

# SECURITIES & EXCHANGE COMMISSION EDGAR FILING

## TOMI Environmental Solutions, Inc.

**Form: 10-Q**

**Date Filed: 2019-11-14**

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, 2019**

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**  
(State or other jurisdiction of  
incorporation or organization)

**59-1947988**  
(I.R.S. 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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, par value \$0.01 par value	TOMZ	OTC Markets Group Inc.

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 every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input checked="" type="checkbox"/>
	Emerging growth company <input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 8, 2019, the registrant had 124,700,418 shares of common stock outstanding.

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## FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (this "Form 10-Q") contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and we intend that such forward looking statements be subject to the safe harbors created thereby. For this purpose, any statements contained in this Form 10-Q, except for historical information, may be deemed forward-looking statements. You can generally identify forward-looking statements as statements containing the words "will," "would," "believe," "expect," "estimate," "anticipate," "intend," "estimate," "assume," "can," "could," "plan," "predict," "should" or the negative or other variations thereof or comparable terminology are intended to identify forward-looking statements. In addition, any statements that refer to projections of our future financial performance, trends in our businesses, or other characterizations of future events or circumstances are forward-looking statements.

The forward-looking statements included herein are based on current expectations of our management based on available information and involve a number of risks and uncertainties, all of which are difficult or impossible to predict accurately and many of which are beyond our control. As such, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under the section "Risk Factors" in our most recent Annual Report on Form 10-K. Readers should carefully review these risks, as well as the additional risks described in other documents we file from time to time with the Securities and Exchange Commission. In light of the significant risks and uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that such results will be achieved, and readers are cautioned not to place undue reliance on such forward-looking information. Except as required by law, we undertake no obligation to revise the forward-looking statements contained herein to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements.

TOMI ENVIRONMENTAL SOLUTIONS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEET

ASSETS

	September 30, 2019 (Unaudited)	December 31, 2018
Current Assets:		
Cash and Cash Equivalents	\$ 1,144,075	\$ 2,004,938
Accounts Receivable - net	1,174,188	2,145,622
Inventories (Note 3)	2,405,576	2,682,014
Deposits	219,130	109,441
Prepaid Expenses	286,149	301,797
Total Current Assets	<u>5,229,118</u>	<u>7,243,812</u>
Property and Equipment – net (Note 4)	1,437,904	1,588,591
Other Assets:		
Intangible Assets – net (Note 5)	1,016,892	1,235,816
Operating Lease - Right of Use Asset (Note - 6)	684,457	-
Capitalized Software Development Costs - net (Note 7)	119,419	-
Other Assets	105,860	11,395
Total Other Assets	<u>1,926,628</u>	<u>1,247,211</u>
Total Assets	<u>\$ 8,593,650</u>	<u>\$ 10,079,614</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities:		
Accounts Payable	\$ 428,974	\$ 1,133,649
Accrued Expenses and Other Current Liabilities (Note 12)	446,558	415,199
Accrued Officers Compensation	30,167	70,000
Accrued Interest (Note 8)	16,667	66,667
Customer Deposits	117,813	1,486
Current Portion of Long-Term Operating Lease	69,210	-
Deferred Rent	-	13,215
Convertible Notes Payable, net of discount of \$0 at September 30, 2019 (Note 8)	5,000,000	-
Total Current Liabilities	<u>6,109,389</u>	<u>1,700,216</u>
Long-Term Liabilities:		
Long-Term Operating Lease, Net of Current Portion (Note 6)	1,053,034	-
Deferred Rent and Tenant Improvement Allowances	-	401,734
Convertible Notes Payable, net of discount of \$17,534 at December 31, 2018 (Note 8)	-	4,982,466
Total Long-Term Liabilities	<u>1,053,034</u>	<u>5,384,200</u>
Total Liabilities	<u>7,162,423</u>	<u>7,084,416</u>
Commitments and Contingencies	-	-
Shareholders' Equity:		
Cumulative Convertible Series A Preferred Stock; par value \$0.01 per share, 1,000,000 shares authorized; 510,000 shares issued and outstanding at September 30, 2019 and December 31, 2018, respectively	5,100	5,100
Cumulative Convertible Series B Preferred Stock; \$1,000 stated value; 7.5% Cumulative dividend; 4,000 shares authorized; none issued and outstanding at September 30, 2019 and December 31, 2018, respectively	-	-
Common stock; par value \$0.01 per share, 200,000,000 shares authorized; 124,700,418 and 124,290,418 shares issued and outstanding at September 30, 2019 and December 31, 2018, respectively.	1,247,004	1,242,904
Additional Paid-In Capital	43,136,683	42,948,705
Accumulated Deficit	(42,957,560)	(41,201,511)
Total Shareholders' Equity	<u>1,431,227</u>	<u>2,995,198</u>
Total Liabilities and Shareholders' Equity	<u>\$ 8,593,650</u>	<u>\$ 10,079,614</u>

The accompanying notes are an integral part of the condensed consolidated 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,	
	2019	2018	2019	2018
Sales, net	\$ 1,600,387	\$ 1,947,570	\$ 4,491,719	\$ 4,506,508
Cost of Sales	460,008	912,466	1,616,680	1,961,935
Gross Profit	<u>1,140,379</u>	<u>1,035,104</u>	<u>2,875,039</u>	<u>2,544,573</u>
<b>Operating Expenses:</b>				
Professional Fees	82,945	78,684	297,349	270,856
Depreciation and Amortization	182,689	153,572	539,070	468,778
Selling Expenses	314,110	368,733	1,274,326	1,004,393
Research and Development	88,137	129,924	249,373	372,234
Equity Compensation Expense (Note 9)	-	-	87,033	12,685
Consulting Fees	31,799	19,711	87,066	93,089
General and Administrative	628,285	598,679	1,931,770	1,999,485
Total Operating Expenses	<u>1,327,965</u>	<u>1,349,302</u>	<u>4,465,987</u>	<u>4,221,520</u>
Loss from Operations	<u>(187,586)</u>	<u>(314,198)</u>	<u>(1,590,947)</u>	<u>(1,676,948)</u>
<b>Other Income (Expense):</b>				
Amortization of Debt Discounts	-	(7,851)	(17,534)	(23,792)
Induced Conversion Costs	-	-	-	(57,201)
Interest Income	773	1,893	2,432	4,842
Interest Expense	(50,000)	(53,000)	(150,000)	(168,878)
Total Other Income (Expense)	<u>(49,227)</u>	<u>(58,958)</u>	<u>(165,102)</u>	<u>(245,029)</u>
Net Loss	<u>\$ (236,813)</u>	<u>\$ (373,156)</u>	<u>\$ (1,756,049)</u>	<u>\$ (1,921,977)</u>
<b>Loss Per Common Share</b>				
Basic and Diluted	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>	<u>\$ (0.02)</u>
<b>Basic and Diluted Weighted Average Common Shares Outstanding</b>				
	<u>124,709,440</u>	<u>124,290,418</u>	<u>124,686,572</u>	<u>123,333,468</u>

