

# SECURITIES & EXCHANGE COMMISSION EDGAR FILING

## TOMI Environmental Solutions, Inc.

**Form: 10-Q**

**Date Filed: 2014-11-12**

Corporate Issuer CIK: 314227

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

**For the quarterly period ended September 30, 2014**

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 000-09908

**TOMI ENVIRONMENTAL SOLUTIONS, INC.**

(Exact name of registrant as specified in its charter)

Florida

59-1947988

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

9454 Wilshire Blvd., Penthouse, Beverly Hills, CA 90212

(Address of principal executive offices) (Zip Code)

(800) 525-1698

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of November 7, 2014, the registrant had 83,459,210 shares of common stock outstanding.

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

The accompanying financial statements are unaudited for the interim periods, but include all adjustments (consisting only of normal recurring adjustments), which we consider necessary for the fair presentation of results for the three and nine months ended September 30, 2014.

Moreover, these financial statements do not purport to contain complete disclosure in conformity with U.S. generally accepted accounting principles and should be read in conjunction with our audited financial statements as of, and for the year ended December 31, 2013.

The results reflected for the three and nine months ended September 30, 2014 are not necessarily indicative of the results for the entire year ending December 31, 2014.

TOMI ENVIRONMENTAL SOLUTIONS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEET

**ASSETS**

|   | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|---|--------------------------------------|----------------------|
| <b>Current Assets:</b>                  |                                      |                      |
| Cash and Cash Equivalents               | \$ 85,837                            | \$ 706,350           |
| Cash – Restricted (Note 6)              | 228                                  | 70,124               |
| Accounts Receivable - net               | 534,690                              | 805,809              |
| Inventories (Note 3)                    | 517,105                              | 407,549              |
| Prepaid Expenses                        | 41,187                               | 7,980                |
| Deferred Financing Costs – net (Note 6) | 285,952                              | -                    |
| Total Current Assets                    | 1,464,998                            | 1,997,812            |
| Property & Equipment – net (Note 4)     | 303,099                              | 164,068              |
| <b>Other Assets:</b>                    |                                      |                      |
| Intangible Assets – net (Note 5)        | 2,749,433                            | 3,026,564            |
| Deferred Financing Costs – net (Note 6) | -                                    | 542,116              |
| Deposits                                | 6,553                                | 2,543                |
| Total Other Assets                      | 2,755,986                            | 3,571,223            |
| <b>Total Assets</b>                     | <b>\$ 4,524,083</b>                  | <b>\$ 5,733,103</b>  |

**LIABILITIES AND STOCKHOLDERS' DEFICIENCY**

|   |                     |                     |
|---|---------------------|---------------------|
| <b>Current Liabilities:</b>   |                     |                     |
| Accounts Payable and Accrued Expenses   | \$ 368,516          | \$ 383,349          |
| Accrued Interest on Convertible Notes (Note 6)  | 84,567              | 211,194             |
| Accrued Officers Compensation (Note 9)  | 81,000              | 25,000              |
| Common Stock to be Issued (Note 12)   | 83,211              | 150,871             |
| Customer Deposits   | 18,873              | 14,105              |
| Deferred Rent   | 3,809               | -                   |
| Derivative Liability (Note 7)   | 3,765,541           | 7,665,502           |
| Convertible Notes Payable, net of discount of \$4,513,775 at September 30, 2014 (Note 6)  | 560,225             | -                   |
| Total Current Liabilities   | 4,965,742           | 8,450,021           |
| Convertible Notes Payable, net of discount of \$5,003,558 at December 31, 2013 (Note 6)   | -                   | 70,442              |
| Total Long-term Liabilities   | -                   | 70,442              |
| Total Liabilities   | 4,965,742           | 8,520,463           |
| Commitments and Contingencies   | -                   | -                   |
| <b>Stockholders' Deficiency:</b>  |                     |                     |
| Cumulative Convertible Series A Preferred Stock;<br>par value \$0.01, 1,000,000 shares authorized; 510,000 shares issued<br>and outstanding at September 30, 2014 and December 31, 2013                 | 5,100               | 5,100               |
| Cumulative Convertible Series B Preferred Stock; \$1,000 stated value;<br>7.5% Cumulative dividend; 4,000 shares authorized; none issued<br>and outstanding at September 30, 2014 and December 31, 2013 | -                   | -                   |
| Common stock; par value \$0.01, 200,000,000 shares authorized;<br>82,690,650 and 79,867,217 shares issued and outstanding<br>at September 30, 2014 and December 31, 2013, respectively.                 | 826,907             | 798,672             |
| Additional Paid-In Capital  | 18,927,408          | 15,674,958          |
| Accumulated Deficit   | (20,201,074)        | (19,266,090)        |
| Total Stockholders' Deficiency  | (441,659)           | (2,787,360)         |
| <b>Total Liabilities and Stockholders' Deficiency</b>   | <b>\$ 4,524,083</b> | <b>\$ 5,733,103</b> |

The accompanying notes are an integral part of the financial statements.

TOMI ENVIRONMENTAL SOLUTIONS, INC.  
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS  
(UNAUDITED)

|  | For The Three Months Ended |                       | For The Nine Months Ended |                        |
|--|----------------------------|-----------------------|---------------------------|------------------------|
|  | September 30,              |                       | September 30,             |                        |
|  | 2014                       | 2013                  | 2014                      | 2013                   |
| Sales, net   | \$ 515,465                 | \$ 294,627            | \$ 1,204,949              | \$ 506,656             |
| Cost of Sales  | 187,943                    | 185,098               | 439,929                   | 280,403                |
| Gross profit   | <u>327,522</u>             | <u>109,529</u>        | <u>765,020</u>            | <u>226,253</u>         |
| Operating Expenses:  |                            |                       |                           |                        |
| Professional Fees  | 89,341                     | 93,200                | 280,166                   | 261,111                |
| Depreciation and Amortization                                | 121,496                    | 112,990               | 345,790                   | 220,332                |
| Selling Expenses   | 107,460                    | 36,327                | 284,615                   | 65,455                 |
| Research and Development                                     | 30,544                     | 23,041                | 127,686                   | 39,388                 |
| Equity Compensation Expense (Note 8)                         | 1,043,069                  | 66,825                | 2,448,591                 | 66,825                 |
| Consulting fees  | 44,338                     | 312,116               | 128,491                   | 495,993                |
| General and Administrative                                   | 313,229                    | 166,847               | 857,571                   | 361,536                |
| Total Operating Expenses                                     | <u>1,749,477</u>           | <u>811,346</u>        | <u>4,472,911</u>          | <u>1,510,640</u>       |
| Loss from Operations   | <u>(1,421,955)</u>         | <u>(701,817)</u>      | <u>(3,707,891)</u>        | <u>(1,284,387)</u>     |
| Other Income (Expense):                                      |                            |                       |                           |                        |
| Amortization of Deferred Financing Costs                     | (86,327)                   | (86,253)              | (256,165)                 | (148,044)              |
| Amortization of Debt Discounts                               | (272,329)                  | (21,254)              | (489,783)                 | (30,071)               |
| Fair Value Adjustment of Derivative Liability                | 653,824                    | (1,677,837)           | 3,899,961                 | (6,233,374)            |
| Financing Costs  | -                          | (330,753)             | -                         | (3,198,803)            |
| Interest Expense – Related Party                             | -                          | -                     | -                         | (161)                  |
| Interest Expense   | (126,850)                  | (128,231)             | (381,106)                 | (229,932)              |
| Total Other Income (Expense)                                 | <u>168,318</u>             | <u>(2,244,328)</u>    | <u>2,772,907</u>          | <u>(9,840,385)</u>     |
| Net Loss   | <u>\$ (1,253,637)</u>      | <u>\$ (2,946,146)</u> | <u>\$ (934,984)</u>       | <u>\$ (11,124,772)</u> |
| Loss Per Common Share  |                            |                       |                           |                        |
| Basic and Diluted  | <u>\$ (0.02)</u>           | <u>\$ (0.04)</u>      | <u>\$ (0.01)</u>          | <u>\$ (0.15)</u>       |
| Basic and Diluted Weighted Average Common Shares Outstanding | <u>81,428,050</u>          | <u>78,569,460</u>     | <u>80,601,165</u>         | <u>76,677,430</u>      |

The accompanying notes are an integral part of the financial statements.

**TOMI ENVIRONMENTAL SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014**  
**(UNAUDITED)**

|   | Series A Preferred |                 | Common Stock      |                   | Additional Paid<br>in Capital | Accumulated<br>Deficit | Total<br>Stockholders'<br>Deficiency |
|---|--------------------|-----------------|-------------------|-------------------|-------------------------------|------------------------|--------------------------------------|
|   | Shares             | Amount          | Shares            | Amount            |                               |                        |                                      |
| Balance at<br>December 31, 2013                             | 510,000            | \$ 5,100        | 79,867,217        | \$ 798,672        | \$ 15,674,958                 | \$ (19,266,090)        | \$ (2,787,360)                       |
| Equity based<br>compensation                                |                    |                 |                   |                   | 2,448,591                     |                        | 2,448,591                            |
| Common stock issued for<br>services provided                |                    |                 | 703,887           | 7,040             | 285,022                       |                        | 292,062                              |
| Common stock issued for<br>executive compensation           |                    |                 | 78,125            | 781               | 24,219                        |                        | 25,000                               |
| Proceeds from issuance<br>of common stock                   |                    |                 | 377,778           | 3,778             | 98,222                        |                        | 102,000                              |
| Proceeds from issuance<br>of common stock and<br>warrants   |                    |                 | 1,652,311         | 16,523            | 461,790                       |                        | 478,313                              |
| Issuance of common<br>stock as finder's fee                 |                    |                 | 11,332            | 113               | (113)                         |                        | -                                    |
| Cash consideration for<br>finder's Fee                      |                    |                 |                   |                   | (50,907)                      |                        | (50,907)                             |
| Value of common stock<br>to be issued as finder's<br>fee    |                    |                 |                   |                   | (14,375)                      |                        | (14,375)                             |
| Net loss for the nine<br>months ended<br>September 30, 2014 |                    |                 |                   |                   |                               | (934,984)              | (934,984)                            |
| Balance at September<br>30, 2014                            | <u>510,000</u>     | <u>\$ 5,100</u> | <u>82,690,650</u> | <u>\$ 826,907</u> | <u>\$ 18,927,407</u>          | <u>\$ (20,201,074)</u> | <u>\$ (441,660)</u>                  |

The accompanying notes are an integral part of the financial statements.



