

BIOLARGO, INC.
Form 10-Q
November 14, 2018

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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 000-19709

Large accelerated filer

Accelerated filer

Emerging growth company

Non-accelerated filer

Smaller reporting 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 pursuant to Section 13(a) of the Exchange Act.

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 November 9, 2018 was 132,292,528 shares.

Table of Contents

BIOLARGO, INC.

FORM 10-Q

INDEX

PART I

Item 1 <u>Financial Statements</u>	1
Item 2 <u>Management's Discussion and Analysis and Financial Condition and Results of Operations</u>	26
Item 4 <u>Controls and Procedures</u>	34

PART II

Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	36
Item 5 <u>Other Information</u>	36
Item 6 <u>Exhibits</u>	36
<u>Signatures</u>	38

i.

Table of Contents**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements****BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2017 AND SEPTEMBER 30, 2018**

	DECEMBER 31, 2017	SEPTEMBER 30, 2018 (Unaudited)
Assets		
Current assets:		
Cash and cash equivalents	\$990,457	\$533,542
Accounts receivable, net of allowance of \$2,500 and \$0, at December 31, 2017 and September 30, 2018	94,413	112,419
Inventories	53,973	46,194
Prepaid expenses and other current assets	20,000	60,173
Total current assets	1,158,843	752,328
Leasehold improvements and equipment, net of depreciation	108,865	125,219
Other non-current assets	32,530	35,215
Deferred offering cost	195,182	176,123
Total assets	\$1,495,420	\$1,088,885
Liabilities and stockholders' deficit		
Current liabilities:		
Accounts payable and accrued expenses	\$224,105	\$361,063
Convertible notes and notes payable	5,248,847	1,383,108
Lines of credit	—	430,000
Discount on debt obligations, net of amortization	(1,257,182)	(345,858)
Total current liabilities	4,215,770	1,828,313
Long-term liabilities:		
Convertible notes and note payable	1,539,271	460,000
Discount on debt obligations, net of amortization	(850,000)	(218,556)
Total liabilities	4,905,041	2,069,757

COMMITMENTS AND CONTINGENCIES (Note 10)

STOCKHOLDERS' EQUITY (DEFICIT):

Convertible Preferred Series A, \$.00067 Par Value, 50,000,000 Shares Authorized, no Shares Issued and Outstanding, at December 31, 2017 and September 30, 2018	—	—
Common stock, \$.00067 Par value, 200,000,000 and 400,000,000 shares authorized, 104,164,465 and 132,036,574 shares issued, at December 31, 2017 and September 30, 2018	69,871	88,617
Additional paid-in capital	97,093,144	108,214,683
Accumulated deficit	(101,204,846)	(109,591,476)
Accumulated other comprehensive loss	(62,489)	(67,373)
Total Biolargo, Inc. and Subsidiaries stockholders' equity (deficit)	(4,104,320)	(1,355,549)
Non-controlling interest (Note 8)	694,699	374,677
Total stockholders' equity (deficit)	(3,409,621)	(980,872)
Total liabilities and stockholders' equity (deficit)	\$1,495,420	\$1,088,885

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****AND COMPREHENSIVE LOSS****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2018****(UNAUDITED)**

	THREE-MONTHS		NINE-MONTHS	
	SEPTEMBER	SEPTEMBER	SEPTEMBER	SEPTEMBER
	30, 2017	30, 2018	30, 2017	30, 2018
Revenues				
Product revenue	\$ 172,045	\$ 245,979	\$ 318,040	\$ 785,929
Service revenue	—	31,047	—	80,864
Total revenue	172,045	277,026	318,040	866,793
Cost of revenue				
Cost of goods sold	(123,278)	(97,578)	(219,207)	(426,042)
Cost of service	—	(23,968)	—	(59,608)
Total cost of revenue	(123,278)	(121,546)	(219,207)	(485,650)
Gross profit	48,767	155,480	98,833	381,143
Selling, general and administrative expenses	1,117,790	1,365,980	3,334,863	3,852,198
Research and development	425,670	443,359	1,141,286	1,390,665
Amortization and depreciation	6,647	13,443	21,086	36,302
Operating loss:	(1,501,340)	(1,667,302)	(4,398,402)	(4,898,022)
Other (expense) income:				
Interest expense	(848,735)	(265,632)	(2,921,564)	(2,826,839)
Debt conversion expense	—	—	—	(275,534)
Loss on extinguishment of debt	—	(578,312)	—	(578,312)
Tax credit income	71,130	73,316	71,130	73,316
Grant income	32,819	58,195	102,968	96,178
Total other expense:	(744,786)	(712,433)	(2,747,466)	(3,511,191)
Net loss	(2,246,126)	(2,379,735)	(7,145,868)	(8,409,213)
Net loss attributable to non-controlling interest	(89,414)	(118,047)	(326,581)	(320,022)
Net loss attributable to common shareholders	\$(2,156,712)	\$(2,261,688)	\$(6,819,287)	\$(8,089,191)
Net loss per share attributable to common shareholders:				

Edgar Filing: BIOLARGO, INC. - Form 10-Q

Loss per share attributable to shareholders – basic and diluted	\$ (0.02)	\$ (0.02)	\$ (0.07)	\$ (0.07)
Weighted average number of common shares outstanding:	100,752,279	130,445,351	97,679,544	118,057,635
Comprehensive loss:				
Net loss	\$ (2,246,126)	\$ (2,379,735)	\$ (7,145,868)	\$ (8,409,213)
Foreign currency translation	41,856	46,975	23,743	(4,884)
Comprehensive loss	(2,204,270)	(2,332,761)	(7,122,125)	(8,414,098)
Comprehensive loss attributable to non-controlling interest	(89,414)	(118,047)	(326,581)	(320,022)
Comprehensive loss attributable to common stockholders	\$ (2,114,856)	\$ (2,214,714)	\$ (6,795,544)	\$ (8,094,076)

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018**

(UNAUDITED)

	Common stock		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss		Non- controlling interest	Total
	Shares	Amount						
Balance, December 31, 2017	104,164,465	\$ 69,871	\$ 97,093,144	\$(101,204,846)	\$ (62,489	)	\$ 694,699	\$(3,409,621)
Conversion of principal due on notes	20,635,675	13,834	6,548,624	—	—	—	—	6,562,458
Issuance of common stock for services	2,140,048	1,439	643,459	—	—	—	—	644,898
Issuance of common stock for interest	2,002,868	1,399	513,560	—	—	—	—	514,959
Financing fee in stock	252,385	168	84,905	—	—	—	—	85,073
Sale of common stock for cash	2,841,133	1,906	824,373	—	—	—	—	826,279
Warrant exercise price reduction for cash	—	—	148,853	—	—	—	—	148,853
Stock option compensation expense	—	—	984,157	—	—	—	—	984,157
Warrants and beneficial conversion feature issued as discount on convertible notes payable, notes payable and line of credit	—	—	570,462	—	—	—	—	570,462
	—	—	505,707	—	—	—	—	505,707

Edgar Filing: BIOLARGO, INC. - Form 10-Q

Fair value of warrants for extension of debt							
Deemed dividend	—	—	297,439	(297,439)	—	—	—
Net loss	—	—	—	(8,089,191)	—	(320,022)	(8,409,213)
Foreign currency translation	—	—	—	—	(4,884)	—	(4,884)
Balance, September 30, 2018	132,036,574	\$88,617	\$108,214,683	\$(109,591,476)	\$ (67,373)	\$374,677	\$(980,872)

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2018****(UNAUDITED)**

	SEPTEMBER	SEPTEMBER
	30, 2017	30, 2018
Cash flows from operating activities		
Net loss	\$ (7,145,868	) \$ (8,409,213)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock option compensation expense	801,716	984,157
Common stock issued for interest and fees for services from consultants	759,988	1,162,919
Interest expense related to amortization of the discount on convertible notes payable	2,315,396	2,212,612
Debt conversion expense	—	275,534
Loss on extinguishment of debt	—	578,312
Deferred offering cost expense	464	19,059
Bad debt expense	2,500	1,000
Depreciation and amortization expense	21,086	36,302
Changes in assets and liabilities:		
Accounts receivable	(48,149	) (19,006)
Inventory	(4,838	) 7,779
Prepaid expenses and other current assets	(42,734	) (42,856)
Accounts payable and accrued expenses	345,844	142,113
Officer bonus	(80,000) —
Net cash used in operating activities	\$ (3,074,645	) \$ (3,051,288)
Cash flows from investing activities		
Equipment and Leasehold improvements	\$ (9,000	) \$ (42,656)
Net cash used in investing activities	\$ (9,000	) \$ (42,656)
Cash flows from financing activities		
Proceeds from convertible notes and notes payable	\$ 1,266,200	\$ 880,000
Proceeds from line of credit	250,000	430,000
Proceeds from sale of Clyra shares	750,000	—
Proceeds from notes payable conversion inducement	—	356,781
Proceeds from warrant exercise-price reduction	—	148,854
Proceeds from sale of stock to Lincoln Park Capital	22,500	826,279
Purchase of Clyra shares	(40,000) —
Proceeds from exercise of warrants	153,000	—
Net cash provided by financing activities	\$ 2,401,700	\$ 2,641,914
Effect of foreign currency translation	23,743	(4,885)

Edgar Filing: BIOLARGO, INC. - Form 10-Q

Net change in cash and cash equivalents	\$ (658,202	) \$ (456,915)
Cash and cash equivalents at beginning of period	\$ 1,910,153	\$ 990,457	
Cash and cash equivalents at end of period	\$ 1,251,951	\$ 533,542	
Supplemental disclosures of cash flow information			
Cash paid during the period for:			
Interest	\$ 6,731	\$ 5,489	
Income taxes	\$ 5,350	\$ 5,719	
Non-cash investing and financing activities:			
Fair value of common stock issued for financing commitments	\$ —	\$ 85,073	
Fair value of warrants issued in conjunction with convertible notes payable	\$ 1,067,629	\$ 570,462	
Original issue discount	\$ —	\$ 10,000	
Fair value of stock issued for line of credit	\$ 250,000	\$ —	
Fair value of stock issued for financing fee (Lincoln Park)	\$ 206,000	\$ —	
Deemed dividend	\$ 299,111	\$ 297,439	
Fair value of stock issued for equipment	\$ —	\$ 10,000	
Common stock to CEO	\$ 1,005	\$ —	
Exercise of stock options	\$ 1,677	\$ —	
Issuance of Clyra shares	\$ 411,455	\$ —	
Cumulative effect of change in accounting	\$ 663,560	\$ —	
Conversion of notes payable into shares of common stock	\$ 836,250	\$ 5,930,143	

See accompanying notes to unaudited consolidated financial statements

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Business and Liquidity

Description of Business

BioLargo, Inc. is an innovative technology developer and environmental engineering company driven by a mission to “**make life better**” by delivering robust, sustainable solutions for a broad range of industries and applications, with a focus on clean water, clean air, and advanced wound care. We develop and commercialize disruptive technologies by providing the capital, support, and expertise to expedite them from “cradle” to “maturity”. Our business strategy is straightforward: we invent or acquire technologies that we believe have the potential to be disruptive in large commercial markets; we incubate these technologies to advance and promote their commercial success as we leverage our considerable scientific, engineering, and entrepreneurial talent; we then monetize these technical assets through a variety of business structures that may include licensure, joint venture, sale, spin off, or by deploying direct to market strategies. We seek to unlock the value of our portfolio of underlying technologies to both advance our purposeful mission while we create value for our stockholders.

Liquidity / Going Concern

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. As reflected in the accompanying consolidated financial statements, for the nine months ended September 30, 2018 we had a net loss of \$8,409,213, and used \$3,051,288 cash in operations, and at September 30, 2018, had negative working capital of \$1,075,985, current assets of \$752,328, and an accumulated stockholders’ deficit of \$109,591,476. The foregoing factors raise substantial doubt about our ability to continue as a going concern. Ultimately, our ability to continue as a going concern is dependent upon our ability to attract significant new sources of capital, attain a reasonable threshold of operating efficiencies and achieve profitable operations by licensing or otherwise commercializing products incorporating our technologies. The consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

We have been, and anticipate that we will continue to be, limited in terms of our capital resources. Our total cash balance was \$533,542 at September 30, 2018. We had revenues of \$866,793 in the nine months ended September 30, 2018, which amount was not sufficient to fund our operations. We believe our current cash position is insufficient to maintain our current level of operations and research/development, and that we will be required to raise substantial additional capital to continue our operations and fund our future business plans. We intend to continue to raise money through public and private securities offerings for the foreseeable future, and through our agreement with Lincoln Park (see Note 3).

At times in the past we have not had enough cash or sources of capital to pay our accounts payable and expenses as they arise, and have relied on the issuance of stock options and common stock, as well as extended payment terms with our vendors, to continue to operate. We will be required to raise substantial additional capital to expand our operations, including without limitation, hiring additional personnel, additional scientific and third-party testing, costs associated with obtaining regulatory approvals and filing additional patent applications to protect our intellectual property, and possible strategic acquisitions or alliances, as well as to meet our liabilities as they become due for the next 12 months.

The unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to Rule 8-03 of Regulation S-X under the Securities Act of 1933, as amended. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. For some of our activities, we are still operating in the early stages of the sales and distribution process, and therefore our operating results for the nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018, or for any other period. These unaudited consolidated financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes included in the Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission (the "SEC") on March 14, 2018.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 2. Summary of Significant Accounting Policies

In the opinion of management, the accompanying consolidated balance sheet and related consolidated statements of operations and comprehensive loss, cash flows, and stockholders' deficit include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its majority owned subsidiaries, and Clyra. Management believes Clyra's financial statements are appropriately consolidated with that of the Company after reviewing the guidance of ASC Topic 810, "Consolidation", because the Company owns 46.3% of its outstanding voting stock at September 30, 2018, and two members of BioLargo's board of directors are two of three members of Clyra's board of directors (see Note 8). All intercompany accounts and transactions have been eliminated.

Foreign Currency

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

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less when acquired to be cash equivalents. Substantially all cash equivalents are held in short-term money market accounts at one of the largest

financial institutions in the United States. Our cash account balances are typically greater than the Federal Deposit Insurance Corporation insurance limit of \$250,000 per owner per bank, and during such times, we are exposed to credit loss for amounts in excess of insured limits in the event of non-performance by the financial institution. We do not anticipate non-performance by our financial institution.

Clyra Medical is not a wholly owned subsidiary. Our cash balance held in Clyra and BioLargo and other subsidiaries are reflected in the following table:

	December	September
	31, 2017	30, 2018
Biolargo, Inc. and wholly owned subsidiaries	\$ 461,914	\$ 511,095
Clyra Medical Technologies, Inc.	528,543	22,447
Total	\$ 990,457	\$ 533,542

Accounts Receivable

Trade accounts receivable are recorded net of allowances for doubtful accounts. Estimates for allowances for doubtful accounts are determined based on payment history and individual customer circumstances. The allowance for doubtful accounts as of December 31, 2017 and September 30, 2018 was \$2,500 and \$0, respectively.

Credit Concentration

We have a limited number of customers that account for significant portions of our revenue. During the nine months ended September 30, 2017 and 2018, we had three and two customers that each accounted for more than 10% of consolidated revenues in the respective periods, as follows:

	September		September	
	30, 2017		30, 2018	
Customer A	26	%	44	%
Customer B	11	%	12	%
Customer C	11	%	<10	%

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

We had five customers that each accounted for more than 10% of consolidated accounts receivable at December 31, 2017 and three customers at September 30, 2018 as follows:

	December		September	
	31, 2017		30, 2018	
Customer A	<10	%	23	%
Customer B	<10	%	17	%
Customer C	<10	%	10	%
Customer D	12	%	<10	%
Customer E	19	%	<10	%
Customer F	12	%	<10	%
Customer G	10	%	<10	%
Customer H	10	%	<10	%

Inventory

Inventory is stated at the lower of cost and net realizable value using the average cost method. All inventory is related to our Odor-No-More business segment. Inventory consisted of:

	December		September	
	31, 2017		30, 2018	
Raw material	\$ 34,104		\$ 26,767	
Finished goods	19,869		19,427	
Total	\$ 53,973		\$ 46,194	

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 transactions, debt transactions, deemed dividends, allowance for bad debt, asset depreciation and amortization, among others.