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

**TOMI ENVIRONMENTAL SOLUTIONS, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2019**  
**(UNAUDITED)**

	Series A Preferred		Common Stock		Additional Paid in Capital	Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount			
Balance at December 31, 2018	510,000	\$ 5,100	124,290,418	\$ 1,242,904	\$42,948,705	\$(41,201,511)	\$ 2,995,198
Equity Compensation					146,878		146,878
Common Stock Issued for Services Provided			410,000	4,100	41,100		45,200
Net Loss for the nine months ended September 30, 2019						(1,756,049)	(1,756,049)
Balance at September 30, 2019	<u>510,000</u>	<u>\$ 5,100</u>	<u>124,700,418</u>	<u>\$ 1,247,004</u>	<u>\$43,136,683</u>	<u>\$(42,957,560)</u>	<u>\$ 1,431,227</u>

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

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

	For the Nine Months Ended September	
	2019	2018
<b>Cash Flow From Operating Activities:</b>		
Net Loss	\$ (1,756,049)	\$ (1,921,977)
Adjustments to Reconcile Net Loss to		
Net Cash Used In Operating Activities:		
Depreciation and Amortization	539,070	468,778
Amortization of Lease Liability	117,986	-
Amortization of Debt Discount	17,534	23,792
Amortization of Software Costs	6,285	-
Equity Compensation Expense	87,033	13,590
Value of Equity Issued for Services	45,200	37,500
Induced Conversion Costs	-	57,201
Reserve for Bad Debt	(190,000)	64,434
<b>Changes in Operating Assets and Liabilities:</b>		
Decrease (Increase) in:		
Accounts Receivable	1,161,434	(513,312)
Inventory	276,438	449,736
Prepaid Expenses	(20,217)	(103,149)
Deposits	(109,689)	(185,893)
Other Assets	(130,692)	(6,695)
Increase (Decrease) in:		
Accounts Payable	(704,675)	300,888
Accrued Expenses	91,204	129,117
Accrued Interest	(50,000)	(57,122)
Accrued Officer Compensation	(39,833)	-
Deferred Rent	-	(781)
Customer Deposits	116,327	(1,817)
Lease Liability	(29,888)	-
<b>Net Cash Used in Operating Activities</b>	<b>(572,533)</b>	<b>(1,245,650)</b>
<b>Cash Flow From Investing Activities:</b>		
Capitalized Software Costs	(125,704)	-
Capitalized Patent Costs	(21,980)	-
Costs Incurred from Construction In Progress	-	(99,629)
Purchase of Property and Equipment	(140,647)	(27,579)
<b>Net Cash Used in Investing Activities</b>	<b>(288,331)</b>	<b>(127,208)</b>

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



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

	For the Nine Months Ended September 30,	
	2019	2018
Cash Flow From Financing Activities:	-	-
(Decrease) In Cash and Cash Equivalents	(860,863)	(1,372,858)
Cash and Cash Equivalents - Beginning	2,004,938	4,550,003
Cash and Cash Equivalents – Ending	<u>\$ 1,144,075</u>	<u>\$ 3,177,145</u>
Supplemental Cash Flow Information:		
Cash Paid For Interest	<u>\$ 200,000</u>	<u>\$ 226,000</u>
Cash Paid for Income Taxes	<u>\$ 800</u>	<u>\$ 800</u>
Non-Cash Investing and Financing Activities:		
Equity Compensation as Consideration for Accrued Expenses	<u>\$ 59,845</u>	<u>\$ -</u>
Capitalization of patent costs reclassified from Other Assets	<u>\$ 36,227</u>	<u>\$ -</u>
Conversion of Convertible Note Payable and Accrued Interest into Common Stock	<u>\$ -</u>	<u>\$ 705,212</u>

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

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

**NOTE 1. DESCRIPTION OF BUSINESS**

TOMI Environmental Solutions, Inc., a Florida corporation ("TOMI", the "Company", "we", "our" and "us") is a global provider of disinfection and decontamination essentials through its premier Binary Ionization Technology® (BIT™) platform, under which it manufactures, licenses, services and sells its SteraMist™ brand of products, including SteraMist™ BIT™, a hydrogen peroxide-based mist and fog.

Invented under a defense grant in association with the Defense Advanced Research Projects Agency (DARPA) of the U.S. Department of Defense, BIT™ is registered with the U.S. Environmental Protection Agency ("EPA") and uses a low percentage hydrogen peroxide as its only active ingredient to produce a fog composed mostly of a hydroxyl radical (-OH ion), known as ionized Hydrogen Peroxide ("iHP™"). Represented by the SteraMist™ brand of products, iHP™ produces a germ-killing aerosol that works like a visual non-caustic gas.

TOMI's products are designed to service a broad spectrum of commercial structures, including, but not limited to, hospitals and medical facilities, bio-safety labs, pharmaceutical facilities, meat and produce processing facilities, universities and research facilities, vivarium labs, all service industries including cruise ships, office buildings, hotel and motel rooms, schools, restaurants, military barracks, police and fire departments, and athletic facilities. TOMI products are also used in single-family homes and multi-unit residences.

TOMI's mission is to help its customers create a healthier world through its product line in its divisions (Healthcare, Life Sciences, TOMI Service Network and Food Safety).

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

***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 financial 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, 2018 and notes thereto which are included in the Annual Report on Form 10-K previously filed with the SEC on April 1, 2019. The Company follows the same accounting policies in the preparation of interim reports. The results of operations for the interim periods covered by this Form 10-Q may not necessarily be indicative of results of operations for the full fiscal year or any other interim period.

The Company's convertible notes payable aggregating \$5,000,000 principal (see Note 8) are due April 3, 2020. As a result, the Company has a working capital deficiency of \$880,271 at September 30, 2019 and does not currently have sufficient resources to satisfy this debt when due. This raises substantial doubt about the Company's ability to continue as a going concern. The Company plans to raise additional capital in order to satisfy this debt when due.

The accompanying unaudited condensed consolidated financial statements do not include any adjustments related to the recoverability or classification of asset-carrying amounts or the amounts and classifications of liabilities that may result should the Company be unable to continue as a going concern.

## ***Principles of Consolidation***

The accompanying condensed consolidated financial statements include the accounts of TOMI and its wholly owned subsidiary, TOMI Environmental Solutions, Inc., a Nevada corporation. 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 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 accounts receivable, inventory, 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.

Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and convertible debt. All these items were determined to be Level 1 fair value measurements.

The carrying amounts of cash and cash 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 Note 8).

## ***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. At times, these deposits may be in excess of insured limits.

## **Accounts Receivable**

Our accounts receivable are credit worthy customers or, for certain international customers, are supported by pre-payments. For those customers to whom we extend credit, we perform periodic evaluations of them and maintain allowances for potential credit losses as deemed necessary. We have a policy of reserving for doubtful accounts based on our best estimate of the amount of potential credit losses in existing accounts receivable. We periodically review our accounts receivable to determine whether an allowance is necessary based on an analysis of past due accounts and other factors that may indicate that the realization of an account may be in doubt. Account balances deemed to be uncollectible are charged to the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Bad debt expense for the three and nine months ended September 30, 2019 was approximately \$1,000 and \$33,000, respectively. Bad debt expense for the three and nine months ended September 30, 2018 was approximately \$0 and \$64,000, respectively.

At September 30, 2019 and December 31, 2018, the allowance for doubtful accounts was \$110,000 and \$300,000, respectively.