**TOMI ENVIRONMENTAL SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(UNAUDITED)**

|   | For The<br>Nine Months Ended<br>September 30, |                 |
|---|---|-----------------|
|   | 2014  | 2013            |
| Cash Flow From Operating Activities:                |   |                 |
| Net Loss  | \$ (934,984)                                  | \$ (11,124,772) |
| Adjustments to Reconcile Net loss to                |   |                 |
| Net Cash Used In Operating Activities:              |   |                 |
| Depreciation and Amortization                       | 345,790                                       | 220,332         |
| Amortization of Deferred Financing Costs            | 256,165                                       | 148,044         |
| Amortization of Debt Discount                       | 489,783                                       | 30,071          |
| Finance Charges in connection with Convertible Debt | -   | 3,198,804       |
| Fair Value Adjustment of Derivative Liability       | (3,899,961)                                   | 6,233,374       |
| Equity Based Compensation                           | 2,448,591                                     | 479,394         |
| Value of Equity Issued for Services                 | 317,061                                       | -               |
| Reserve for Bad Debts                               | 99,933  | -               |
| Changes in Operating Assets and Liabilities:        |   |                 |
| Decrease (Increase) in:                             |   |                 |
| Accounts Receivable                                 | 171,186                                       | (179,181)       |
| Inventory   | (252,472)                                     | (220,240)       |
| Prepaid Expenses                                    | (33,207)                                      | (22,977)        |
| Deposits  | (4,010)                                       | (1,853)         |
| Increase (Decrease) in:                             |   |                 |
| Accounts Payable and Accrued Expenses               | (17,893)                                      | 142,436         |
| Accrued Interest                                    | (126,628)                                     | -               |
| Warranty Liability                                  | -   | 10,000          |
| Accrued Officers Compensation                       | 56,000  | 15,000          |
| Common Stock to be Issued                           | (82,035)                                      | 173,448         |
| Deferred Revenue                                    | -   | 83,957          |
| Deferred Rent                                       | 3,809   | -               |
| Customer Deposits                                   | 4,772   | 18,445          |
| Net Cash Used in Operating Activities               | (1,158,100)                                   | (795,718)       |
| Cash Flow From Investing Activities:                |   |                 |
| Purchase of Intangibles                             | -   | (172,690)       |
| Purchase of Property and Equipment                  | (64,774)                                      | (3,278,300)     |
| Net Cash Used in Investing Activities               | (64,774)                                      | (3,450,990)     |

The accompanying notes are an integral part of the financial statements.

**TOMI ENVIRONMENTAL SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS – CONTINUED**  
**(UNAUDITED)**

|  | For The<br>Nine Months Ended<br>September 30, |                     |
|--|---|---------------------|
|  | 2014  | 2013                |
| Cash Flow From Financing Activities:                   |   |                     |
| Proceeds from Convertible Notes Payable                | -   | 5,074,000           |
| Repayment of Loan Payable to Officer                   | -   | (3,988)             |
| Deferred Debt Costs                                    | -   | (611,306)           |
| Proceeds From Issuance of Common Stock and Warrants    | 580,313                                       | 866,099             |
| Decrease in Bond Sinking Fund                          | 69,895  | -                   |
| Payment of Finder's Fee                                | (47,847)                                      | (30,000)            |
| <b>Net Cash Provided by Financing Activities</b>       | <b>602,361</b>                                | <b>5,294,805</b>    |
| Increase (Decrease) In Cash and Cash Equivalents       | (620,513)                                     | 1,048,097           |
| Cash and Cash Equivalents - Beginning                  | 706,350                                       | 73,424              |
| Cash and Cash Equivalents – Ending                     | \$ 85,837                                     | \$ 1,121,520        |
| Supplemental Cash Flow Information:                    |   |                     |
| Cash Paid For Interest                                 | \$ 507,956                                    | \$ 145,527          |
| Cash Paid For Income Taxes                             | \$ 2,006                                      | \$ 933              |
| Non-Cash Investing and Finance Activities:             |   |                     |
| Reclassification of demo                               |   |                     |
| equipment from inventory to property and equipment     | \$ 142,916                                    | \$ -                |
| Discount on convertible debt                           | \$ -  | \$ 4,117,288        |
| <b>Financing Charges</b>                               | <b>\$ -</b>                                   | <b>\$ 3,198,804</b> |
| Value of Common Stock Issued as Finder's Fee           | \$ 3,060                                      | \$ -                |
| Common Stock Warrants Issued As Deferred Finance Costs | \$ -  | \$ 165,181          |
| Cash Finder's Fee Accrual                              | \$ 3,060                                      | \$ -                |
| Common Stock Finder's Fee Accrual                      | \$ 14,375                                     | \$ -                |

The accompanying notes are an integral part of the financial statements.

**TOMI ENVIRONMENTAL SOLUTIONS, INC.**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

As discussed in the Quarterly Report on Form 10-Q, "Company," "we," "us," "our," and "TOMI" refer to TOMI Environmental Solutions, Inc.

**NOTE 1. DESCRIPTION OF BUSINESS**

TOMI Environmental Solutions, Inc. is a global decontamination and infectious disease control company, providing environmental solutions for indoor and outdoor surface decontamination through the sale of equipment, services and licensing of our SteraMist™ Binary Ionization Technology® ("BIT™") hydrogen peroxide based mist and fogs.

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Going Concern***

The Company incurred net losses of approximately \$935,000 and \$11,125,000 for the nine months ended September 30, 2014 and 2013, respectively. In addition, the Company had a working capital deficiency of approximately \$3,501,000 and a stockholders' deficit of \$442,000 at September 30, 2014. Cash and cash equivalents was approximately \$86,000 as of September 30, 2014. These factors raise substantial doubt about the Company's ability to continue as a going concern. There can be no assurance that the Company will be able to raise additional capital.

The Company plans on funding operations and liquidity needs from the sales of its products and services, licensing arrangements, debt financing and/or sales of its common stock and notes convertible into common stock. There can be no assurance that additional funds required for continued operations during the next year or thereafter will be generated from our operations.

Should the Company seek additional funds from external sources such as debt or additional equity financings or other potential sources, there can be no assurance that such funds will be available on terms acceptable to the Company or that they will not have a significant dilutive effect on the Company's existing stockholders. The inability to generate cash flow from operations or to raise sufficient capital from external sources would force the Company to substantially curtail or cease operations and would, therefore, have a material adverse effect on its business.

During the quarter ended September 30, 2014 the Company raised gross proceeds of \$580,313 through the sale of 2,030,089 shares of common stock and equity units (see note 8 for additional details).

Accordingly, the Company's existence is dependent on management's ability to develop profitable operations and resolve its liquidity problems. The accompanying unaudited consolidated financial statements do not include any adjustments related to the recoverability or classification of asset-carrying amounts or the amounts and classification of liabilities that may result should the Company be unable to continue as a going concern.

***Basis of Presentation***

The interim unaudited condensed consolidated financial statements included herein, presented in accordance with generally accepted accounting principles utilized in the United States of America ("GAAP"), and stated in U.S. dollars, have been prepared by the Company, without an audit, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements of the Company for the year ended December 31, 2013 and notes thereto which are included in the Form 10-K previously filed with the SEC on March 25, 2014. The Company follows the same accounting policies in the preparation of interim reports.

## ***Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of TOMI Environmental Solutions, Inc. (a Florida Corporation) (TOMI-Florida), and its wholly-owned subsidiary, TOMI Environmental Solutions, Inc. (a Nevada Corporation) (TOMI-Nevada). The Company's 55% owned subsidiary, TOMI Environmental-China (TOMI-China), has been dormant since its formation in April 2011. All significant intercompany accounts and transactions have been eliminated in consolidation.

## ***Reclassification of Accounts***

Certain reclassifications have been made to prior-year comparative financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or financial position.

## ***Use of Estimates***

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the accompanying unaudited condensed consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates. On an ongoing basis, we evaluate our estimates, including those related to the accounts receivable, fair values of financial instruments, intangible assets, useful lives of intangible assets and property and equipment, fair values of stock-based awards, income taxes, and contingent liabilities, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of our assets and liabilities.

## ***Fair Value Measurements***

The authoritative guidance for fair value measurements defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or the most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact. The guidance describes a fair value hierarchy based on the levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or corroborated by observable market data or substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the value of the assets or liabilities.

The Company's financial instruments include cash and equivalents, accounts receivable, and accounts payable and accrued expenses. All these items were determined to be Level 1 fair value measurements.

The carrying amounts of cash and equivalents, accounts receivable, and accounts payable and accrued expenses approximated fair value because of the short maturity of these instruments. The recorded value of convertible debt approximates its fair value as the terms and rates approximate market rates (See also Note 6).

## ***Cash and Cash Equivalents***

For purposes of the statement of cash flows, cash and cash equivalents includes cash on hand held at financial institutions and other liquid investments with original maturities of three months or less.

## ***Inventories***

Inventories are valued at the lower of cost or market using the first-in, first-out ("FIFO") method. Inventories consist primarily of raw materials and finished goods.

## ***Property and Equipment***

We account for property and equipment at cost less accumulated depreciation. We compute depreciation using the straight-line method over the estimated useful lives of the assets, generally three to five years. Depreciation for equipment, furniture and fixtures and vehicles commences once placed in service for its intended use.

## ***Deferred Financing Costs***

The Company follows authoritative guidance for accounting for financing costs as it relates to convertible debt issuance cost. These costs are deferred and amortized over the term of the debt period or until redemption of the convertible debentures. Amortization of deferred financing costs amounted to approximately \$256,000 for the nine months ended September 30, 2014.

## ***Income taxes***

Deferred income tax assets and liabilities are determined based on differences between the financial statement reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws in effect when the differences are expected to reverse. The measurement of deferred income tax assets is reduced, if necessary, by a valuation allowance for any tax benefits, which are, on a more likely than not basis, not expected to be realized; in accordance with ASC guidance for income taxes. Net deferred tax benefits have been fully reserved at September 30, 2014 and 2013. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the period that such tax rate changes are enacted.

## ***Loss Per Share***

Basic loss per share is computed by dividing the Company's net loss by the weighted average number of common shares outstanding during the period presented. Diluted loss per share is based on the treasury stock method and includes the effect from potential issuance of common stock such as shares issuable pursuant to the exercise of warrants and conversions of debentures.

