CLEARSIGN COMBUSTION CORP
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from ______________ to _______________

Commission File Number 001-35521

CLEARSIGN COMBUSTION CORPORATION

(Exact name of registrant as specified in its charter)

WASHINGTON	**26-2056298**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

12870 Interurban Avenue South

Seattle, Washington 98168

(Address of principal executive offices)

(Zip Code)

(206) 673-4848

(Registrant’s telephone number, including area code)

No change

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x	Smaller reporting company x Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided to Section 7(a)(2)(B) of the Securities Act. ¨

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

As of November 8, 2018, the issuer has 26,660,980 shares of common stock, par value $.0001, issued and outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ClearSign Combustion Corporation and Subsidiary

Condensed Consolidated Balance Sheets

(Unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 18,078,000	$ 1,247,000
Contract assets	39,000	184,000
Prepaid expenses and other assets	576,000	366,000
Total current assets	18,693,000	1,797,000
Fixed assets, net	362,000	498,000
Patents and other intangible assets, net	1,929,000	1,856,000
Other assets	10,000	10,000
Total Assets	$ 20,994,000	$ 4,161,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 778,000	$ 768,000
Current portion of lease liabilities	163,000	159,000
Accrued compensation and taxes	650,000	607,000
Total current liabilities	1,591,000	1,534,000
Long Term Liabilities:		
Long term lease liabilities	73,000	195,000
Total liabilities	1,664,000	1,729,000
Commitments		
Stockholders' Equity:		
Preferred stock, $0.0001 par value, zero shares issued and outstanding	-	-

Common stock, $0.0001 par value, 26,660,980 and 15,608,853 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	3,000	2,000
Additional paid-in capital	76,297,000	52,441,000
Accumulated deficit	(56,970,000)	(50,011,000)
Total stockholders' equity	19,330,000	2,432,000
Total Liabilities and Stockholders' Equity	$ 20,994,000	$ 4,161,000

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

ClearSign Combustion Corporation and Subsidiary

Condensed Consolidated Statements of Operations

(Unaudited)

	For the Three Months Ended September 30, 2018	For the Three Months Ended September 30, 2017	For the Nine Months Ended September 30, 2018	For the Nine Months Ended September 30, 2017
Sales	$ -	$ -	$ 530,000	$ 360,000
Cost of goods sold	9,000	15,000	424,000	266,000
Gross profit (loss)	(9,000)	(15,000)	106,000	94,000
Operating expenses:				
Research and development	980,000	1,329,000	3,133,000	3,644,000
General and administrative	1,326,000	1,131,000	3,956,000	3,569,000
Total operating expenses	2,306,000	2,460,000	7,089,000	7,213,000
Loss from operations	(2,315,000)	(2,475,000)	(6,983,000)	(7,119,000)
Other income:				
Interest income	23,000	3,000	24,000	32,000
Net loss	$ (2,292,000)	$ (2,472,000)	$ (6,959,000)	$ (7,087,000)
Net loss per share - basic and fully diluted	$ (0.09)	$ (0.16)	$ (0.32)	$ (0.46)
Weighted average number of shares outstanding - basic and fully diluted	25,555,705	15,603,880	21,573,884	15,358,655

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

ClearSign Combustion Corporation and Subsidiary

Condensed Consolidated Statement of Stockholders' Equity

(Unaudited)

For the Nine Months Ended September 30, 2018

	Common Stock Shares	Amount	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity
Balances at December 31, 2017	15,608,853	$ 2,000	$ 52,441,000	$ (50,011,000)	$ 2,432,000
Shares issued in stock offerings ($2.25 per share)	10,963,543	1,000	24,667,000	-	24,668,000
Issuance costs of offerings	-	-	(1,157,000)	-	(1,157,000)
Shares issued for services ($3.50 per share)	7,500	-	26,000	-	26,000
Shares issued for board service ($1.85 per share)	81,084	-	150,000	-	150,000
Share based compensation	-	-	170,000	-	170,000
Net loss	-	-	-	(6,959,000)	(6,959,000)
Balances at September 30, 2018	26,660,980	3,000	76,297,000	(56,970,000)	19,330,000

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

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ClearSign Combustion Corporation and Subsidiary

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net loss	$ (6,959,000)	$ (7,087,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Common stock issued for services	176,000	258,000
Share based compensation	170,000	284,000
Depreciation and amortization	267,000	209,000
Abandonment and impairment of capitalized patents pending	35,000	-
Change in operating assets and liabilities:		
Contract assets	145,000	(126,000)
Accounts receivable	-	103,000
Prepaid expenses and other assets	(210,000)	(40,000)
Accounts payable and accrued liabilities	10,000	116,000
Accrued compensation and taxes	43,000	322,000
Contract liabilities	-	(115,000)
Net cash used in operating activities	(6,323,000)	(6,076,000)
Cash flows from investing activities:		
Acquisition of fixed assets	(44,000)	(89,000)
Disbursements for patents and other intangible assets	(313,000)	(250,000)
Net cash used in investing activities	(357,000)	(339,000)
Cash flows from financing activities:		
Proceeds from issuance of common stock and units of common stock and warrants for cash, net of offering costs	23,511,000	8,667,000
Net cash provided by financing activities	23,511,000	8,667,000
Net increase in cash and cash equivalents	16,831,000	2,252,000
Cash and cash equivalents, beginning of period	1,247,000	1,259,000
Cash and cash equivalents, end of period	$ 18,078,000	$ 3,511,000

<u>Supplemental disclosure of non-cash operating activities:</u>

During the six months ended June 30, 2017, the Company issued 136,110 shares of common stock to its officers in satisfaction of $490,000 of accrued compensation at December 31, 2016.