As of September 30, 2019, two customers accounted for 22% of accounts receivable. As of December 31, 2018, two customers accounted for 37% of accounts receivable.

One customer accounted for 12% and 32% of net revenue for the three months ended September 30, 2019 and 2018, respectively.

One customer accounted for 10% and 16% of net revenue for the nine months ended September 30, 2019 and 2018, respectively.

## **Inventories**

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

We expense costs to maintain certification to cost of goods sold as incurred.

We review inventory on an ongoing basis, considering factors such as deterioration and obsolescence. We record an allowance for estimated losses when the facts and circumstances indicate that particular inventories may not be usable. Our reserve for obsolete inventory was \$100,000 as of September 30, 2019 and December 31, 2018.

## **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. Leasehold improvements are amortized using the straight-line method over the lives of the respective leases or service lives of the improvements, whichever is shorter.

## **Leases**

In February 2016, the FASB issued ASU No. 2016-02 ("ASC 842"), *Leases*, to require lessees to recognize all leases, with certain exceptions, on the balance sheet, while recognition on the statement of operations will remain similar to current lease accounting. Subsequently, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*, ASU No. 2018-11, *Targeted Improvements*, ASU No. 2018-20, *Narrow-Scope Improvements for Lessors*, and ASU 2019-01, *Codification Improvements*, to clarify and amend the guidance in ASU No. 2016-02. ASC 842 eliminates real estate-specific provisions and modifies certain aspects of lessor accounting. This standard is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted. We adopted ASC 842 as of January 1, 2019 using the modified retrospective basis with a cumulative effect adjustment as of that date. In addition, we elected the package of practical expedients permitted under the transition guidance within the new standard, which allowed us to carry forward the historical determination of contracts as leases, lease classification and not reassess initial direct costs for historical lease arrangements. Accordingly, previously reported financial statements, including footnote disclosures, have not been recast to reflect the application of the new standard to all comparative periods presented.

Operating lease assets are included within operating lease right-of-use assets, and the corresponding operating lease liabilities are recorded as current portion of long-term operating lease, and within long-term liabilities as long-term operating lease, net of current portion on our condensed consolidated balance sheet as of September 30, 2019.

We have elected not to present short-term leases on the consolidated balance sheet as these leases have a lease term of 12 months or less at lease inception and do not contain purchase options or renewal terms that we are reasonably certain to exercise. All other lease assets and lease liabilities are recognized based on the present value of lease payments over the lease term at commencement date. Because most of our leases do not provide an implicit rate of return, we used our incremental borrowing rate based on the information available at adoption date in determining the present value of lease payments.

Adoption of the new lease standard on January 1, 2019 had a material impact on our interim unaudited condensed consolidated financial statements. The most significant impacts related to the recognition of right-of-use ("ROU") asset of \$714,421 and lease liability of \$678,556 for our operating lease on the consolidated balance sheet. We also reclassified prepaid expenses of \$35,865 and deferred rent balance, including tenant improvement allowances, and other liability balances of \$414,949 relating to our existing lease arrangements as of December 31, 2018, into the ROU asset balance as of January 1, 2019. ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. The standard did not materially impact our consolidated statement of operations and consolidated statement of cash flows.

The cumulative effect of the changes made to our consolidated balance sheet as of January 1, 2019 for the adoption of the new lease standard was as follows:

	<u>Balances at December 31, 2018</u>	<u>Effect of Adoption of New Lease Standard</u>	<u>Balances at January 1, 2019</u>
<b>Assets</b>			
Prepaid Expenses	\$ 301,797	\$ (35,865)	\$ 265,932
Operating Lease Right of Use Asset	\$ -	\$ 714,421	\$ 714,421
<b>Liabilities</b>			
Deferred Rent	\$ 13,215	\$ (13,215)	\$ -
Current Portion of Long-Term Operating Lease	\$ -	\$ -	\$ -
Deferred Rent and Tenant Improvement Allowances	\$ 401,734	\$ (401,734)	\$ -
Long-Term Operating Lease, Net of Current Portion	\$ -	\$ 1,093,505	\$ 1,093,505
<b>Shareholders' Equity</b>			
Accumulated Deficit	\$ (41,201,511)	\$ -	\$ (41,201,511)

#### **Capitalized Software Development Costs**

In accordance with ASC 985-20 regarding the development of software to be sold, leased, or marketed, the Company expenses such costs as they are incurred until technological feasibility has been established, at and after which time those costs are capitalized until the product is available for general release to customers. The periodic expense for the amortization of capitalized software development costs will be included in cost of sales. Amortization expense for the three and nine months ended September 30, 2019 was \$6,285.

### **Accounts Payable**

As of September 30, 2019, two vendors accounted for approximately 27% of accounts payable. As of December 31, 2018, three vendors accounted for approximately 63% of accounts payable.

For the three and nine months ended September 30, 2019, one vendor accounted for 54% and 68% of cost of sales, respectively. For the three and nine months ended September 30, 2018, one vendor accounted for 80% and 76% of cost of sales, respectively.

### **Accrued Warranties**

Accrued warranties represent the estimated costs, if any, that will be incurred during the warranty period of our products. We estimate the expected costs to be incurred during the warranty period and record the expense to the consolidated statement of operations at the date of sale. Our manufacturer assumes the warranty against product defects for one year from date of sale, which we extend to our customers upon sale of the product. We assume responsibility for product reliability and results. As of September 30, 2019 and December 31, 2018, our warranty reserve was \$30,000 (See Note 13).

### **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 that are, on a more likely than not basis, not expected to be realized in accordance with Accounting Standards Codification ("ASC") guidance for income taxes. Net deferred tax benefits have been fully reserved at September 30, 2019 and December 31, 2018. 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.

### **Net Loss Per Share**

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

Potentially dilutive securities as of September 30, 2019 consisted of 9,259,250 shares of common stock from convertible debentures, 21,340,523 shares of common stock issuable upon exercise of outstanding warrants, 620,000 shares of common stock issuable upon outstanding options and 510,000 shares of common stock issuable upon conversion of outstanding shares of Preferred A stock ("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, 2018 consisted of 9,814,805 shares of common stock from convertible debentures, 26,375,611 shares of common stock issuable upon exercise of outstanding warrants, 320,000 shares of common stock issuable upon outstanding options and 510,000 shares of common stock issuable upon conversion of outstanding shares of Convertible Series A Preferred Stock. Diluted and basic weighted average shares are the same, as potentially dilutive shares are anti-dilutive.

Diluted net loss per share is computed similarly to basic net loss per share except that the denominator is increased to include the number of additional shares of common stock that would have been outstanding if the potential shares of common stock had been issued and if such additional shares were dilutive. Options, warrants, preferred stock and shares associated with the conversion of debt to purchase approximately 31.7 million and 36.6 million shares of common stock were outstanding at September 30, 2019 and December 31, 2018, respectively, but were excluded from the computation of diluted net loss per share due to the anti-dilutive effect on net loss per share.