Potentially dilutive securities as of September 30, 2014, consisted of 17,496,552 common shares from convertible debentures, 32,356,578 common shares from outstanding warrants, 80,000 common shares from options and 510,000 common shares from convertible Series A preferred stock. Diluted and basic weighted average shares are the same, as potentially dilutive shares are anti-dilutive.

Potentially dilutive securities as of September 30, 2013, consisted of 17,496,552 common shares from convertible debentures, 19,325,800 common shares from outstanding warrants, 80,000 common shares from options and 510,000 common shares from convertible Series A preferred stock. Diluted and basic weighted average shares are the same, as potentially dilutive shares are anti-dilutive.

## ***Revenue Recognition***

For revenue from services and product sales, the Company recognized revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition" (SAB No. 104), which superseded Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB No. 101). SAB No. 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) service has been rendered or delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectability is reasonably assured. Determination of criteria (3) and (4) are based on management's judgment regarding the fixed nature of the selling prices of the services rendered or products delivered and the collectability of those amounts. Provisions for discounts to customers, and allowance, and other adjustments will be provided for in the same period the related sales are recorded.

## ***Stock-Based Compensation***

The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board ("FASB"), ASC 718, Compensation- "Stock Compensation." Under the provisions of FASB ASC 718, stock-based compensation cost is estimated at the grant date based on the award's fair value and is recognized as expense over the requisite service period. The Company currently has one active stock-based compensation plan, TOMI Environmental Solutions, Inc. Stock Option and Restricted Stock Plan (the "Plan"). The Plan calls for the Company, through a committee of its Board of Directors, to issue up to 2,500,000 shares of restricted common stock or stock options. The Company generally issues grants to its employees, consultants, and board members. Stock options are granted with an exercise price equal to the closing price of its common stock on the date of the grant with a term no greater than 10 years. Generally, stock options vest over two to four years. Incentive stock options granted to shareholders who own 10% or more of the Company's outstanding equity securities are granted at an exercise price that may not be less than 110% of the closing price of the Company's common stock on the date of grant and have a term no greater than five years. On the date of a grant, the Company determines the fair value of the stock option award and recognizes compensation expense over the requisite service period, which is generally the vesting period of the award. The fair value of the stock option award is calculated using the Black-Scholes option-pricing model. As of September 30, 2014, the Company had 751,896 shares available to be issued under the Plan.

On February 11, 2014, the Company's Board of Directors adopted the 2014 Stock Option Plan (the "Plan"), subject to shareholder approval, intended to attract and retain individuals of experience and ability, to provide incentive to our employees, consultants, and non-employee directors, to encourage employee and director proprietary interests in us, and to encourage employees to remain in our employ. Each of the named executive officers is eligible for annual equity awards, which are granted pursuant to the Plan. The Plan authorizes the grant of non-qualified and incentive stock options, stock appreciation rights and restricted stock awards (each, an "Award"). A maximum of 5,000,000 shares of common stock are reserved for potential issuance pursuant to Awards under the Plan. As of September 30, 2014, no shares have been issued under the 2014 Stock Option Plan.

## ***Concentrations of Credit Risk***

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents. The Company maintains cash balances at financial institutions which exceed the current Federal Deposit Insurance Corporation ("FDIC") limit of \$250,000 at times during the year.

## ***Long-Lived Assets Including Acquired Intangible Assets***

The Company assesses long-lived assets for potential impairments at the end of each year, or during the year if an event or other circumstance indicates that we may not be able to recover the carrying amount of the asset. In evaluating long-lived assets for impairment, the Company measures recoverability of these assets by comparing the carrying amounts to the future undiscounted cash flows the assets are expected to generate. If the Company's long-lived assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the asset exceeds its fair market value. The Company bases its calculations of the estimated fair value of its long-lived assets on the income approach. For the income approach, The Company uses an internally developed discounted cash flow model that include, among others, the following assumptions: projections of revenues and expenses and related cash flows based on assumed long-term growth rates and demand trends; expected future investments to grow new units; and estimated discount rates. We base these assumptions on our historical data and experience, industry projections, micro and macro general economic condition projections, and our expectations. We have had no long-lived asset impairment charges for the nine months ended September 30, 2014.

## ***Advertising and Promotional Expenses***

The Company expenses advertising costs in the period in which they are incurred. For the nine months ended September 30, 2014 and 2013, advertising and promotional expenses were approximately \$6,000 and \$1,000, respectively.

## ***Recent Accounting Pronouncements***

In 2014, the FASB issued Accounting Standards Updates ("ASU") 2014-1 through 2014-08. These updates did not have a significant impact on the financial statements.

**NOTE 3: INVENTORIES**

Inventories consist of the following:

|                          | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|--------------------------|--------------------------------------|----------------------|
| Raw materials            | \$ 248,283                           | \$ 1,500             |
| Finished goods           | 268,822                              | 406,049              |
| Inventory, end of period | <u>\$ 517,105</u>                    | <u>\$ 407,549</u>    |

**NOTE 4. PROPERTY AND EQUIPMENT**

Property and equipment consists of the following:

|                                | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|--------------------------------|--------------------------------------|----------------------|
| Furniture and fixtures         | \$ 64,820                            | \$ 22,390            |
| Equipment                      | 360,364                              | 217,672              |
| Computer equipment             | 10,402                               |                      |
| Computer Software              | 12,166                               | -                    |
| Vehicles                       | <u>44,344</u>                        | <u>44,344</u>        |
|                                | 492,096                              | 284,406              |
| Less: Accumulated depreciation | <u>188,997</u>                       | <u>120,338</u>       |
|                                | <u>\$ 303,099</u>                    | <u>\$ 164,068</u>    |

For the nine months ended September 30, 2014 and 2013, depreciation was \$68,659 and \$51,031, respectively.

## NOTE 5. INTANGIBLE ASSETS AND ASSET ACQUISITION

On April 15, 2013 the Company completed the acquisition of binary ionization technology and related patents and other assets consisting of personal property and inventory related to implementation of the Binary Ionization Technology related to these patents from L-3 Applied Technologies, Inc. ("L-3"). All of these assets are pledged as collateral for the convertible notes issued as described below in Note 6.

The purchase price allocation was obtained from an independent valuation firm. The following sets forth the components of the final purchase price allocation:

### Purchase Price

|                             |           |                  |
|-----------------------------|-----------|------------------|
| Cash payment                | \$        | 3,500,000        |
| Warranty expense            |           | 10,000           |
| <b>Total purchase price</b> | <b>\$</b> | <b>3,510,000</b> |

### Assets Purchased

|                              |           |                  |
|------------------------------|-----------|------------------|
| Inventory                    | \$        | 71,700           |
| Fixed assets                 |           | 150,000          |
| Patents                      |           | 2,848,300        |
| Trademarks                   |           | 440,000          |
| <b>Total Assets Acquired</b> | <b>\$</b> | <b>3,510,000</b> |

The intangible assets purchased consist of Patents and Trademarks. The patents are being amortized over the estimated remaining lives of the related patents, which is 7.7 years. The trademarks have an indefinite life. Amortization expense was \$277,131 and \$169,301 for the nine months ended September 30, 2014 and 2013.

Definite life intangible assets consist of the following:

|   | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|---|--------------------------------------|----------------------|
| Intellectual Property and Patents           | \$ 2,959,400                         | \$ 2,959,400         |
| Less: Accumulated Amortization              | 649,967                              | 372,836              |
| <b>Definite Life Intangible Assets, net</b> | <b>\$ 2,309,433</b>                  | <b>\$ 2,586,564</b>  |



Indefinite life intangible assets consist of the following:

|                              | September 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|------------------------------|--------------------------------------|----------------------|
| Trademarks                   | \$ 440,000                           | \$ 440,000           |
| Total Trademarks             | \$ 440,000                           | \$ 440,000           |
| Total Intangible Assets, net | <u>\$ 2,749,433</u>                  | <u>\$ 3,026,564</u>  |

#### NOTE 6. CONVERTIBLE DEBT

In November 2012, the Company initiated a Private Placement offering a maximum of 240 Units of the Company's securities at a price of \$25,000 per Unit or \$6,000,000. The initial closing of the offering occurred in April 2013 as the bulk of the net proceeds of the offering were to be allocated for the asset purchase from L-3 Applied Technologies, Inc., which agreement was not finalized until April 2013. Each Unit consists of \$25,000 par amount of a 10% Senior Secured Callable Convertible Promissory Note due and payable on July 31, 2015 and 37,500 warrants each of which allows the investor to purchase one share of common stock and expires on July 31, 2018. Interest is payable on the Notes at a rate of 10% per annum, and payable on July 31<sup>st</sup> and January 31<sup>st</sup>. The Notes are secured by the Company's intellectual property such as the Patents, royalties, receivables of the Company and all equipment except for the new equipment acquired with the proceeds from any future financing that is initially secured by this new equipment. The Notes call for the establishment of a sinking fund. Within 45 days of each calendar quarter 15% of the Company's reported revenue will be deposited into the Company's escrowed sinking fund account. Subsequent to September 30, 2014, the Company deposited approximately \$79,000 or 15% of the third quarter revenue into the sinking fund account.

The Company sold 202.96 Units for gross proceeds of \$5,074,000 and issued 7,611,000 warrants in connection with the Units. Net proceeds amounted to \$4,462,693 after expenses of offering totaling \$611,307. In addition, the placement agent received 1,014,800 warrants valued at \$165,180.

The convertible notes are convertible, at the option of the note holder, into shares of our common stock at an initial conversion price of \$.29 (which conversion price is subject to adjustment upon the occurrence of events specified in the Convertible Notes, including stock dividends, stock splits, certain fundamental corporate transactions, and certain issuances of common stock by the Company).

The Warrants are exercisable into shares of Common Stock (the "Warrant Shares") at an initial exercise price of \$0.30 (which may be subject to certain adjustments as set forth in the Warrants).

The Company evaluated the warrants under ASC 815-40-15 due to the exercise price being adjustable upon certain events occurring. The company determined that the warrants are considered indexed to the Company's own stock and thus meet the scope exception under FASB ASC 815-10-15-74 and are therefore not considered a derivative. The estimated fair value of the warrants, which contain reset provisions, were calculated using the Monte Carlo valuation model. The Company recorded the warrant's relative fair value of \$956,712 as an increase to additional paid in capital and a discount against the related debt.