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

Share-based Payments

For stock and stock options issued to consultants and other non-employees for services, the Company measures and records an expense as of the earlier of the date at which either: a commitment for performance by the non-employee has been reached or the non-employee's performance is complete. The equity instruments are measured at the current fair value, and for stock options, the instruments are measured at fair value using the Black Scholes option model.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For equity instruments issued and outstanding where performance is not complete, but the instrument has been recorded, those instruments are measured again at their then current fair market values at each of the reporting dates (they are “marked-to market”) until the performance and the contract are complete.

Warrants

The Unit Offerings of our convertible promissory note and a Series A stock purchase warrant are accounted for under the fair value and relative fair value method.

The warrant is first analyzed per its terms as to whether it has derivative features or not. If the warrant is determined to be a derivative, then it is measured at fair value using the Black Scholes Option Model, and recorded as a liability on the balance sheet. The warrant is re-measured at its then current fair value at each subsequent reporting date (it is “marked-to-market”).

If the warrant is determined to not have derivative features, it is recorded into equity at its fair value using the Black Scholes option model, however, limited to a relative fair value based upon the percentage of its fair value to the total fair value including the fair value of the convertible note.

The convertible note is recorded at its fair value, limited to a relative fair value based upon the percentage of its fair value to the total fair value including the fair value of the warrant. Further, the convertible promissory note is examined for any intrinsic beneficial conversion feature (“BCF”) of which the convertible price of the note is less than the closing stock price on date of issuance. If the relative fair value method is used to value the convertible promissory note and there is an intrinsic BCF, a further analysis is undertaken of the BCF using an effective conversion price which assumes the conversion price is the relative fair value divided by the number of shares the convertible debt is converted into by its terms. The adjusted BCF value is accounted for as equity.

The warrant and BCF relative fair values are also recorded as a discount to the convertible promissory notes. As present, these equity features of the convertible promissory notes have recorded a discount to the convertible notes

that is substantially equal to the proceeds received.

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.

Revenue Recognition

We adopted ASU 2014-09, "Revenue from Contracts with Customers", Topic 606, on January 1, 2018. The guidance focuses on the core principle for revenue recognition.

The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

We have revenue from two subsidiaries, Odor-No-More and BLEST. Odor-No-More identifies its contract with the customer through a purchase order whether in writing or verbal, in which the details of the contract are defined including the transaction price and method of shipment. The only performance obligation is to create and ship the product and each product has separate pricing. Odor-No-More recognizes revenue at a point in time when the order for its goods are shipped if its agreement with the customer is FOB Odor-No-More's warehouse facility, and when goods are delivered to its customer if its agreement with the customer is FOB destination. Revenue is recognized with a reduction for sales discounts, as appropriate and negotiated in the customer's purchase order.

BLEST identifies services to be performed in a written contract, which specifies the performance obligations and the rate at which the services will be billed. Each service is separately negotiated and priced. Revenue is recognized as services are performed and completed. BLEST's contracts typically call for invoicing for time and materials incurred for that contract. To date, there have been no discounts or other financing terms for the contracts.

In the future, we may generate revenues from royalties or license fees from our intellectual property. In the event we do so, we anticipate a licensee would 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. Upon entering into a licensing agreement, we will determine the appropriate method of recognizing the royalty and license fees.

Government Grants

We have been awarded multiple research grants from the Canadian National Research Institute – Industrial Research Assistance Program (NRC-IRAP) and the National Science and Engineering Research Council of Canada (NSERC). The grants received are considered other income and are included in our consolidated statements of operations. We received our first grant in 2015 and have been awarded over 60 grants totaling approximately \$1,600,000. Some of the funds from these grants are given directly to third parties (such as the University of Alberta or a third-party research scientist) to support research on our technology. The grants have terms generally ranging between six and eighteen months and support a majority, but not all, of the related research budget costs. This cooperative research allows us to utilize (i) a depth of resources and talent to accomplish highly skilled work, (ii) financial aid to support research and development costs, (iii) independent and credible validation of our technical claims.

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

While the FASB has issued a proposed Accounting Standards Update, Not-for-Profit Entities - (Topic 958): “Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made”, there has been no guidance related to for profit entities such as BioLargo. In reviewing Topic 606, “Revenue from Contracts with Customers”, and its potential application to the Canadian government grants, our management concluded that these grants do not meet the requirements for revenue recognition. Specifically, these grants typically provide reimbursement for research personnel working on the BioLargo technology. For some grants, funds are given directly to third parties for research on our technology and are not controlled by the Company. In this structure, the grants are not revenue, but rather a reimbursement.

Business Segment Information

In 2017, the Company operated with three business segments. In 2018, given the increased operations of the engineering division formed in late 2017, we determined that it should be considered our fourth business segment. This decision was based on the manner in which the chief operating decision maker now manages the engineering division, including resource allocation and performance assessment.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Our four business segments include: (i) Odor-No-More, which is engaged in developing and selling odor and VOC control products and services; (ii) BLEST, which provides professional engineering services; (iii) Clyra, which is engaged in developing medical products utilizing our technology, with an emphasis in the medical field and advanced wound care; and (iv) our corporate operations (labeled in the below table as “BioLargo/Other”), which includes certain functional roles that do not engage in revenue generating activities, such as general corporate and administrative functions, including finance, human resources, marketing, legal, and research and development.

The segment information for the three and nine months ended September 30, 2017 and 2018, is as follows:

	Three months September 30,		Nine months September 30,	
	2017	2018	2017	2018
Revenues				
Odor-No-More	\$ 172,045	\$ 245,979	\$ 318,040	\$ 785,929
BLEST	—	31,047	—	80,864
Consolidated revenue	\$ 172,045	\$ 277,026	\$ 318,040	\$ 866,793
Cost of goods/services				
Odor-No-More	\$(123,278)	\$(97,578)	\$(219,207)	\$(426,042)
BLEST	—	(23,968)	—	(59,608)
Consolidated costs of goods/services	\$(123,278)	\$(121,546)	\$(219,207)	\$(485,650)
Net loss				
Odor-No-More	\$(112,500)	\$(111,963)	\$(387,500)	\$(365,651)
BLEST	—	(63,555)	—	(180,281)
Clyra	(223,610)	(219,971)	(708,182)	(596,333)
BioLargo/Other	(1,910,016)	(1,984,246)	(6,050,186)	(7,266,948)
Consolidated net loss	\$(2,246,126)	\$(2,379,735)	\$(7,145,868)	\$(8,409,213)

The segment information as of December 31, 2017 and September 30, 2018, is as follows:

	December 31, 2017	September 30, 2018
Assets, net		
Odor-No-More	\$210,725	\$231,216
BLEST	—	150,087
Clyra	528,543	25,807
BioLargo/Other	756,152	681,775
Consolidated assets, net	\$1,495,420	\$1,088,885

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 nine months ended September 30, 2017 and 2018, 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.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Recent Accounting Pronouncements

In June 2018, The FASB issued Accounting Standards Update No. 2018-07, “Compensation - Stock Compensation (topic 718): Improvements to Nonemployee Share-Based Payment Accounting”. The amendments in this update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. An entity should apply the requirements of Topic 718 to nonemployee awards except for specific guidance on inputs to an option pricing model and the attribution of cost (that is, the period of time over which share-based payment awards vest and the pattern of cost recognition over that period). The amendments specify that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor’s own operations by issuing share-based payment awards. The amendments also clarify that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, Revenue from Contracts and Customers. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Management has not concluded its evaluation of the guidance. Its initial analysis is that it does not believe the new guidelines will substantially impact the company’s financial statements.

In May 2017, the FASB issued Accounting Standards Update No. 2017-09, “Compensation – Stock Compensation (topic 718): Scope of Modification Accounting”. The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all the following are met: (i) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified, (ii) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified and (iii) 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 original award is modified. The amendments in this Update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Management has analyzed the new guideline and it has not substantially impacted its accounting for stock compensation awards upon adoption in the current period.

Note 3. Lincoln Park Financing

On August 25, 2017, we entered into a stock purchase agreement (“LPC Purchase Agreement”) with Lincoln Park Capital Fund, LLC (“Lincoln Park”), pursuant to which Lincoln Park agreed to purchase from us at our request up to an aggregate of \$10,000,000 of our common stock (subject to certain limitations) from time to time over a period of three years. Concurrently, we entered into a registration rights agreement with Lincoln Park (“LPC RRA”), pursuant to which we were required to file with the Securities and Exchange Commission (“SEC”) a registration statement on Form S-1 to register for resale under the Securities Act of 1933, as amended, the shares of common stock that have been or may be issued to Lincoln Park under the LPC Purchase Agreement. The registration statement was filed, and on September 22, 2017, it was deemed effective by the SEC. The LPC Purchase Agreement allows us, from time to time and at our sole discretion, to direct Lincoln Park to purchase shares of our common stock, subject to limitations in both volume and dollar amount. The volume of shares is limited to a maximum of 50,000 shares if our stock closes at less than \$0.50 per share, 75,000 if it closes from \$0.50 to \$0.74 per share, 100,000 if it closes from \$0.75 to \$1.24 per share, and 200,000 if it closes at or above \$1.25 per share. The maximum dollar amount for any single purchase is \$500,000. There are no trading volume requirements under the LPC Purchase Agreement, and we alone control the timing and amount of any sales of our common stock to Lincoln Park. The purchase price of the shares that may be sold to Lincoln Park under the Purchase Agreement is the lower of (i) the lowest sale price on the date of purchase, or (ii) the average of the three lowest closing prices in the prior 12 business days. The purchase price per share will be equitably adjusted for any reorganization, recapitalization, non-cash dividend, stock split, or other similar transaction occurring during the business days used to compute such price. We may at any time in our sole discretion terminate the LPC Purchase Agreement without fee, penalty or cost upon one business day notice. There are no restrictions on future financings, rights of first refusal, participation rights, penalties or liquidated damages in the LPC Purchase Agreement or LPC RRA other than a prohibition on entering into a “Variable Rate Transaction,” as defined in the Purchase Agreement. Lincoln Park may not assign or transfer its rights and obligations under the Purchase Agreement.

In consideration for entering into the LPC Purchase Agreement, on August 25, 2017, we issued to Lincoln Park 488,998 shares of common stock as an “initial commitment fee.” For no additional consideration, when and if Lincoln Park purchases (at the Company’s discretion) any portion of the \$10,000,000 aggregate commitment, we are required to issue up to 488,998 shares, pro-rata, as “additional commitment shares”. For example, if we elect, at our sole discretion, to require Lincoln Park to purchase \$25,000 of our stock, then we would issue 1,222 additional commitment shares, which is the product of \$25,000 (the amount we have elected to sell) divided by \$10,000,000 (total amount we can sell Lincoln Park pursuant to the LPC Purchase Agreement) multiplied by 488,998 (the total number of additional commitment shares). The additional commitment shares will only be issued pursuant to this formula as and when we elect at our discretion to sell stock to Lincoln Park.

During the three- and nine-months ended September 30, 2018, we elected to sell to Lincoln Park 1,543,982 and 2,800,733 shares of our common stock, respectively, for which we received \$445,476 and \$826,279 in gross and net proceeds, respectively. As a result of these purchases, we issued Lincoln Park 21,780 and 40,400 “additional commitment” shares, respectively, pursuant to the LPC Purchase Agreement. We recorded the stock sale in our equity statement and the additional shares issued as a fee for the transaction was offset against the shares issued.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 4. Debt Obligations

The following table summarizes our debt obligations outstanding as of December 31, 2017 and September 30, 2018.

	December	September
	31, 2017	30, 2018
Current liabilities		
Lines of credit, matures September 1, 2019	\$—	\$430,000
Notes payable, mature January 5, 2019	—	400,000
Convertible notes payable		
Convertible notes, mature July 18, 2018	280,000	—
Convertible notes, mature June 1, 2018	4,468,847	—
Convertible note, matures December 18, 2018*	500,000	543,108
Convertible note, matures July 20, 2019	—	440,000
Total convertible notes payable	\$5,248,847	\$983,108
Total current liabilities	\$5,248,847	\$1,813,108
Long-term liabilities:		
Convertible notes, mature June 17, 2019	\$283,571	\$—
Convertible note, matures July 20, 2019	440,000	—
Convertible notes, mature December 31, 2019	292,000	75,000
Note payable, matures March 8, 2023 (or on demand 60 days' notice)	—	50,000
Convertible notes, mature June 20, 2020	523,700	125,000
Convertible notes, mature April 20, 2021	—	100,000
Convertible notes, mature June 15, 2021	—	110,000
Total long-term liabilities	\$1,539,271	\$460,000
Total	\$6,788,118	\$2,273,108

* The original maturity date of September 18, 2018 was extended to December 18, 2018 (see “*Convertible Note, matures December 18, 2018 (Vista Capital)*”, below)

See our Annual Report on Form 10-K for the year ended December 31, 2017, for a complete description of the debt obligations set forth in the above table.

Conversion of Debt Obligations

One-year convertible notes, mature July 18, 2018

On July 2, 2018, the holders of two one-year notes in the aggregate principal amount of \$280,000, which were due to mature on July 18, 2018, tendered an offer to the Company to convert 100% of the balance due on the outstanding notes into shares of our common stock in lieu of receiving cash. We accepted the offer and agreed to convert the principal balance of \$280,000 and \$8,400 outstanding interest into an aggregate 1,153,600 shares of our common stock, at \$0.25 per share.

FirstFire Investment

On January 16, 2018, we entered into a securities purchase agreement (the “FirstFire Purchase Agreement”) and a registration rights agreement (the “FirstFire RRA”) with FirstFire Global Opportunity Fund, LLC (“FirstFire”), and issued a convertible promissory note (the “FirstFire Note”) in the aggregate principal amount of \$150,000 at 5% annual interest, which is convertible into shares of common stock of the Company at \$0.394 per share, subject to the terms, and certain limitations and conditions set forth in the FirstFire Purchase Agreement and FirstFire Note. FirstFire may convert the FirstFire Note at any time. The FirstFire Note was scheduled to mature on October 16, 2018. In June 2018, FirstFire elected to convert \$95,761 of the outstanding principal balance of the FirstFire Note and we issued 383,047 shares. On July 15, 2018, FirstFire elected to convert the remaining outstanding principal and interest balance of \$54,239. We issued an aggregate 217,960 shares at \$0.25.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Pursuant to the FirstFire Purchase Agreement, the Company issued 75,000 shares of common stock to FirstFire as a commitment fee (the “FirstFire Commitment Shares”) at \$0.39 per share and \$29,250 is recorded as a discount on convertible notes and will amortize to interest expense over the term of the note.

Pursuant to the FirstFire RRA, the Company agreed to file a registration statement with the SEC registering all shares of common stock into which the FirstFire Note is convertible, and the FirstFire Commitment Shares. The FirstFire Purchase Agreement allows for an adjustment to the number of FirstFire Commitment Shares in the event the closing price of our common stock, on the earlier of the date the registration statement is deemed effective and 20 trading days following the six-month anniversary of the FirstFire Note, is lower than the closing price on January 16, 2018 (which was \$0.39). In such event, additional shares would be issued to FirstFire such that the aggregate FirstFire Commitment Shares issued have the same value as the shares issued on January 16, 2018.

