presentation or disclosures.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03 (ASU 2015-03), “Interest – Imputation of Interest” (Subtopic 835-30). ASU 2015-03 simplifies the presentation of debt issuance costs and requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the new guidance. ASU 2015-3 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within that fiscal year. Early adoption is permitted for financial statements that have not been previously issued. An entity is required to apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effects of applying the new guidance. Upon transition, an entity is required to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for the change in accounting principle, the transition method, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (i.e., debt issuance cost asset and the debt liability). The Company is currently evaluating the impact of the adoption of ASU 2015-03 on the

Company's financial statement presentation and disclosures.

### **Note 3. Deposits**

#### **Royalty Revenue**

In 2012, we executed a joint venture agreement with Peter Holdings 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. 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. Private Securities Offerings**

#### **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. 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. 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 5.)

Purchasers of the Units will receive an unsecured convertible promissory note bearing interest at the rate of 12% per annum on the amount invested. Any 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. 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. Notes mature on June 1, 2018.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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.

**Summer 2013 Private Securities Offering**

Pursuant to a private offering of our common stock at a price of \$0.25 per share that commenced June 2013, through its expiration on March 31, 2014, we sold 3,370,000 shares of our common stock to 23 accredited investors and received \$842,500 gross and \$837,000 net cash proceeds from the sales. In addition, we received a subscription agreement for \$20,000 through an individual retirement account, the funds for which had not been received by June 30, 2014 (but were received in the July 2014). Of the aggregate 3,370,000 shares sold in the offering, for the three-month period ended March 31, 2014, we sold 3,110,000 shares of our common stock and received \$767,500 gross proceeds from the sales. Fees related to this offering consisted of \$15,500 cash payments, \$34,600 were paid by issuing 138,400 shares of our common stock at an exercise price of \$0.25 per share. The share price on the grant date was \$0.47 resulting in additional interest expense of \$65,000.

Each purchaser of stock received, for no additional consideration, a stock purchase warrant which entitles the holder to purchase a number of additional shares of our common stock equal to the number of shares originally purchased and is subject to a call provision in the event BioLargo’s common stock price reaches \$0.60 per share over a period of 40 days. (See Note 7).

**Clyra Spring 2014 Private Securities Offering**

On February 1, 2014, our subsidiary Clyra (see Note 11) began a private securities offering, selling up to 1,000 shares of its common stock at \$1,000 per share. From inception through June 30, 2014, Clyra sold 220 shares of its common stock to five accredited investors and received \$220,000 gross and net proceeds from the sales.

Each purchaser of stock received, for no additional consideration, (i) a stock purchase warrant entitling the holder to purchase the same number of shares of Clyra common stock as purchased in the offering for \$1,833.33 per share until July 30, 2015, and (ii) a warrant issued by BioLargo that allows the holder to exchange one share of Clyra common stock for 4,000 shares of BioLargo common stock, until July 30, 2015. (See Note 7.)

## **Note 5. Notes and Convertible Notes Payable**

### **2015 Unit Offering**

In accordance with the terms of our 2015 Unit Offering (see Note 4), during the six-month period ended June 30, 2015, we received \$645,000 and issued unsecured convertible promissory notes with a maturity date of June 1, 2018, which accrue interest at a rate of 12% per annum. Each investor, for no additional consideration, received a Series A stock purchase warrant exercisable at \$0.40 per share, which expires June 1, 2020. (See Note 7).

### **December/January Notes**

In December 2014, we received \$200,000 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 terminates three years after the date of issuance. We issued warrants to purchase an aggregate 350,000 shares. The fair value of the warrants and the intrinsic value of the beneficial conversion feature resulted in a \$200,000 discount on the convertible note payables. Each noteholder may exchange the note for the securities offered in our current private securities offering.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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 terminates three year after the date of issuance. (See Note 7).

On April 27, 2015 a noteholder exchanged this note for a note and warrant on the terms offered in our 2015 Unit Offering (see Note 4), such that the noteholder was issued a new convertible promissory note totaling \$56,610, with a due date of June 1, 2018, and a stock purchase warrant to purchase 226,440 shares at \$0.40, expiring June 1, 2018. (See Note 7).

On June 17, 2015 a noteholder exchanged this note for a note and warrant on the terms offered in our 2015 Unit Offering (see Note 4), such that the noteholder was issued a new convertible promissory note totaling \$58,309 with an expiration date of June 1, 2018, and a stock purchase warrant to purchase 233,236 shares at \$0.40, expiring June 1, 2018. (See Note 7).

**Line of Credit**

On November 19, 2013, we received \$50,000 pursuant to a line of credit which accrues interest at a rate of 24%. We have pledged our inventory and accounts receivable as collateral. The maturity date of the line of credit is May 15, 2016.