The Convertible Notes contain a provision whereby the conversion price is adjustable upon the occurrence of certain events, including the issuance of common stock or common stock equivalents at a price which is lower than the current conversion price. Under FASB ASC 815-40-15-5, the embedded conversion feature is not considered indexed to the Company's own stock and, therefore, does not meet the scope exception in FASB ASC 815-10-15 and thus needs to be accounted for as a derivative liability. The initial fair value of the embedded conversion feature was estimated at \$7,316,092 and recorded as a derivative liability, resulting in an additional discount of \$4,117,288 to the convertible notes and a finance charge of \$3,198,804 included in the statement of operations for the year ended December 31, 2013. The fair value of the embedded conversion feature is estimated at the end of each quarterly reporting period using the Monte Carlo model.

The debt discount is being amortized over the life of the convertible note using the effective interest method.

Inherent in the Monte Carlo Valuation model are assumptions related to expected volatility, remaining life, risk-free rate and expected dividend yield. For the Convertible Notes using a Monte Carlo model, we estimate the probability and timing of potential future financing and fundamental transactions as applicable. The assumptions used by the Company are summarized below:

## Convertible Notes

|                         | September 30,<br>2014<br>(Unaudited) | Inception    |
|-------------------------|--------------------------------------|--------------|
| Closing stock price     | \$ 0.30                              | \$ 0.13-0.55 |
| Conversion price        | \$ 0.29                              | \$ 0.29      |
| Expected volatility     | 170%                                 | 185%-190%    |
| Remaining term (years)  | .83                                  | 2.30-2.07    |
| Risk-free rate          | 0.10%                                | 0.25%-0.43%  |
| Expected dividend yield | 0%                                   | 0%           |

Convertible notes consist of the following at September 30, 2014 and December 31, 2013:

|                                       | September 30,<br>2014<br>(Unaudited) | December 31, 2013 |
|---------------------------------------|--------------------------------------|-------------------|
| Convertible notes                     | \$ 5,074,000                         | \$ 5,074,000      |
| Initial Discount on convertible notes | (5,074,000)                          | (5,074,000)       |
| Accumulated amortization of discount  | 560,255                              | 70,442            |
| Total convertible notes, net          | <u>\$ 560,255</u>                    | <u>\$ 70,442</u>  |

### NOTE 7. FAIR VALUE

In accordance with FASB ASC 820, "Fair Value Measurements and Disclosures", the following table represents the Company's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013:

| <b>September 30, 2014:</b> | Level 3      | Total        |
|----------------------------|--------------|--------------|
| Derivative Instruments     | \$ 3,765,541 | \$ 3,765,541 |
| <b>December 31, 2013:</b>  | Level 3      | Total        |
| Derivative Instruments     | \$ 7,665,502 | \$ 7,665,502 |

Level 3 financial instruments consist of certain embedded conversion features. The fair value of these embedded conversion features that have exercise reset features are estimated using a Monte Carlo valuation model. The Company adopted the disclosure requirements of ASU 2011-04, "Fair Value Measurements," during the quarter ended March 31, 2012. The unobservable input used by the Company was the estimation of the likelihood of a reset occurring on the embedded conversion feature of the Convertible Notes. These estimates of the likelihood of completing an equity raise that would meet the criteria to trigger the reset provisions are based on numerous factors, including the remaining term of the financial instruments and the Company's overall financial condition.

The following table summarizes the changes in fair value of the Company's Level 3 financial instruments for the period ended September 30, 2014.

|   | <b>September 30,<br/>2014<br/>(Unaudited)</b> |
|---|---|
| Balance at December 31, 2013                  | \$ 7,665,502                                  |
| Fair Value Adjustment of Derivative Liability | (3,899,961)                                   |
| Balance at September 30, 2014                 | <u>\$ 3,765,541</u>                           |

Changes in the unobservable input values would likely cause material changes in the fair value of the Company's Level 3 financial instruments. The significant unobservable input used in the fair value measurement is the estimation of the likelihood of the occurrence of a change to the conversion price based on the contractual terms of the financial instruments. A significant increase (decrease) in this likelihood would result in a higher (lower) fair value measurement.

#### **NOTE 8. STOCKHOLDERS' DEFICIENCY**

The Company's Board of Directors may, without further action by the Company's stockholders, from time to time, direct the issuance of any authorized but unissued or unreserved shares of preferred stock in series and at the time of issuance, determine the rights, preferences and limitations of each series. The holders of such preferred stock may be entitled to receive a preference payment in the event of any liquidation, dissolution or winding-up of the Company before any payment is made to the holders of our common stock. Furthermore, the Board of Directors could issue preferred stock with voting and other rights that could adversely affect the voting power of the holders of our common stock.

##### ***Convertible Series A Preferred Stock***

The Company has authorized 1,000,000 shares of Convertible Series A Preferred Stock, \$0.01 par value. At September 30, 2014 and December 31, 2013, there were 510,000 shares issued and outstanding, respectively. The Convertible Series A Preferred Stock is convertible at the rate of one share of common stock for one share of Convertible Series A Preferred Stock.

##### ***Convertible Series B Preferred Stock***

The Company has authorized 4,000 shares of Convertible Series B Preferred Stock, \$1,000 stated value, 7.5% Cumulative dividend. At September 30, 2014 and December 31, 2013, there were no shares issued and outstanding, respectively.

##### ***Common Stock***

During the nine months ended September 30, 2014, the Company issued 222,947 shares of common stock valued at approximately \$77,111 for professional services rendered. In addition, the Company issued 24,714 shares of common stock valued at \$9,000 to Harold Paul, Director, as payment for legal services rendered. The Company also issued 380,000 shares to the Rolyn Companies, Inc. ("Rolyn") for labor and services support valued at \$180,951 of which 230,000 shares valued at \$128,000 were recorded as common stock to be issued at December 31, 2013. (See Note 9). In addition, the Company issued 76,226 shares valued at \$25,000 to a consultant for services rendered for the nine months ended September 30, 2014.

During the nine months ended September 30, 2014, the Company issued 78,125 shares as consideration for payment of accrued compensation to the CEO amounting to \$25,000.

During the quarter ended September 30, 2014, the Company sold 377,778 shares of common stock at \$.27 per share for gross proceeds of \$102,000. In connection with the sale, the Company incurred a cash finder fee in the amount of \$3,060 in addition to a finder's fee paid in common stock of 11,332 shares valued at \$3,060.

During the quarter ended September 30, 2014, the Company sold 1,652,311 equity units. Each unit consisted of 1 share of common stock and 2.5 warrants. The warrants have an exercise price of \$.29 per share and a term of five years. Gross proceeds to the Company amounted to \$478,313 net of expenses. In connection with the sale, the Company incurred a cash finder's fee in the amount of \$47,847 in addition to a finder's fee to be paid in common stock of 49,569 shares valued at \$14,375.

## Stock Options

The Company issued 20,000 options valued at \$3,000 to a director in January 2013. The options have an exercise price of \$0.15 per share. The options expire in January 2023. The options were valued using the Black-Scholes model using the following assumptions: volatility: 343%; dividend yield: 0%; zero coupon rate: 0.25%; and a life of 10 years.

The Company issued 20,000 options valued at \$8,723 to a director in January 2014. The options have an exercise price of \$0.44 per share. The options expire in January 2024. The options were valued using the Black-Scholes model using the following assumptions: volatility: 233%; dividend yield: 0%; zero coupon rate: 1.72%; and a life of 10 years.

The following table summarizes stock options outstanding as of September 30, 2014:

|                                 | September 30, 2014   |                                    |
|---------------------------------|----------------------|------------------------------------|
|                                 | Number of<br>Options | Weighted Average<br>Exercise Price |
| Outstanding, January 1, 2014    | 60,000               | \$ 1.42                            |
| Granted                         | 20,000               | .44                                |
| Exercised                       | -                    | -                                  |
| Outstanding, September 30, 2014 | 80,000               | \$ 1.17                            |

Options outstanding and exercisable by price range as of September 30, 2014 were as follows:

| Outstanding Options |        |        | Average Weighted Remaining<br>Contractual Life in Years | Exercisable Options                |         |
|---------------------|--------|--------|---|------------------------------------|---------|
| Range               | Number | Number |   | Weighted Average Exercise<br>Price |         |
| \$ 0.05             | 20,000 | 20,000 | 6.27  | 20,000                             | \$ 0.05 |
| \$ 2.10             | 40,000 | 40,000 | 5.27  | 40,000                             | \$ 2.10 |
| \$ 0.44             | 20,000 | 20,000 | 9.26  | 20,000                             | \$ 0.44 |

## Stock Warrants

The Company issued 250,000 warrants valued at \$37,495 to a consultant in January 2013. The warrants have an exercise price of \$0.15 and expire in January 2018. The warrants were valued using the Black-Scholes model with the following assumptions: volatility: 343%; dividend yield: 0%; zero coupon rate: 0.25%; and a life of 5 years.

During the year ended December 31, 2013, the Company issued 7,611,000 warrants in connection with convertible debt units and 1,014,800 warrants to the placement agent (see Note 6). These warrants have an initial exercise price of \$0.30 per share and expire July 31, 2018.

In June 2013, the Company issued 100,000 warrants with an exercise price of \$2.61 per share to a consultant for services. The warrants were valued at \$54,767 using the Black-Scholes model with the following assumptions: volatility, 245%; dividend yield, 0%; zero coupon rate, 0.25%; and a life of 5 years.

On September 26, 2013, the Company's Chief Financial Officer, Christopher Chipman, was granted 300,000 warrants. The warrants have a term of five years and vest 100,000 upon the grant date, 100,000 on September 26, 2014 and 100,000 on September 26, 2015. The exercise price of the warrant is \$0.77 per share based on the volume weighted average price of the Company's common stock for the five days prior to the grant date. If employment is terminated, the terms of any then outstanding warrant held by the holder shall extend for a period ending on the earlier of the date on which such warrant would otherwise expire or three months after such termination of employment and the warrant shall be exercisable as of the date of termination of employment. Any unvested warrants shall be deemed null and void. The Company utilized the Black-Scholes method to fair value the 300,000 warrants received by this individual totaling \$208,022 with the following assumptions: volatility, 179%; expected dividend yield, 0%; risk free interest rate, 1.43%; and a life of 5 years. Effective July 18, 2014, Chris Chipman resigned from his position of Chief Financial Officer of the Company and accordingly, his unvested share of warrants were deemed to be null and void. During the quarter ended September 30, 2014, the Company reversed out the equity based compensation for the accrued but not vested portion of the warrants in the amount of \$51,000 that was previously expensed.