	For the Three Months Ended September 30, (Unaudited)	
	2019	2018
Net loss	\$ (236,813)	\$ (373,158)
Adjustments for convertible debt - as converted		
Interest on convertible debt	50,000	53,000
Amortization of debt discount on convertible debt	-	7,851
Net loss attributable to common shareholders	<u>\$ (186,813)</u>	<u>\$ (312,307)</u>
Weighted average number of shares of common stock outstanding:		
Basic and diluted	<u>124,709,440</u>	<u>124,290,418</u>
Net loss attributable to common shareholders per share:		
Basic and diluted	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>

	For the Nine Months Ended September 30, (Unaudited)	
	2019	2018
Net loss	\$ (1,756,049)	\$ (1,921,977)
Adjustments for convertible debt - as converted		
Interest on convertible debt	150,000	168,878
Amortization of debt discount on convertible debt	17,534	23,792
Net loss attributable to common shareholders	<u>\$ (1,588,515)</u>	<u>\$ (1,729,307)</u>
Weighted average number of shares of common stock outstanding:		
Basic and diluted	<u>124,686,572</u>	<u>123,333,468</u>
Net loss attributable to common shareholders per share:		
Basic and diluted	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>

### Revenue Recognition

We recognize revenue in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, when there is persuasive evidence that an arrangement exists, title and risk of loss have passed, delivery has occurred, or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to our customers upon shipment.

### Disaggregation of Revenue

The following table presents our revenues disaggregated by revenue source.

Net Revenue

Product and Service Revenue

	For the three months ended September 30, (Unaudited)	
	2019	2018
	\$ 928,000	\$ 1,613,000
Service and Training	672,000	335,000
Total	\$ 1,600,000	\$ 1,948,000

	For the nine months ended September 30, (Unaudited)	
	2019	2018
	\$ 3,461,000	\$ 3,723,000
Service and Training	1,031,000	784,000
Total	\$ 4,492,000	\$ 4,507,000

Revenue by Geographic Region

	For the three months ended September 30, (Unaudited)	
	2019	2018
	\$ 1,288,000	\$ 1,754,000
International	312,000	194,000
Total	\$ 1,600,000	\$ 1,948,000

	For the nine months ended September 30, (Unaudited)	
	2019	2018
	\$ 3,852,000	\$ 3,545,000
International	640,000	962,000
Total	\$ 4,492,000	\$ 4,507,000

Product revenue includes sales from our standard and customized equipment, solution and accessories sold with our equipment. Revenue is recognized upon transfer of control of promised products to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services.

Service and training revenue include sales from our high-level decontamination and service engagements, validation of our equipment and technology and customer training. Service revenue is recognized as the agreed upon services are rendered to our customers in an amount that reflects the consideration we expect to receive in exchange for those services.

Costs to Obtain a Contract with a Customer

We apply a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within selling expenses.



### *Contract Balances*

As of September 30, 2019, and December 31, 2018 we did not have any unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

### *Arrangements with Multiple Performance Obligations*

Our contracts with customers may include multiple performance obligations. We enter into contracts that can include various combinations of products and services, which are primarily distinct and accounted for as separate performance obligations.

### *Significant Judgments*

Our contracts with customers for products and services often dictate the terms and conditions of when the control of the promised products or services is transferred to the customer and the amount of consideration to be received in exchange for the products and services.

### **Equity Compensation Expense**

We account for equity compensation expense using the Black Scholes model in accordance with FASB ASC 718, "Compensation Stock Compensation." Under the provisions of FASB ASC 718, equity compensation expense is estimated at the grant date based on the award's fair value.

On July 7, 2017, our shareholders approved the 2016 Equity Incentive Plan (the "2016 Plan"). The 2016 Plan authorizes the grant of stock options, stock appreciation rights, restricted stock, restricted stock units and performance units/shares. Up to 5,000,000 shares of common stock are authorized for issuance under the 2016 Plan. Shares issued under the 2016 Plan may be either authorized but unissued shares, treasury shares, or any combination thereof. Provisions in the 2016 Plan permit the reuse or reissuance by the 2016 Plan of shares of common stock for numerous reasons, including, but not limited to, shares of common stock underlying canceled, expired, or forfeited awards of stock-based compensation and stock appreciation rights paid out in the form of cash. Equity compensation expense will typically be awarded in consideration for the future performance of services to us. All recipients of awards under the 2016 Plan are required to enter into award agreements with the Company at the time of the award; awards under the 2016 Plan are expressly conditioned upon such agreements. For the nine months ended September 30, 2019 and 2018, we issued 400,000 and 300,000 shares of common stock, respectively, out of the 2016 Plan.

### **Concentrations of Credit Risk**

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash and cash equivalents. We maintain cash balances at financial institutions which exceed the current Federal Deposit Insurance Corporation limit of \$250,000 at times during the year.

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

We assess 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, we measure recoverability of these assets by comparing the carrying amounts to the future undiscounted cash flows the assets are expected to generate. If our 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. We base the calculations of the estimated fair value of our long-lived assets on the income approach. For the income approach, we use an internally developed discounted cash flow model that includes, 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 had no long-lived asset impairment charges for the three and nine months ended September 30, 2019 and 2018.

### **Advertising and Promotional Expenses**

We expense advertising costs in the period in which they are incurred. Advertising and promotional expenses included in selling expenses for the three and nine months ended September 30, 2019 were approximately \$29,000 and \$94,000, respectively. Advertising and promotional expenses included in selling expenses for the three and nine months ended September 30, 2018 were approximately \$44,000 and \$156,000, respectively.

### **Research and Development Expenses**

We expense research and development expenses in the period in which they are incurred. For the three and nine months ended September 30, 2019, research and development expenses were approximately \$88,000 and \$249,000, respectively. For the three and nine months ended September 30, 2018, research and development expenses were approximately \$130,000 and \$372,000, respectively.

### **Shipping and Handling Costs**

We include shipping and handling costs relating to the delivery of products directly from vendors to the Company in cost of sales. Other shipping and handling costs, including third-party delivery costs relating to the delivery of products to customers, are classified as a general and administrative expense. Shipping and handling costs included in general and administrative expense were approximately \$59,000 and \$138,000 for the three and nine months ended September 30, 2019, respectively. Shipping and handling costs included in general and administrative expense were approximately \$52,000 and \$143,000 for the three and nine months ended September 30, 2018, respectively.

### **Business Segments**

We currently have one reportable business segment due to the fact that we derive our revenue primarily from one product. A breakdown of revenue is presented in "Revenue Recognition" in Note 2 above.

### **Recent Accounting Pronouncements**

In January 2017, the FASB issued ASU No. 2017-04, *Simplifying the Test for Goodwill Impairment*, to simplify the test for goodwill impairment by removing Step 2. An entity will, therefore, perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, recognizing an impairment charge for the amount by which the carrying amount exceeds the fair value, not to exceed the total amount of goodwill allocated to the reporting unit. An entity still has the option to perform a qualitative assessment to determine if the quantitative impairment test is necessary. ASU No. 2017-04 is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Adoption of ASU No. 2017-04 is prospective.