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

ClearSign Combustion Corporation

Notes to Unaudited Condensed Financial Statements

Note 1 – Organization and Description of Business

ClearSign Combustion Corporation (ClearSign or the Company) designs and develops technologies for the purpose of improving key performance characteristics of combustion systems, including emission and operational performance, energy efficiency and overall cost-effectiveness. The Company's primary technologies include its Duplex™ technology, which achieves very low emissions without the need of external flue gas recirculation, selective catalytic reduction, or higher excess air operation, and its Electrodynamic Combustion Control™ or ECC™ technology, which introduces a computer-controlled electric field into the combustion region that may better control gas-phase chemical reactions and improve system performance and cost-effectiveness. The Company is headquartered in Seattle, Washington and was incorporated in the state of Washington in 2008. On July 28, 2017, the Company incorporated a subsidiary, ClearSign Asia, Limited, in Hong Kong. During the quarter ended September 30, 2018, the subsidiary commenced operations.

Liquidity

The Company's technologies are currently in field development and have generated nominal revenues from operations to date to meet operating expenses. In order to generate meaningful revenues, the technologies must be fully developed, gain market recognition and acceptance, and develop a critical level of successful sales and product installations. The Company has historically financed its operations primarily through issuances of equity securities, including $11.9 million in proceeds, net of offering costs, from the stock offering completed on February 27, 2018 and $11.6 million in proceeds, net of offering costs, from a stock offering completed on July 20, 2018 as described in Note 6. The Company has incurred losses since its inception totaling $56,970,000 and expects to experience operating losses and negative cash flow for the foreseeable future. Management believes that the successful growth and operation of the Company's business is dependent upon its ability to obtain adequate sources of funding through co-development agreements, strategic partnering agreements, or equity or debt financing to adequately support research and development efforts, protect intellectual property, form relationships with strategic partners, and provide for working capital and general corporate purposes. There can be no assurance that the Company will be successful in achieving its long-term plans as set forth above, or that such plans, if consummated, will result in profitable operations or enable the Company to continue in the long-term as a going concern.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

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

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

The accompanying unaudited condensed financial statements include the accounts of Clearsign and its subsidiary. Intercompany balances and transations have been eliminated in consolidation.

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 certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition, Cost of Sales and Change in Accounting Principle

The Company recognizes revenue and related cost of goods sold in accordance with FASB ASC 606 *Revenue from Contracts with Customers* (ASC 606). Revenues and cost of goods sold are recognized once the goods or services are delivered to the customer's control and performance obligations are satisfied. Typically, the Company's contracts with customers have performance obligations regarding air emissions and operational performance that are satisfied upon completion of service. Since this is the singular performance obligation and cannot be achieved until the air emissions and operational performance have been successfully tested, revenue related to the contracts is recognized upon project completion.

The Company's contracts generally include progress payments from the customer upon completion of defined milestones. As these payments are received they are offset against accumulated project costs and recorded as either contract assets or contract liabilities. Upon completion of the performance obligations and acceptance by the customer the projects can be recorded as revenue.

The Company's contracts with customers contain no variable considerations or incentives or discounts that would cause revenue to be allocated or adjusted over time. Therefore, no separate methods of evaluating the contracts other than consideration of the price at achievement of the performance objectives was used in satisfying the review requirements of ASC 606.

Contract Acquisition Costs and Practical Expedients

For contracts that have a duration of less than one year, the Company follows the practical expedients provisions of ASC 606 and expenses those costs when incurred; for contracts with a life exceeding one year, the Company records those costs when performance obligations related to the contract are completed. The Company generally expenses sales commissions when earned and records those costs within general and administrative expenses.

Product Warranties

The Company warrants all installed products against defects in materials and workmanship for a period specified in each contract by replacing failed parts. Accruals for product warranties are based on historical warranty experience and current product performance trends, and are recorded at the time revenue is recognized as a component of cost of sales. The warranty liabilities are reduced by material and labor costs used to replace parts over the warranty period in the periods in which the costs are incurred. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary, and such adjustments could be material in the future if estimates differ significantly from actual warranty expense. The warranty liabilities are included in accrued liabilities in the balance sheets.

Cash and Cash Equivalents

Highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents. Cash is maintained with a commercial bank where accounts are generally guaranteed by the Federal Deposit Insurance Corporation up to $250,000. The Company’s deposits may at times exceed this limit. The Company also maintains a cash balance in China. Accounts at such banks are insured up to $75,000 (500,000RMB). The Company has not experienced losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount. An allowance for doubtful accounts is established, as necessary, based on past experience and other factors which, in management's judgment, deserve current recognition in estimating bad debts. The determination of the collectability of amounts due from customer accounts requires the Company to make judgments regarding future events and trends. Allowances for doubtful accounts are determined based on assessing the Company's portfolio on an individual customer and on an overall basis. This process consists of a review of historical collection experience, current aging status of the customer accounts, and the financial condition of the Company's customers. Based on a review of these factors, the Company may establish or adjust the allowance for specific customers and the accounts receivable portfolio as a whole.

Fixed Assets

Fixed assets are recorded at cost. Leases are recorded in accordance with FASB ASC 842 *Leases*. For those leases with a term greater than one year, the Company recognizes on the balance sheet at the time of lease inception or modification a right-of-use asset and a lease liability, initially measured at the present value of the lease payments. Lease costs are recognized in the income statement over the lease term on a straight-line basis. Operating leases with a term of 1 year or less are recognized on a straight line basis over the term. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are depreciated over the life of the lease or their useful life, whichever is shorter. All other fixed assets are depreciated over two to four years. Maintenance and repairs are expensed as incurred.

Patents and Trademarks

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

Impairment of Long-Lived Assets

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

Fair Value of Financial Instruments

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

- Level 1 – Quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company's financial instruments primarily consist of cash and cash equivalents, accounts payable and accrued expenses. As of the balance sheet dates, the estimated fair values of the financial instruments were not materially different from their carrying values as presented on the balance sheets. This is primarily attributable to the short term maturities of these instruments.