On February 11, 2014, as part of the employment agreements entered into with its three executive officers (CEO, President and COO), the Board of Directors approved the grant of 3,000,000 stock warrants to each of them as executive compensation. The warrants have a term of five years and vest as follows: 1,000,000 warrants will vest upon issuance; 1,000,000 warrants will vest as of February 11, 2015, and 1,000,000 warrants will vest as of February 11, 2016. The exercise price of the warrants is \$0.30 per share based on the closing price of the Company's common stock on the grant date of \$0.32. If employment is terminated, the terms of any then outstanding warrant held by the holder shall extend for a period ending on the earlier of the date on which such warrant would otherwise expire or three months after such termination of employment and the warrant shall be exercisable to the extent it was exercisable as of the date of termination of employment. Any unvested warrants shall immediately vest on termination. The Company utilized the Black-Scholes method to fair value the 3,000,000 warrants received by these individuals totaling approximately \$952,000 for each executive with the following assumptions: volatility, 233%; expected dividend yield, 0%; risk free interest rate, 1.54%; and a life of 5 years. The grant date fair value of each warrant was \$0.32. Effective September 25, 2014, the President and COO resigned from their positions with the Company and accordingly, the remaining unvested warrants immediately vested. The Company recognized equity based compensation of approximately \$1,904,000 in connection with the vested warrants for the President and COO for the nine months ended September 30, 2014.

On February 11, 2014, the Company's Board of Directors approved the granting of 300,000 stock warrants to its CFO as incentive compensation. The warrants have a term of five years and vest as follows: 100,000 warrants will vest upon issuance; 100,000 warrants will vest as of February 11, 2015, and 100,000 warrants will vest as of February 11, 2016. The exercise price of the warrants is \$0.30 per share based on the closing price of the Company's common stock on the grant date of \$0.32. If employment is terminated, the terms of any then outstanding warrant held by the holder shall extend for a period ending on the earlier of the date on which such warrant would otherwise expire or three months after such termination of employment and the warrant shall be exercisable to the extent it was exercisable as of the date of termination of employment. Any unvested warrants shall be deemed null and void. The Company utilized the Black-Scholes method to fair value the 300,000 warrants received by the Company's executive totaling approximately \$95,000 with the following assumptions: volatility, 233%; expected dividend yield, 0%; risk free interest rate, 1.54%; and a life of 5 years. The grant date fair value of each warrant was \$0.32. Effective July 18, 2014, Chris Chipman resigned from his position of Chief Financial Officer of the Company and accordingly, his unvested share of warrants were deemed to be null and void. For the nine months ended September 30, 2014, the Company recognized approximately \$32,000 in equity based compensation for the vested portion of the warrants. During the quarter ended September 30, 2014, the Company reversed out the equity based compensation for the accrued but not vested portion of the warrants in the amount of \$12,000 that was previously expensed in the first and second quarter of 2014.

For the nine months ended September 30, 2014, the Company recorded approximately \$2,449,000 in equity based compensation expense on the vested and accrued portion of the warrants issued to executives.

During the quarter ended September 30, 2014, the Company issued 4,130,778 warrants in connection with the private placement of common stock equity units. See note 8 (common stock) for additional details.

The following table summarizes the outstanding common stock warrants as of September 30, 2014:

|                                 | Number of<br>Warrants | Weighted Average<br>Exercise Price |
|---------------------------------|-----------------------|------------------------------------|
| Outstanding, January 1, 2014    | 19,325,800            | \$ 0.21                            |
| Granted                         | 13,430,778            | 0.30                               |
| Expired                         | (200,000)             | 0.77                               |
| Expired                         | (200,000)             | 0.30                               |
| Exercised                       | -                     | -                                  |
| Outstanding, September 30, 2014 | 32,356,578            | \$ 0.24                            |

Warrants outstanding and exercisable by price range as of September 30, 2014 were as follows:

| Outstanding Warrants |            |   | Exercisable Warrants |                                    |
|----------------------|------------|---|----------------------|------------------------------------|
| Range                | Number     | Average Weighted Remaining<br>Contractual Life in Years | Number               | Weighted Average Exercise<br>Price |
| \$ 0.01              | 1,575,000  | 2.78  | 1,575,000            | \$ 0.01                            |
| \$ 0.05              | 975,000    | 2.87  | 975,000              | \$ 0.05                            |
| \$ 0.15              | 7,750,000  | 3.05  | 7,750,000            | \$ 0.15                            |
| \$ 0.261             | 100,000    | 3.74  | 100,000              | \$ 0.261                           |
| \$ 0.29              | 4,130,778  | 4.92  | 4,130,778            | \$ 0.29                            |
| \$ 0.30              | 17,725,800 | 2.69  | 15,725,800           | \$ 0.30                            |
| \$ 0.77              | 100,000    | 0.08  | 100,000              | \$ 0.77                            |

Unvested warrants outstanding as of September 30, 2014 were as follows:

| Unvested Warrants               |           |   |
|---------------------------------|-----------|---|
| Weighted Average Exercise Price | Number    | Average Weighted Remaining Contractual Life in<br>Years |
| \$ 0.30                         | 2,000,000 | 4.37  |

## **NOTE 9. RELATED PARTY TRANSACTIONS**

### ***Employment Agreement***

On February 11, 2014, the Company entered into an amended employment agreement with its CEO as well as new employment agreements with its President and COO that provide each with a base salary of \$36,000 per year. The agreements provide for an increase in the base salary to \$120,000 if annual gross revenue exceeds five million and \$175,000 if annual gross revenue were to exceed ten million on a calendar year basis. Any bonuses awarded will be based upon the Company's performance and be made at the discretion of the Board of Directors. The CEO, President and COO will also have the right to receive expense reimbursements and certain employee benefits. The terms of the employment agreements will be three years terminating on December 31, 2016. The CEO's base salary will no longer be subject to CPI adjustments and the incentive performance bonus equal to 12% of the Company's annual GAAP earnings for the years 2011 through 2015 was removed. Effective September 24, 2014, the president and COO resigned from the Company and their employment contracts were terminated.

### ***Support and Service Agreement***

Effective April 1, 2013 the Company entered into a Support and Service Agreement ("the Agreement") with Rolyn Companies, Inc. ("Rolyn") under the terms of which Rolyn will provide labor and services support. The Agreement called for payment to Rolyn of 76,666 shares of the Company's common stock per month as well as payment of out of pocket expenses. This agreement was amended, effective January 1, 2014, to reduce the payment to Rolyn to 25,000 shares of the Company's common stock per month. All other terms and conditions of the agreement remained the same. Either party can terminate the Agreement within 30 days written notice. The Company has recorded approximately \$75,000 and \$203,000 support and service expense for the nine months ended September 30, 2014 and 2013, respectively, and a related liability of approximately \$23,000 (75,000 shares) has been recorded as common stock to be issued based on the fair value of the Company's common stock as of September 30, 2014. Certain officers of Rolyn were appointed officers of the Company in June and July 2013. The service agreement was terminated effective October 7, 2014.

### ***Engagement Agreement***

On September 26, 2013, the Company entered into an engagement agreement with Christopher M. Chipman. Pursuant to the engagement agreement, Mr. Chipman serves as our Chief Financial Officer and receives a base annual fee of at least \$60,000. On February 11, 2014, the Company's Board of Directors approved an increase to its Chief Financial Officer's base annual fee to at least \$120,000. On July 18, 2014 Mr. Chipman resigned as Chief Financial Officer.

### ***Distribution and Licensing Agreement***

On March 21, 2014, the Company entered into a distribution and licensing agreement with Plascencia Universal, S. de R.L. de C.V. ("Plascencia Universal"), a Mexican company that will act as the exclusive distributor of TOMI's products and services in Mexico. The principal of Plascencia Universal is also the broker for the Company's insurance policies and was appointed a director of the Company. For the nine months ended September 30, 2014, revenues of approximately \$296,000 were recognized with regards to Plascencia Universal. Included in the revenue was a license fee for approximately \$26,000.

## NOTE 10. COMMITMENTS AND CONTINGENCIES

### *Lease Commitments*

The Company leased 1,611 square feet of office/warehouse space in San Diego, CA for research and development purposes. The lease payments amounted to approximately \$2,000 per month. This lease expired and the Company has continued to rent the space on a month-to-month basis. The Company vacated the office/warehouse in July of 2014 and has moved the lab to its new facility in Frederick, Maryland.

In September 2014, the Company entered into a lease agreement for approximately 6,000 square feet in Frederick MD comprised of space for offices, warehousing, laboratory, training and mock hospital facilities. As part of the lease agreement, the Company is to receive a rent holiday in the first 5 months of the lease. The lease also provides for an escalation clause where the Company will be subject to an annual rent increase of 3%, year over year. The lease expires on January 31, 2018. The Company accounts for the lease using the straight line method and recorded \$3,809 in rent expense for the quarter ended September 30, 2014. Approximate minimum annual rents under lease are as follows:

| <u>Year Ending December 31,</u> | <u>Amount</u>     |
|---------------------------------|-------------------|
| 2015                            | \$ 42,000         |
| 2016                            | 52,000            |
| 2017                            | 53,000            |
| 2018                            | 4,000             |
|                                 | <u>\$ 151,000</u> |

### *Purchase Commitments*

In April 2014, the Company entered into purchase commitments with a new manufacturer for the procurement of inventory amounting to \$465,000. For the nine months ended September 30, 2014, the Company has purchase \$278,000 in inventory as part of the agreement with manufacturer.

## NOTE 11. CONTRACTS AND AGREEMENTS

In September 2014, the Company entered into a Sales and Distribution Agreement, superseding previous agreements, with TOMI Panama covering Panama, El Salvador, Guatemala, Nicaragua, Columbia, Honduras, Costa Rica and Ecuador. TOMI Panama is its exclusive distributor of the Company's products and services within the country of Panama.

On September 25, 2014, the Company appointed Norris Gearhart as Principal Operating Officer of the Company and entered into an employment agreement with him. The agreement provides for a base salary of \$126,000 per year and bonus in the form of 100,000 shares of the Company's restricted stock valued at \$29,000. The restricted shares were issued in October of 2014.

## NOTE 12. COMMON STOCK TO BE ISSUED

As of September 30, 2014, the Company was obligated to issue 313,071 shares of common stock valued at approximately \$83,000 primarily to certain vendors, consultants and an executive including 75,000 shares valued at \$23,000 for the Rolyn Companies.



### NOTE 13. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through the date the financial statements were issued and up to the time of filing of the financial statements with the Securities and Exchange Commission.