For the six-month periods ended June 30, 2014 and 2015, we recorded \$64,665 and \$317,075 of interest expense related to our line of credit, convertible notes payable and amortization of discount on convertible notes payable.

**Note 6. Conversion of Notes**



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On March 26, 2014, we issued an aggregate 1,360,000 shares of our common stock, at a conversion price of \$0.25, resulting in a fair value of \$584,800, as payment for an aggregate \$275,000 in principal and \$65,000 of accrued and unpaid interest expense for three promissory notes (originally issued on June 8, 2010, October 28, 2013, and November 15, 2013). Our stock price on the date of issuance was \$0.43 per share, resulting in an additional financing costs of \$244,800 which was recorded as interest expense during the three-month period ended March 31, 2014.

**Note 7. Warrants**

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

	<b>Number of Shares</b>	<b>Price Range</b>
Outstanding as of December 31, 2013	10,618,771	\$ 0.125 – 2.00
Issued	4,150,001	\$ 0.25 – 1.00
Exercised	(574,288 )	\$ 0.25 – 0.50
Expired	(6,111,362 )	\$ 0.50 – 1.00
Outstanding as of June 30, 2014	8,083,122	\$ 0.125 – 1.00
	<b>Number of Shares</b>	<b>Price Range</b>
Outstanding as of December 31, 2014	8,838,122	\$ 0.125 - 1.00
Issued	3,670,976	\$ 0.30 - 0.75
Exercised	—	\$—
Expired	(2,333,329 )	\$0.55
Outstanding as of June 30, 2015	10,175,769	\$0.125 - 1.00

## BIOLARGO, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

To determine interest expense related to our outstanding warrants issued in conjunction with debt offerings, the fair value of each award grant is estimated on the date of grant using the Black-Scholes option-pricing model and the calculated value is amortized over the life of the warrant. 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:

	2014	2015
Risk free interest rate	.15 %	1.32 – 1.71%
Expected volatility	112 %	329 %
Expected dividend yield	—	—
Forfeiture rate	—	—
Contractual life in years	1	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.

**Warrants Issued Concurrently with Convertible Note Payables**

During the six-month period ended June 30, 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 fair value of warrants totaled \$133,000 and was recorded as a discount on the convertible notes payable.

Pursuant to the terms of our Convertible Notes Payable, two noteholders of the December and January convertible notes payable exchanged their notes and accrued interest for notes and warrants on the terms offered in our 2015 Unit Offering totaling \$114,919 (See Note 4 & 5). With the exchange, these note holders received additional warrants to purchase an aggregate 459,676 of our common stock at an exercise price of \$0.40 which expire in June 2018. The fair value of the warrants and the intrinsic value of the beneficial conversion feature resulted in an aggregate \$114,919 discount on these new convertible notes payable.

**2015 Unit Offering Warrants**

Pursuant to the terms of our 2015 Unit Offering (see Note 4), during the six-month period ended June 30, 2015, we issued warrants to purchase up to an aggregate 2,732,800 shares of our common stock at an exercise price of \$0.40 per share. These warrants were issued to investors and as commissions, and are set to expire June 1, 2020. The fair value of the warrants and the intrinsic value of the beneficial conversion feature resulted in an aggregate \$645,000 discount on the convertible notes payable.

**Summer 2013 Warrants**

Pursuant to the terms of our Summer 2013 Offering (see Note 4), since inception in June 2013 through its termination on March 31, 2014, we issued warrants to purchase up to an aggregate 3,370,000 shares of our common stock to the investors in the Summer 2013 Offering at an exercise price of \$0.30 per share. Of this amount, we issued warrants to purchase up to an aggregate 3,110,000 shares of our common stock during the six-month period ended June 30, 2014. These warrants are set to expire October 15, 2015.

**Clyra 2014 Warrants**

Pursuant to the terms of the Clyra 2014 Spring Offering (see Note 4), during the six-month period ended June 30, 2014, we issued warrants to purchase up to an aggregate 880,000 shares of our common stock to the investors in the Clyra 2014 Spring Offering at an exercise price of \$1,833.33 per share. These warrants expired unexercised July 30, 2015.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

During the six-month period ended June 30, 2015, two Clyra shareholders exercised their BioLargo warrant and tendered an aggregate 75 Clyra shares in exchange for 300,000 shares of BioLargo common stock. Subsequent to June 30, 2015, the final three Clyra investors exercised their BioLargo warrants and tendered 115 shares of Clyra common stock to BioLargo, and were issued an aggregate 460,000 shares of BioLargo common stock. All Clyra investors that participated in the Clyra 2012 and Clyra 2014 Private Securities Offering exercised tendered their shares of Clyra common stock for Biolargo common stock.