The Company did not identify any other non-recurring assets and liabilities that are required to be presented in the balance sheets at fair value.

Research and Development

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

Income Taxes

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

Stock-Based Compensation

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

Net Loss per Common Share

Basic loss per share is computed by dividing loss available to common stockholders by the weighted-average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include additional common shares available upon exercise of stock options and warrants using the treasury stock method, except for periods for which no common share equivalents are included because their effect would be anti-dilutive. At September 30, 2018 and 2017, potentially dilutive shares outstanding amounted to 3,534,579 and 3,474,094, respectively.

Recently Adopted Standards

In May, 2017 the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-09 *Scope of Modification Accounting, clarifies Topic 718, Compensation – Stock Compensation*, which requires a company to apply modification accounting to changes in the terms or conditions of a share-based payment award unless all of the following criteria are met: (1) the fair value of the modified award is the same as the fair value of the original award immediately before the modification. The ASU indicates that if the modification does not affect any of the inputs to the valuation technique used to value the award, the entity is not required to estimate the value immediately before and after the modification; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the modification; and (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the modification. The ASU is effective for all entities for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company currently does not have any modifications to existing stock compensation agreements and will be able to calculate the impact of the ASU once modifications arise.

Recently Issued Accounting Announcements

In June 2018, the FASB issued ASU 2018-07 "*Compensation - Stock Compensation (Topic 718): Improvements to Nonemployees Share-Based Payment Accounting*" ("ASU 2018-07"). The intention of ASU 2018-07 is to expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. These sharebased payments will now be measured at grant-date fair value of the equity instrument issued. Upon adoption, only liabilityclassified awards that have not been settled and equity-classified awards for which a measurement date has not been established should be remeasured through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018 and is applied retrospectively. The Company currently does not expect this ASU to have any material impact on the financial statements as all non-employee agreements are valued within the expected guidelines of the standard.

Management does not believe that any other recently issued, but not yet effective, authoritative guidance, if currently adopted, would have a material impact on the Company's consolidated financial statement presentation or disclosures.

Reclassifications

Certain items in prior period financial statements have been reclassified to conform to current period financial statements.

Note 3 – Fixed Assets

Fixed assets are summarized as follows:

	September 30, 2018 *(unaudited)*	December 31, 2017
Machinery and equipment	$ 832,000	$ 801,000
Office furniture and equipment	177,000	167,000
Leasehold improvements	150,000	147,000
Right of use asset-operating leases	518,000	518,000
Accumulated depreciation and amortization	(1,315,000)	(1,135,000)

	$ 362,000	$ 498,000

The Company has a triple net operating lease for office and laboratory space in Seattle, Washington through March 2020 with rent of $12,000 per month plus triple net operating costs. The Company also has a triple net operating lease for office space in Tulsa, Oklahoma through August 2019 with monthly rent of $2,000 per month plus triple net operating costs. Both leases include lessee renewal options for three years at the then prevailing market rate.

Lease costs for the three and nine months ended September 30, 2018 and 2017 and other quantitative disclosures are as follows (unaudited):

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	For the three months ended September 30, 2018	2017	For the nine months ended September 30, 2018	2017
Lease cost:				
Operating lease cost	$ 52,000	$ 94,000	$ 158,000	$ 209,000
Short-term lease cost	-	-	-	-
Total lease cost	$ 52,000	$ 94,000	$ 158,000	$ 209,000

Other information:	
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$130,000
For operating lease:	
Weighted average remaining lease term (in years)	1.44
Weighted average discount rate	5.00 %

Minimum future payments under the Company's leases at September 30, 2018 and their application to the corresponding lease liabilities are as follows (unaudited):

	Discounted lease liability payments	Payments due under lease agreements
2018	$ 40,000	$ 43,000
2019	158,000	164,000
2020	38,000	37,000
Total	$ 236,000	$ 244,000

Note 4 – Patents and Other Intangible Assets

Patents and other intangible assets are summarized as follows:

	September 30, 2018 **(unaudited)**	December 31, 2017
Patents		
Patents pending	$ 1,246,000	$ 1,167,000
Issued patents	1,120,000	930,000
	2,366,000	2,097,000

Trademarks		
Trademarks pending	50,000	41,000
Registered trademarks	23,000	23,000
	73,000	64,000
Other	8,000	8,000
	2,447,000	2,169,000
Accumulated amortization	(518,000)	(313,000)
	$ 1,929,000	$ 1,856,000

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Future amortization expense associated with issued patents and registered trademarks as of September 30, 2018 is estimated as follows (unaudited):

2018	$69,000
2019	255,000
2020	165,000
2021	73,000
2022	38,000
Thereafter	25,000
	$625,000

Note 5 – Sales, Contract Assets and Contract Liabilities

The Company recognized no revenue during the three months ended September 30, 2018. For the nine months ended September 30, 2018 the Company recognized revenues totaling $360,000 from completed flare projects, $128,000 of revenue from completion of a once through steam generator (OTSG) project and revenue of $42,000 from a small project. At September 30, 2018, the Company had contract assets of $39,000 and contract liabilities of $0. The cost of goods sold of $9,000 and $15,000 recognized during the three months ended September 30, 2018 and 2017, respectively, related to additional warranty costs incurred for completed contracts.

Note 6 – Stockholders' Equity

Common Stock and Preferred Stock

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

In February 2018, the Company completed an underwritten public offering of 5,750,000 shares of common stock at a price of $2.25 per share. Gross proceeds from the offering totaled $12.9 million and net cash proceeds approximated $11.9 million.