The Company appointed Nick Jennings as its Principal Financial Officer effective September 25, 2014. Mr. Jennings employment with the Company commenced on October 1, 2014. The employment agreement between Mr. Jennings and the Company provides for an annual base salary of \$60,000 to be paid in the form of cash and \$24,000 to be paid in the form of the Company's restricted stock. As part of Mr. Jennings's agreement, 300,000 warrants were issued with a term of five years vesting 100,000 upon the grant date (October 1, 2014), 100,000 on October 1, 2015 and 100,000 on October 1, 2016. The exercise price of the warrant is \$0.30 per share based on the volume weighted average price of the Company's common stock for the five days prior to the grant date.

On October 14, 2014, the Company announced that RG Group was named its platinum manufacturing partner for the Company's decontamination technology.

During November of 2014, the Company sold 551,725 equity units consisting of 1 share of common stock and 2.5 warrants for gross proceeds of \$160,000.

On November 10, 2014, the Company deposited \$79,000 or approximately 15% of the third quarter revenue into the bank sinking fund account.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

In this report references to "TOMI" "we," "us," and "our" refer to TOMI Environmental Solutions, Inc.

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Securities and Exchange Commission ("SEC") encourages companies to disclose forward-looking information so that investors can better understand future prospects and make informed investment decisions. This report contains these types of statements. Words such as "may," "will," "expect," "believe," "anticipate," "estimate," "project," or "continue" or comparable terminology used in connection with any discussion of future operating results or financial performance identify forward-looking statements. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this report. All forward-looking statements reflect our present expectation of future events and are subject to a number of important factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements.

#### General

The Company was incorporated in Florida in 1979. In October 2007, the Company and its controlling shareholders entered into a definitive Agreement whereby the Company acquired 100% of the issued and outstanding common shares of The Ozone Man, Inc., a Nevada Corporation ("Ozone Nevada"). Although the Company was the legal acquirer, for accounting purposes Ozone Nevada was the surviving entity and, accordingly, the transaction has been accounted for as a reverse acquisition that was in substance a recapitalization of Ozone Nevada.

During the second quarter of 2009, the Company exited the status of development stage enterprise and commenced its planned principal operations since the Company earned revenues during the quarter ended June 30, 2009.

During August 2010, TOMI entered into negotiations with BIT Technology a division of L-3, and we began to develop applications for and distribution of the SteraMist™ equipment that currently accounts for nearly all of our revenue.

In April 2013, we completed the acquisition of certain assets from L-3 Applied Technologies, Inc. ("L-3") for \$3,510,000. This acquired patented technology relates to a disinfection/decontamination system that applies cold plasma activation to a hydrogen peroxide based mist and fog and produces a Reactive Oxygen Species (ROS) mist and is trademarked as Binary Ionization Technology® (BIT™) which deactivates most organic compounds quickly and effectively kills viruses, bacteria, bacteria spores, molds spores, other fungi and yeast, both in the air and on surfaces. The products byproducts are oxygen and water and thus are environmentally friendly.

The technology applies cold plasma activation to a low percentage hydrogen peroxide based solution to create a mist and fog which does not damage delicate medical equipment and computers. SteraMist™ (BIT™) provides a group of ROS that provides fast acting, broad-spectrum decontamination, and leaves no residue or noxious fumes. The environmentally friendly characteristics ensure safety of employees and equipment, while providing maximum decontamination efficacy to both air and surfaces. BIT™ has also been shown to effectively decontaminate weaponized biological agents like Anthrax, chemical agents such as VX, and Mustard gas when applied using properly developed protocols. A summary of BIT™ capabilities can be found in the DHS "Guide for the Selection of Chemical, Biological, Radiological, and Nuclear Decontamination Equipment for Emergency First Responders" (2nd Edition, March 2007).

By acquiring this technology, TOMI now controls this innovative, patented technology and has the ability to build its client base and expand into other market segments. For example, once a hospital customer has purchased one of our portable hand-held or mobile units (or has tried our service), they have regularly reordered TOMI's reactive solution for continued applications and have expanded their initial SteraMist™ program assuring repeat business and an ongoing revenue stream as long as the system is in use.

We believe that reducing Healthcare Associated Infections ("HAIs"), which are the fourth leading cause of death in the United States and cost the healthcare system is approximately \$36 - \$45 billion annually according to the Centers for Disease Control provide significant opportunities for our technology, services, and products. Statistically, it has been documented that approximately 10% of inpatients contract infections from hospitals resulting in more than 2,000,000 illnesses and over 100,000 deaths per annum. Further, it has been estimated that approximately 15% of all discharged patients are readmitted with infections, which among other things results in the healthcare facility becoming financially penalized. According to published studies, current hospital cleaning procedures leave behind between 30%-60% of microorganisms depending upon the process. These remaining surface and air pathogens increase the risk of acquiring a HAI. TOMI's BIT™ safely and effectively kills 99.9999% (a six-log kill) of all known pathogens. In comparison to most of its competitors, SteraMist™ technology has a quicker and higher kill level, leaves no residue, is not effected by humidity, is not caustic, has a shorter treatment time and converts to oxygen and water which differentiates us from our competition.

Our SteraMist™ and BIT™ technology and TOMI's related service platform are currently being used in a broad spectrum of industries including:

- medical facilities
- tissue labs
- office buildings
- hospitality
- schools
- pharmaceutical companies
- clean rooms
- remediation companies
- military
- transportation
- airports
- first responders
- single-family homes and multi-unit residences

Other vertical industry applications for SteraMist™ that have expressed interest in our technology, service and products include:

- blood banks
- food safety industry
- athletic facilities (from professional to educational)
- airlines
- entertainment
- homeland defense of multiple countries

The Company intends to generate and support research on improving, extending and applying our patents. To date, we have received interest, both domestically and internationally, to form business alliances with major healthcare companies, tissue and blood labs, cruise industry, pharmaceutical companies, the food safety industry, border protection including homeland defense companies, construction companies and remediation companies.

In September 2013, the Company entered into a Sales and Distribution Agreement with TOMI Panama, a non-affiliated company in Panama and successfully completed an official pilot study at the request of Panama Social Security Program (CSS), performing bio-mass reduction and remediation of biological bacterial colonies. As a result, the Panamanian Government accepted the Company's technology as the only decontamination product of its kind that is authorized by the Panamanian Government to be purchased by their hospitals for the next two years. On September 30, 2013, TOMI was awarded a multi-year contract from Panama Social Security Program ("CSS Contract") to initiate bio-mass reduction and decontamination services. During the 4<sup>th</sup> quarter 2013, TOMI completed the bio-mass reduction and decontamination services at The Complejo Hospitalario Metropolitano in Panama City, Panama. Currently, we are actively engaged to expand this program and make SteraMist<sup>TM</sup> a standard for decontamination in over 41 Panamanian hospitals. During the 3<sup>rd</sup> quarter of 2014, we received an order from our Panamanian agent for another three hospitals for bio-mass reduction and decontamination which will commence in mid-November 2014. We expect that a total of six new hospitals in Panama will be serviced in the 4<sup>th</sup> quarter of 2014 and the 1<sup>st</sup> quarter of 2015.

During the 4<sup>th</sup> quarter of 2013, the Company's Panamanian distribution partner initiated bio-mass reduction and decontamination services at The Complejo Hospitalario Metropolitano in Panama City, Panama. The initial project in Panama provides for decontamination services for 64,583 sq/ft. of space for an approximate value to the Company of \$420,000. The Company completed this project in October 2013. Rolyn Companies, Inc. was engaged by TOMI to perform the bio-mass reduction and decontamination services as a subcontractor, as well as to train our Panamanian distribution partner's personnel. The revenue distribution for the CSS Contract is broken up into two segments:

- (1) The first segment consisted of bio-mass reduction, a deep cleaning, and the initial application of SteraMist<sup>TM</sup>. This consisted of 64,583 sq/ft at \$6.50 per sq/ft which amounted to approximately \$420,000.
- (2) The second segment consists of maintenance services for the same square footage area which has a contract value of \$60,000 per month for 3 years. The Company receives 15% of the \$60,000 or \$9,000 per month as a management fee for the first 12 months and 10% or \$6,000 for the remaining 24 months of the CSS Contract.

Internationally and domestically, we have continued to increase the use and subsequent sales of TOMI's<sup>TM</sup> patented BIT<sup>TM</sup> technology under our existing programs to twenty nine clients in a variety of industries internationally and domestically including, healthcare, tissue banks, remediation companies, sterilization hood industry, pharmaceutical companies, Civil Defenses and military.

Effective April 1, 2013 the Company entered into a Support and Service Agreement ("the Agreement") with Rolyn Companies, Inc. ("Rolyn") under the terms of which Rolyn will provide labor and services support. The Agreement called for payment to Rolyn of 76,666 shares of the Company's common stock per month as well as payment of out of pocket expenses. This agreement was amended, effective January 1, 2014, to reduce the payment to Rolyn to 25,000 shares of the Company's common stock per month. All other terms and conditions of the agreement remained the same. Either party can terminate the Agreement within 30 days written notice. The Company has recorded approximately \$75,000 and \$203,000 support and service expense for the nine months ended September 30, 2014 and 2013, respectively, and a related liability of approximately \$23,000 (75,000 shares) has been recorded as common stock to be issued based on the fair value of the Company's common stock as of September 30, 2014. Certain officers of Rolyn were appointed officers of the Company in June and July 2013. The service agreement was terminated effective October 7, 2014.

Through our sales and services, our business growth objective is to be "The Global Leader in Decontamination and Infectious Disease Control" through our premier novel platform of hydrogen peroxide mists and fogs, as well as other products and technologies. We have, and continue to expand and support research on other air remediation solutions including hydroxyl radicals and other ROS and to form business alliances which may include selling licenses and or performing decontamination services with tissue banks, pharmaceutical labs, blood labs, kidney dialysis centers, major remediation companies, construction companies and corporations specializing in disaster relief. Our intended targets are located internationally including South America, Central America, Middle East and the Far East.