**Note 8. Stock-Based Compensation and Other Employee Benefit Plans**

During the six-month periods ended June 30, 2014 and 2015, we recorded an aggregate \$442,374 and \$655,655 in selling general and administrative expense related to options issued pursuant to our 2007 Equity Incentive Plan and to options issued outside of the 2007 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 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 April 20, 2015, we issued an option to purchase 700,000 shares of our common stock to a consultant. The option vests ratably over ten-months, expires ten years from the date of issuance, and is exercisable at \$0.40 per share. The price of our common stock on the grant date was \$0.34 per share. The fair value of this option totaled \$238,000 and is being expensed as selling, general and administrative expense over the vesting period.

On June 24, 2015, our board of directors extended by five years the expiration of an option to purchase 200,000 shares of our common stock issued to our Chief Science Officer in February 2010. The option was issued in exchange for unpaid salary obligation at an exercise price of \$0.575 and now expires February 5, 2020. Fair value of the option totaled \$68,000 of additional selling, general and administrative expenses.

On June 24, 2015, the date of our annual stockholder meeting, we recorded the issuance of options to purchase an aggregate 40,000 shares of our common stock to the non-employee members of our Board of Directors, pursuant to the terms of the 2007 Equity Plan which calls for an annual automatic issuance. The options expire ten years from the date of issuance, and are exercisable at \$0.38 per share, the price of our common stock on the grant date. The fair value of these options totaled \$15,200 and was recorded as selling, general and administrative expense.

On June 23, 2014, the date of our annual stockholder meeting, we recorded the issuance of options to purchase an aggregate 40,000 shares of our common stock to the non-employee members of our Board of Directors, pursuant to the terms of the 2007 Equity Plan which calls for an annual automatic issuance. The options expire ten years from the date of issuance, and are exercisable at \$0.63 per share, the price of our common stock on the grant date. The fair value of these options totaled \$25,200 and was recorded as selling, general and administrative expense.

## BIOLARGO, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Activity for our stock options under the 2007 Plan for the six-month period ended June 30, 2014 and 2015 is as follows:

	<b>Options Outstanding</b>	<b>Shares Available</b>	<b>Price per share</b>	<b>Weighted Average Price per share</b>
Balances as of December 31, 2013	8,521,086	4,260,742	\$ 0.23 – 1.89	\$ 0.44
Granted	40,000	(40,000 )	\$ 0.63	0.63
Exercised	—	—	\$ —	—
Expired	—	—	\$ —	—
Balances as of June 30, 2014	8,561,086	4,420,742	\$ 0.23 – 1.89	\$ 0.44

	<b>Options Outstanding</b>	<b>Shares Available</b>	<b>Price per share</b>	<b>Weighted Average Price per share</b>
Balances as of December 31, 2014	8,601,086	4,420,742	\$ 0.23 – 1.89	\$ 0.44
Granted	940,000	(940,000 )	\$ 0.38 – 0.575	0.44
Exercised	—	—	\$ —	—
Expired	(200,000 )	—	\$ 0.575	0.575
Balances as of June 30, 2015	9,341,086	3,480,742	\$ 0.23 – 1.89	\$ 0.43

*Options issued Outside of the 2007 Equity Incentive Plan*

On June 29, 2015, we issued options to purchase 218,143 shares of our common stock at an exercise price of \$0.35 per share to vendors, in lieu of \$50,900 in accrued and unpaid fees. The fair value of these options totaled \$76,350, resulting in \$25,450 of additional selling, general and administrative expenses.

On June 29, 2015, we issued options to purchase 192,857 shares of our common stock at an exercise price of \$0.35 per share to our members of our board of directors, in lieu of \$45,000 in accrued and unpaid fees due for their services on the board. The fair value of these options totaled \$67,500, resulting in \$22,500 of additional selling, general and administrative expenses.

On April 20, 2015, we issued an option to purchase 75,000 shares of our common stock to a consultant. The option is vested at issuance, expires ten years from the date of issuance, and is exercisable at \$0.34 per share, the price of our common stock on the grant date was \$0.34 per share. The fair value of this option totaled \$25,500 and was recorded as selling, general and administrative expense.

On April 19, 2015, we issued an option to purchase an aggregate 200,000 shares of our common stock to two consultants. The options vested at issuance, expire ten years from the date of issuance, and are exercisable at \$0.37 per share. The price of our common stock on the grant date was \$0.34 per share. The fair value of these options totaled \$74,000 and was recorded as selling, general and administrative expense.

On March 31, 2015, we issued options to purchase 387,676 shares of our common stock at an exercise price of \$0.36 per share to two vendors, in lieu of \$91,750 in accrued and unpaid fees. The fair value of these options totaled \$137,625, resulting in \$45,875 of additional selling, general and administrative expenses.

On March 30, 2015, we issued options to purchase 190,142 shares of our common stock at an exercise price of \$0.36 per share to our members of our board of directors, in lieu of \$45,000 in accrued and unpaid fees due for their services on the board. The fair value of these options totaled \$68,451, resulting in \$23,451 of additional selling, general and administrative expenses.