In July 2018, the Company completed a private equity offering of 5,213,543 shares of common stock at a price of $2.25 per share to ClirSPV, LLC (Investor). Gross proceeds from the offering totaled $11.7 million and net cash proceeds approximated $11.6 million. The Stock Purchase Agreement permits the Investor to purchase from the Company up to an aggregate 478,854 shares of common stock at a price of $4 per share (Additional Purchase Right). Pursuant to the terms of the Additional Purchase Right, the Investor will have the right to purchase shares of common stock from the Company as the warrants issued by the Company in its January 25, 2017 rights offering are exercised and the warrant shares are issued. The Additional Purchase Right expires on February 1, 2019. As of September 30, 2018, no warrants issued in the rights offering have been exercised. The Additional Purchase Right is an equity instrument accounted for as a component of the actual price per common share paid by the Investor in the private offering. For basic earnings per share, the common shares associated with the Additional Purchase Right are treated as contingently issuable shares and will not be included in basic earnings per share until the actual number of shares have been issued.

The Stock Purchase Agreement also permits the Investor to participate in future capital raising transactions (Participation Right) on the same terms as other investors participating in such transactions. The Participation Right will expire on December 31, 2023.

In no event may the Additional Purchase Right and/or the Participation Right be exercised to the extent it would cause the Investor or any of its affiliates to beneficially own 20% or more of the Company’s then outstanding common stock or hold shares with 20% or more of the voting power.

The Company filed a registration statement to register the shares issued in this private offering and shares underlying the Additional Purchase Right. The registration statement was declared effective by the SEC on September 21, 2018.

Equity Incentive Plan

The Company has adopted and the Company's shareholders have approved the ClearSign Combustion Corporation 2011 Equity Incentive Plan (the Plan) which permits the Company to grant to eligible participants, including officers, employees, directors, consultants and advisors, options to purchase shares of common stock, stock awards and stock bonuses. The Compensation Committee of the Board of Directors is authorized to administer the Plan and establish the grant terms, including the grant price, vesting period and exercise date. As of September 30, 2018, the number of shares of common stock reserved for issuance under the Plan totaled 2,343,686. The Plan provides for quarterly increases in the available number of authorized shares equal to the lesser of 10% of any new shares issued by the Company during the quarter immediately prior to the adjustment date or such lesser amount as the Board of Directors shall determine.

In the nine months ended September 30, 2018, the Company granted 224,000 stock options under the Plan to employees. The stock options have exercise prices at the grant date fair value ranging from $1.85 to $2.10 per share, contractual lives of 10 years, and vest over 3-4 years. The fair value of the stock options estimated on the date of grant using the Black-Scholes option valuation model was $239,000. The recognized compensation expense associated with these grants for the three and nine months ended September 30, 2018 was $15,000 and $43,000, respectively. The following weighted-average assumptions were utilized in the calculation of the fair value of the stock options:

Expected life	6.25	
Weighted average volatility	69	%
Forfeiture rate	15	%
Weighted average risk-free interest rate	2.75	%
Expected dividend rate	0	%

In May 2018, the Company authorized 108,108 shares of common stock to be issued under the Plan to its four independent directors in accordance with board agreements and which will be earned quarterly for service in 2018. The fair value of the stock at the time of grant was $1.85 per share for a total value of $200,000. The Company recognized $150,000, represented by 81,084 shares, in general and administrative expense for the nine months ended September 30, 2018 and will recognize the remaining $50,000 in the remainder of 2018.

Outstanding stock option grants at September 30, 2018 and December 31, 2017 totaled 1,038,795 shares and 993,860 shares, respectively, with the right to purchase 694,881 shares and 754,989 shares being vested and exercisable at

September 30, 2018 and December 31, 2017, respectively. The recognized compensation expense associated with these grants for the three and nine months ended September 30, 2018 and 2017 totaled $59,000, $170,000, $65,000 and $284,000, respectively. On October 1, 2018 the number of shares reserved under the Plan but unissued totaled 1,171,000. At September 30, 2018, there was $446,000 of total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted average period of 2.7 years.

Consultant Stock Plan

The Company has a Consultant Stock Plan (the Consultant Plan) which provides for the granting of shares of common stock to consultants who provide services related to capital raising, investor relations, and making a market in or promoting the Company’s securities. The Company’s officers, employees, and board members are not entitled to receive grants from the Consultant Plan. The Compensation Committee of the Board of Directors is authorized to administer the Consultant Plan and establish the grant terms. The number of shares reserved for issuance under the Consultant Plan on September 30, 2018 totaled 200,524 with 149,774 of those shares unissued. The Consultant Plan provides for quarterly increases in the available number of authorized shares equal to the lesser of 1% of any new shares issued by the Company during the quarter immediately prior to the adjustment date or such lesser amount as the Board of Directors shall determine. In August 2017, the Company granted 10,000 shares of common stock under the Consultant Plan to a consultant for services provided and to be provided from June 2017 to June 2018. Subject to completion of service each quarter, this contract was extended without modification through September 2018. The fair value of the stock at the time of grant was $3.50 per share for a total value of $35,000 which the Company recognizes in general and administrative expense on a pro-rated quarterly basis. The Consultant Plan expense for the three and nine months ended September 30, 2018 and 2017 was $9,000 and $26,000 and $9,000 and $33,000, respectively.

Warrants

The Company has the following warrants outstanding at September 30, 2018:

Exercise Price	Warrants	Wtd. Avg. Exercise Price	Remaining Life (in years)
$1.80	80,000	$ 1.80	2.38
$4.00	2,395,471	$ 4.00	0.32
$10.00	20,313	$ 10.00	0.43
	2,495,784	$ 3.98	

The intrinsic value of the outstanding warrants was $0 at September 30, 2018.