### **NOTE 3. INVENTORIES**

Inventories consist of the following at:

	September 30, 2019 (Unaudited)	December 31, 2018
Finished goods	\$ 2,475,891	\$ 2,782,014
Raw Materials	29,685	-
Inventory Reserve	(100,000)	(100,000)
	<u>\$ 2,405,576</u>	<u>\$ 2,682,014</u>

#### NOTE 4. PROPERTY AND EQUIPMENT

Property and equipment consist of the following at:

	September 30, 2019 (Unaudited)	December 31, 2018
Furniture and fixtures	\$ 357,236	\$ 277,976
Equipment	1,336,440	1,300,139
Vehicles	60,703	60,703
Computer and software	161,665	143,579
Leasehold improvements	362,898	355,898
Tenant Improvement Allowance	405,000	405,000
	<u>2,683,942</u>	<u>2,543,295</u>
Less: Accumulated depreciation	1,246,038	954,704
	<u>\$ 1,437,904</u>	<u>\$ 1,588,591</u>

For the three and nine months ended September 30, 2019, depreciation was \$90,312 and \$261,939, respectively. For the three and nine months ended September 30, 2018, depreciation was \$61,195 and \$191,647, respectively. For the three and nine months ended September 30, 2019, amortization of tenant improvement allowance was \$9,798 and \$29,395, respectively and was recorded as lease expense and included within general and administrative expense on the consolidated statement of operations.

#### NOTE 5. INTANGIBLE ASSETS

Intangible assets consist of patents and trademarks related to our Binary Ionization Technology. We amortize the patents over the estimated remaining lives of the related patents. The trademarks have an indefinite life. Amortization expense was \$92,377 and \$277,131 for the three and nine months ended September 30, 2019 and 2018, respectively.

Definite life intangible assets consist of the following:

	September 30, 2019 (Unaudited)	December 31, 2018
Intellectual Property and Patents	\$ 2,906,507	\$ 2,848,300
Less: Accumulated Amortization	2,386,407	2,109,276
Intangible Assets, net	<u>\$ 520,100</u>	<u>\$ 739,024</u>

Indefinite life intangible assets consist of the following:

Trademarks	\$ 496,792	496,792
Total Intangible Assets, net	<u>\$ 1,016,892</u>	<u>\$ 1,235,816</u>

Approximate future amortization is as follows:

**Year Ended:**

October 1 – December 31, 2019	\$ 93,000
December 31, 2020	373,000
December 31, 2021	3,000
December 31, 2022	3,000
December 31, 2023	3,000
Thereafter	45,000
	<u>\$ 520,000</u>

**NOTE 6. LEASES**

In April 2018, we entered into a 10-year lease agreement for a new 9,000-square-foot facility that contains office, warehouse, lab and research and development space in Frederick, Maryland. The lease agreement was scheduled to commence on December 1, 2018 or when the property was ready for occupancy. The agreement provided for annual rent of \$143,460, an escalation clause that increases the rent 3% year over year, a landlord tenant improvement allowance of \$405,000 and additional landlord work as discussed in the lease agreement. We took occupancy of the property on December 17, 2018 and the lease was amended in March 2019 to provide for a 4-month rent holiday and a commencement date of April 1, 2019. Lease expense for operating lease payments is recognized on a straight-line basis over the lease term.

The balances for our operating lease where we are the lessee are presented as follows within our condensed consolidated balance sheet:

	<b>September 30, 2019</b>
	<u>(Unaudited)</u>
<b>Operating leases:</b>	
<b>Assets:</b>	
Operating lease right-of-use asset	<u>\$ 684,457</u>
<b>Liabilities:</b>	
Current Portion of Long-Term Operating Lease	\$ 69,210
Long-Term Operating Lease, Net of Current Portion	\$ 1,053,034
	<u>\$ 1,122,244</u>

The components of lease expense are as follows within our condensed consolidated statement of operations:

	<b>Three Months Ended September 30, 2019</b>	<b>Nine Months Ended September 30, 2019</b>
	<u>(Unaudited)</u>	<u>(Unaudited)</u>
Operating lease expense	<u>\$ 39,329</u>	<u>\$ 117,986</u>

Other information related to leases where we are the lessee is as follows:

	<b>September 30, 2019 (Unaudited)</b>
Weighted-average remaining lease term:	
Operating leases	9.50 years
Discount rate:	
Operating leases	7.00%

Supplemental cash flow information related to leases where we are the lessee is as follows:

	<b>Three Months Ended September 30, 2019 (Unaudited)</b>	<b>Nine Months Ended September 30, 2019 (Unaudited)</b>
Cash paid for amounts included in the measurement of lease liabilities:	<u>\$ 29,888</u>	<u>\$ 29,888</u>

As of September 30, 2019, the maturities of our operating lease liability are as follows:

<b>Year Ended:</b>	<b>Operating Lease</b>
October 1 – December 31, 2019	\$ 35,865
December 31, 2020	146,688
December 31, 2021	151,088
December 31, 2022	155,621
December 31, 2023	160,290
Thereafter	910,280
Total minimum lease payments	1,559,833
Less: Interest	437,589
Present value of lease obligations	1,122,244
Less: Current portion	69,210
Long-term portion of lease obligations	<u>\$ 1,053,034</u>

As previously reported in our Annual Report on Form 10-K for the year ended December 31, 2018 and under legacy lease accounting (ASC 840), future minimum lease payments under non-cancellable leases as of December 31, 2018 were as follows:

<b>Year Ended:</b>	<b>Operating Lease</b>
December 31, 2019	\$ 102,000
December 31, 2020	147,000
December 31, 2021	151,000
December 31, 2022	156,000
December 31, 2023	160,000
Thereafter	923,000
	<u>\$ 1,639,000</u>

## NOTE 7. CAPITALIZED SOFTWARE DEVELOPMENT COSTS

In accordance with ASC 985-20 we capitalized certain software development costs associated with updating our continuing line of product offerings. Capitalized software development costs consist of the following at:

	September 30, 2019 (Unaudited)	December 31, 2018
Capitalized Software Development Costs	\$ 125,704	\$ -
Less: Accumulated Amortization	(6,285)	-
	<u>\$ 119,419</u>	<u>\$ -</u>

Amortization expense for the three and nine months ended September 30, 2019 was \$6,285.

## NOTE 8. CONVERTIBLE DEBT

In March and May 2017, we closed a private placement transaction in which we issued to certain accredited investors unregistered senior callable convertible promissory notes (the "Notes") and three-year warrants to purchase an aggregate of 999,998 shares of common stock at an exercise price of \$0.69 per share in exchange for aggregate gross proceeds of \$6,000,000. The Notes bear interest at a rate of 4% per annum. \$5,300,000 in principal was originally scheduled to mature on August 31, 2018 and \$700,000 in principal was originally scheduled to mature on November 8, 2018, unless earlier redeemed, repurchased or converted. The Notes are convertible at the option of the holder into common stock at a conversion price of \$0.54 per share. Subsequent to September 1, 2017, we may redeem the Notes that are scheduled to mature on August 31, 2018 at any time prior to maturity at a price equal to 100% of the outstanding principal amount of the Notes to be redeemed, plus accrued and unpaid interest as of the redemption date. Prior to November 8, 2018, we may redeem the Notes that are scheduled to mature on such date at any time prior to maturity at a price equal to 100% of the outstanding principal amount of the Notes to be redeemed, plus accrued and unpaid interest as of the redemption date. Interest on the Notes is payable semi-annually in cash on February 28 and August 31 of each year, beginning on August 31, 2017. Interest expense related to the Notes for the three and nine months ended September 30, 2019 was \$50,000 and \$150,000, respectively. Interest expense related to the Notes for the three and nine months ended September 30, 2018 was \$53,000 and \$168,878, respectively.