On February 5, 2015, we issued an option to purchase 200,000 shares of our common stock to a consultant. The option vests after a period of ten months from the date of grant, expires ten years from the date of issuance, and is exercisable at \$0.33 per share. The fair value of this option totaled \$66,000 and is being expensed over the vesting period.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

On June 24, 2014, we issued options to purchase 103,847 shares of our common stock at an exercise price of \$0.65 per share to our board of directors in lieu of \$45,000 in accrued and unpaid fees. The fair value of the Options totaled \$67,501, resulting in \$22,501 of additional selling, general and administrative expenses.

On June 24, 2014, we issued options to purchase 148,848 shares of our common stock at an exercise price of \$0.65 per share to vendors in lieu of \$64,500 in accrued and unpaid fees. The fair value of the Options totaled \$96,750, resulting in \$32,250 of additional selling, general and administrative expenses.

On June 23, 2014, BioLargo, Inc. (the "Company") and its Chief Financial Officer Charles K. Dargan, II formally agreed to extend the engagement agreement dated February 1, 2008 (the "Engagement Agreement", which had been previously extended multiple times), pursuant to which Mr. Dargan has been serving as the Company's Chief Financial Officer. The Engagement Extension Agreement dated as of June 23, 2014 (the "Engagement Extension Agreement") provides for an additional term to expire January 31, 2015 (the "Extended Term"), and is retroactively effective to February 1, 2014. During the Extended Term, Mr. Dargan shall be compensated through the issuance of an option to purchase 300,000 shares of the Company's common stock, at a strike price of \$0.63 per share, to expire June 23, 2024, and to vest over the term of the engagement with 100,000 shares vested as of June 23, 2014, and the remaining shares to vest 25,000 monthly, provided that the Engagement Extension Agreement with Mr. Dargan has not been terminated prior to each vesting date. During the six-month period ended June 30, 2014, we recorded \$78,750 in selling, general and administrative expense for this option.

On March 31, 2014, we issued options to purchase 156,888 shares of our common stock at an exercise price of \$0.43 per share to our board of directors, in lieu of \$45,000 in accrued and unpaid fees. The fair value of the Options totaled \$67,461, resulting in \$22,461 of additional selling, general and administrative expenses.

On March 31, 2014, we issued options to purchase 78,488 shares of our common stock at an exercise price of \$0.43 per share to a vendor, in lieu of \$22,500 in accrued and unpaid fees. The fair value of the Options totaled \$33,750, resulting in \$11,250 of additional selling, general and administrative expenses.

On February 20, 2014, we issued options to purchase 40,000 shares of our common stock at an exercise price of \$0.35 per share, set to expire February 20, 2024, and to vest over the term of the agreement. The fair value of the Options



totaled \$14,000 of additional selling, general and administrative expenses.

Activity of our stock options issued outside of the 2007 Plan for the six-month period ended June 30, 2014 and 2015 is as follows:

	<b>Options</b>	<b>Price</b>	<b>Weighted Average Price per</b>
	<b>Outstanding</b>	<b>per share</b>	<b>share</b>
Balances as of December 31, 2013	16,398,395	\$ 0.18 – 1.89	\$ 0.41
Granted	816,532	\$ 0.43 – 0.65	\$ 0.62
Exercised	—	\$ —	—
Expired	—	\$ —	—
Balances as of June 30, 2014	17,214,927	\$ 0.18 – 1.00	\$ 0.39

	<b>Options</b>	<b>Price</b>	<b>Weighted Average Price per</b>
	<b>Outstanding</b>	<b>per share</b>	<b>share</b>
Balances as of December 31, 2014	17,965,291	\$ 0.18 – 1.00	\$ 0.39
Granted	1,463,818	\$ 0.34 – 0.36	0.35
Exercised	—	\$ —	—
Expired	—	\$ —	—
Balances as of June 30, 2015	19,429,109	\$ 0.18 – 1.00	\$ 0.39

## BIOLARGO, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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 six-month period ended June 30:

	2014		2015	
	<b>Non Plan</b>	<b>2007 Plan</b>	<b>Non Plan</b>	<b>2007 Plan</b>
Risk free interest rate	2.63 – 2.73%	2.63 %	1.83 – 2.33%	1.62 - 2.38 %
Expected volatility	927 - 935 %	927 %	807 - 821 %	326 - 807 %
Expected dividend yield	—	—	—	—
Forfeiture rate	—	—	—	—
Expected life in years	7	7	7	3-7

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.