Pursuant to the requirements set forth in the registration rights agreements, we filed a registration statement with the SEC which was deemed effective as of February 8, 2018. On February 8, 2018, our common stock last traded at \$0.3147 per share. Because the last traded price of our common stock on the date the registration statement was deemed effective was less than the price of our common stock on the dates of the FirstFire Purchase Agreements, at their option, we are required to issue additional “commitment shares”. FirstFire exercised that right, and we issued 36,536 additional shares of our common stock and \$11,498 is recorded as additional discount on convertible notes and will amortize to interest expense over the term of the note.

FirstFire represented to the Company, among other things, that it was an “accredited investor” (as such term is defined in Rule 501(a) of Regulation D under the Securities Act of 1933, as amended). The FirstFire Note, FirstFire Purchase Agreement, and the FirstFire RRA contain customary representations, warranties, agreements and conditions including indemnification rights and obligations of the parties. The FirstFire Note contains a price protection provision such that if we issue a security with any term more favorable to the holder of such security that was not similarly provided in the FirstFire Note, then the Company shall notify FirstFire of such additional or more favorable term and such term, at its option, shall become a part of the FirstFire Note. As a result of our sale of common stock at \$0.25, the conversion price of the FirstFire Note was reduced from \$0.394 to \$0.25.

Convertible Note, matures December 18, 2018 (Vista Capital)

On December 18, 2017, we received \$500,000 pursuant to a securities purchase agreement (the “Vista Purchase Agreement”) and a registration rights agreement (the “Vista RRA”) with Vista Capital Investments, LLC (“Vista Capital”), and issued a Note (the “Vista Note”) in the aggregate principal amount of \$500,000 at 5% annual interest, which was originally convertible into shares of common stock of the Company at \$0.394 per share, subject to the terms, and certain limitations and conditions, set forth in the Vista Purchase Agreement and Vista Note. The Vista Note originally matured on September 18, 2018.

Pursuant to the Vista Purchase Agreement, the Company issued 250,000 shares of common stock to Vista Capital as a commitment fee at \$0.39 per share and \$98,500 is recorded as a discount on convertible notes and was amortized to interest expense over the term of the note.

Pursuant to the Vista RRA, the Company agreed to file a registration statement with the SEC registering all shares of common stock into which the Vista Note is convertible, and the 250,000 shares issued as a commitment fee. The Vista Purchase Agreement requires additional shares be issued for the commitment fee in the event the closing price of our common stock on the date the registration statement is deemed effective is lower than the closing price on December 18, 2017, (which was \$0.41). In such event, additional shares would be issued such that the aggregate shares issued have the same value as the 250,000 shares issued on December 18, 2017. The beneficial conversion feature resulted in a \$20,305 relative fair value recorded as a discount. The discount was amortized monthly to interest expense through September 18, 2018.

Vista Capital represented to the Company, among other things, that it was an “accredited investor” (as such term is defined in Rule 501(a) of Regulation D under the Securities Act of 1933, as amended). The Vista Note, Vista Purchase Agreement, and Vista RRA contain customary representations, warranties, agreements and conditions including indemnification rights and obligations of the parties. The Vista Note contains a price protection provision such that if we issue a security with any term more favorable to the holder of such security that was not similarly provided in the Vista Note, then we shall notify Vista Capital of such additional or more favorable term and such term, at its option, shall become a part of the Vista Note. As a result of our sale of common stock at \$0.25, the conversion price of the Vista Note was reduced from \$0.394 to \$0.25.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In June 2018, Vista Capital elected to convert \$52,025 of the outstanding principal and interest balance of the Vista Note and we issued 208,100 shares.

On September 12, 2018, Vista Capital agreed to extend the maturity date of this note to December 18, 2018. In return, we increased the principal outstanding balance by 20% or \$90,518. In addition, we issued the note holder a warrant to purchase 1,812,000 shares of our common stock at \$0.25 per share, which was fair valued using the Black Scholes Option Model at \$488,344 (see Note 6). As of September 30, 2018, the outstanding balance on the Vista Note totaled \$543,108. The Company reserved 2,172,432 shares of common stock for issuance upon conversion. Per the guidance of ASC 470-50, Debt Modifications and Extinguishments, modified terms are considered substantially different, if the present value of the cash flows after modification differ by at least 10% prior to the modification. With the increase in principal, the Vista Note met the 10% cash flow test and therefore the Company accounted for the transaction as an extinguishment of debt. The increased principal, and the warrant fair value treated as a fee for the extension, produced a \$578,942 loss on extinguishment of the convertible debt. The new 5% Convertible Note is recorded at principal value with a 90-day maturity.

Notes payable, mature January 5, 2019

On September 19, 2018, we received \$400,000 and issued promissory notes and stock purchase warrants to two investors. The promissory notes mature January 5, 2019, and incur interest at an annual rate of 12%. We may extend the maturity date of the notes by 60 days by giving written notice at any time prior to the maturity date, and in such event the principal amount of the notes will increase by 10%, effective as of the date of the notice. The stock purchase warrants allow the purchase of up to an aggregate 1,387,500 shares of our common stock for \$0.25 per share until September 19, 2023. We may “call” the warrants if the closing price of our common stock equals or exceeds \$2.50 for 10 consecutive trading days and the shares underlying the warrant are subject to an effective registration statement with the Securities and Exchange Commission. If we call the warrants, each investor would have 30 days to exercise its rights to purchase shares under the warrant or forever forfeit such rights. (See Note 6.)

Lines of credit, mature September 1, 2019

On March 1, 2018, we received \$390,000, and on September 1, 2018, we received \$40,000, pursuant to a line of credit, accruing interest at a rate of 18% per annum, for which we have pledged our inventory and accounts receivable as collateral. Interest is paid quarterly, and, at the option of the holder, payable in either (i) cash, (ii) our common stock, calculated based on the 20-day average closing price, or (iii) options to purchase our common stock, priced at the 20-day average closing price, the number of shares doubled, and expiring 10 years from the date of grant. The holder of the line of credit has the right to call due the outstanding principal amount on 30-days' notice at any time after September 1, 2019.

Each creditor, for no additional consideration, received a warrant to purchase our common stock. (See Note 6). The warrant allows for the purchase of the number of common shares equal to the investment amount (e.g., one warrant share for each dollar invested).

Convertible Note, matures April 20, 2021 (Spring 2018 Unit Offering)

On March 26, 2018, we commenced a private securities offering (titled the "Spring 2018 Unit Offering") which offered the sale of \$1,500,000 of "Units," each Unit consisting of a convertible promissory note and stock purchase warrant. Concurrently, we issued Pricing Supplement No. 1 setting the initial unit/conversion price at \$0.30 per share, and the initial warrant exercise price at \$0.48 per share. The promissory notes issued to investors mature April 20, 2021, and incurs interest at the rate of 12% per annum on the amount invested. 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. Promissory 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 the following conditions are met: (i) the shares issued as payment are registered with the SEC; and (ii) the Company's common stock closes for ten consecutive trading days at or above three times the Unit price.

In addition to the convertible promissory note, each investor will receive a warrant allowing for the purchase of the number of shares of BioLargo common stock equal to the investment amount divided by the unit/conversion price (e.g., one warrant share for each share of common stock which the investor is eligible to receive through conversion of the note).

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Through March 31, 2018, we had received one investment for \$100,000, and issued a warrant to purchase 333,333 shares. This investment was received from an entity owned/controlled by a member of our board of directors. We did not receive any investments in this offering during the three months ended September 30, 2018.

During September 2018 we issued a second pricing supplement, which reduced the convertible note conversion price from \$0.30 to \$0.25 and reduced the warrant exercise price from \$0.48 to \$0.40. As a result, the number of warrant shares available for purchase by each investor increased from 333,333 to 400,000. (See Note 6.)

Convertible Note, matures June 15, 2021 (OID Note)

On June 15, 2018, we received \$75,000, and on August 7, 2018, we received an additional \$25,000 and we issued a convertible promissory note (titled the "OID Note") for 100% of the funds received, or \$110,000. The convertible promissory note is convertible into shares of the company's common stock at a conversion price of \$0.30 per share. The original issuance discount totaled \$10,000, recorded as a discount on convertible notes on our balance sheet. The discount will be amortized and recorded to interest expense over the term of the note. The convertible promissory note matures June 15, 2021 and incurs interest at the rate of 15% per annum on the OID Note. Interest due will be paid quarterly in arrears in shares of common stock, 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 OID Note is convertible by the investor at any time, and convertible by the Company (i) at maturity, (ii) in the event the Company's stock price closes at two times the conversion price for 20 consecutive days, provided that either the shares underlying the convertible note are registered with the SEC, or more than six months has elapsed since the date of the investment.

Note 5. Share-Based Compensation

Stock Options

During the nine months ended September 30, 2017 and 2018, we recorded an aggregate \$801,716 and \$984,157, respectively, in selling general and administrative expense related to the issuance of stock options.

2018 Equity Incentive Plan

On June 22, 2018, the BioLargo, Inc. 2018 Equity Incentive Plan (“2018 Plan”) was adopted 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 for a period of 10 years. It is set to expire on its terms on June 22, 2028. Our Board of Director’s Compensation Committee administers this plan. As plan administrator, the Compensation Committee has sole discretion to set the price of the options. The plan authorizes the following types of awards: (i) incentive and non-qualified stock options, (ii) restricted stock awards, (iii) stock bonus awards, (iv) stock appreciation rights, (v) restricted stock units, and (vi) performance awards. The total number of shares reserved and available for awards pursuant to this Plan as of the date of adoption of this 2018 Plan by the Board is forty million shares. The number of shares available to be issued under the 2018 Plan can increase up to 5% each year at the discretion of the board.

During the three months ended September 30, 2018, we issued options to purchase 493,111 shares of our common stock at an exercise price ranging between \$0.25 – \$0.31 per share to members of our board of directors for services and to employees in lieu of salary, pursuant to the 2018 Plan. The fair value of these options totaled \$136,150 and is recorded as selling, general and administrative expenses.

On June 29, 2018, we issued options to purchase 296,976 shares of our common stock at an exercise price of \$0.43 per share to members of our board of directors for services and to employees in lieu of salary, pursuant to the 2018 Plan. The fair value of these options totaled \$127,700 and is recorded as selling, general and administrative expenses.

Activity for our stock options under the 2018 Plan for the nine months ended September 30, 2018 is as follows:

As of September 30, 2018:	Options Outstanding	Exercise Price per share	Weighted Average Price per share
Inception, June 22, 2018			
Granted	790,087	\$0.25–0.43	\$ 0.34
Expired	—	—	—
Balance, September 30, 2018	790,087	\$0.25–0.43	\$ 0.34

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

2007 Equity Incentive Plan

On September 7, 2007, and as amended April 29, 2011, the BioLargo, Inc. 2007 Equity Incentive Plan (“2007 Plan”) was adopted as a means of providing our directors, key employees and consultants additional incentive to provide services. Both stock options and stock grants were made under this plan for a period of 10 years. It expired on its terms on September 7, 2017. The Board’s Compensation Committee administers this plan. As plan administrator, the Compensation Committee has sole discretion to set the price of the options.

On June 19, 2017, the date of our annual stockholders’ 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 exercise price of \$0.43 equals the price of our common stock on the grant date. The fair value of these options totaled \$15,600 and was recorded as selling, general and administrative expense.

On February 10, 2017, we extended the engagement agreement with our Chief Financial Officer, retroactive to October 1, 2016. The sole consideration for the one-year extension was the issuance of an option to purchase 300,000 shares of our common stock, at an exercise price of \$0.69 per share which was equal to the closing price of our common stock on the date of grant. The option expires February 10, 2027, and vests over the term of the engagement with 125,000 shares having vested as of February 10, 2017, and the remaining shares vested as of September 30, 2017. The fair value of the option totaled \$207,000 and is recorded as selling, general and administrative expense on our statement of operations during the nine months ended September 30, 2017.

Activity for our stock options under the 2007 Plan for the nine months ended September 30, 2017 and 2018 is as follows:

As of September 30, 2017:	Options Outstanding	Exercise Price per share	Weighted Average Price per share
----------------------------------	--------------------------------	---	---

Balance, December 31, 2016	9,916,586	\$0.23–1.89	\$ 0.44
Granted	340,000	0.39–0.69	0.65
Expired	—	—	—
Balance, September 30, 2017	10,256,586	\$0.23–1.89	\$ 0.44

As of September 30, 2018:	Options Outstanding	Exercise Price per share	Weighted
			Average Price per share
Balance, December 31, 2017	9,831,586	\$0.23–1.89	\$ 0.44
Granted	—	—	—
Expired	(110,000)	0.99–1.89	1.60
Balance, September 30, 2018	9,721,586	\$0.23–1.65	\$ 0.43

Options issued Outside of the 2007 Equity Incentive Plan

During the nine-months ended September 30, 2018, we issued options to purchase 1,211,527 shares of our common stock at exercise prices ranging between \$0.23 – \$0.43 per share to vendors and to members of our board of directors in exchange for unpaid obligations for their services. The fair value of the options totaled \$315,551 and is recorded as selling, general and administrative expenses.

During the nine-months ended September 30, 2017, we issued options to purchase 1,097,550 shares of our common stock at exercise prices ranging between \$0.43 – \$0.67 per share to vendors and to members of our board of directors in exchange for unpaid obligations for their services. The fair value of the options totaled \$389,976 and is recorded as selling, general and administrative expenses.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

On May 2, 2017, pursuant to his employment agreement, we granted to Mr. Calvert, an option (the “Option”) to purchase 3,731,322 shares of the Company’s common stock. The Option shall be a non-qualified stock option, exercisable at \$0.45 per share, which represents the market price of the Company’s common stock as of the date of the agreement, exercisable for ten years from the date of grant and vesting in equal increments on the anniversary of the agreement for five years. Notwithstanding the foregoing, any portion of the Option which has not yet vested shall be immediately vested in the event of, and prior to, a change of control, as defined in the Calvert Employment Agreement. The Option contains the other terms standard in option agreements issued by the Company, including provisions for a cashless exercise. The fair value of this option totaled \$1,679,095 and will be amortized monthly through May 2, 2022. During the nine months ended September 30, 2017 and 2018, we recorded \$111,940 and \$251,865, respectively, of option expense included in selling, general and administrative expense.

On September 5, 2017, we issued options to purchase 2,000,000 shares of our common stock to the employees of our newly created engineering subsidiary (see Note 9). The options are non-qualified stock options, exercisable at \$0.45 per share, the closing price of our common stock as of September 5th, exercisable for ten years from the date of grant and subject to vesting in five equal increments on the anniversary of the agreement for five years based on certain performance milestones related to the operations of the subsidiary. (See Note 9 for details of the performance milestones.) The options contain other terms standard in option agreements issued by the Company, including provisions for a cashless exercise.

BLEST’s Compensation Committee met on September 26, 2018 for the purpose of evaluating the operating performance of the engineering subsidiary to determine whether profit sharing interests in the subsidiary would vest for any of the employee members, and correspondingly whether up to 20% of the options issued September 5, 2017 would vest. The committee determined that due to factors largely outside of the control of the individual employee, the operations had progressed slower the first year than anticipated, and thus decided to delay the determination of vesting for a period of one year. As a result, no compensation expense has yet been recognized for these options.

Exercise of Stock Option

On April 30, 2017, the Company’s president, Dennis Calvert, delivered a notice of exercise of 3,866,630 shares pursuant to his stock option agreement dated April 30, 2007. The exercise price was \$0.18 per share, and the Company issued 2,501,937 shares, calculated by multiplying the difference between the market price of \$0.51 and the exercise price of \$0.18 with the number of shares exercised, and dividing that amount by the market price. No cash

consideration was tendered with respect to the exercise. The remaining 3,866,629 shares available for purchase under the option agreement expired unexercised.