**Net Loss**

The Company incurred a loss for the three months ended September 30, 2014 of approximately \$1,254,000 as compared to a net loss for the same period in the prior year of approximately \$2,946,000 representing a decrease in net loss of \$1,692,000. The primary reasons for this decrease in net loss can be attributed to:

- Increase in sales of approximately \$220,000 and the overall gross profit of approximately \$218,000;
- Reduction in consulting fees of approximately \$268,000;
- Changes in the fair value of the embedded conversion feature of the convertible notes of \$2,332,000 and financing costs of approximately \$331,000 resulting from the issuance of convertibles notes in 2013; offset by;
- Increase in one-time non-cash charges of approximately \$976,000 in equity compensation expense;
- Increase in general and administrative expenses of approximately \$146,000;
- Higher selling expenses of approximately \$71,000 mainly due to a ramp up of sales and marketing during the current quarter, and;
- Higher amortization of debt discount charges of approximately \$251,000 related to the \$5,074,000 in convertible notes issued in 2013.

**Sales**

During the three months ended September 30, 2014 and 2013, we had net revenue of approximately \$515,000 and \$295,000, respectively, representing an increase in revenue of \$220,000 or 75%. The primary reason for the increase in revenue was attributable mainly to the fact that we were able to acquire and take control over the entire SteraMist™ line of products from L-3 in April 2013, including manufacturing as well as research and development, which facilitated the Company having sufficient supply of product to fill orders, as well as diversify our client base. We have also ramped up sales, marketing and trade shows which has positively impacted sales as compared to the prior period.

**Cost of Sales**

During the three months ended September 30, 2014 and 2013, we had cost of sales of approximately \$188,000 and \$185,000, respectively, representing an increase of \$3,000 or 2%. We also experienced higher profit margins attributable to gaining economies of scale through the acquisition of the SteraMist™ line of products from L-3 in April 2013.

### **Professional Fees**

Professional fees for the three months ended September 30, 2014 totaled approximately \$89,000 as compared to \$93,000 during the same quarter in the prior year representing a decrease of approximately \$4,000 or 4%. Professional fees are mainly comprised of legal, environmental advisory, accounting and financial consulting fees during the three months ended September 30, 2014 and 2013.

### **Depreciation and Amortization**

Depreciation and amortization was approximately \$121,000 and \$113,000 for the three months ended September 30, 2014 and 2013, respectively. The increase in depreciation expense was attributable to SteraMist™ equipment being reclassified and utilized by the company for demo and/or rental use in the preceding quarter and during the three months ended September 30, 2014.

### **Selling Expenses**

Selling expenses for the three months ended September 30, 2014 totaled approximately \$107,000 as compared to \$36,000 for the same period in 2013 representing an increase of \$71,000. These expenses represent selling salaries and wages, trade show fees, commissions and marketing expenses. We have ramped up sales and marketing in the current period which has positively impacted sales as compared to the prior period.

### **Research & Development**

Research and development expenses for the three months ended September 30, 2014 totaled approximately \$30,000 as compared to \$23,000 for the same period in 2013. Research and development expenses mainly include costs incurred in generating and supporting research on improving, extending and applying our patents in the field of mechanical cleaning and decontamination.

### **Consulting Fees**

Consulting fees for the three months ended September 30, 2014 totaled approximately \$44,000 as compared to \$312,000 during the same quarter in the prior year representing a decrease of approximately \$268,000 or 86%. The decrease in consulting fees is primarily due to a decrease in non-cash charges incurred with regard to the support and services agreement with Rolyn Companies, Inc. ("Rolyn") in the current period as well as a general decrease in consulting fees as the Company hired full time employees during 2014 rather than out-sourcing to consultants.

### **Equity Compensation Expense**

Equity compensation expense represents one-time non-cash charges for the three months ended September 30, 2014 and was approximately \$1,043,000 as compared to \$67,000 for the same period in 2013. Equity compensation expense is incurred upon the issuance of warrants to our executive officers. On the date of a grant, we determine the fair value of the stock option award and recognize compensation expense over the requisite service period, which is generally the vesting period of the award. The fair value of the stock option award is calculated using the Black-Scholes Method option-pricing model. The increase in equity compensation is primarily due to the immediate vesting of warrants of two executive officers of the Company upon their resignation in September of 2014. See Note 8. Stockholders' Deficiency for details on these issuances.

### **General and Administrative Expense**

General and administrative expenses include salaries and payroll taxes, rent, insurance expense, and office expenses. General and administrative expenses were approximately \$313,000 and \$167,000 for the three months ended September 30, 2014 and 2013, respectively, representing an increase of \$146,000 or 88%. The primary reason for the increase in General and administrative expenses can be attributed mainly to higher salaries and wages due to new hires during the current period.

### **Other Income and Expense**

Amortization of deferred financing costs was approximately \$86,000 and \$86,000 for the three months ended September 30, 2014 and 2013, respectively. This represents the amortization of costs incurred to raise capital in relation to the acquisition of the SteraMist™ line of products from L-3.

Amortization of debt discount was approximately \$272,000 and \$21,000 during the three months ended September 30, 2014 and 2013, respectively, representing the charges related to the amortization of debt discount on our \$5,074,000 in convertible notes issued in 2013. These convertible notes are being amortized over the life of the note utilizing the effective interest method.

The fair value adjustment of the derivative liability during the three months ended September 30, 2014, amounted to approximately a \$654,000 gain in the current period versus a loss of \$1,677,000 in the prior period. This represents the change in the fair value of the embedded conversion feature of the convertible notes.

Financing costs were \$0 for the three months ended September 30, 2014 versus \$331,000 of such costs during the same period in the prior year. These costs were attributed to the \$5,074,000 in convertible notes issued in 2013 in connection with the acquisition of the SteraMist™ line of products from L-3.

Interest expense for the three months ended September 30, 2014 and 2013 was approximately \$127,000 and 128,000, respectively. This represents the interest due on the \$5,074,000 in convertible notes issued in 2013 in connection with the acquisition of the SteraMist™ line of products from L-3.

### ***Results of Operations for the Nine Months Ended September 30, 2014 Compared to the Nine Months Ended September 30, 2013***

#### **Net Loss**

The Company incurred a loss for the nine months ended September 30, 2014 of approximately \$935,000 as compared to a net loss for the same period in the prior year of approximately \$11,124,000 representing a decrease in net loss of \$10,189,000. The primary reasons for this decrease in net loss can be attributed to:

- Increase in revenue of approximately \$698,000 and the overall gross profit of approximately \$539,000;
- Reduced consulting fees of approximately \$367,000;
- Changes in the fair value of the embedded conversion feature of the convertible notes of \$10,133,000 and financing costs of approximately \$3,199,000 resulting from the issuance of convertibles notes in 2013; offset by;
- Increase in depreciation and amortization expense of approximately \$125,000;
- Higher selling expenses of approximately \$219,000 mainly due to a ramp up of sales, tradeshow and marketing during the nine months ended September 30, 2014;
- Higher research and development costs of approximately \$88,000 due to continued improvement and development to the Company's products;
- Higher non-cash charges of approximately \$2,382,000 in equity compensation expense;
- Higher general and administrative expenses of approximately \$496,000;
- Higher amortization of deferred financing costs of \$108,000 related to the \$5,074,000 in convertible notes issued in 2013;
- Higher amortization of debt discount charges of approximately \$459,000 related to the \$5,074,000 in convertible notes issued in 2013; and;
- Higher interest expense of \$151,000 related to the \$5,074,000 in convertible notes issued in 2013.

#### **Sales**

During the nine months ended September 30, 2014 and 2013, we had net revenue of approximately \$1,205,000 and \$507,000, respectively, representing an increase in revenue of \$698,000 or 138%. The primary reason for the increase in revenue was attributable mainly to the fact that we were able to acquire and take control over the entire SteraMist™ line of products from L-3 in April 2013, including manufacturing as well as research and development, which facilitated the Company having sufficient supply of product to fill orders, as well as diversify our client base. We have also ramped up sales, marketing and trade shows which has positively impacted sales as compared to the prior period.

#### **Cost of Sales**

During the nine months ended September 30, 2014 and 2013, we had cost of sales of approximately \$440,000 and \$280,000, respectively, representing an increase of \$160,000 or 57%. The primary reason for the increase in cost of sales was due to sales increasing mostly conjunction with costs during the nine months ended September 30, 2014. We also experienced higher profit margins attributable to gaining economies of scale through the acquisition of the SteraMist™ line of products from L-3 in April 2013.

### **Professional Fees**

Professional fees for the nine months ended September 30, 2014 totaled approximately \$280,000 as compared to \$261,000 during the same period in the prior year representing an increase of approximately \$19,000 or 7%. Professional fees are mainly comprised of legal, environmental advisory, accounting and financial consulting fees.

### **Depreciation and Amortization**

Depreciation and amortization was approximately \$346,000 and \$220,000 for the nine months ended September 30, 2014 and 2013, respectively. The increase in depreciation expense was attributable to: 1) amortization expense recognized during the nine months ended September 30, 2014 in connection with our patents associated with the SteraMist™ line of products. There was no such expense during the three months ended March 31, 2013 as the patents were acquired in April 2013, and 2) SteraMist™ equipment being reclassified and utilized by the company for demo and/or rental use during the nine months ended September 30, 2014.

### **Selling Expenses**

Selling expenses for the nine months ended September 30, 2014 totaled approximately \$285,000 as compared to \$66,000 for the same period in 2013 representing an increase of \$219,000. These expenses represent selling salaries and wages, trade show fees, commissions and marketing expenses. We have ramped up sales, marketing and trade shows in the current period which has positively impacted sales as compared to the prior period.

### **Research & Development**

Research and development expenses for the nine months ended September 30, 2014 totaled approximately \$128,000 as compared to \$39,000 in 2013. Research and development expenses mainly include costs incurred in generating and supporting research on improving, extending and applying our patents in the field of mechanical cleaning and decontamination. There were minimal costs during the nine months ended September 30, 2013 as we had recently acquired the patents associated with the SteraMist™ line of products from L-3 (April 2013).

### **Consulting Fees**

Consulting fees for the nine months ended September 30, 2014 totaled approximately \$128,000 as compared to \$496,000 during the same period in the prior year representing a decrease of approximately \$368,000 or 74%. The decrease in consulting fees is primary due to a general decrease in consulting fees as the Company hired full time employees during 2014 rather than out-sourcing to consultants.

### **Equity Compensation Expense**

Equity compensation expense represents primarily one-time non-cash charges for the nine months ended September 30, 2014 and totaled approximately \$2,448,000 as compared to \$67,000 in 2013. Equity compensation expense is incurred upon the issuance of warrants to our executive officers. On the date of a grant, we determine the fair value of the stock option award and recognize compensation expense over the requisite service period, which is generally the vesting period of the award. The fair value of the stock option award is calculated using the Black-Scholes Method option-pricing model. The increase in equity compensation is primarily due to the immediate vesting of warrants of two executive officers of the Company upon their resignation in September of 2014. See Note 8. Stockholders' Deficiency for details on these issuances.