**Note 10. Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses included the following:

	<b>December 31, 2014</b>	<b>June 30, 2015</b>
Accounts payable and accrued expenses	\$ 313,286	\$ 203,622
Uncertain tax position	137,500	137,500
Accrued interest	32,256	53,390
Officer and board of director payables	11,896	49,452
Total accounts payable and accrued expenses	\$ 494,938	\$ 443,964

#### **Note 11. Non-Controlling Interest**

In May 2012, we formed a subsidiary for the purpose of marketing and selling medical products containing our technology, Clyra Medical Technologies, Inc. (“Clyra”). Until December 17, 2012, this subsidiary was wholly owned, with 7,500 shares issued to BioLargo, Inc. On December 17, 2012, Clyra signed executive employment agreements with three individuals, in which each was granted 500 shares of Clyra common stock, 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.

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Clyra sold shares of its common stock (see Note 4). The holdings of the Clyra executive officers and investors represented 19.6% of the issued and outstanding stock of the company as of June 30, 2015.

From inception, Clyra has generated no revenues and the financial impact of Clyra's operations for the six-month period ended June 30, 2015, resulted in a net loss of \$57,930.

**Note 12. 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 June 30, 2015, we received \$25,000 and issued a convertible promissory note with a maturity date of June 1, 2018 to three investors in our 2015 Unit Offering (see Note 4). Each investor, for no additional consideration, received a stock purchase warrant exercisable at \$0.40 per share, which expires June 1, 2020. We issued warrants to purchase an aggregate 420,000 shares.

**Exercise of Warrants Issued to Clyra Investors**

Subsequent to June 30, 2015, the final three Clyra investors exercised their BioLargo warrants and tendered 115 shares of Clyra common stock to BioLargo, and were issued an aggregate 460,000 shares of BioLargo common stock.



**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 technology and products incorporating our technology;
- the effects of competitive factors on our technology and products incorporating our technology;
- 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 technology in industries other than the animal health industry and to bring viable products to market in such industries;
- the application of our technology in the food and beverage industry;
- the willingness of other companies to incorporate our technology 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 technology;
- the continued success and viability of our licensees holding the exclusive right to exploit our technology 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 technology 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 ending December 31, 2015. Unless otherwise expressly stated herein, all statements, including forward-looking statements, set forth in this Form 10-Q are as of June 30, 2015, 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, and Odor-No-More, Inc., a California corporation, BioLargo Water USA, Inc., its 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 condensed consolidated financial statements and the related notes to the consolidated financial statements included elsewhere in this report.

## Overview

We make life better by delivering simple and sustainable solutions to big problems. 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.

### 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.

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**’. These results have been replicated and confirmed in five unique design configurations, validating the initial results from the University of Alberta.



*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. Our product designs include liquids, sprays, gels, powders, coatings and absorbents.

*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 steam 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.

***Our Research Lab at the University of Alberta***

We are engaged in a cooperative research relationship with the University of Alberta and its researchers in Edmonton, Canada. We lease office and dedicated research lab space in two large academic and pilot labs at “Agri-Food Discovery Place” within the University of Alberta, approximately 2,000 square feet. We conduct most of our AOS Filter research and development activities in this labs or elsewhere on the on the University of Alberta campus. Our research team is led by Richard Smith, Ph.D., and our Chief Science Officer, Kenneth Reay Code. We currently have seven full time researchers on staff, as well as eight university employed researchers working for us pursuant to contacts with the university. We work closely with the Department of Agricultural, Food and Nutritional Science at the University of Alberta and its Department of Engineering.

Included in the seven full time researchers are two recent hires, , Dr. Ahmed Moustafa and Mr. Alex Evans, and a consultant starting in the fall, Dr. Michael Gaultois. These gentlemen bring a vast amount of expertise to our team. Dr. Ahmed Moustafa is spearheading the design of a scaled up AOS unit to validate performance at industrial scale. Dr. Moustafa is a former Fulbright Scholar and brings a superb skillset to the team, drawing on a Ph.D. in Environmental Engineering, a Master’s in Water Resources Engineering, as well as a Master’s in Environmental Engineering. His expertise will allow BioLargo to transition and demonstrate the AOS technology’s capabilities for large-scale water treatment applications.

Alex Evans is assisting with initiatives that expand the disinfection capabilities of the AOS technology. His expertise stems from a Master of Science with Specialization in Microbiology and Biotechnology, in which his focus was bacterial adaptation to stress. Mr. Evans’ research into the anti-viral activities of AOS will allow BioLargo to widen the scope of the AOS technology’s disinfection applications.

Dr. Michael Gaultois will be collaborating this fall with BioLargo on AOS reactor and experimental design, as well as consulting on physical and materials chemistry. Dr. Gaultois is a former Fulbright Scholar and has a Ph.D. in Chemistry, specific to new functional material design and characterization, as well as a MSc in Chemistry. He currently conducts research via a European Union Marie Sklodowska-Curie Fellowship at the University ofCambridge, UK. His expertise will be used to further refine and enhance the performance of the AOS technology’s filter materials.