The warrants were valued at \$62,559 using the Black-Scholes pricing model with the following assumptions: expected volatility: 104.06%–111.54%; expected dividend: \$0; expected term: 3 years; and risk-free rate: 1.49%–1.59%. We recorded the warrants' relative fair value of \$61,904 as an increase to additional paid-in capital and a discount against the related Notes.

The debt discount was amortized over the life of the Notes using the effective interest method. Amortization expense for the three and nine months ended September 30, 2019 was \$0 and \$17,534, respectively. Amortization expense for the three and nine months ended September 30, 2018 was \$7,851 and \$23,792, respectively.

In February and March 2018, we extended the maturity date of the Notes— we extended the maturity date to April 1, 2019 for \$5,300,000 of principal on the Notes and to June 8, 2019 for the remaining \$700,000 Note. No additional consideration was paid or accrued by us. The stated rate of the Notes was unchanged, and the estimated fair value of the new debt approximates its carrying amount (principal plus accrued interest at the date of the modification). We determined that the modification of these Notes is not a substantial modification in accordance with ASC 470-50, "Modifications and Extinguishments".

In May 2018, we offered a noteholder the option to convert its Note at a reduced conversion price of \$0.46. The noteholder accepted and converted at such price. Pursuant to the terms of the conversion offer, an aggregate of \$700,000 of principal and \$5,212 of accrued interest outstanding under the Note were converted into 1,877,960 shares of common stock. We recognized an induced conversion cost of \$57,201 related to the conversion.

In December 2018, a noteholder redeemed a note with a principal balance of \$300,000 in exchange for \$150,000 in cash. We recognized a gain on redemption of convertible note income in the amount of \$150,000 as a result of the transaction.

On March 30, 2019, the two-remaining noteholders agreed to extend the maturity dates of their notes totaling \$5,000,000 to April 3, 2020. As part of the extensions, we agreed that if we do not make payment on or before the new maturity dates, after five (5) days written notice, the holders will have the right, but not the obligation, to convert the notes into our common shares at a conversion price of \$0.11 per share or a total of 45,454,545 shares. All other provisions of the notes remain unchanged. We determined that the modification of these Notes is not a substantial modification in accordance with ASC 470-50, "Modifications and Extinguishments". At September 30, 2019, the convertible notes payable with a maturity of April 3, 2020 is classified as a current liability on our balance sheet.

Convertible notes consist of the following at:

	September 30, 2019 (Unaudited)	December 31, 2018
Convertible notes	\$ 5,000,000	\$ 5,000,000
Initial discount	(53,873)	(53,873)
Accumulated amortization	53,873	36,339
Convertible notes, net	<u>\$ 5,000,000</u>	<u>\$ 4,982,466</u>

#### NOTE 9. SHAREHOLDERS' EQUITY

Our Board of Directors (the "Board") may, without further action by our shareholders, 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 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**

Our authorized Convertible Series A Preferred Stock, \$0.01 par value, consists of 1,000,000 shares. At September 30, 2019 and December 31, 2018, there were 510,000 shares issued and outstanding. 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**

Our authorized Convertible Series B Preferred Stock, \$1,000 stated value, 7.5% cumulative dividend, consists of 4,000 shares. At September 30, 2019 and December 31, 2018, there were no shares issued and outstanding, respectively. Each share of Convertible Series B Preferred Stock may be converted (at the holder's election) into two hundred shares of our common stock.

### **Common Stock**

During the nine months ended September 30, 2018, we issued 362,500 shares of common stock valued at \$37,500 to members of our board of directors (see Note 11).

In May 2018, we issued 1,877,960 shares of common stock in connection with the conversion of \$705,212 of principal and accrued interest outstanding under a Note (see Note 8).

During the nine months ended September 30, 2019, we issued 400,000 shares of common stock valued at \$44,000 to members of our board of directors (see Note 11). During the nine months ended September 30, 2019, we issued 10,000 shares of common stock valued at \$1,200 to a consultant.

### **Stock Options**

In January 2018, we issued options to purchase an aggregate of 100,000 shares of common stock to our Chief Operating Officer, valued at \$11,780. The options have an exercise price of \$0.12 per share and expire in January 2023. The options were valued using the Black-Scholes model using the following assumptions: volatility: 146%; dividend yield: 0%; zero coupon rate: 2.27%; and a life of 5 years.

In January 2018, we issued options to purchase an aggregate of 20,000 shares of common stock to our Scientific Advisory Board members, valued at \$1,810 in total. The options have an exercise price of \$0.10 per share and expire in January 2028. The options were valued using the Black-Scholes model using the following assumptions: volatility: 147%; dividend yield: 0%; zero coupon rate: 2.41%; and a life of 10 years.

In January 2019, pursuant to an employment agreement, we issued options to purchase an aggregate of 250,000 shares of common stock to our Chief Operating Officer, valued at \$24,694. The options have an exercise price of \$0.11 per share and expire in January 2024. The options were valued using the Black-Scholes model using the following assumptions: volatility: 144%; dividend yield: 0%; zero coupon rate: 2.47%; and a life of 5 years. The value of the options was expensed in the fourth quarter of 2018 and included in accrued expenses at December 31, 2018.

In January 2019, we issued options to purchase an aggregate of 50,000 shares of common stock to our Chief Financial Officer, valued at \$4,483. The options have an exercise price of \$0.10 per share and expire in January 2024. The options were valued using the Black-Scholes model using the following assumptions: volatility: 143%; dividend yield: 0%; zero coupon rate: 2.58%; and a life of 5 years.



The following table summarizes stock options outstanding as of September 30, 2019 and December 31, 2018:

	September 30, 2019 (Unaudited)		December 31, 2018	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of period	320,000	\$ 0.52	200,000	\$ 0.76
Granted	300,000	0.11	120,000	0.12
Exercised	—	—	—	—
Outstanding, end of period	<u>620,000</u>	<u>\$ 0.32</u>	<u>320,000</u>	<u>\$ 0.52</u>

Options outstanding and exercisable by price range as of September 30, 2019 were as follows:

Outstanding Options		Average Weighted Remaining Contractual Life in Years	Exercisable Options	
Range	Number		Number	Weighted Average Exercise Price
\$ 0.05	20,000	1.28	20,000	\$ 0.05
\$ 0.10	70,000	5.47	70,000	\$ 0.10
\$ 0.11	250,000	4.26	250,000	\$ 0.11
\$ 0.12	100,000	3.28	100,000	\$ 0.12
\$ 0.27	40,000	5.26	40,000	\$ 0.27
\$ 0.55	100,000	6.35	100,000	\$ 0.55
\$ 2.10	40,000	0.26	40,000	\$ 2.10
	<u>620,000</u>	<u>4.29</u>	<u>620,000</u>	<u>\$ 0.32</u>

#### Stock Warrants

We did not issue any warrants during the nine months ended September 30, 2018.

In January 2019 we issued a warrant to purchase 1,000,000 shares of common stock to the CEO at an exercise price of \$0.10 per share pursuant to an employment agreement. The warrant was valued at \$89,654 and has a term of 5 years. We utilized the Black-Scholes model to fair value the warrant received by the CEO with the following assumptions: volatility, 143%; expected dividend yield, 0%; risk free interest rate, 2.58%; and a life of 5 years. The grant date fair value of each share of common stock underlying the warrant was \$0.09.