Note 7 – Commitments

The Company and its Chief Executive Officer, Stephen E. Pirnat entered into an employment agreement on February 3, 2015 that was amended on October 30, 2017 (the Agreement) and which terminates on December 31, 2018, unless earlier terminated. Compensation under the Agreement includes an annual salary of $350,000, a grant of 300,000 stock options that vested in 2016 and 2017, an annual cash bonus that may equal up to 60% of his annual salary and equity bonuses based on performance standards established by the Compensation Committee of the Board of Directors, medical and dental benefits for Mr. Pirnat and his family, other employee benefits offered to employees generally and relocation expenses up to approximately $100,000. The Agreement may be terminated by the Company without cause under certain circumstances, as defined in the Agreement, whereby a severance payment would be due in the amount of compensation that would have been due pursuant to the Agreement had employment not been terminated or one year of the current annual compensation, whichever is greater. In the event of his termination through a change in control, Mr. Pirnat would receive one year’s compensation, and all previously granted stock options would vest in full. On October 1, 2018 Mr. Pirnat announced his intention to retire, but will remain in any capacity in which he is needed to facilitate a smooth transition. The board has engaged an internationally known search firm to conduct the search for a new CEO.

The Company has a field test agreement with a customer to demonstrate and test the Duplex technology in an OTSG used to facilitate a thermally enhanced oil recovery process. Under the terms of the agreement, the Company has retrofitted an OTSG unit in order to achieve certain performance criteria. The agreement also includes time-sensitive pricing, delivery and installation terms, if elected, that will apply to future purchases of this Duplex application by this customer.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION CONTAINED IN THIS REPORT

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

- our history of losses;
- our ability to successfully develop and implement our technology and achieve profitability;
- our limited operating history;
- emerging competition and rapidly advancing technology in our industry that may outpace our technology;
- changes in government regulations that could substantially reduce, or even eliminate, the need for our technology;
- customer demand for the products and services we develop;
- the impact of competitive or alternative products, technologies and pricing;
- our ability to manufacture any products we design;
- general economic conditions and events and the impact they may have on us and our potential customers;
- our ability to obtain adequate financing in the future;
- our ability to continue as a going concern;
- our success at managing the risks involved in the foregoing items; and
- other factors discussed in this report and in the section titled "Risk Factors" in our Annual Report on Form 10-K.

Forward-looking statements may appear throughout this report, including, without limitation, Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations." The forward-looking statements are based upon management's beliefs and assumptions and are made as of the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements included in this report. You should not place undue reliance on these forward-looking statements.

Unless otherwise stated or the context otherwise requires, the terms "ClearSign," "we," "us," "our" and the "Company" refer t ClearSign Combustion Corporation and its subsidiary.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited consolidated condensed financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q as well as our audited financial statements and related notes included in our Annual Report on Form 10-K. In addition to historical information, this discussion and analysis here and throughout this Form 10-Q contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements due to a number of factors, including but not limited to, the risks described in the section titled "Risk Factors" in our Annual Report on Form 10-K.

OVERVIEW

We design and develop technologies for the purpose of improving key performance characteristics of combustion systems, including emission and operational performance, energy efficiency and overall cost-effectiveness. We believe that our patented Duplex™ technology is capable of enhancing the performance of combustion systems in a broad range of markets, including the energy (upstream oil production and down-stream refining), commercial/industrial boiler, chemical, petrochemical, and power industries. Our Duplex technology, which is our primary technology, uses a porous ceramic tile above a standard burner to significantly reduce flame length and achieve very low emissions without the need for external flue gas recirculation, selective catalytic reduction, or excess air systems. To date, our operations have been funded primarily through sales of our equity securities. We have earned nominal revenue since inception in 2008. In order to generate meaningful revenues, our technologies must be fully developed, gain market recognition and acceptance, and develop a critical level of successful sales and product installations.

While we have recently begun commercializing our Duplex technology, Duplex has had limited testing and verification by independent third parties. However, based on the results of our laboratory and field testing as well as our initial commercialized installations in different applications, we believe that this proprietary technology is capable of improving emissions control performance and operational performance for many types of industrial and commercial combustion systems. As a result, we also believe that Duplex may reduce costs associated with the construction (including refurbishment and upgrade), operation and maintenance of these combustion systems as compared to combustion systems that use no or alternative technologies to enhance combustion and control emissions.

Based on the results of our testing, we believe that Duplex compares favorably with current industry-standard air pollution control technologies, such as selective catalytic reduction devices, low- and ultra-low NOx burners (which address nitrogen oxides or NOx), excess air systems and other similar technologies. Such systems are used in our current target market segments of petroleum refining and petrochemical process heaters, large-scale once through steam generators (OTSGs), enclosed ground flares, and packaged boilers.

We were incorporated in Washington on January 23, 2008. The address of our corporate headquarters is 12870 Interurban Avenue South, Seattle, Washington 98168 and our telephone number is (206) 673-4848. Our website can be accessed at www.clearsign.com. The information contained on or that may be obtained from our website is not a part of this report. To date, our operations have been located in the United States, but we are actively pursuing opportunities in China and Europe.

Our Industry

The combustion and emissions control markets are significant, both in the wide array of industries in which the systems are used and in the amount of money spent in installing and upgrading systems. These are used to provide heat for all manner of industrial processes including boilers, furnaces, kilns and turbines. In order to maximize energy efficiency while keeping pace with regulatory guidelines for air pollution emissions, operators of these systems are continually installing, maintaining and upgrading a variety of costly process control, air pollution control and monitoring systems. Although we believe that there are many potential markets for our Duplex technology, to date we have targeted the introduction of Duplex to certain high-value segments including petroleum refining process heaters, steam generation, and enclosed ground flares.

Our initial target markets center on the energy sector, including upstream crude oil production through the use of OTSGs and wellhead enclosed flares and downstream oil refineries through the use of process heaters and boilers. In recent years, the energy sector has been significantly affected by the volatile market price of crude oil and marginal economic growth. Crude oil prices increased during 2018 due to some instability in certain markets and commodities along with an improving but less certain economic outlook. According to the U.S. Energy Information Administration, the spot price of West Texas intermediate crude oil in the last five years has ranged from approximately $110 per barrel to approximately $25 per barrel, with 2018 prices ranging from $58 to $75 per barrel and October 2018 prices approximating $75 per barrel. Regardless of the effect of crude oil price volatility, based upon our experience and feedback from current and prospective customers, we believe that the value of our Duplex technology to the energy sector continues to be validated because of the technology’s ability to cost-effectively lower emissions and drive certain operational efficiencies.