***Canadian Research Grants***

We have been awarded a number of 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 to support work on and around our technology; and second, grants to BioLargo Water, Inc., our Canadian Subsidiary, to support ongoing science and engineering to advance our AOS Filter towards commercialization. In both cases, the financial awards support much of the research budget, but not all of the related costs. This cooperative research arrangement 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, (iii) independent and credible validation of our technical claims. We have been awarded eight grants, and have applied for three additional grants totaling over \$1 million Canadian dollars. (See Part II, Item 1a Risk Factors.)

**Clarion Water**

As announced on August 18, 2014, we entered into a manufacturing and distribution license agreement for its 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., 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.

Since licensing the technology from BioLargo last August, 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 February of 2015, Clarion Water introduced the new and improved Isan System at the world's largest agricultural trade show, the World AG Expo, as part of its commercial launch into the U.S. market. It is currently testing the product at multiple customer sites, primarily golf courses.

### **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. In March 2015, our distribution partner Downeast Logistics was awarded a \$150,000 "Indefinite Delivery Purchase Order"

(IDPO) for 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. The DLA has the option to expand the maximum award up to \$300,000 for the year. There are no minimums under the IDPO, and the DLA can choose to purchase any amount, including zero, up to the maximum amount of \$300,000. To date, purchases under the IDPO have been nominal.

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.

Additionally, we continue to seek relationships with established companies for potential technology licenses in which our technology would be incorporated into new products for existing brands, or established products.

**Results of Operations—Comparison of the three and six-month periods ended June 30, 2014 and 2015.**

**Revenue and cost of goods sold**

We record revenue from three sources – product sales, licensing, and government grants. Our revenue from product sales for the three and six-month periods ended June 30, 2014 and 2015 remained nominal. Our product revenue continues to consist primarily of sales of our Odor-No-More branded animal bedding additive to horse stables and a farming retailer, our Specimen Transport Solidifier pouches to the U.S. Defense Logistics Agency, and our Suction Canister Solidifiers to primarily military hospitals. We also generated nominal sales from the private label of our liquid Stain and Odor Eliminator products. A small portion of our product sales came pursuant to the IDPO with the Defense Logistics Agency (see “Commercial, Household and Personal Care Products” above). Sales under the contract have been steady but nominal, and we have no assurance under that contract as to the amount of product the Defense Logistics Agency will purchase during that time. For sales of our Odor-No-More branded products, we do not currently have the financial resources to devote to the marketing and sale of these products, and do not expect a material change in product sales until we can significantly invest in sales and marketing.

We have not recognized any licensing revenue during the periods covered by this Report. In February 2014 we entered into a license agreement with Clarion Water, (see Note 3), and received a \$100,000 deposit towards licensing revenues. The deposit is included on our Balance Sheet as a liability, and will be credited to revenues as of the earlier of license revenues generated under the license agreement, or June 30, 2016. Subsequent to June 30, 2016, to retain its exclusive rights, Clarion must pay to us minimum license fees of \$50,000 per quarter.

Our grant revenues consists of grants received from the Canadian government and industry research agencies per the efforts by our wholly owned Canadian subsidiary, BioLargo Water, Inc. The grants are awarded to fund research activities at our lab at the University of Alberta. Eight grants in the aggregate amount of \$168,500 have been awarded, of which \$37,028 was recognized in the six-month period ended June 30, 2015. All funds received 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, and currently have grant applications pending in the aggregate amount of approximately \$1,050,000, with additional grant applications in preparation. 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. (See Part II, Item 1a, Risk Factors.)

**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 expense. While our total SG&A did not differ materially in the 2015 versus 2014 periods covered by this Report, our cash expenses decreased by approximately 30% (from \$1,008,763 to \$813,362) due to a smaller amount of investor funding during 2015 (as compared with 2014), and we thus were forced to rely on the issuance of stock and options to officers, employees and vendors in lieu of cash payments larger non-cash payments to fund operations.

The differences from period-to-period in our net cash used in operating activities are dependent on our cash position during the period. If we have sufficient cash reserves from financing activities, we typically pay employees and vendors in cash. If we do not have cash during the period, we issue common stock or options to purchase common stock to compensate employees and vendors the remainder of what they are owed. We do so at the end of the quarter. When we issue options, we do so pursuant to a plan adopted by our board of directors that allows us to set a price based on the trading price of our common stock. The options we issue typically have a fair value greater than the cash owed, and that fact increases our non-cash expense.

The largest components of our SG&A expenses were salaries and payroll-related expenses (\$191,959 and \$336,283 for the three and six-month periods ended June 30, 2015), consulting expenses (\$311,362 and \$416,358 for the three and six-month periods ended June 30, 2015), professional fees (\$103,326 and \$214,771 for the three and six-month periods ended June 30, 2015), and investor relations fees (\$31,782 and \$74,175 for the three and six-month periods ended June 30, 2015).