### **General and Administrative Expense**

General and administrative expenses include salaries and payroll taxes, rent, insurance expense, and office expenses. General and administrative expenses were approximately \$858,000 and \$361,000 for the nine months ended September 30, 2014 and 2013, respectively, representing an increase of \$497,000 or 138%. The primary reason for the increase in General and administrative expenses can be attributed to higher salaries and wages due to new hires during the current period.



## Other Income and Expense

Amortization of deferred financing costs was approximately \$256,000 and \$148,000 for the nine months ended September 30, 2014 and 2013, respectively. This represents the amortization of costs incurred to raise capital in relation to the acquisition of the SteraMist™ line of products from L-3.

Amortization of debt discount was approximately \$490,000 and \$30,000 during the nine months ended September 30, 2014 and 2013, respectively, representing the charges related to the amortization of debt discount on our \$5,074,000 in convertible notes issued in 2013. These convertible notes are being amortized over the life of the note utilizing the effective interest method.

The fair value adjustment of the derivative liability during the nine months ended September 30, 2014, amounted to approximately a \$3,900,000 gain in the current period versus a loss of \$6,233,000 in the prior period. This represented a \$10,133,000 change in the fair value of the embedded conversion feature of the convertible notes.

Financing costs were \$0 for the nine months ended September 30, 2014 versus \$3,199,000 of such costs during the same period in the prior year. These costs were attributed to the \$5,074,000 in convertible notes issued in 2013 in connection with the acquisition of the SteraMist™ line of products from L-3.

Interest expense for the nine months ended September 30, 2014 and 2013 was approximately \$381,000 and 230,000, respectively. The primary reason for the increase in interest expense can be attributed to the interest due on the \$5,074,000 in convertible notes issued during the second quarter 2013 in connection with the acquisition of the SteraMist™ line of products from L-3.

## Summary of Results

|   | For the nine<br>months ended<br>September 30,<br>2014 | For the nine<br>months ended<br>September 30,<br>2013 |
|---|---|---|
| Revenues                                    | \$ 1,205,000  | \$ 507,000  |
| Gross Profit                                | 765,000   | 226,000   |
| Total Operating Expenses <sup>(1)</sup>     | 4,473,000   | 1,511,000   |
| Loss from Operations                        | (3,708,000)   | (1,284,000)   |
| Total Other Income (Expense) <sup>(2)</sup> | 2,773,000   | (9,840,000)   |
| Net Loss                                    | \$ (935,000)  | \$ (11,125,000)                                       |
| Basic and diluted loss per share            | \$ (0.01)   | \$ (0.15)   |

(1) Includes approximately \$2,449,000 and \$67,000 in non-cash equity compensation expense for the nine Months ended September 30, 2014 and 2013, respectively.

(2) Includes fair value adjustment gain on derivative liability of approximately \$3,900,000 for the nine months ended September 30, 2014 and a fair value adjustment loss of \$6,233,000 and finance costs of \$3,198,000 for the nine months ended September 30, 2013.

## Summary of Revenues

|                              | For the nine<br>months ended<br>September 30,<br>2014 | For the nine<br>months ended<br>September 30,<br>2013 |
|------------------------------|---|---|
| Revenues:                    |   |   |
| Equipment / Product          | \$ 779,000  | \$ 305,000  |
| BIT Solution                 | 302,000   | 132,000   |
| Bio-mass and Decontamination |   |   |
| Services                     | 28,000  | 64,000  |
| Maintenance fees             | 81,000  | -   |
| Training                     | 15,000  | 6,000   |
| Total Revenues               | \$ 1,205,000  | \$ 507,000  |

## Sales Information of Geographic Basis

|                | <u>For the nine<br/>months ended<br/>September 30,<br/>2014</u> | <u>For the nine<br/>months ended<br/>September 30,<br/>2013</u> |
|----------------|---|---|
| Revenues:      |   |   |
| International  | \$ 684,000  | 128,000   |
| United States  | 521,000   | 379,000   |
| Total Revenues | <u>\$ 1,205,000</u>   | <u>\$ 507,000</u>   |

## Liquidity and Capital Resources

### **Going Concern**

The condensed consolidated financial statements contained in this Interim Report have been prepared on a "going concern" basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. We have an immediate and urgent need for additional capital. For the reasons discussed herein, there is a significant risk that we will be unable to continue as a going concern, in which case, you would suffer a total loss of your investment in our company. We plan on funding operations and liquidity needs from the sales of its products and services, licensing arrangements, debt financing and/or sales of its common stock and notes convertible into common stock. There can be no assurance that additional funds required for continued operations during the next year or thereafter will be generated from our operations. Should we seek additional funds from external sources such as debt or additional equity financings or other potential sources, there can be no assurance that such funds will be available on terms acceptable to us or that they will not have a significant dilutive effect on our existing stockholders. The inability to generate cash flow from operations or to raise sufficient capital from external sources would force us to substantially curtail or cease operations and would, therefore, have a material adverse effect on its business.

### **Operating activities**

*Cash used in operating activities* during the nine months ended September 30, 2014 and 2013 was approximately \$1,158,000 and \$796,000, respectively. Cash used in operating activities increased \$362,000 as compared to the nine months ended September 30, 2013, primarily due to: 1) A decrease in accounts receivable of \$171,000 versus an increase in 2013 for \$179,000, offset by; 2) the Company experienced a decrease in accounts payable of approximately \$18,000 in 2014 versus an increase of \$142,000 in 2013, 3) increase in procuring raw material inventory for an anticipated increase in sales in 2014 of 32,000, 4) a decrease of accrued interest of approximately \$127,000 in 2014 versus an increase of \$0 in 2013, 5) a decrease of common stock to be issued of \$82,000 versus an increase of \$173,000 in 2013, 6) a decrease in deferred revenue \$0 in 2014 versus \$84,000 in 2013, 7) various other items of approximately increasing the net cash used in operating activities \$54,000.

### **Investing Activities**

*Cash used in investing activities* during the nine months ended September 30, 2014, amounted to approximately \$65,000 primarily due to the acquisition of trade show and computer equipment. *Cash used in investing activities* during the nine months ended September 30, 2013, amounted to approximately \$3,451,000, primarily from the acquisition of patents and equipment from L-3.

## **Financing Activities**

*Cash provided in financing activities* during the nine months ended September 30, 2014 amounted to approximately \$602,000, primarily from the proceeds from the issuance of common stock of \$580,000 and the increase in the bond sinking fund of \$70,000. In addition, the Company incurred a finder's fee in the amount for approximately \$48,000 in connection with the issuance of the stock for the quarter ended September 30, 2014.

*Cash provided by financing activities* during the nine months ended September 30, 2013 amounted to approximately \$5,295,000, primarily from proceeds received of approximately \$866,000 during the period from the issuance of common stock and \$5,074,000 from proceeds received from the issuance of convertible notes. In addition, the Company incurred deferred finance costs from the issuance the convertible notes for \$611,000 and a finder's fee in the amount of \$30,000 in connection with the sale of common stock.

As of September 30, 2014 we had a cash balance of approximately \$86,000. We have incurred significant losses from operations since inception, including a loss of approximately \$935,000 for the nine months ended September 30, 2014. We have, since inception, consistently incurred negative cash flow from operations. We experienced a decrease in working capital deficiency and a decrease in stockholders' deficiency mainly related to non-cash fair value derivative adjustments charges incurred as a result of the completion of the private placement in April 2013 in which the Company raised approximately \$5,074,000 in gross proceeds, enabling it to complete the asset purchase from L-3. As of September 30, 2014, we had a working capital deficiency of approximately \$3,501,000 and a stockholders' deficiency of \$441,000.

We currently have 7,611,000 warrants issued to note holders of our convertible debt at an exercise price of \$0.30. In the event, all holders were to exercise their warrant holdings, we would receive approximately \$2,283,000 in gross proceeds. There can be no assurance that the note holders will exercise their warrants by the expiration date of their respective warrant.

### **Recently Issued Accounting Pronouncements**

See Note 2 to the Condensed Consolidated Financial Statements contained in Item 1. Financial Statements above.

### **Disclosure About Off-Balance Sheet Arrangements**

We do not have any transactions, agreements or other contractual arrangements that constitute off-balance sheet arrangements.

### **Critical Accounting Policies**

See Note 2 to the Condensed Consolidated Financial Statements contained in Item 1. Financial Statements above.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

None.

### **ITEM 4. CONTROLS AND PROCEDURES**

We have established a set of disclosure controls and procedures designed to ensure that information required to be disclosed by us in our reports filed under the Securities Exchange Act, is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls have also designed with the objective of ensuring that this information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. We believe our disclosure controls and internal controls are effective for the nine months ended September 30, 2014.

We do not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of 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. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We did not implement any changes in controls during the nine months ended September 30, 2014.

## PART II: OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

We are not a party to any material proceedings or threatened proceedings as of the date of this filing.

### ITEM 1A. RISK FACTORS.

See our discussion contained in our Form 10-K filed with the Commission on March 25, 2014.

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

In July 2014 the Company sold 377,778 common shares for \$102,000.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

### ITEM 5. OTHER INFORMATION.

None.

### ITEM 6. EXHIBITS

#### Part I: Exhibits

|      |   |
|------|---|
| 31.1 | Principal Executive Officer Certification |
| 31.2 | Principal Financial Officer Certification |
| 32.1 | Section 1350 Certification                |
| 32.2 | Section 1350 Certification                |

#### Part II: Exhibits

None.

**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.

**TOMI ENVIRONMENTAL SOLUTIONS, INC**

November 12, 2014

By: /s/ Halden Shane

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Halden Shane  
Principal Executive Officer

## CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, Halden S. Shane, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 of TOMI Environmental Solutions, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 12, 2014

By: /s/ Halden S. Shane  
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Halden S. Shane  
Principal Executive Officer

## CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Nick Jennings, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 of TOMI Environmental Solutions, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 12, 2014

By: /s/ Nick Jennings

Nick Jennings  
Principal Financial Officer





**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of TOMI Environmental Solutions, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2014, as filed with the Securities and Exchange Commission on November 12, 2014 (the "Report"), I, Nick Jennings, Principal Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

November 12, 2014

By:           /s/ Nick Jennings            
Nick Jennings  
Principal Financial Officer