Pursuant to a “lock-up agreement” dated April 30, 2017, Mr. Calvert agreed to restrict the sales of the shares received until the earlier of (i) the consummation of a sale (in a single transaction or in a series of related transactions) of the Company by means of a sale of (a) a majority of the then outstanding common stock (whether by merger, consolidation, sale or transfer of common stock, reorganization, recapitalization or otherwise) or (b) all or substantially all of its assets; and (ii) the successful commercialization of the Company’s products or technologies as demonstrated by its receipt of at least \$3,000,000 in cash, or the recognition of \$3,000,000 in revenue, over a 12-month period from the sale of products and/or the license of technology; and (iii) the Company’s breach of the employment agreement between the Company and Calvert dated May 2, 2017 and resulting in Calvert’s termination.

Activity of our stock options issued outside of the 2007 Equity Incentive Plan for the nine months ended September 30, 2017 and 2018 is as follows:

As of September 30, 2017:	Options Outstanding	Exercise Price per share		Weighted Average Price per share
Balance, December 31, 2016	20,148,766	\$0.18–	1.00	\$ 0.43
Granted	6,828,872	0.43–	0.67	0.46
Expired	(3,866,629)	0.18		0.18
Exercised	(3,866,630)	0.18		0.18
Balance, September 30, 2017	19,244,379	\$0.18–	1.00	\$ 0.51

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

As of September 30, 2018:	Options Outstanding	Exercise Price per share	1.00	Weighted Average Price per share
Balance, December 31, 2017	20,018,408	\$0.25–	1.00	\$ 0.51
Granted	1,211,527	0.23–	0.43	0.26
Expired	(2,400,000)	0.99		0.99
Balance, September 30, 2018	18,829,935	\$0.25–	1.00	\$ 0.45

For employees, 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 nine months ended September 30:

	2017	2007 Plan	2018	2018 Plan
	Non Plan		Non Plan	
Risk free interest rate	2.29- 2.40%	2.31- 2.40%	2.43–2.91%	2.91%
Expected volatility	571 - 601%	578 - 601%	538 –563%	538– 548%
Expected dividend yield	—	—	—	—
Forfeiture rate	—	—	—	—
Expected life in years	7	7	7	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. 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 6. Warrants

Warrants issued concurrently with Notes payable

On September 19, 2018, pursuant to the terms of the convertible note payable. (see Note 4, “Convertible Note, matures January 5, 2019”), we issued warrants to purchase up to an aggregate 1,987,500 shares of our common stock at an exercise price of \$0.25 per share. These warrants expire January 5, 2024. The relative fair value of these warrants resulted in \$217,394 recorded as a discount on our consolidated balance sheet in the period issued. The discount will amortize to interest expense through the maturity date of the convertible note, January 5, 2019.

Extension of Convertible Note Maturity Date, December 18, 2018 (Vista Capital)

On September 12, 2018, Vista Capital agreed to extend the maturity date of this note to December 18, 2018 (See Note 4). In return, we issued the note holder a warrant to purchase 1,812,000 shares of our common stock at \$0.25 per share. These warrants expire September 12, 2023. The fair value of these warrants resulted in \$488,334 of loss on extinguishment of debt for the three months ended September 30, 2018.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Reduction of Warrant Exercise Price

In May 2018, certain holders of outstanding warrants to purchase common stock received in prior unit offerings paid us cash in exchange for a reduction of the exercise price in their warrant(s). In the aggregate, we received \$148,854 from holders of 37 warrants which allow for the purchase of an aggregate 4,326,358 shares of our common stock. Exercise prices of these warrants were reduced to \$0.30. Management determined that the appropriate accounting treatment for the reduction in the exercise price of the warrants was a capital transaction rather than a contract modification treatment analogous to changes in stock option contracts. As such, the fair market value was equal to the cash received, \$148,854.

Warrants Issued Concurrently with Spring 2018 Unit Offering

During the three months ended March 31, 2018, pursuant to the terms of our Spring 2018 Unit Offering (see Note 4), we issued a warrant to purchase up to 333,333 shares of our common stock at an exercise price of \$0.48 per share to the investor in the Spring 2018 Offering. The warrant expires April 20, 2023. The relative fair value of the warrant resulted in \$49,306 recorded as a discount on our convertible notes on our consolidated balance sheet in the period issued.

The Company may “call” the warrants issued in the Spring 2018 Offering, requiring the holder to exercise their warrant within 30 days or forever lose the rights to do so, if the following conditions have been met: (i) the shares of common stock underlying the warrants 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.

Pursuant to the Summer 2018 Unit Offering, we issued warrants to purchase the number of shares of stock equal to each investor’s investment amount, divided by the “unit price” set forth in a “pricing supplement”. The offering documents assured the investors that in the event a subsequent pricing supplement offered a lower conversion or exercise price, prior investors would be given those favorable terms. On September 14, 2018, we issued a second pricing supplement, lowering the unit price to \$0.25. As a result of this reduction, the number of shares purchasable pursuant to warrants issued to prior investors increased by an aggregate 67,777 shares. The fair value of these warrants resulted in \$17,373 recorded as interest expense during the three-months ended September 30, 2018.

Warrants Issued Concurrently with Line of Credit Offering

During the nine months ended September 30, 2018, pursuant to the terms of our Line of Credit (see Note 4, “Line of Credit, matures September 1, 2019”), we issued warrants to purchase up to an aggregate of 430,000 shares of our common stock. Of this amount 390,000 shares of our common stock are at an exercise price of \$0.35 per share and 40,000 shares are at an exercise price of \$0.25 per share. These warrants expire March 1, 2023. The relative fair value of these warrants resulted in \$97,966 recorded as a discount on our “convertible notes payable and line of credit” on our consolidated balance sheet in the period issued.

The Company may “call” these warrants, requiring the holder to exercise their warrants within 30 days or forever lose the rights to do so, if the following conditions have been met: (i) the shares of common stock underlying the warrants 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.

Warrants Issued Concurrently with Note Payable

During the three months ended March 31, 2018, pursuant to the terms of the note payable. (see Note 4, “Note payable, matures March 8, 2020”), we issued warrants to purchase up to an aggregate 150,000 shares of our common stock at an exercise price of \$0.35 per share. At the end of each month 6,250 warrants vest as long as the note payable is outstanding. Although the note matures March 8, 2020, the investor may call the note at any time after June 30, 2018. Thus, a minimum of 25,000 warrants will vest, and the fair value of these warrants totaled \$6,500 and was recorded as interest expense. These warrants expire February 28, 2023.

Warrants Issued to Summer 2017 Unit Offering Investors

Pursuant to the Summer 2017 Unit Offering, we issued warrants to purchase the number of shares of stock equal to each investor’s investment amount, divided by the “unit price” set forth in a “pricing supplement”. The offering documents assured the investors that in the event a subsequent pricing supplement offered a lower conversion or exercise price, prior investors would be given those favorable terms. On February 12, 2018, we issued a third pricing supplement, lowering the unit price to \$0.30. As a result of this reduction, the number of shares purchasable pursuant to warrants issued to prior investors increased by an aggregate 416,478 shares. Additionally, during the three months ended March 31, 2018, we accepted two final investments in the aggregate amount of \$80,000, pursuant to the third pricing supplement, and issued these investors warrants to purchase an aggregate 266,667 shares. The relative fair value of these warrants, including the increase in purchasable shares, resulted in \$103,322 recorded as a discount on our consolidated balance sheet in the period issued.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Warrants Issued Concurrently with One Year Convertible Notes

We have accepted \$250,000 investments and issued one-year OID convertible notes on three occasions: July 8, 2016, December 30, 2016, and July 17, 2017. In addition to the notes, the investors received warrants on each of those three dates to purchase an aggregate 400,000 shares of our common stock. These warrants were initially exercisable at \$0.65 per share (for July 2016 warrants), \$0.70 per share (for December 2016 warrants), and \$0.65 per share (for July 2017 warrants), and expire five years from the date of grant. Each of the warrants contain a provision that the exercise price may be reduced in the event we sell our common stock or issue warrants to third parties at a lower prices, with particular exclusions, the details of which are available in our Form 10-K. The exercise price of these warrants has decreased, and the number of shares increased, on multiple occasions prior to December 31, 2017, most recently on December 11, 2017, at which time the exercise price was reduced to \$0.394 per share, and the number of shares issuable pursuant to the warrants, in the aggregate, increased from the original 1,200,000 shares, to 2,081,216.

On February 22, 2018, we sold shares of our common stock at \$0.25 per share (see Note 3). Since these securities were sold at less than the then previously adjusted \$0.394 warrant exercise price, the exercise price of the warrants were decreased from \$0.394 to \$0.25 per share, and the number of shares issuable pursuant to the warrants increased by an aggregate 1,198,784 shares. The fair value of the warrants issued totaled \$297,439 and is recorded as a deemed dividend in our equity statement for the nine months ended September 30, 2018.

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

	Number of Shares	Price Range
As of September 30, 2017		
Outstanding as of December 31, 2016	20,035,114	\$0.125– 1.00
Issued	2,499,933	0.42 – 0.70
Exercised	(510,000)	0.30
Expired	(250,000)	0.25 – 0.30
Outstanding as of September 30, 2017	21,775,047	\$0.125– 1.00

As of September 30, 2018	Number of Shares	Price Range
Outstanding as of December 31, 2017	22,104,817	\$0.125– 1.00
Issued	6,451,013	0.25 – 0.48
Exercised	—	—
Expired	(2,683,400)	0.40
Outstanding as of September 30, 2018	25,872,430	\$0.125– 1.00

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The fair value of each award grant is estimated on the date of grant using the Black-Scholes option-pricing model. The determination of expense of warrants issued for services or settlement also uses the option-pricing model. The principal assumptions we used in applying this model were as follows for the nine months ended September 30, 2017 and 2018:

	2017	2018
Risk free interest rate	1.71–1.93%	2.54–2.96%
Expected volatility	293 –297%	252 –277%
Expected dividend yield	—	—
Forfeiture rate	—	—
Expected life in years	5	5

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

Note 7. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included the following:

	December 31, 2017	September 30, 2018
Accounts payable and accrued expenses	\$88,381	\$ 242,113
Accrued interest	50,748	82,569
Accrued payroll	84,976	36,381
Total accounts payable and accrued expenses	\$ 224,105	\$ 361,063

Issuance of Common Stock in exchange for payment of payables

Payment of Officer Salaries

On September 28, 2018, we issued 249,258 shares of our common stock at \$0.27 per share in lieu of \$67,300 of accrued and unpaid obligations to two of our officers. The price-per-share was based on the closing price of our common stock on the last day of the month.

On June 29, 2018, we issued 176,947 shares of our common stock at \$0.43 per share in lieu of \$75,968 of accrued and unpaid obligations to two of our officers. The price-per-share was based on the closing price of our common stock on the last day of the month.

On March 31, 2018, we issued 323,030 shares of our common stock at \$0.26 per share in lieu of \$83,665 of accrued and unpaid obligations to two of our officers. The price-per-share was based on the closing price of our common stock on the last day of the month.

Payment of Consultant Fees

During the nine months ended September 30, 2018, we issued 1,390,813 shares of our common stock, at prices ranging between \$0.23 - \$0.41 per share, in lieu of \$417,965 of accrued and unpaid obligations to consultants.

During the nine months ended September 30, 2017, we issued 480,625 shares of our common stock, at prices ranging between \$0.43 - \$0.52, in lieu of \$252,317 of accrued and unpaid obligations to consultants.

Payment of Accrued Interest

During the nine months ended September 30, 2018, we issued 2,002,868 shares of our common stock, at prices ranging between \$0.31 – 0.42 per share, in lieu of accrued interest totaling \$514,959.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

During the nine months ended September 30, 2017, we issued 1,034,762 shares of our common stock, at prices ranging between, \$0.41 – \$0.70 per share, in lieu of accrued interest totaling \$507,621.

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.

Note 8. Non-controlling Interest

Clyra Medical Technologies

Our subsidiary Clyra Medical Technologies, Inc. (“Clyra”) was formed to develop and sell medical products containing our technology. Although we initially owned 100% of this subsidiary, we have issued shares to management and to investors. As of September 30, 2018, we own 46.3% of Clyra’s outstanding shares. Clyra’s three-member board of directors includes BioLargo president Dennis P. Calvert, BioLargo board member (and also an owner of Clyra’s Series A preferred shares) Jack B. Strommen, and Clyra’s president. On September 26, 2018, we entered into an agreement to purchase assets from Scion Solutions, LLC (the details of which are found in Note 10).

Clyra’s Series A preferred shares (“Preferred Shares”) accrue an annual dividend of 8% for a period of five years. Although the dividends began to accrue immediately, Clyra has no obligation to declare a dividend until a product of the company has received a premarket approval by the United States Federal Drug Administration (“FDA”), or for which a premarket notification pursuant to form 510(k) has been submitted and for which the FDA has given written clearance to market the product in the United States (either, “FDA Approval”). After FDA Approval, annually on December 20, and unless prohibited by California law governing distributions to shareholders, Clyra is required to declare and pay any accruing dividends to holders of Preferred Shares then accrued but unpaid. As the declaration and payment of such dividends is contingent on an uncertain future event, no liability has been recorded for the dividends. The accumulated and undeclared dividend balance as of September 30, 2018 is \$165,000.

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

On March 31, 2017, Clyra obtained a \$250,000 line of credit from Sanatio Capital LLC, accruing interest at a rate of 10% per annum and a 5% original issue discount. The line of credit was scheduled to mature on March 31, 2019, but was subsequently converted to Clyra stock in full payment (see below).

In April 2017, BioLargo purchased 500 shares of Clyra common stock from a former member of Clyra's management for \$40,000.

In August 2017, Clyra commenced a private offering of its common shares at a price of \$160 per share, and accepted \$1,000,000 in subscriptions. It issued 6,250 shares of its common stock to two investors. Of that amount, BioLargo invested \$250,000 and was issued 1,562.5 shares. On August 4, 2017, Clyra issued 1,690 shares of its common stock at \$160 per share to Sanatio in exchange for payment of the \$270,400 principal and interest outstanding under the line of credit held by Sanatio (see above). Subsequent to the issuance of shares to investors in the offering, and to Sanatio for the conversion of the line of credit, BioLargo owned 15,297.5 shares of Clyra common stock, which is 46.3% of the outstanding stock at Clyra. Two members of BioLargo's board of directors (Dennis P. Calvert and Jack B. Strommen) comprise a majority of the three-member Clyra board of directors. Management has determined that BioLargo does control Clyra after reviewing the guidance of ASC Topic 810, "Consolidation". While BioLargo does not have voting interest control through 50% ownership of Clyra, it does exercise control under the Variable Interest Model. BioLargo is the primary beneficiary since it has the power to direct Clyra's activities that most significantly impact Clyra's performance and it has the obligation to absorb losses or receive benefits (through royalties and licensing) that could be potentially significant to Clyra. BioLargo has consolidated Clyra's operations through September 30, 2018.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 9. Biolargo Engineering, Science and Technologies, LLC

In September 2017, we commenced a full-service environmental engineering firm and formed a Tennessee entity named BioLargo Engineering, Science & Technologies, LLC (“BLEST”). In conjunction with the start of this subsidiary, we entered into a three-year office lease in the Knoxville, Tennessee area, and entered into employment agreements with seven scientists and engineers. These agreements and related operational obligations add approximately \$100,000 to our monthly budget for payroll, taxes, benefits, insurance, and other related obligations. The company was capitalized with two classes of membership units: Class A, 100% owned by Biolargo, and Class B, held by management of BLEST, and which initially have no “profit interest,” as that term is defined in Tennessee law. However, over the succeeding five years, the Class B members can earn up to a 30% profit interest. They also have been granted options to purchase up to an aggregate 2,000,000 shares of BioLargo, Inc. common stock. The profit interest and option shares are subject to a five year vesting schedule tied to the performance of the subsidiary, including gross revenue targets that increase over time, obtaining positive cash flow by March 31, 2018 (which was not met), collecting 90% of its account receivables, obtaining a profit of 10% in its first year (and increasing in subsequent years), making progress in the scale-up and commercialization of our AOS system, and using BioLargo research scientists (such as our Canadian team) for billable work on client projects. These criteria are to be evaluated annually by a committee of the company (which includes BioLargo’s president, CFO, and BLEST’s president), beginning September 2018. The details of these transactions were reported on a Form 8-K filed with the SEC on September 8, 2017. Given the significant performance criteria, the Class B units and the stock options will only be recognized in compensation expense if or when the criteria are satisfied.