Operators in all of our target markets are under intense pressure to meet current and proposed federal, state and local pollution emissions standards. The standards applicable to our target markets have been developed over the past 50 years with broad political input. Due to the localized effects of poor air quality, we expect these standards to continue to become more stringent regardless of political leadership. We believe this to be the case in the U.S. and worldwide in most major developed and developing countries. As an illustration, air pollution emission standards are most stringent in the states of California and Texas, historically politically leaning in opposite directions. As a result, these standards are a significant driver in our development and sales efforts. We believe that our Duplex technology can provide a unique, cost-effective pollution control solution for operators in comparison to all known competing products.

Emissions standards largely emanate from the Clean Air Act, which is administered by the Environmental Protection Agency (EPA) and which regulates six common criteria air pollutants, including ground-level ozone. These regulations are enforced by state and local air quality districts as part of their compliance plans. As a precursor to ground-level ozone, NOx is a regulated emission by local air quality districts in order to achieve the EPA limits. The 8-hour ground-level ozone regulations have been reduced from 84 parts per billion (ppb) in 1997, to 75 ppb in 2008, and 70 ppb in 2015, with the requirement of realizing these levels approximately 25 years following the year of legislation. The areas of non-attainment related to the 1997 limit of 84 ppb are depicted below in the map on the left and the projected areas of non-attainment related to the 2015 limit of 70 ppb are depicted below in the map on the right.

Non-attainment areas under the 1997 limit of 84 ppb
Source: EPA, August 2016

Projected non-attainment areas under the 2015 limit of 70 ppb
Source: URS, August 2015

Additionally, we believe that current emissions standards in Europe, China and Canada will continue to trend towards stricter air emission standards as these jurisdictions seek to achieve cleaner air. Existing and new emissions standards in such jurisdictions may create additional market opportunities for us.

We have noted that local air quality districts in EPA designated “severe non-attainment zones” in California are uncertain as to how they will achieve the 2015 standard. As such, we believe that local regulators are in search of additional means beyond those included in the current regulations to comply with the impending standards. For example, although NOx emissions from refineries and other oil production and processing operations are highly regulated since they are historically a significant source of stationary NOx emissions, enclosed ground flares have not historically been viewed as a source requiring the same level of regulation. We believe that our Duplex technology is uniquely able to address the emissions challenges being faced by oil producers and other industries as those challenges relate to both current and reasonably predictable future local air emission standards.

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Product Applications of Duplex

We have to date applied our Duplex technology through retrofits of existing burners. These often involve engineering around an existing burner architecture that can complicate the Duplex installation. Because of this, we believe that the retrofit market is best suited for larger projects and larger applications of Duplex.

Process Heaters in the Oil Refining Industry

We have completed laboratory testing and our first field test at a Texas oil refinery of the Duplex Plug & Play™, a recently developed burner product for refinery and industrial process heater applications. To date we have successfully retrofitted two process heaters with the standard Duplex and one with the Duplex Plug & Play design. We have two additional installations in process. The Duplex Plug & Play design provides a more simplified, pre-engineered and standardized direct burner replacement for traditional refinery process heaters. We believe that this product will reduce the customized engineering associated with typical retrofits and lend itself to mass production. The product derives its name from the fact that it is designed to allow quick and easy installation into a multi-burner heater or furnace and possibly allow the heater to continue operating during installation rather than be shut down. If field testing continues to confirm this design attribute, the ability to install the Duplex Plug & Play while the remaining burner system is operational will allow customers to limit down time and shorten the sales cycle often prolonged by annual or semi-annual scheduled maintenance. We plan to continue field testing of additional configurations and burner sizes to further enhance the performance and dependability of the product. If successful, we believe that this product, our first complete burner product, will be suitable for licensing and potential manufacturing arrangements with original equipment manufacturers (OEMs) with established manufacturing and distribution capabilities.

Wellhead Enclosed Ground Flares

A major California oil producer approached us in early 2016 to address a unique emission compliance need relating to wellhead enclosed ground flares. We developed a Duplex application and received contracts for a total of six units, all of which have been completed as of September 30, 2018. This has been an important milestone because it demonstrates the broad application of our Duplex technology in the ground flare market.

Based upon discussions with local regulators and examination of regulatory reports, we believe that flare emissions are a potential target for increased regulation, in part because the success of our installations to date has shown regulators that establishing emissions standards for ground flares is possible. In anticipation of this, we are pursuing potential customers with target ground flare applications that would benefit from our proven installations.

OTSGs in Enhanced Oil Recovery Industry

We have successfully installed our Duplex technology in three OTSG projects in the enhanced oil recovery industry in Southern California. We believe that our successful installations in the OTSG market to date are gaining regulator acceptance by the Southern California regulatory authorities and, as a result, market acceptance.

Duplex's Emission Results and Licensing

We have now achieved emission results which exceed current local Best Available Control Technology (BACT) levels in multiple installations in California related to three of our five target industries. We intend to continue to demonstrate Duplex capabilities through (i) working with local air quality officials to demonstrate the effectiveness of the technology, (ii) operating in-place units, (iii) engineering and testing with new customers and applications, (iv) pursuing additional lab research and development of new applications (e.g. packaged boilers) and next generation improvements to Duplex design and standardization, including the pursuit of more complete systems similar to the Duplex Plug & Play for application in other vertical markets, and (v) assisting our customers in making emission results available for designation as BACT by local regulatory bodies.