### **Research and Development**

We expect our research and development activities to continue to increase over time, especially as grant revenue increases. The increase in 2015 versus 2014 is reflective of the grants that have been awarded. The amounts reported on our financial statements do not include the portions of grants paid directly to the University of Alberta employees working on our technology. We currently have seven full time researchers on staff, as well as eight university employed researchers working on research projects pursuant to contacts with the university.

### **Interest expense**

Our interest expense increased in the 2015 periods covered by this Report. The increase is the result from issuing convertible notes payable in Q4 of 2014 and continued during the six month period ended June 30, 2015. The fair value of the warrants and the intrinsic value of the beneficial conversion feature resulted in a full discount on our convertible notes. This discount is being amortized as interest expense over the term of the convertible notes. We expect our interest expense to continue to increase.

### **Liquidity and Capital Resources**

The accompanying condensed 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 \$1,995,086 for the six-month period ended June 30, 2015, and at June 30, 2015, we had negative working capital of \$545,517, current assets of \$164,105, and an accumulated stockholders' deficit of \$81,003,461. 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 technology. 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 and cash equivalents were \$96,948 at June 30, 2015. We recorded revenues of \$66,514 in the six-month period ended June 30, 2015, 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 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 June 30, 2015, we had \$1,042,919 principal amount outstanding on our convertible note payables (see Note 5), and \$443,964 of outstanding accounts payable and accrued expenses. (See Note 10.)

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. We may also be compelled to reduce or curtail certain activities to preserve cash. We have been, and may continue to be, required to financially support the operations our subsidiaries, none of which are operating at a positive cash flow.

In addition to the private securities offerings discussed above, we are continuing to explore numerous alternatives for our current and longer-term financial requirements, including additional raises of capital from investors in the form of convertible debt or equity. There can be no assurance that we will be able to raise any additional capital. No commitments are in place as of the date of the filing of this report for any such additional financings. Moreover, in light of the current unfavorable economic conditions, we do not believe that any such financing is likely to be in place in the immediate future.

It is also unlikely that we will be able to qualify for bank or other financial institutional debt financing until such time as our operations are considerably more advanced and we are able to demonstrate the financial strength to provide confidence for a lender, which we do not currently believe is likely to occur for at least the next 12 months or more.

If we are unable to raise sufficient capital, we may be required to curtail some of our operations, including efforts to develop, test, market, evaluate and license our BioLargo technology. If we were forced to curtail aspects of our operations, there could be a material adverse impact on our financial condition and results of operations.

### **Critical Accounting Policies**

Our discussion and analysis of our results of operations and liquidity and capital resources are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, valuation of intangible assets and investments, convertible debt, and share-based payments. We base our estimates on anticipated results and trends and on various other assumptions that we believe are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results that differ from our estimates could have a significant adverse effect on our operating results and financial position. We believe that the following significant accounting policies and assumptions may involve a higher degree of judgment and complexity than others.

The methods, estimates and judgments the Company uses in applying these most critical accounting policies have a significant impact on the results of the Company reports in its financial statements.

It the Company's policy to expense share based payments as of the date of grant in accordance with Auditing Standard Codification Topic 718 "Share-Based Payment." Application of this pronouncement requires significant judgment regarding the assumptions used in the selected option pricing model, including stock price volatility and employee exercise behavior. Most of these inputs are either highly dependent on the current economic environment at the date of grant or forward-looking expectations projected over the expected term of the award. As a result, the actual impact of adoption on future earnings could differ significantly from our current estimate.

The Company accounts for hybrid contracts such as convertible notes payable that feature conversion options in accordance with applicable generally accepted accounting principles ("GAAP"). ASC 815 *Derivatives and Hedging Activities*, ("ASC 815") requires companies to bifurcate conversion options from their host instruments and account for

them as free standing derivative financial instruments according to certain criteria. The criteria includes circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument.

Conversion options that contain variable settlement features such as provisions to adjust the conversion price upon subsequent issuances of equity or equity linked securities at exercise prices more favorable than that featured in the hybrid contract generally result in their bifurcation from the host instrument.

The Company accounts for convertible instruments, when management has determined that the embedded conversion options should not be bifurcated from their host instruments, in accordance with ASC 470-20 *Debt with Conversion and Other Options* (“ASC 470-20”). Under ASC 470-20 the Company records, when necessary, discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note.

### **Recent Accounting Pronouncements**

See Note 2.

### **Inflation**

Inflation affects the cost of raw materials, goods and services we use. In recent years, inflation overall has been modest, but we believe inflation may increase our costs in the near future. We seek to mitigate the adverse effects of inflation primarily through improved productivity and strategic buying initiatives. Additionally, some of our products incorporate oil-based polymers, which are subject to price fluctuations based on the price of crude oil, as well as shortages.