The Compensation Committee met on September 26, 2018 and reviewed the operating performance of the engineering subsidiary and determined that the performance metrics were not met and as a result, did not award any Class B units or stock options. The Committee decided to roll forward one additional year to the time allowed for the performance metrics to be met and for the Class B units and stock options to be awarded.

Note 10. Commitments and Contingencies

Clyra Acquisition Corp (Scion Acquisition)

On September 26, 2018, we entered into a transaction whereby we would acquire the assets of Scion Solutions, LLC (“Scion”), and in particular its stem cell based technology, the SkinDisc, and key team members to support the sale and distribution of Clyra’s products based on our BioLargo technologies.

Scion is led by Spencer Brown, a medical device industry veteran with more than 35 years’ experience in sales, account management, and distribution in the medical device industry. The SkinDisc product was developed by Dr. Brock Liden, a renowned medical podiatrist and expert in wound care and diabetic limb salvage. The SkinDisc is a therapy product that uses a patient’s own bone marrow and plasma to generate a cell-rich bio gel for use with chronic wounds. It has been tested in over 250 patient cases with no adverse effects, and has successfully aided in the salvage of limbs that otherwise would have been amputated.

The parties entered into a Stock Purchase Agreement and Plan of Reorganization (“Purchase Agreement”) whereby Scion and Clyra agreed to contribute all of their assets to a new entity (initially named Clyra Acquisition Corp., to be later renamed Clyra Medical Technologies, Inc., and referred to herein as “Clyra Acquisition”) in exchange for stock of the new entity. In exchange for the contribution of its assets, Clyra received from Clyra Acquisition the exact number of common and preferred shares it has outstanding (totaling 33,015 shares), and entered into a plan of reorganization whereby it will distribute the shares of the acquisition corporation to its shareholders such that its shareholders will hold the exact same number of common and preferred shares in the new entity as it did in Clyra prior to the transaction.

The consideration provided to Scion is subject to an escrow agreement and earn out provisions and includes: (i) 21,000 shares of the Clyra Acquisition common stock; (ii) 10,000 shares of Clyra Acquisition common stock redeemable for BioLargo common shares (detailed below); and (iii) a promissory note in the principal amount of \$1,250,000 to be paid through new capital investments and revenue, as detailed below. The Clyra Acquisition common stock will be held in escrow subject to the new entity raising \$1,000,000 “base capital” to fund its business operations. If \$1,000,000 in base capital is received within 120 days, one-half of the common stock would be released, and the second half would be subject to the following performance metrics, each vesting one-fifth of the remaining shares of common stock: (a) notification of FDA premarket clearance of certain orthopedics products, or recognition by Clyra Acquisition of \$100,000 gross revenue; (b) the recognition by Clyra of \$100,000 in aggregate gross revenue; (c) the granting of all or any part of the patent application for the Skin Disc product, or recognition by Clyra Acquisition of \$500,000 in gross revenue; (d) recognition by Clyra Acquisition of \$1,000,000 in aggregate gross revenue; and (e) recognition by Clyra Acquisition of \$2,000,000 in gross revenue. If \$1,000,000 base capital is not raised within 120 days, then either party may completely terminate the transaction upon which termination we would have no further rights in the SkinDisc nor any further obligations to Scion.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The promissory note issued by Clyra Acquisition to Scion accrues interest at the rate of 5%. Principal and interest due under the note are to be paid periodically once the company receives \$1,000,000 in “base capital”, at a rate of 25% of investment proceeds received. If the note is not paid off within 18 months after the date of issuance, it is automatically extended for additional 12-month periods until the note is repaid in full. Payments after the initial 18-month maturity date are required to be made as investment proceeds are received, at a rate of 25% of such proceeds, and 5% of Clyra Acquisition’s gross revenues. BioLargo purchased the Scion intellectual property and 12,755 common shares from Clyra Acquisition. and in exchange issued 7,142,858 shares of its common stock, and in turn licensed back the technology to Clyra Acquisition. Scion may redeem these shares from Clyra Acquisition by exchanging its 10,000 common shares once (and only if) those 10,000 Clyra Acquisition shares are vested as discussed above.

We were initially introduced to the SkinDisc product and Scion Solutions through Dr. Liden and Tanya Rhodes’s work with Clyra (both Dr. Liden and Ms. Rhodes have ownership interest in Scion). Prior to the execution of the above-described agreements, BioLargo did not have any material relationship with Scion’s founder Spencer Brown.

The transactions contemplated by the Purchase Agreement were approved by BioLargo’s Board of Directors by written consent on September 26, 2018. In connection with the transaction, the Board of Directors obtained a fairness opinion from an independent appraiser, Berg Capital Markets, LLC. The fairness opinion states that the terms of the transaction is fair, from a financial point of view, to BioLargo, Clyra, and their shareholders. Calvert Employment Agreement

On May 2, 2017, the Company entered into an employment agreement with its President and Chief Executive Officer Dennis P. Calvert (the “Calvert Employment Agreement”), replacing in its entirety the previous employment agreement with Mr. Calvert dated April 30, 2007.

The Calvert Employment Agreement provides that Mr. Calvert will continue to serve as our President and Chief Executive Officer and receive base compensation equal to his current rate of pay of \$288,603 annually. In addition to this base compensation, the agreement provides that he is eligible to participate in incentive plans, stock option plans, and similar arrangements as determined by the Company’s Board of Directors, health insurance premium payments for himself and his immediate family, a car allowance of \$800 per month, paid vacation of four weeks per year, and bonuses in such amount as the Compensation Committee may determine from time to time.

The Calvert Employment Agreement provides that Mr. Calvert will be granted an option (the “Option”) to purchase 3,731,322 shares of the Company’s common stock. The Option shall be a non-qualified stock option, exercisable at \$0.45 per share, which represents the market price of the Company’s common stock as of the date of the agreement, exercisable for ten years from the date of grant and vesting in equal increments over five years. Notwithstanding the foregoing, any portion of the Option which has not yet vested shall be immediately vested in the event of, and prior to, a change of control, as defined in the Calvert Employment Agreement. The agreement also provides for a grant of 1,500,000 shares of common stock, subject to the execution of a “lock-up agreement” whereby the shares remain unvested unless and until the earlier of (i) a sale of the Company, (ii) the successful commercialization of the Company’s products or technologies as demonstrated by its receipt of at least \$3,000,000 in cash, or the recognition of \$3,000,000 in revenue, over a 12-month period from the sale of products and/or the license of technology, and (iii) the Company’s breach of the employment agreement resulting in his termination. The Option contains the other terms standard in option agreements issued by the Company, including provisions for a cashless exercise.

The Calvert Employment Agreement has a term of five years, unless earlier terminated in accordance with its terms. The Calvert Employment Agreement provides that Mr. Calvert’s employment may be terminated by the Company due to his death or disability, for cause, or upon a merger, acquisition, bankruptcy or dissolution of the Company. “Disability” as used in the Calvert Employment Agreement means physical or mental incapacity or illness rendering Mr. Calvert unable to perform his duties on a long-term basis (i) as evidenced by his failure or inability to perform his duties for a total of 120 days in any 360-day period, or (ii) as determined by an independent and licensed physician whom Company selects, or (iii) as determined without recourse by the Company’s disability insurance carrier. “Cause” means that Mr. Calvert has (i) engaged in willful misconduct in connection with the Company’s business; or (ii) been convicted of, or pled guilty or nolo contendere in connection with, fraud or any crime that constitutes a felony or that involves moral turpitude or theft. If Mr. Calvert’s employment is terminated due to merger or acquisition, then he will be eligible to receive the greater of (i) one year’s compensation plus an additional one-half year for each year of service since the effective date of the employment agreement or (ii) one year’s compensation plus an additional one-half year for each year remaining in the term of the agreement. Otherwise, he is only entitled to receive compensation due through the date of termination.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The Calvert Employment Agreement requires Mr. Calvert to keep certain information confidential, not to solicit customers or employees of the Company or interfere with any business relationship of the Company, and to assign all inventions made or created during the term of the Calvert Employment Agreement as “work made for hire”.

Clyra Consulting Agreement

Our partially owned subsidiary Clyra (see Note 8) entered into a consulting agreement with Beach House Consulting, LLC, through which Jack B. Strommen will be providing consulting services to Clyra related to its sales and marketing activities once it has received FDA Approval (as defined in Note 8 and the associated agreement) on a product, at which point the agreement provides that Mr. Strommen is to receive \$23,438 per month for a period of four years. This agreement has not started, and the total cash obligation related to the agreement would be \$1,125,024 over four years.

Note 11. Subsequent Events.

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

Triton Fund Investment

On October 16, 2018, we entered into a Securities Purchase Agreement (“Purchase Agreement”) with Triton Fund, LP (“Triton”) for a \$225,000 bridge loan, and issued a promissory note in the principal amount of \$300,000 (the “Triton Note”). The note incurs interest at an annual rate of 5%, and matures January 11, 2019. If we fail to pay the note by January 11, 2019, the maturity date automatically extends for 30 days, and in such event the principal amount of the note will increase by 15%, effective as of the original issuance date. We must repay the note through any financing we close in excess of \$3,000,000. In the event of a default, Triton may convert the note at a conversion price equal to one-half of the lowest volume weighted average price of our common stock during the 30 days preceding the

conversion. The note is not convertible otherwise.

The Triton Note requires the Company to register the shares of Company common stock issuable upon conversion of the Triton Note in the next registration statement filed by the Company. Failure to register the shares will result in liquidated damages equal to 25% of the outstanding principal balance of the Triton Note.

The Triton Note also provides that, upon the occurrence of certain events of default, the Triton Note becomes immediately due and payable and the principal amount of the Triton Note shall increase to 150% of the current outstanding principal amount plus accrued interest plus additional default interest at an annual rate of 12%. Such events of default include a breach of the representation and warranties, a breach of any covenant, a failure to comply with the reporting requirements of the Securities Exchange Act of 1934, a failure to maintain any intellectual property rights, a change in the transfer agent, any cessation of trading of the Company's common stock, any default by the Company on any other agreements such as promissory notes to third parties, and the failure to register the common stock issuable upon conversion of the Triton Note within 45 days after the closing date. The Triton Note and the related Purchase Agreement also contain a number of other penalty and damage provisions triggered by certain breaches.

In addition to the note, we issued a stock purchase warrant to Triton (the "Triton Warrant") allowing Triton to purchase up to an aggregate 1,000,000 shares of our common stock for \$0.25 per share, until October 12, 2023. We may "call" the warrant if the closing price of our common stock equals or exceeds \$0.50 for 10 consecutive trading days and the shares underlying the warrant are subject to an effective registration statement with the Securities and Exchange Commission. If we call the warrant, Triton would have 30 days to exercise its rights to purchase shares under the warrant or forever forfeit such rights. If the shares underlying the warrant are not registered, Triton may exercise the warrant pursuant to a formula (a "cashless" exercise).

In addition to the foregoing, we donated 150,000 shares of our common stock to the student-run Triton Fund, LLC, a fund-manager founded by undergraduates from the University of California, San Diego and California State University, Northridge that provides students real-world experience investing alongside experienced financial professionals.

Registration Statement

On November 6, 2018, we filed a registration statement with the SEC on Form S-1. The purpose of the registration statement is to conduct a public offering to raise equity capital required to meet the listing requirements of the Nasdaq Capital Market. The offering is being underwritten by H.C. Wainwright & Co., LLC.

Table of Contents

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

This quarterly report on Form 10-Q contains forward-looking statements. These forward-looking statements involve risks and uncertainties, including statements regarding BioLargo’s capital needs, business plans and expectations. Such forward-looking statements involve risks and uncertainties regarding BioLargo’s ability to carry out its planned development and production of products. Forward-looking statements are made, without limitation, in relation to BioLargo’s operating plans, BioLargo’s liquidity and financial condition, availability of funds, operating and exploration costs and the market in which BioLargo competes. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as “may”, “will”, “should”, “expect”, “plan”, “intend”, “anticipate”, “believe”, “estimate”, “predict”, “potential” or “continue”, the negative of such terms or other comparable terminology. Actual events or results may differ materially. In evaluating these statements, you should consider various factors, including the risks outlined in our Form most recent annual report on Form 10-K, and, from time to time, in other reports BioLargo files with the SEC. These factors may cause BioLargo’s actual results to differ materially from any forward-looking statement. BioLargo disclaims any obligation to publicly update these statements, or disclose any difference between its actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Unless otherwise expressly stated herein, all statements, including forward-looking statements, set forth in this Form 10-Q are as of September 30, 2018, unless expressly stated otherwise, and we undertake no duty to update this information.

As used in this report, “we” and “Company” refers to (i) BioLargo, Inc., a Delaware corporation; (ii) its wholly-owned subsidiaries BioLargo Life Technologies, Inc., a California corporation, Odor-No-More, Inc., a California corporation, BioLargo Water USA, Inc., a California corporation, BioLargo Development Corp., a California corporation, BioLargo Maritime Solutions, Inc., a California corporation, BioLargo Engineering, Science & Technologies, LLC, a Tennessee limited liability company, and Canadian subsidiary BioLargo Water, Inc.; and (iii) Clyra Medical Technologies, Inc. (“Clyra”), a partially owned subsidiary.

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

Our Business- A Sustainable Products and Technology Developer

BioLargo, Inc. is an innovative technology developer and environmental engineering company driven by a mission to **“make life better”** by delivering robust, sustainable solutions for a broad range of industries and applications, with a focus on clean water, clean air, and advanced wound care. We develop and commercialize disruptive technologies by providing the capital, support, and expertise to expedite them from “cradle” to “maturity”. Our business strategy is straightforward: we invent or acquire technologies that we believe have the potential to be disruptive in large commercial markets; we incubate and develop these technologies to advance them and promote their commercial success as we leverage our considerable scientific, engineering, and entrepreneurial talent; we then monetize these technical assets through a variety of business structures that may include licensure, joint venture, sale, spin off, or by deploying direct to market strategies. We seek to unlock the value of our portfolio of underlying technologies to both advance our purposeful mission while we create value for our stockholders.

Our first significant commercial success is currently unfolding in our subsidiary, Odor-No-More, Inc., which is focused on odor and volatile organic compound (“VOC”) control products sold under the brands CupriDyne Clean and Nature’s Best Science. We are gearing up for rapid growth as our products are experiencing more widespread market adoption. To this end, we have recently begun to offer a menu of services to our clients including engineering design, construction, and installation of equipment used to deliver our products, as well as ongoing maintenance services for installed systems. We have also begun expanding with early adopters into new vertical segments such as wastewater treatment and industrial facilities.

Our second commercial operation provides professional engineering services, through our subsidiary BioLargo Engineering, Science & Technologies, LLC (“BLEST”). Through BLEST, we provide a menu of professional engineering and consulting services to compliment and nurture our technologies as well as serve clients on a fee-for-service basis.