Our business plan contemplates licensing our technology after we prove commercial viability and generate interest from OEMs. We believe licensing would significantly change the makeup of our sales mix, sales cycles, and margins. Licensing our technology within one or an array of selected vertical markets (e.g. burners for refinery process heaters or packaged boilers) could dramatically accelerate the global sales and market adoption rate of our technology. In order to create channel flexibility and meet end user demand however, we intend to continue to pursue end user customers through direct sales, sub-contractors and channel partners. While we are currently pursuing various licensing arrangements, we have no agreements at this time and do not anticipate entering into any such agreements prior to completing the field development projects discussed above and completing a meaningful number of installations and sales. We believe that the continuing development of Duplex, the completion of sales and an increase in end-users will enhance our ability to license our technology.

Historically, we have funded our operations through the sale of our securities Over the years we have raised a gross of $72 million and a net of $65.9 million through six offerings of our securities.

Our costs include employee salaries and benefits, compensation paid to consultants, materials and supplies for research, costs associated with development activities including materials, sub-contractors, travel and administration, legal expenses, sales and marketing costs, general and administrative expenses, and other costs associated with an early stage, publicly-traded technology company. We currently have 18 full-time employees and 1 part-time employee. The development of new products and any increase in sales of our existing products may result in an increase to the number of employees required to support our activities in the areas of research and development, sales and marketing, and general and administrative functions. We expect to continue to incur consulting expenses related to technology development commensurate with our current levels and we expect to continue to incur expenses to protect our intellectual property.

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

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

We cannot assure that our technology will be accepted, that we will ever earn revenues sufficient to support our operations, or that we will ever be profitable. Furthermore, we have no committed source of financing and we cannot assure that we will be able to raise money as and when we need it to continue our operations. If we cannot raise funds as and when we need them, we may be required to scale back our development plans by reducing expenditures for employees, consultants, business development and marketing efforts or to otherwise severely curtail, or even to cease, our operations.

CRITICAL ACCOUNTING POLICIES

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

Revenue Recognition and Cost of Goods Sold. Effective January 1, 2017, the Company retroactively adopted ASU No. 2014-09 which has as its core principle that an entity should recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in the exchange for those goods or services. The Company reviews each contract to identify contract rights, performance obligations, and transaction prices, including the allocation of prices to separate performance obligations. Revenues and costs of sales are recognized once the goods or services are delivered to the customer's control and performance obligations are satisfied. Typically, the Company's customer contracts include performance obligations related to emission levels or other metrics that are measured at project completion. Since this is the singular performance obligation and cannot be achieved until the air emissions and operational performance have been successfully tested, revenue related to the contracts is recognized upon project completion.

Product Warranties. The Company warrants all installed products against defects in materials and workmanship for a period specified in each contract by replacing failed parts. Accruals for product warranties are based on historical warranty experience and current product performance trends, and are recorded at the time revenue is recognized as a component of cost of sales. The warranty liabilities are reduced by material and labor costs used to replace parts over the warranty period in the periods in which the costs are incurred. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary and such adjustments could be material in the future if estimates differ significantly from actual warranty expense. The warranty liabilities are included in accrued liabilities in the balance sheets.

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

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

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

The Company's financial instruments primarily consist of cash and cash equivalents, accounts payable and accrued expenses. As of the balance sheet date, the estimated fair values of the financial instruments were not materially different from their carrying values as presented on the balance sheets. This is primarily attributed to the short maturities of these instruments. The Company has lease assets as defined in Note 2 and disclosed in Note 3 to the financial statements. The Company did not identify any other non-recurring assets and liabilities that are required to be presented in the balance sheets at fair value.

RESULTS OF OPERATIONS

Comparison of the Three and Nine Months Ending September 30, 2018 and 2017

Sales and Gross Profit. Gross profit of $106,000, or 20%, was realized on product sales totaling $530,000 in the nine months ended September 30, 2018. This profit resulted from the installation of our Duplex technology in two enclosed ground flares for a major California oil producer and in an OTSG owned by another major California oil producer. We earned no revenues during the quarter ended September 30, 2018, referred to herein as Q3 2018. We incurred $9,000 in warranty costs during Q3 2018 which resulted in a gross loss. We earned $360,000 in revenues and realized a gross profit of $94,000 from the installation of our Duplex technology in two enclosed ground flares for a major California oil producer during the nine month period ending September 30, 2017 and no revenues during the quarter ended September 30, 2017, referred to herein as Q3 2017.

Operating Expenses. Operating expenses, consisting of research and development (R&D) and general and administrative (G&A) expenses, decreased by approximately $154,000 to $2,306,000 for Q3 2018, as compared to $2,460,000 for Q3 2017. The Company decreased its R&D expenses by $349,000, or approximately 26%, to $980,000 for Q3 2018 as compared to $1,329,000 for Q3 2017. The decrease in R&D expenses was due primarily to decreased field testing and development costs of our Duplex technology. G&A expenses increased by $195,000, or approximately 17%, to $1,326,000 in Q3 2018 as compared to $1,131,000 in Q3 2017, resulting primarily from increased intellectual property expenses including a write-down of $35,000, amortization, professional fees, and compensation, offset by reduced selling and marketing costs.

Operating expenses decreased by approximately $124,000, to $7,089,000 for the nine months ended September 30, 2018 compared to $7,213,000 for the same period in 2017. The Company decreased its R&D expenses by $511,000, or approximately 14%, to $3,133,000 for 2018 as compared to $3,644,000 for the same period in 2017. Like the decrease in R&D expenses for the quarter, the decrease in R&D expenses for the nine months ended September 30, 2018 was due primarily to decreased field testing and development costs of our Duplex technology. G&A expenses increased by $387,000, or approximately 11%, to $3,956,000 in 2018 as compared to $3,569,000 in 2017 resulting primarily from increased intellectual property and personnel expenses.