In January 2019 we issued a warrant to purchase 250,000 shares of common stock to an employee at an exercise price of \$0.12 per share. The warrant was valued at \$21,931 and has a term of 3 years. We utilized the Black-Scholes model to fair value the warrant received by the employee with the following assumptions: volatility, 148%; expected dividend yield, 0%; risk free interest rate, 2.55%; and a life of 3 years. The grant date fair value of each share of common stock underlying the warrant was \$0.09. The value of the warrants was expensed in the fourth quarter of 2018 and included in accrued expenses at December 31, 2018.

In April 2019 we issued a warrant to purchase 50,000 shares of common stock to an employee at an exercise price of \$0.14 per share. The warrant was valued at \$6,116 and has a term of 5 years. We utilized the Black-Scholes model to fair value the warrant received by the employee with the following assumptions: volatility, 134%; expected dividend yield, 0%; risk free interest rate, 2.32%; and a life of 5 years. The grant date fair value of each share of common stock underlying the warrant was \$0.12.

The following table summarizes the outstanding common stock warrants as of September 30, 2019 and December 31, 2018:

	September 30, 2019 (Unaudited)		December 31, 2018	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of period	26,550,611	\$ 0.34	35,501,411	\$ 0.33
Granted	1,300,000	0.11	250,000	0.08
Exercised	-	-	-	-
Expired	(6,510,088)	(0.29)	(9,200,800)	(0.30)
Outstanding, end of period	<u>21,340,523</u>	<u>\$ 0.34</u>	<u>26,550,611</u>	<u>\$ 0.34</u>

Warrants outstanding and exercisable by price range as of September 30, 2019 were as follows:

Outstanding Warrants			Exercisable Warrants		
Exercise Price	Number	Average Weighted Remaining Contractual Life in Years	Number	Weighted Average Exercise Price	
\$ 0.08	250,000	4.15	250,000	\$	0.08
\$ 0.10	1,265,000	4.01	1,265,000	\$	0.10
\$ 0.12	3,750,000	3.17	3,750,000	\$	0.12
\$ 0.12	4,000,000	0.04	4,000,000	\$	0.12
\$ 0.14	50,000	4.55	50,000	\$	0.14
\$ 0.17	10,000	3.07	10,000	\$	0.17
\$ 0.27	250,000	2.25	250,000	\$	0.27
\$ 0.29	4,615,525	2.41	4,615,525	\$	0.29
\$ 0.30	2,300,000	0.89	2,300,000	\$	0.30
\$ 0.32	250,000	2.00	250,000	\$	0.32
\$ 0.42	250,000	1.75	250,000	\$	0.42
\$ 0.50	250,000	1.50	250,000	\$	0.50
\$ 0.55	100,000	1.33	100,000	\$	0.55
\$ 0.69	999,998	0.47	999,998	\$	0.69
\$ 1.00	3,000,000	0.59	3,000,000	\$	1.00
	<u>21,340,523</u>	<u>1.68</u>	<u>21,340,523</u>	\$	<u>0.34</u>

There were no unvested warrants outstanding as of September 30, 2019.

## **NOTE 10. COMMITMENTS AND CONTINGENCIES**

### ***Legal Contingencies***

We may become a party to litigation in the normal course of business. In the opinion of management, there are no legal matters involving us that would have a material adverse effect upon our financial condition, results of operations or cash flows. In addition, from time to time, we may have to file claims against parties that infringe on our intellectual property.

### ***Product Liability***

As of September 30, 2019, and December 31, 2018, there were no claims against us for product liability.

## **NOTE 11. CONTRACTS AND AGREEMENTS**

### ***Agreements with Directors***

In December 2017, we increased the annual board fee to directors to \$40,000, to be paid in cash on a quarterly basis, with the exception of the audit committee chairperson, whose annual fee we increased to \$45,000, also to be paid in cash on a quarterly basis. Director compensation also includes the annual issuance of our common stock.

For the nine months ended September 30, 2018, we issued an aggregate of 362,500 shares of common stock that were valued at \$37,500 to members of our board of directors.

For the nine months ended September 30, 2019, we issued an aggregate of 400,000 shares of common stock that were valued at \$44,000 to members of our board of directors.

### ***Other Agreements***

In June 2015, we launched the TOMI Service Network ("TSN"). The TSN is a national service network composed of existing full-service restoration industry specialists that have entered into licensing agreements with us to become Primary Service Providers ("PSPs"). The licensing agreements grant protected territories to PSPs to perform services using our SteraMist™ platform of products and also provide for potential job referrals to PSPs whereby we are entitled to referral fees. Additionally, the agreement provides for commissions due to PSPs for equipment and solution sales they facilitate to other service providers in their respective territories. As part of these agreements, we are obligated to provide to the PSPs various training, ongoing support and facilitate a referral network call center. As of September 30, 2019, we had entered into 93 licensing agreements in connection with the launch of the TSN. The licensing agreements contain fixed price minimum equipment and solution orders based on the population of the territories granted pursuant to the licensing agreements. The nature and terms of our TSN agreements may represent multiple deliverable arrangements. Each of the deliverables in these arrangements typically represent a separate unit of accounting.

**NOTE 12. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consisted of the following at:

	September 30, 2019 (Unaudited)	December 31, 2018
Commissions	\$ 136,287	\$ 136,631
Payroll and related costs	173,475	144,359
Director fees	41,250	41,250
Sales Tax Payable	3,652	11,296
Accrued warranty (Note 13)	30,000	30,000
Other accrued expenses	61,894	51,663
Total	<u>\$ 446,558</u>	<u>\$ 415,199</u>

**NOTE 13. ACCRUED WARRANTY**

Our manufacturer assumes warranty against product defects for one year from the sale to customers, which we extend to our customers upon sale of the product. We assume responsibility for product reliability and results. The warranty is generally limited to a refund of the original purchase price of the product or a replacement part. We estimate warranty costs based on historical warranty claim experience.

The following table presents warranty reserve activities at:

	September 30, 2019 (Unaudited)	December 31, 2018
Beginning accrued warranty costs	\$ 30,000	\$ 5,000
Provision for warranty expense	1,839	47,454
Settlement of warranty claims	(1,839)	(22,454)
Ending accrued warranty costs	<u>\$ 30,000</u>	<u>\$ 30,000</u>

**NOTE 14. CUSTOMER CONCENTRATION**

The Company had certain customers whose revenue individually represented 10% or more of the Company's total revenue, or whose accounts receivable balances individually represented 10% or more of the Company's accounts receivable.

As of September 30, 2019, two customers accounted for 22% of accounts receivable. As of December 31, 2018, two customers accounted for 37% of accounts receivable.

One customer accounted for 12% and 32% of net revenue for the three months ended September 30, 2019 and 2018, respectively.

One customer accounted for 10% and 16% of net revenue for the nine months ended September 30, 2019 and 2018, respectively.

**NOTE 15. SUBSEQUENT EVENTS**

In November 2019, we filed an amendment to our Restated Articles of Incorporation, increasing the number of authorized shares of our Common Stock from 200,000,000 to 250,000,000.