### **Item 4. Controls and Procedures**

We conducted an evaluation, under the supervision and with the participation of management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Report.

Our procedures have been designed to ensure that the information relating to our company, including our consolidated subsidiaries, required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow for timely decisions regarding required disclosure. Based on this evaluation, our chief executive officer and chief financial officer concluded that as of the evaluation date our disclosure controls and procedures are effective.

It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1a. Risk Factors**

The following risk factor is supplemented to the Risk Factors contained in our Annual Report on Form 10-K filed March 31, 2015, beginning at page 12.

*We may not be able to obtain, or to agree on acceptable terms and conditions for, all or a significant portion of the government or agency grants for which we have applied and may in the future apply. As a result, our business and prospects may be adversely affected.*

We have applied for Canadian government agency grants under programs designed to stimulate the economy and support research and development activities in Edmonton, Canada. We anticipate that in the future there will be new opportunities for us to apply for grants. Our ability to obtain funds or incentives from Canadian government agency sources is subject to the availability of funds under applicable programs and approval of our applications to participate in such programs. The application process for these funds and other incentives is and will be highly competitive. We cannot assure you that we will be successful in obtaining any of these additional grants. If we are not successful in obtaining any of these additional incentives and we are unable to find alternative sources of funding to meet our planned capital needs, our research and development of our AOS filter and related technologies, and resulting business and prospects, could be materially adversely affected.

#### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

##### **Stock Issued**

On April 20, 2015, we issued 100,000 shares to a consultant providing business development services, as well as an option to purchase 700,000 shares of common stock pursuant to our 2007 Equity Incentive Plan. The stock was issued at a price of \$0.34 per share. The option exercise price was \$0.40 per share, and the shares vest over 10 months.

On June 30, 2015, we issued an aggregate 316,086 shares of our common stock, at \$0.35 per share, to employees, officers and consultants in lieu of accrued and unpaid compensation and unreimbursed expenses.

On June 30, 2015, we issued 32,821 shares of our common stock as payment for rent at a contract price based on rent due for the three prior months in the amount of \$11,250, at a price of \$0.33 per share.

On June 30, 2015, we issued 300,000 shares of common stock to two investors in the Clyra 2014 offering, in exchange for 75 shares of Clyra common stock previously purchased by the investors for \$75,000.

**Issuance of Stock Options in exchange for payment of payables**

On June 29, 2015, we issued Options to purchase 411,000 shares of our common stock at an exercise price of \$0.35 per share to members of our board of directors, certain vendors and consultants, in lieu of \$95,900 in accrued and unpaid fees, pursuant to our an “accounts payable” conversion plan adopted by our Board of Directors.

**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. 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. 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 gross proceeds of \$3,000,000 are raised in the Offering.

Purchasers of the Units will receive a convertible promissory note bearing interest at the rate of 12% per annum on the amount invested. Any 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. 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. Notes mature on June 1, 2018.

In addition to the convertible promissory note, each investor will receive a "Series A Warrant" allowing 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.

In accordance with the terms of our 2015 Unit Offering (see Note 4), during the six-month period ended June 30, 2015, we received \$645,000 and issued unsecured convertible promissory notes with a maturity date of June 1, 2018, which accrue interest at a rate of 12% per annum. Each investor, for no additional consideration, received a stock purchase warrant exercisable at \$0.40 per share, which expires June 1, 2020. We issued warrants to purchase an aggregate 2,732,800 shares to investors and for commissions.

All of these offerings and sales were made in reliance on the exemption from registration contained in Section 4(2) of the Securities Exchange Act and/or Regulation D promulgated thereunder as not involving a public offering of securities.

## **Item 6. Exhibits**

The exhibits listed below are attached hereto:

<b><u>Exhibit No.</u></b>	<b><u>Description of Exhibit</u></b>
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Exhibit 31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and Rules 13(a)-14 and 15(d)-14 under the Securities Exchange Act of 1934
Exhibit 31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and Rules 13(a)-14 and 15(d)-14 under the Securities Exchange Act of 1934
Exhibit 32*	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.
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

† Management contract or compensatory plan, contract or arrangement

\* Filed herewith

\*\* Furnished herewith

(1) Incorporated herein by reference from the Form 8-K filed by the Company on June 23, 2014.

## **SIGNATURES**

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

BIOLARGO, INC.

Date: August 7, 2015 By: /s/ DENNIS P. CALVERT  
Dennis P. Calvert

Chief Executive Officer

Date: August 7, 2015 By: /s/ CHARLES K. DARGAN, II  
CHARLES K. DARGAN, II

Chief Financial Officer

**EXHIBIT INDEX**

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