Loss from Operations. Our loss from operations decreased during Q3 2018 by $160,000, to $2,315,000 in Q3 2018 from $2,475,000 in Q3 2017 and decreased for the nine months ended September 30, 2018 by $136,000, to $6,983,000 as compared with $7,119,000 for the nine months ended September, 30, 2017.

Net Loss. Primarily as a result of the decrease in field testing costs, our net loss for Q3 2018 was $2,292,000 as compared to a net loss of $2,472,000 for Q3 2017, resulting in a decreased net loss of $180,000 or approximately 7%, and our net loss for the nine months ended September 30, 2018 was $6,959,000 as compared to a net loss of $7,087,000 for the same period in 2017, resulting in a decrease in net loss of $128,000 or approximately 2%.

Liquidity and Capital Resources

At September 30, 2018, our cash and cash equivalent balance totaled $18,078,000 compared to $1,247,000 at December 31, 2017. This increase resulted primarily from $11.9 million in net proceeds we received from an underwritten public offering of 5,750,000 shares of our common stock at a price of $2.25 per share in February 2018, and a private offering of 5,213,543 shares of common stock at a price of $2.25 per share which provided $11.6 million in net proceeds in July 2018, offset by operating costs. Assuming that our expenses do not increase significantly and that we make no material acquisitions, we anticipate that the current available cash and cash equivalent balance will be sufficient to fund the Company’s ongoing business activities into 2020.

At September 30, 2018, our current assets were in excess of current liabilities resulting in working capital of $17,102,000 compared to $263,000 at December 31, 2017. The increase in working capital resulted primarily from the net proceeds of the February and July 2018 offerings, offset by the funds used in operations and invested in intangible and fixed assets.

Operating activities for the nine months ended September 30, 2018 resulted in cash outflows of $6,323,000 which were due primarily to the loss for the period of $6,959,000 and net changes in working capital, exclusive of cash, which reduced cash flow by $12,000. These were offset primarily by other non-cash expenses of $302,000 and services paid with common stock and stock options of $346,000. Operating activities for the nine months ended September 30, 2017 resulted in cash outflows of $6,076,000, which were due primarily to the loss for the period of $7,087,000 and net changes in working capital (exclusive of cash) which increased cash flow by $260,000 and were partially offset by services paid with common stock and stock options of $542,000 and other non-cash expenses of $209,000.

Investing activities for the nine months ended September 30, 2018 resulted in cash outflows of $313,000 for development of patents and $44,000 for acquisition of fixed assets, compared to $250,000 in disbursements for patent development and $89,000 for the acquisistion of fixed assets during the same period of 2017.

There were net cash inflows from financing activities of $23,511,000 from the February and July 2018 securities offerings in the nine months ended September 30, 2018. During the same period in 2017, there were net cash inflows of $8,667,000 from a rights offering we completed in January 2017.

Off-Balance Sheet Transactions

We do not have any off-balance sheet transactions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Disclosure controls and procedures

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer (CEO) (principal executive officer) and our Interim Chief Financial Officer (CFO) (principal financial and accounting officer), has concluded that, as of September 30, 2018, our disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

There have been no material changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well-designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on 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. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II-OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties and an adverse result in these or other matters may arise from time to time that may harm our business. We are currently not aware of any such legal proceedings or claims that we believe will have a material adverse effect on our business, financial condition or operating results.

ITEM 1A. RISK FACTORS

We incorporate herein by reference the risk factors included under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017 which we filed with the Securities and Exchange Commission on March 27, 2018. There have been no material changes to such risk factors as of September 30, 2018.

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

On September 28, 2018 we issued 2,500 shares of common stock, having a per share value of $3.50, the closing price of our common stock on August 3, 2017, the date of grant, from our 2013 Consultant Stock Plan to our investor relations firm, Three Part Advisors, LLC, for services provided in the three months ended September 30, 2018.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

On November 6, 2018 the Company’s Board of Directors voted to separate the positions of Chairman of the Board and Chief Executive Officer and elected Robert T. Hoffman Sr. as Chairman of the Board.

ITEM 6. EXHIBITS

Exhibit Number	Document
3.1	Articles of Incorporation of ClearSign Combustion Corporation, amended on February 2, 2011 (1)
3.1.1	Articles of Amendment to Articles of Incorporation of ClearSign Combustion Corporation filed on December 22, 2011 (2)
3.2	Bylaws (1)
10.1	Stock Purhcase Agreement dated July 12, 2018 between ClearSign Combustion Corporation and CLIRSPV, LLC (3)
10.2	Registration Rights Agreement dated July 20, 2018 between ClearSign Combustion Corporation and CLIRSPV, LLC (4)
10.3	Voting Agreement dated July 20, 2018 between ClearSign Combution Corporation and CLIRSPV, LLC (4)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer*
31.2	Rule 13a-14(a)/15d-14(a) Certification of Interim Chief Financial Officer*
32.1	Section 1350 Certification of Chief Executive Officer and Interim Chief Financial Officer+
101.INS	XBRL Instant Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*

*Filed herewith

+Furnished herewith

(1) Incorporated by reference from the registration statement on Form S-1 filed by ClearSign Combustion Corporation on March 18, 2011.

(2) Incorporated by reference from pre-effective amendment number 2 to the registration statement on Form S-1 filed by ClearSign Combustion Corporation on February 7, 2012.

(3) Incorporated by reference from the Current Report on Form 8-K filed by ClearSign Combustion Corporation on July 17, 2018.

(4) Incorporated by reference from the Current Report on Form 8-K filed by ClearSign Combustion Corporation on July 20, 2018.

SIGNATURES

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

	CLEARSIGN COMBUSTION CORPORATION (Registrant)
Date: November 8, 2018	By: /s/ Stephen E. Pirnat Stephen E. Pirnat Chief Executive Officer
	By: /s/ Brian G. Fike Brian G. Fike Interim Chief Financial Officer