In addition to our two operating subsidiaries, we have technologies and products in the development pipeline progressing towards commercialization, including our Advanced Oxidation System (“AOS”), being developed by our subsidiary BioLargo Water, that we target to have commercially ready in 2019, and our medical products, being developed by our subsidiary Clyra Medical Technologies, Inc. (“Clyra”), which will be ready for commercialization as soon as we pass Food and Drug Administration (“FDA”) clearance. We have also recently entered into agreements pursuant to which we have purchased, subject to certain escrow conditions, a stem cell therapy called the SkinDisc™ technology which is licensed to our subsidiary Clyra.

Table of Contents

We believe our current success with our industrial odor and VOC control products serves to validate our overall business strategy which is focused on technology-based products and services capable of disrupting the status quo in their applicable industry market segment. We believe that the future of our medical and clean water technologies has similar and also very large market opportunities ahead as they are introduced commercially.

Industrial Odor and VOC Control – CupriDyne Clean

Our CupriDyne Clean industrial products reduce and eliminate tough odors and VOC's in various industrial settings, delivered through misting systems, sprayers, water trucks and similar water delivery systems. We believe the product is the number one performing odor-control product in the market and offers substantial savings to our customers compared with competing products.

Market Opportunity Validated

Our customer base is expanding. We are now selling product to four of the largest solid waste handling companies in the country, and also have secured multiple flagship clients in the wastewater treatment industry, which we expect to be a top priority market. We are also expanding to new industrial markets, including steel manufacturing, paper production, construction, building and facilities management, and livestock production, and internationally. To that end, we participated in the China InnoStars Semi Finals competition in China in early November, gaining exposure for both our company and our products to stakeholders in China's air quality and odor control market as well as potential strategic investors.

Many of our customers have adopted CupriDyne Clean as a replacement for a non-performing competitive product. We are realizing systematic adoption by our very large corporate customers and expect to serve these customers for years to come. Our experience has helped refine our value proposition and assemble a comprehensive menu of products and services. Our success in this market has validated the market opportunity for our products and services and encourages us to continue investing in infrastructure and sales and marketing to increase revenues. We estimate there are approximately 2,000 active landfills¹ and 8,000 transfer stations² and 15,000 waste water treatment agencies³ in the United States. While all may not have ongoing odor problems or neighbor complaints, many of the facilities have needed for a disruptive odor solution like CupriDyne Clean.

Turn-key Full-service Solutions

At the request of our clients, we have begun offering a menu of services to landfills, transfer stations, and wastewater treatment facilities. These services include ongoing maintenance and on-site support services to assist our clients in the design and continued use of the various systems that deliver our product in the field (such as misting systems at landfills, transfer stations, and wastewater treatment facilities). We have recently begun providing engineering design, construction and installation services related to the various water-based delivery systems used to deploy our products. Our engineering team at BLEST has been instrumental in supporting these operations. Our subsidiary Odor-No-More has applied for a general contractor's license, a plumbing license and a low-voltage electrical license from the California Contractors State License Board. These licenses will allow us to offer a full-service solution to our current and future customers within the state of California. We currently have more than 30 "design build" bids out to clients for CupriDyne Clean delivery systems.

Regional Adoption

Sales of our CupriDyne Clean products and related services were initially made at the local level. We would demonstrate our product to the manager of operations at a transfer station or landfill, and he or she would ultimately decide whether to use our products. If owned by a national company, in some instances, before the operations manager could buy our products, we were required to obtain official "vendor" status with the company and sign a "national purchasing agreement" ("NPA"). Doing so required a tremendous amount of effort and time. These agreements typically include the addition of our line of products which will be offered through an online purchasing portal to the members around the nation. The process of integrating the data is often delayed by months from the start date of our agreements given their very technical nature. As an example, we are still working to finish this portion of the startup process with our fourth national agreement account. These processes establish an easy and familiar selling and purchasing process for the ongoing and long-term relationships we seek to develop. We now have NPAs with four of the largest solid waste handling companies in the United States. Some of these accounts are now introducing us to regional managers around the country who have the ability to direct the facilities in their region to use our product. We are now servicing 100% of local facilities in two southern California regions. We believe that "regional adoption" is a scalable approach for the larger solid waste handling companies that, with sufficient resources, we can implement nationwide.

¹ "Municipal Solid Waste Landfills - Economic Impact Analysis for the Proposed New Subpart to the New Source Performance Standards" (2014), by U.S. Environmental Protection Agency Office of Air and Radiation and Office of Air Quality Planning and Standards.

² The top 5 Waste Management companies in the US, as of 2011, operated 624 transfer stations, and 565 landfills. "Municipal Solid Waste Landfills - Economic Impact Analysis for the Proposed New Subpart to the New Source Performance Standards" (2014), by U.S. Environmental Protection Agency Office of Air and Radiation and Office of Air Quality Planning and Standards. This is a ratio of 1:4 (landfill to transfer stations). The estimated number of transfer stations is this ratio multiplied by the approximate 1,900 total landfills, and rounded.

³ "Failure to Act, The Economic Impact of Current Investment Trends in Water and Wastewater Treatment Infrastructure" (2011), by American Society of Civil Engineers and Economic Development Research Group. Figure includes treatment facilities owned and operated by municipalities, as well as those owned and/or operated by private entities contracting with municipalities.

Table of Contents

Wastewater Treatment Facilities

We have begun selling products and services to wastewater treatment facilities in our local markets. Our clients are prominent municipal agencies and have indicated a desire to expand the use of our products and services to additional locations in their service areas. As a result of our success in the field, a client featured our product as an example of ‘Best Practices’ for the waste water treatment industry at a national water quality conference hosted by the Water Environment Federation. We anticipate overall longer selling cycles given the technical sophistication of the customers in this market and believe significant capital and high levels of service will be required for our ultimate success. We are highly encouraged and are evaluating various strategies to maximize our marketing and selling proposition into this mature and well-established market. In fact, Odor-No-More has been invited by a water utility innovation group, Isle Utilities, to present CupriDyne Clean at two upcoming “TAG” events (Technology Approval Group), giving Odor-No-More substantial exposure to decision makers representing a large number of municipalities and wastewater treatment facilities.

Infrastructure and Capital Needs for Odor-No-More

We recognize the scope of the opportunity for CupriDyne Clean and related services, and understand the task of building the personnel and infrastructure to become a disruptive company in the solid waste industry. In the United States, we currently operate out of two locations – Southern California, and Tennessee. We expect to expand our manufacturing and staffing in our Tennessee operation as we achieve critical mass in that region. In the meantime, as a result of the rapid adoption we are experiencing in our local Southern California market, we are focused on adding staff and infrastructure to meet the obvious need for our products and services. Since January 1, 2018, we have added five people in both sales and support roles.

We believe that a significant number of personnel will be required to fully service the solid waste handling and wastewater treatment industries. We plan to expand as adequate capital to fund these needs becomes available.

Full Service Environmental Engineering

In September 2017 we formed a subsidiary for the purpose of offering full service environmental engineering to third parties, and to provide engineering support services to our internal teams to accelerate the commercialization of our AOS technologies. Its website is found at www.BioLargoEngineering.com.

The subsidiary, BioLargo Engineering, Science & Technologies, LLC (“BLEST”), opened its office in Oak Ridge (a suburb of Knoxville Tennessee), and entered into employment agreements with seven scientists and engineers who collectively have over two hundred years of experience in diverse engineering fields. The team is led by Randall Moore, who served as Manager of Operations for Consulting and Engineering for the Knoxville office of CB&I Environmental & Infrastructure and was formerly a leader at The Shaw Group, Inc., a Fortune 500 global engineering firm. The other team members are also former employees of CB&I and Shaw. The team is highly experienced across multiple industries and they are considered experts in their respective fields, including chemical engineering, wastewater treatment (including design, operations, data gathering and data evaluation), process safety, energy efficiency, air pollution, design and control, technology evaluation, technology integration, air quality management & testing, engineering management, permitting, industrial hygiene, applied research and development, air testing, environmental permitting, HAZOP review, chemical processing, thermal design, computational fluid dynamics, mechanical engineering, mechanical design, NEPDES permitting, RCRA/TSCA compliance and permitting, project management, storm water design & permitting, marine engineering, AutoCAD, bench chemistry, continuous emission monitoring system operator, data handling and evaluation and decommissioning and decontamination of radiological and chemical contaminated facilities.

Our engineering team has focused its efforts in two areas. First, servicing third party clients in similar roles as to what they did at CB&I and Shaw, and throughout their well-established careers. Second, they are working to scale-up, engineer and commercialize our AOS water treatment technologies, as well as support other technology and product development efforts within the BioLargo family of companies, including our industrial odor control solutions (CupriDyne Clean). By way of example, the team has recently engineered and designed multiple misting systems requested by our large waste handling company clients. BLEST will also pursue new inventions and be available to provide engineering support where needed for any commercial opportunities that are presented by and through any and all operating units of BioLargo.

During the third quarter of 2018, our engineering team continues to expand its client list of regional utilities, healthcare, and Fortune 500 companies. Although growth has been slower than originally expected, it has been steady, and last month’s billings to third party clients exceeded BLEST’s monthly expenses for the first time.

BLEST management believes the company can expect growth in several areas. For one, BLEST is under contract to design, build, and install wastewater treatment equipment and “treatment trains” for clients in collaboration with BioLargo’s water technology subsidiary BioLargo Water. Not only does this represent important synergy between two BioLargo business units, but it offers BLEST the opportunity to become a total water treatment solutions provider for customers in the widely under-served small industrial wastewater treatment sector. Another area of predicted growth is the growing list of contracts BLEST has signed to conduct environmental engineering and permitting work for large industrial facilities such as fuel conversion plants, an area that BLEST has experienced increased traction in the past quarter.

Table of Contents

BioLargo Water and the Advanced Oxidation System - AOS

BioLargo Water is our wholly owned subsidiary located on campus at the University of Alberta that has been primarily engaged in the research and development of our Advanced Oxidation System (AOS). The AOS is a water treatment device in development that generates a series of highly oxidative species of iodine and other molecules that, because of the proprietary configuration and inner constituents of the AOS, allow the AOS to eliminate pathogenic organisms and organic contaminants with extreme efficacy while consuming very little electricity.

The key value proposition of the AOS is its ability to eliminate a wide variety of contaminants with high performance while consuming extremely low levels of input electricity – a trait made possible by the complex set of highly oxidative iodine compounds generated within the AOS reactor. Our proof-of-concept studies and case studies have generated results that project the AOS will be more cost- and energy-efficient than commonly used advanced water treatment technologies such as UV, electro- chlorination, and ozonation. This value proposition sets the AOS technology above other water treatment options, as we believe the AOS may allow safe and reliable water treatment for significantly lower cost compared to its competitors and may even enable advanced water treatment in applications where it otherwise would have been prohibitively costly.

The AOS has the potential to allow reliable and cost-effective water treatment in numerous industries and applications where high-level disinfection or elimination of hard-to-treat organic contaminants is required. We are first pursuing commercial piloting in preparation of commercialization of the AOS in beachhead industries: 1) livestock processing wastewater treatment and reuse; 2) municipal wastewater tertiary treatment; 3) oil and gas process affected water treatment, remediation, and/or reuse; 4) beverage wastewater treatment; and 5) stormwater recapture, treatment, and reuse. These industries were chosen as a result of extensive market research which highlighted them as areas where current water treatment technologies fall short of industry needs, and/or where the AOS has the potential to provide economic advantages over incumbent water treatment technologies. In each of these markets, we have or expect to receive significant grant support to perform pre-commercial trials with potential customers.

Our AOS was the result of breakthroughs in both advanced iodine electrochemistry and advances in materials engineering, and its invention led to BioLargo's co-founding of a multi-year industrial research chair whose goal was to solve the contaminated water issues associated with the Canadian Oil Sands at the University of Alberta Department of Engineering in conjunction with the top five oil companies in Canada, the regional water district, and various environmental agencies of the Canadian government. Based on recovering oil prices and our ongoing work in Canada, we recently reinitiated discussions with a number of stakeholders in the oil sands industry to support the completion of AOS development for oil and gas water treatment and to discuss the initiation of pre-commercial and commercial pilots for our AOS to help treat and remediate oil sands process-affected water ("OSPW") found in tailings ponds in the Canadian oil sands, an application that currently has no good economically viable solution. We have recently applied for significant grant funding to re-initiate our work to help treat OSPW and other oil and gas wastewaters using the AOS, and we will be notified about the status of our funding application in the coming months.

Our AOS is an award-winning invention that is supported by science and engineering financial support and grants from various federal and provincial funding agencies in Canada such as NSERC, NRC- IRAP, and Alberta Innovates and in the USA by the Metropolitan Water District and National Water Research Institute.

Recent AOS Milestones

The most important advances in AOS development in recent months have been 1) recent validation of the AOS as an effective tool to eliminate hard-to-treat micropollutants from wastewater, 2) design and engineering advances and changes to the AOS in preparation for piloting and scale-up for industrial flow-rates and conditions, and 3) the planning and design of pre-commercial field pilot projects.

One recent and important milestone for the AOS was the demonstration that it has the ability to eliminate and reduce the toxicity of certain high-concern pharmaceutical byproducts (i.e. micropollutants) common in certain municipal wastewater streams. BioLargo Water had previously reported preliminary findings that suggest its AOS technology can effectively remove pharmaceutical by-products (i.e. micropollutants) from water. Those results, collected in a collaboration with researchers at the Centre Des Technologies de L'Eau, showed that the AOS had promise as a treatment tool for eliminating pharmaceutical pollutants such as carbamazepine, ibuprofen, and amoxicillin from MWW. In a follow-up study conducted in collaboration with Dr. Greg Goss, an expert in aquatic organism toxicology at the University of Alberta, BioLargo Water sought to examine A) the environmental safety of AOS-treated MWW, and B) whether the AOS' ability to eliminate pharmaceuticals from water would improve the environmental safety of MWW "spiked" with high concentrations of micropollutant contaminants. In this study, it was shown that water treated by the AOS technology was non-toxic in long-term exposure to aquatic organisms such as Daphnia, rainbow trout, and zebrafish embryos, under the experiential conditions examined. Additionally, the AOS reduced the toxic effects of MWW that has been experientially contaminated (spiked) with compounds known to negatively affects those organisms (benzo[a]pyrene and 17 β -estradiol). Finally, the study also showed that the AOS can reduce the well-documented aberrant developmental effects of 17 β -estradiol (an estrogen derivative) on rainbow trout. The AOS was successful in removing 17 β -estradiol from MWW spiked with the hormone, thereby reducing the developmental effects of the compound. Importantly, the AOS was also able to reduce the effects of the 17 β -estradiol and/or other hormones found normally in MWW (not spiked). These results represent promising evidence that the AOS can remove micropollutants that are an emerging concern to the water treatment industry. Currently, there are no economically viable solutions to remove these compounds from MWW, and incumbent technologies fall short.

Table of Contents

Several advances and improvements to the AOS have also been made in recent months with the purpose of preparing the technology for pre-commercial piloting, commercial piloting, and subsequent mass production, as well as to prepare it for scale-up to allow industrial flow rates. These advancements have largely been proprietary physical improvements to the AOS, including the transitioning of the AOS to using inner substrates more amenable to mass-production and greater flow rates and pressures. Management believes it will continue to advance the scale-up to higher volume throughputs of water flow and enhances the AOS ability to be more compact and longer lasting in the field. This work is not complete, but management believes it does represent a significant step forward to achieving high throughput quality results. Importantly, we have also designed and begun assembling our own proprietary water treatment train that will be used in pilots for the AOS and that will pave the way for complete wastewater treatment in industrial settings.

We are now underway on multiple pre-commercial field pilot projects. The first is a pre-commercial pilot to treat poultry wastewater on-site at a poultry producer's facility in Alberta, where the AOS will be assessed for its ability to eliminate bacteria and other contaminants from the wastewater effectively and cost-efficiently and to establish operating costs (OPEX) and capital costs (CAPEX) in a field setting. Importantly, in this pilot, BioLargo Water is installing the AOS as part of a complete "treatment train", with equipment to address all aspects of the client's water treatment needs, including organic contaminants, suspended solids, and biological organisms. Therefore, this pilot also represents BioLargo's first assessment as a "total solutions provider", which could open the door for a wider array of future water treatment market opportunities. In the second pre-commercial pilot, the AOS will be used on-site at a Californian brewery as a polishing step treatment regimen to eliminate bacteria and enable wastewater discharge in compliance with Californian regulatory standards. This pilot will help establish not only the efficacy of the AOS in a field setting, but also the OPEX and CAPEX of the system which will be used in preparation of future pilots, trials, and sales of the AOS. In this pilot, the AOS will be plugged into an existing treatment train (built in collaboration with BLEST and Aquacycl), and therefore will help assess the AOS' ability to "plug and play" in the context of diverse supporting equipment and logistics. In addition to the poultry and brewery pilots, we are negotiating to begin a pilot to treat captured stormwater for recycling and reuse. Finally, we have applied for a grant co-funded by the governments of Canada and China to install an AOS pilot unit on-site at a petrochemical plant in Tianjin City, China, where the AOS would be used to eliminate hard-to-treat organic contaminants to new standards set by the Chinese government. These pilot projects represent an important step for our AOS technology, as well as for our company. We are confident in our disruptive water treatment technology and have proven its treatment capabilities in the lab and nauseum. However, pilot projects for the AOS, as with any technology, are crucial to prove its reliability to industry stakeholders as well the capital cost and operating costs of our technology at-scale. These data will be critical to pave the way for future market adoption. As a reminder, we have many other pilots in evaluation to support this same cause.

We have also been selected as a semi-finalist for the Canadian "green growth program," a \$155 million government funding program for green growth initiatives for which over 750 grant applications were received. Our grant proposal would support our work in the Canadian oil sands industry and further validate our AOS' efficacy for treating oil sands process affected waters (OSPW). Treatment of OSPW is a large and unmet market need. The goal of this project is to demonstrate that the AOS is more effective and cost-efficient than existing treatment options, and that it has the potential to enable feasible treatment and remediation of OSPW. Success in this project would be expected to generate a large amount of interest in the AOS from oil and gas industry members and accelerate its market uptake in Canada.

We believe that our current designs for the AOS are cost-effective, commercially viable and should be ready for their first commercial launch in 2019. We intend to continue refining and improving the AOS continually to accomplish a series of goals: expanded patent coverage, extended useful life, lower capital costs, lower energy costs, optimized performance, precise configurations for specific industry challenges, portability, and identifying its performance limits. Our current and most pressing goal for the AOS, as evidenced by the pilot projects described above, is to demonstrate its efficacy in field settings, which is a crucial and necessary step for the commercialization of any water treatment system.

Advanced Wound Care - Clyra Medical

We formed Clyra Medical Technologies, Inc. (“Clyra”) to commercialize our technology in the medical products industry, which we believe can be disruptive to many competing product lines. Our initial product designs focus in the “advanced wound care” field, which includes traumatic injury, diabetic ulcers, and chronic hard-to-heal wounds. We are presently seeking pre-market clearance for an advanced wound care product from the U.S. Food & Drug Administration (“FDA”) under Section 510(k) of the Food, Drug, and Cosmetic Act.

Our advanced wound care products combine broad-spectrum antimicrobial capabilities with iodine’s natural and well-understood metabolic pathway to promote healing. Our products are highly differentiated from existing antimicrobials in multiple ways - by the gentle nature in which they can perform, reduced product costs, extended antimicrobial activity, and biofilm efficacy. In addition, iodine has no known acquired microbial resistance, unlike many competing products. We believe the future markets for some of our product designs may also include infection control and wound therapy for chronic wounds. We also intend to pursue and study the use of our technology as a compliment to regenerative tissue therapy.

We have three patent applications pending for medical products, and are preparing additional applications. While these patent applications are pending, we intend to continue expanding patent coverage as we refine our medical products.

We submitted premarket notification to the FDA under Section 510(k) in late June of 2018 for an advanced wound care product. We have since engaged in a series of communications back and forth to refine our understanding of the pathway to a successful conclusion of our submission, as well as responded to a series of questions about the product by the FDA. We are highly encouraged by our interactions with the FDA staff, and that the pathway to success is more well defined than ever before and the product’s design falls in the scope of the 510(k) process. We have a short list of information that has been requested that primarily relate to the labelling of the product and certain data related to systemic toxicity which requires that we engage third party testing to provide such data. We believe the time and cost to meet these requests is manageable within the next six months. While we remain confident that we will ultimately receive premarket clearance for this product, we can make no assurance or prediction as to success of these efforts, and must wait patiently for the process with the FDA to conclude. The company has numerous medical device product designs that it intends to pursue in the future as resources permit.

Table of Contents

Clyra's management has been actively engaged in arranging for clinical work and is in discussions with a number of potential strategic partners. One such discussion has resulted in the recent acquisition of the SkinDisc technology from Scion Solutions, LLC. On September 26, 2018, we and Clyra agreed to a transaction whereby we would acquire the assets of Scion Solutions, LLC ("Scion"), and in particular its stem cell based technology, the SkinDisc, and key team members to support the sale and distribution of Clyra Medical's products based on our BioLargo technologies.

Scion is led by Spencer Brown, a medical device industry veteran with more than 35 years' experience in sales, account management, and distribution in the medical device industry. The SkinDisc product was developed by Dr. Brock Liden, a renowned medical podiatrist and expert in wound care and diabetic limb salvage. The SkinDisc is a therapy product that uses a patient's own bone marrow and plasma to generate a cell-rich bio gel for use with chronic wounds. It has been tested in over 250 patient cases with no adverse effects, and has successfully aided in the salvage of limbs that otherwise would have been amputated.

The parties entered into a Stock Purchase Agreement and Plan of Reorganization ("Purchase Agreement") whereby Scion and Clyra Medical agreed to contribute all of their assets to a new entity (initially named Clyra Acquisition Corp., to be later renamed Clyra Medical Technologies, Inc., and referred to herein as "Clyra Acquisition") in exchange for stock of the new entity. In exchange for the contribution of its assets, Clyra Medical received from Clyra Acquisition the exact number of common and preferred shares it has outstanding (totaling 33,015 shares), and entered into a plan of reorganization whereby it will distribute the shares of the acquisition corporation to its shareholders such that its shareholders will hold the exact same number of common and preferred shares in the new entity as it did in Clyra Medical prior to the transaction.

The consideration provided to Scion is subject to an escrow agreement and earn out provisions and includes: (i) 21,000 shares of the Clyra Acquisition common stock; (ii) 10,000 shares of Clyra Acquisition common stock redeemable for BioLargo common shares (detailed below); and (iii) a promissory note in the principal amount of \$1,250,000 to be paid through new capital investments and revenue, as detailed below. The Clyra Acquisition common stock will be held in escrow subject to the new entity raising \$1,000,000 "base capital" to fund its business operations; of that amount, \$600,000 was raised in the first 30 days after the transaction closed. If \$1,000,000 in base capital is received within 120 days, one-half of the common stock would be released, and the second half would be subject to the following performance metrics, each vesting one-fifth of the remaining shares of common stock: (a) notification of FDA premarket clearance of certain orthopedics products, or recognition by Clyra Acquisition of \$100,000 gross revenue; (b) the recognition by Clyra of \$100,000 in aggregate gross revenue; (c) the granting of all or any part of the patent application for the Skin Disc product, or recognition by Clyra Acquisition of \$500,000 in gross revenue; (d) recognition by Clyra Acquisition of \$1,000,000 in aggregate gross revenue; and (e) recognition by Clyra Acquisition of \$2,000,000 in gross revenue. If \$1,000,000 base capital is not raised within 120 days, then either party may completely terminate the transaction upon which termination we would have no further rights in the SkinDisc nor any further obligations to Scion.

The promissory note issued by Clyra Acquisition to Scion accrues interest at the rate of 5%. Principal and interest due under the note are to be paid periodically once the company receives \$1,000,000 in "base capital", at a rate of 25% of

investment proceeds received. If the note is not paid off within 18 months after the date of issuance, it is automatically extended for additional 12-month periods until the note is repaid in full. Payments after the initial 18-month maturity date are required to be made as investment proceeds are received, at a rate of 25% of such proceeds, and 5% of Clyra Acquisition's gross revenues. BioLargo purchased the Scion intellectual property and 12,755 common shares from Clyra Acquisition, and in exchange issued 7,142,858 shares of its common stock, and in turn licensed back the technology to Clyra Acquisition. Scion may redeem these shares from Clyra Acquisition by exchanging its 10,000 common shares once (and only if) those 10,000 Clyra Acquisition shares are vested as discussed above.

We were initially introduced to the SkinDisc product and Scion Solutions through Dr. Liden and Tanya Rhodes's consulting work with Clyra Medical (both Dr. Liden and Ms. Rhodes have ownership interest in Scion). Prior to the execution of the above-described agreements, BioLargo did not have any material relationship with Scion's founder Spencer Brown.

The acquisition is contingent upon Clyra raising initial minimum capital of \$1 million; of that amount, \$625,000 has been received, with an additional \$300,000 subscribed. If Clyra is unable to raise the funds in 120 days, either party may unwind the transaction.

Clyra also continues to actively work on the development of new products. It recently added Julian Bejarano, PhD to its team as an expert scientific researcher with more than 11 years of experience leading fundamental and applied research projects related to materials science and nanotechnology. In particular, Dr. Bejarano has six years of experience in projects related to biomaterials for regenerative medicine and multifunctional nanoparticles for controlled drug delivery. He holds a Materials Engineering degree and a Masters in Materials Engineering from the Universidad del Valle, Colombia. He also holds a PhD in Engineering Sciences with emphasis in Materials Science from the Universidad de Chile, Chile. Dr. Bejarano was a visiting researcher during his PhD studies at the Institute of Biomaterials at the University of Erlangen-Nuremberg, Germany. Following his doctorate studies, Dr. Bejarano was a postdoctoral fellow at the Advanced Center for Chronic Diseases in Chile for three years and Research Advisor for the Group of Polymer Engineering at the Universidad de Chile. Moreover, he has outstanding skills in project management, R&D, and innovation. His projects have been focused on the development and characterization of composites materials based on metals, polymers and ceramics, synthesis of multifunctional nanoparticles, encapsulation of therapeutic agents, and biological evaluation of materials. His findings in materials research have been published by prestigious international journals and he has presented at several international events related to biomaterials and materials science.

Table of Contents

Results of Operations—Comparison of the three and nine months ended September 30, 2017 and 2018

Revenue

Our revenue from product sales for the three and nine months ended September 30, 2018 increased by 43% and 147%, respectively, compared with the three and nine months ended September 30, 2017. These increases are due to new customers, increased client adoption of our CupriDyne Clean Industrial Odor Control products, and an increase in volume of sales of our Specimen Transport Solidifier pouches to the U.S. military.

In 2018, sales of our CupriDyne Clean products generated approximately 50% of our revenue from product sales, compared to approximately 75% in 2017. The majority of our CupriDyne Clean sales are to large waste handling companies with whom we have “National Purchasing Agreements” (“NPA”). Our CupriDyne Clean sales revenue increased due to an increase in the volume of sales resulting from continued market penetration and ongoing marketing and sales efforts. We continue to receive extremely positive feedback from our customers about our service, our product’s effectiveness, and its cost savings. We intend to increase our infrastructure and sales support to service our national accounts. We do not yet have enough history or sales volume to identify trends or uncertainties related to our CupriDyne Clean sales, although we are discovering that landfills and transfer stations in colder climates generally have less of a need for odor control products during winter months. We suspect that this fact will affect our product sales during colder months, although the extent of that effect is yet unknown and difficult to predict given the continued increase in market adoption we are experiencing.

Sales of our Specimen Transport Solidifier pouches to the U.S. Defense Logistics Agency generated approximately 41% and 42% of our revenue in the three and nine months ended September 30, 2018. Sales of this product increased by approximately \$63,000 and \$260,000 for the three and nine months ended September 30, 2018 compared to the same period for 2017. These sales were primarily through our distributor Downeast Logistics. The vast majority of sales of our Specimen Transport Solidifier pouches are made through a bid process in response to a request for bids to which any qualified government vendor can respond. Although the number of these bids was higher in the nine months ended September 30, 2018 as compared with the same period in 2017, we do not know if this trend will continue, and cannot know in advance the frequency or size of such requests from the U.S. Government, or whether our bids will be successful. As such, we are uncertain as to our future revenues of this product through this system.

Our engineering segment generated approximately \$31,000 and \$81,000 in revenue for the three and nine-months ended September 30, 2018. As this division started in the fourth quarter of 2017, the nine months ended September 30, 2017 does not provide a comparison.

Cost of Goods Sold and Services

Our cost of goods sold includes costs of raw materials, contract manufacturing, and other direct expenses related to the manufacturing of our products. As a percentage of gross sales, our costs of goods was 40% and 54% in the three and nine months ended September 30, 2018, versus 72 and 69% in the three and nine months ended September 30, 2017. The decrease in our cost of goods is primarily attributed to our higher volume of sales and the resulting increased purchasing power with our component suppliers.

Our cost of services includes costs of employee time, a portion of overhead, and, when applicable, cost of subcontractors.

Selling, General and Administrative Expense

Our Selling, General and Administrative (“SG&A”) expenses include both cash and non-cash expenses. Our SG&A increased approximately \$248,000 (22%) and \$517,000 (16%) in the three and nine months ended September 30, 2018 compared to the same periods in 2017. The largest components of our selling, general and administrative expenses included:

	Three months ended		Nine months ended	
	September 30, 2017	September 30, 2018	September 30, 2017	September 30, 2018
Salaries and payroll related	\$437,929	\$496,976	\$1,158,532	\$1,468,538
Professional fees	194,649	210,934	521,843	589,936
Consulting	138,441	253,240	612,696	607,625
Office expense	195,665	233,523	543,080	701,173
Sales and marketing	29,398	53,792	120,915	171,207

Table of Contents

Overall, our SG&A expenses are increasing due primarily to the expansion of our business and through the increase of service offerings. For example, the formation of our engineering subsidiary in Tennessee and hiring of associated personnel in the fourth quarter of 2017 resulted in increased legal and accounting fees, additional office expense related to the new office in Tennessee, and additional salaries and payroll, reflected in the three and nine months ended September 30, 2018, but not for the same periods in 2017. As sales increase, we have added sales and support personnel. Our consulting fees increased in the three months related to fees for Clyra and are comparable with the nine months ended September 30, 2018 and 2017.

Research and Development

Research and development expenses increased \$17,689 (4%) and \$249,379 (22%) for the three and nine months ended September 30, 2018, as compared to the same periods in 2017. These expenses increased in part as a result of the formation of our engineering subsidiary, where we have accelerated the work related to the scale-up, engineering and testing of our AOS technology.

Interest expense

Interest expense decreased \$583,103 (69%) and \$94,725 (3%) for the three and nine months ended September 30, 2018, as compared to the same periods in 2017. These decreases are a result of the reduction of our convertible note liability by approximately \$5,000,000.

During 2018 we recorded \$275,534 of debt conversion expense related to the early conversion of promissory notes and \$578,312 of a loss on extinguishment of debt and due to the maturity date extension of the Vista Note (see Note 4, “*Convertible Note, matures December 18, 2018 (Vista Capital)*” to our consolidated financial statements).

Net Loss

Net loss increased \$133,609 (6%) and \$1,263,345 (18%) for the three and nine months ended September 30, 2018, as compared to the same periods in 2017. The net loss was somewhat offset by an increase in revenue, nevertheless, the net loss increased mainly due to the increased payroll and related expenses, and research and development expense. The net loss per share did not change as the increase in net loss was offset by the increase in common shares outstanding. Although our sales continue to increase, we expect to continue to incur a net loss for the foreseeable future. (See Part I, Item II, “Our Business”, above.)

Liquidity and Capital Resources

We have been, and anticipate that we will continue to be, limited in terms of our capital resources. Our total cash and cash equivalents was \$533,542 at September 30, 2018, a decrease of approximately \$457,000 since December 31, 2017. We had revenues of \$866,793 in the nine months ended September 30, 2018. Our gross profits are not sufficient to fund our operations. We are required to financially support the operations of our subsidiaries, none of which are operating at a positive cash flow.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. As reflected in the accompanying consolidated financial statements, for the nine months ended September 30, 2018 we had a net loss of \$8,409,213, used \$3,051,288 cash in operations, and at September 30, 2018 had negative working capital of \$1,075,985, current assets of \$752,328, and an accumulated stockholders' deficit of \$109,591,476. As of September 30, 2018, we had \$2,273,108 in principal amounts due on various debt obligations, of which \$1,813,108 is due over the course of the next year. At our current stock prices, we cannot compel the conversion of the note into stock and are examining alternatives to refinance these obligations. The foregoing factors raise substantial doubt about our ability to continue as a going concern. Ultimately, our ability to continue as a going concern is dependent upon our ability to attract significant new sources of capital, attain a reasonable threshold of operating efficiencies, and achieve profitable operations by licensing or otherwise commercializing products incorporating our technologies. The consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Although sales of our odor control products are increasing, and our engineering subsidiary has begun generating revenue, we do not expect those divisions to support the general corporate overhead in the immediate future. As such, we will be required to raise substantial additional capital to continue our operations and fund our future business plans. We are continuing our efforts to raise capital through our purchase agreement with Lincoln Park (see Note 3, of the Notes to the Consolidated Financial Statements), and a current private securities offering (see Note 4, of the Notes to the Consolidated Financial Statements). We are reluctant to utilize the Lincoln Park instrument when our stock price is below \$0.25 because doing so would trigger the reduction of warrant exercise prices on some outstanding warrants. During the nine months ended September 30, 2018, we received \$826,279 from sales of stock to Lincoln Park, and an aggregate \$2,641,914 net proceeds from our private securities offerings and financing activities (including Lincoln Park).

Table of Contents

In addition to our financing arraignment with Lincoln Park, and the private securities offerings discussed above, we are continuing to explore alternatives for our current and longer-term financial requirements, including additional raises of capital from investors in the form of convertible debt or equity, a fully underwritten public offering associated with our plan to uplist our stock to Nasdaq, and significant grant funding from government sources. It is 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 technologies and products. 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 unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these financial statements. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on March 14, 2018, in the Notes to the Consolidated Financial Statements and the Critical Accounting Estimates sections. In addition, refer to Note 2 to the consolidated interim consolidated financial statements included in Part I, Item 1 of this report.

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 consolidated financial statements.

Recent Accounting Pronouncements

See Note 2, “Recent Accounting Pronouncements”, to the Consolidated Financial Statements.

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. However, our Company is continuing to grow and evolve in 2018, as we have added a new accounting manager for Odor No More and the engineering division and implemented more detailed reviews of the accounting records. In late 2017, we added an engineering division operating in Tennessee. The volume of our product sales continues to grow, increasing strain on our accounting systems. And, our operations do not yet generate enough cash to fund operations, and thus we rely on financing activities to maintain our level of operations and fund our anticipated growth. These activities put stress on our overall controls and procedures. Although we have made some improvements, our chief executive officer and chief financial officer have concluded that as of the evaluation date our disclosure controls and procedures were not effective, due to the material weakness identified below.

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.

Table of Contents

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Under the supervision and with the participation of our management, including our chief executive officer and the chief financial officer, we have established internal control procedures in accordance with the guidelines established in the 2013 Framework —Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Recognizing the dynamic nature and growth of the Company’s business during the prior 12 months, including the addition of an engineering division, growth of the core operations, and the increase in the number of employees, management has recognized the strain on the overall internal control environment. As a result, management has concluded that its internal controls over financial reporting are not effective. Management identified a material weakness with respect to deficiencies in its financial closing and reporting procedures. Management believes this is due to a lack of resources. Management intends to add accounting personnel and operating staff and more sophisticated systems in order to improve its reporting procedures and internal controls, subject to available capital. A material weakness is a significant deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected. Although management believes progress was made related to remediating the material weakness noted at December 31, 2017 by adding a new accounting manager and implementing more detailed reviews of the accounting records, it believes additional changes will be necessary to alleviate its concerns as the company grows. There was no further change in our internal control over financial reporting that occurred during the nine-month period covered by this Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls or our internal control over financial reporting, or any system we design or implement in the future, 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 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.

Table of Contents

PART II

OTHER INFORMATION

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

Stock Issued for Services

During the three months ended September 30, 2018, we issued 691,791 shares of common stock in lieu of fees for service provided by consultants, resulting in a grant date fair value of \$198,410. Of the shares issued, 442,258 were issued under the Company's 2018 Equity Incentive Plan and registered with the SEC on Form S-8.

During the three months ended September 30, 2018, we issued 83,062 shares of common stock as payment for interest due on unit offering notes, resulting in a grant date fair value of \$21,132.

Issuance of Stock Options in exchange for payment of payables

During the three months ended September 30, 2018, we issued options to purchase 665,968 shares of our common stock at exercise prices ranging between \$0.25 – \$0.31 per share to employees, vendors and to members of our board of directors in exchange for unpaid obligations for their services. The fair value of the options totaled \$182,213 and is recorded as selling, general and administrative expenses.

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 5. Other Information

Edgar Filing: BIOLARGO, INC. - Form 10-Q

During the three months ended September 30, 2018, we continued to sell stock to Lincoln Park Capital, LLC (see Note 3 to our Consolidated Financial Statements titled “*Lincoln Park Financing*”).

During the three months ended September 30, 2018, certain investors converted promissory notes to our common stock (see Note 4 to our Consolidated Financial Statements titled “*Debt Obligations*”, and specifically the subsection titled “*Conversion of Debt Obligations*”).

During the three months ended September 30, 2018, we incurred new debt obligations (see Note 4 to our Consolidated Financial Statements titled “*Debt Obligations*”, and specifically the subsections titled “*Notes payable, mature January 5, 2019*,” “*Convertible Note, matures June 15, 2021 (OID Note)*,” and “*Line of credit, matures September 1, 2019*.” We also extended a debt obligation that had been due on September 18, 2018 (see Note 4, subsection titled “*Convertible Note, matures December 18, 2018 (Vista Capital)*.”

On November 6, 2018, we filed a registration statement with the SEC on Form S-1. The purpose of the registration statement is to conduct a public offering to raise equity capital required to meet the listing requirements of the Nasdaq Capital Market. The offering is being underwritten by H.C. Wainwright & Co., LLC.

Item 6. Exhibits

		<u>Incorporated by Reference</u>	
		<u>Herein</u>	
<u>Exhibit Number</u>	<u>Exhibit Description</u>	<u>Form</u>	<u>File Date</u>
3.1	<u>Bylaws of BioLargo, Inc., as amended and restated</u>	Form 10-KSB	5/23/2003
3.2	<u>Amended and Restated Certificate of Incorporation for BioLargo, Inc. filed March 16, 2007</u>	Form 10-KSB	5/4/2007
3.3	<u>Certificate of Amendment to Certificate of Incorporation, filed May 25, 2018</u>	Pos Am	6/22/2018
4.1	<u>Form of Convertible Promissory Note issued in 2015 Unit Offering</u>	Form 10-K	3/31/2015
4.2	<u>Form of Series A Stock Purchase Warrant issued in 2015 Unit Offering</u>		3/31/2015

Edgar Filing: BIOLARGO, INC. - Form 10-Q

		Form 10-K	
4.3	<u>Form of Stock Options issued in exchange for reduction in accounts payable.</u>	Form 10-K	3/31/2015
4.4	<u>Amended and Restated Articles of Incorporation of Clyra Medical Technologies, Inc.</u>	Form 8-K	1/6/2016
4.5	<u>Stock purchase warrant issued with Line of Credit in June 2016</u>	Form 10-Q	8/15/2016
4.6	<u>Form of Warrant issued to One Year Note holder in July 2016</u>	Form 10-Q	8/15/2016
4.7	<u>Form of Note Issued in Winter 2016 Unit Offering</u>	Form S-1	1/25/2017
4.8	<u>Form of Warrant Issued in Winter 2016 Unit Offering</u>	Form S-1	1/25/2017
4.9	<u>Form of Warrant issued to One Year Note holder dated December 30, 2016</u>	Form S-1	1/25/2017
4.10	<u>Option to purchase common stock issued to Dennis P. Calvert dated May 2, 2017</u>	Form 8-K	5/4/2017
4.11	<u>Form of Note issued in Summer 2017 Offering</u>	Form 10-Q	8/14/2017
4.12	<u>Form of Warrant issued in Summer 2017 Offering</u>	Form 10-Q	8/14/2017
4.13	<u>Form of One-Year Note issued July 2017</u>	Form 10-Q	8/14/2017
4.14	<u>Form of Warrant issued to One-Year Noteholder July 2017</u>	Form 10-Q	8/14/2017
4.15	<u>\$440,000 convertible note, matures July 20, 2019</u>	Form 10-Q	8/14/2017
4.16	<u>Securities Purchase Agreement, dated as of December 14, 2017 by and between BioLargo, Inc. and Vista Capital Investments, LLC.</u>	Form 8-K	12/22/2017
4.17	<u>Registration Rights Agreement, dated as of December 14, 2017, by and between BioLargo, Inc. and Vista Capital Investments, LLC.</u>	Form 8-K	12/22/2017

Table of Contents

4.18	<u>Note, dated as of December 14, 2017, by and between BioLargo, Inc. and Vista Capital Investments, LLC.</u>	Form 8-K	12/22/2017
4.19	<u>Amendment, dated as of December 18, 2017, by and between BioLargo, Inc. and Vista Capital Investments, LLC.</u>	Form 8-K	12/22/2017
4.20	<u>Stock Option dated December 31, 2017, issued to Chief Financial Officer Charles K. Dargan II</u>	Form 8-K	1/3/2018
4.21	<u>Purchase Agreement, dated as of August 25, 2017 by and between BioLargo, Inc. and Lincoln Park Capital Fund, LLC</u>	Form 8-K	8/31/2017
4.22	<u>Registration Rights Agreement, dated as of August 25, 2017, by and between BioLargo, Inc. and Lincoln Park Capital Fund, LLC</u>	Form 8-K	8/31/2017
4.23	<u>2018 Equity Incentive Plan</u>	Form S-8	6/22/2018
4.24	<u>Line of credit, matures September 1, 2019</u>	Form 10-Q	5/14/2018
4.25	<u>Notice of Restricted Stock Unit Award under 2018 Equity Incentive Plan</u>	Form S-8	6/22/2018
4.26	<u>Warrant issued with Line of credit that matures September 1, 2019</u>	Form 10-Q	5/14/2018
4.27	<u>Restricted Stock Unit Award Agreement under 2018 Equity Incentive Plan</u>	Form S-8	6/22/2018
4.28	<u>\$50,000 convertible note, matures March 8, 2020</u>	Form 10-Q	5/14/2018
4.29	<u>Notice of Stock Option Grant under 2018 Equity Incentive Plan</u>	Form S-8	6/22/2018
4.30	<u>Form of convertible notes that mature April 20, 2021 (Spring 2018 Offering)</u>	Form 10-Q	5/14/2018
4.31	<u>Stock Option Award Agreement under 2018 Equity Incentive Plan</u>	Form S-8	6/22/2018
4.32	<u>Form of warrant issued with convertible notes that mature April 20, 2021 (Spring 2018 Offering)</u>	Form 10-Q	5/14/2018
4.33	<u>Amendment to \$440,000 convertible notes that matures July 20, 2019</u>	Form 10-Q	5/14/2018
4.34	<u>Amendment to Promissory Note dated December 14, 2017, by and between BioLargo, Inc. and Vista Capital Investments, LLC.</u>	Form 8-K	9/18/2018
4.35	<u>Stock Purchase Warrant issued to Vista Capital Investments dated September 12, 2018.</u>	Form 8-K	9/18/2018
4.36	<u>Promissory Note dated January 16, 2018, by and between BioLargo, Inc. and FirstFire Global Opportunity Fund, LLC.</u>	S-1	17-Jan
4.37	<u>Promissory Note issued to Vernal Bay Investments, LLC on September 19, 2018</u>	Form 8-K	9/24/2018
4.38	<u>Stock Purchase Warrant issued to Vernal Bay Investments, LLC on September 19, 2018</u>	Form 8-K	9/24/2018
4.39	<u>Promissory Note issued to Chappy Bean, LLC on September 19, 2018</u>	Form 8-K	9/24/2018
4.40	<u>Stock Purchase Warrant issued to Chappy Bean, LLC on September 19, 2018</u>	Form 8-K	9/24/2018
4.41	<u>Stock Purchase Agreement and Plan of Reorganization dated September 26, 2018, with Scion Solutions, LLC</u>	Form 8-K	10/2/2018

Edgar Filing: BIOLARGO, INC. - Form 10-Q

4.42	<u>Promissory note issued by Clyra dated September 26, 2018</u>	Form 8-K	10/2/2018
4.43	<u>Escrow Agreement dated September 26, 2018</u>	Form 8-K	10/2/2018
4.44	<u>Triton Funds LP Securities Purchase Agreement</u>	Form 8-K	10/22/2018
4.45	<u>Convertible Promissory Note issued to Triton Funds LP</u>	Form 8-K	10/22/2018
4.46	<u>Stock Purchase Warrant issued to Triton Funds LP</u>	Form 8-K	10/22/2018
10.1†	<u>February 10, 2017 extension to Engagement Extension Agreement with Charles K. Dargan, II.</u>	Form 8-K	2/14/2017
10.2†	<u>Employment Agreement with Dennis P. Calvert dated May 2, 2017.</u>	Form 8-K	5/4/2017
10.3†	<u>Lock-Up Agreement with Dennis P. Calvert dated April 30, 2017</u>	Form 8-K	5/4/2017
10.4†	<u>Lock-Up Agreement with Dennis P. Calvert dated May 2, 2017.</u>	Form 8-K	5/4/2017
10.5	<u>Form of Employment Agreement for Engineering Subsidiary</u>	Form 8-K	9/8/2017
10.6	<u>Form of Option issued to founding employees of Engineering subsidiary</u>	Form 8-K	9/8/2017
10.7†	<u>Engagement Agreement extension dated December 31, 2017, between BioLargo, Inc. and Charles K. Dargan, II</u>	Form 8-K	1/3/2018
31.1*	<u>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</u>		
31.2*	<u>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</u>		
32*	<u>Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.</u>		
101.INS**	XBRL Instance		
101.SCH**	XBRL Taxonomy Extension Schema		
101.CAL**	XBRL Taxonomy Extension Calculation		
101.DEF**	XBRL Taxonomy Extension Definition		
101.LAB**	XBRL Taxonomy Extension Labels		
101.PRE**	XBRL Taxonomy Extension Presentation		

* Filed herewith

** Furnished herewith

† Management contract or compensatory plan, contract or arrangement

Table of Contents

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: November 14, 2018 By: /s/ DENNIS P. CALVERT
Dennis P. Calvert

Chief Executive Officer

Date: November 14, 2018 By: /s/ CHARLES K. DARGAN, II
Chief Financial Officer