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

*You should read the following discussion of our financial condition and results of operations in conjunction with the condensed consolidated financial statements and the related notes included elsewhere in this Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the SEC. In addition to our historical condensed consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Form 10-Q, particularly in Part II, Item 1A, "Risk Factors."*

### **Overview**

TOMI Environmental Solutions, Inc. ("TOMI", "we" and "our") is a global provider of disinfection and decontamination essentials through our premier Binary Ionization Technology® (BIT™) platform, under which we manufacture, license, service and sell our SteraMist® brand of products, including SteraMist® BIT™, a hydrogen peroxide-based fog or mist.

TOMI's SteraMist is a patented technology that produces ionized Hydrogen Peroxide (iHP™) using plasma science invented by the United States Defense Advanced Research Projects Agency (DARPA). TOMI's EPA registered BIT™ Solution is composed of a low concentration of hydrogen peroxide and converts it to iHP™ after passing the trade secret blended solution including its sole active ingredient of 7.8% hydrogen peroxide through an atmospheric cold plasma arc. The newly formed iHP™ fog and mist consists of submicron's to 3 micron radical particles that are carried throughout the treatment area in a fog or mist moving with the same velocity and characteristics of a gas. This allows the fog or mist to affect all surfaces and space throughout the targeted treatment area, over, above and beyond the ability of a manual cleaning processes. iHP™ damages pathogenic organisms through oxidation of proteins, carbohydrates, and lipids. SteraMist® disinfection/decontamination mechanical clean in the treated area occur by cellular disruptions and/or dysfunctions resulting in a 6-log (99.9999%) and greater kill of all pathogens in the treatment area.

SteraMist® Binary Ionization Technology® allows a facility to have a Hospital-HealthCare EPA registered tool and solution to replace manual cleaning technology, upgrade existing protocols, and limit liability in a facility when it comes to resistant infectious pathogens. SteraMist® BIT™ is the first EPA registered solution and system combination on the market. BIT™ is also listed on EPA's List G, L, K, and M for Norovirus, C. diff, Ebola, and Influenza, respectively. TOMI maintains this registration in 50 states, Canada, and approximately 20 other countries.

### **Markets**

TOMI's SteraMist® products are designed to address a panoply of industries using iHP™. Our operations are organized into four main divisions based on our current target industries: Hospital-Healthcare, Life Sciences, TOMI Service Network (TSN) and Food Safety.

### **Products**

We continue to offer our customers a wide range of innovative products designed to be easily incorporated into their existing disinfection and decontamination procedures. In addition, we offer equipment installations, iHP® Service (routine & emergency), validations and qualifications, and onsite performance maintenance requests - all of which are structured to address the disinfection and decontamination needs of our customers worldwide.

## **Divisions**

### *Hospital-Healthcare*

TOMI's hospital-healthcare customer list expands with the close of every quarter. TOMI's E-Z SteraMist® Disinfection Cart, an all-in-one cart that houses our handheld point-and-spray SteraMist® Surface Unit as well as accompanying supplies, has increased interest in our technology for this division. This product is designed to make the terminal cleaning process of patient rooms more efficient than traditional manual cleaning methods and since its release four (4) new hospitals have purchased and are utilizing the product. We believe that our E-Z SteraMist® Disinfection Cart will allow our customers within the Hospital-Healthcare industry to address the growing concern regarding the increasing high level of transference of pathogens including multiple drug resistant organisms (MDRO's) leading to HAI's from hospital and healthcare related environmental surfaces and equipment to patients and healthcare workers. TOMI's SteraMist 55-minute terminal clean protocol includes incorporating most stages of a facility's current cleaning protocol and by just adding SteraMist mechanical clean protocol, allows an average 90-minute manual clean protocol to be reduced to 55-minutes, as confirmed by the Shield Study at UCLA , from beginning to end, including the changing of the bed linens, demonstrating remarkable results in our clients' facilities from coast to coast.

### *Life Sciences*

TOMI's SteraMist® Environment System, iHP Decontamination Complete Room, SteraMist® Select Surface Unit, iHP™ implementation to decontamination chambers and cage washers, and our iHP® Service Division, are designed to provide a complete room solution to address the regulatory inspections of disinfecting/decontaminating and Installation Qualification (IQ)-Operational Qualification (OQ)-Performance Qualification (PQ) validation processes within the life sciences industry.

### *TOMI Service Network*

TSN is our network comprised of outside professionals who are exclusively licensed and trained to use the SteraMist® products. TSN sells, trains and services professional remediation companies in the use of SteraMist®. These companies specialize in mold abatement, water damage (including damage from CAT 1 through 3 water loss) and fire damage, as well as professional specialists that are certified and practice in the area of forensic restoration. Currently, TSN is comprised of companies throughout the United States and Canada. TSN members use SteraMist® as a standalone service as well as incorporating our products into their existing business models. We derive a continuous revenue stream from our TSN customers through recurring purchases of our BIT™ solution.

Our TSN network continues to grow and currently the total number of TSN provider contracts fully executed to date is ninety-three (93) expanding our network membership across 35 U.S. States and two (2) Canadian provinces. Our service providers, with approximately 160 SteraMist® with BIT technology units in the field, allows for rapid deployment for use in the control of a biological outbreak and border security nationally and internationally upon short notice.

### *Food Safety*

Food Safety is one of our newest and potentially largest targeted markets, as we believe it presents an opportunity for substantial growth. This is in light of the implementation and enforcement of new and existing rules in the United States under the FDA Food Safety Modernization Act and in Canada under the Safe Food for Canadians Act and the Safe Food for Canadians Regulations, the latter two of which became effective in January 2019. This is in part due to the increased focus on concerns within the food safety industry in North America and abroad. Our consultants have submitted to the regulatory bodies a request to expand our current labels from the treatment of food processing machinery, restaurants and food contact areas, to include direct food and crop applications using a 1% acceptable concentration of hydrogen peroxide that is already approved for direct food use by the USDA and EPA.

We intend to target the following segments, with an initial emphasis on the profitable organic market:

- Growing crops
- Seeds
- Packaging facilities
- Food storage (produce, meats, fish)
- Food transportation vehicles
- Food processing plants
- Grocery stores
- Cannabis labs, grow-houses, extraction facilities and retail shops

In each area, our main objective is to prevent and/or minimize food decay without utilizing harsh chemicals that leave toxic residues. This could create an opportunity to supplement, or replace, current pesticides and fungicides currently being used by these industry leaders.

### ***Business Highlights and Recent Events***

#### ***Customers:***

We have added nineteen (19) new customers across all our divisions in the third quarter of 2019. This represents a fifty-eight (58%) percent increase over the same quarter in 2018.

We added four (4) new facilities in the hospital-healthcare division in third quarter of 2019. Through September 30, 2019, we have added ten (10) new hospital-healthcare facilities which represents 100% increase compared to the same prior year period.

Our Life Sciences customer base showed continued growth in the third quarter of 2019. We added eleven (11) new customers.

During the third quarter 2019, we added two (2) new Food Safety customers who purchased and implemented our SteraMist technology into their facilities.

#### ***Revenues:***

The hospital-healthcare division showed a 27% increase in revenue in the third quarter of 2019 when compared to the same quarter last year, and a 60% percent increase in revenue for the nine months ended September 30, 2019 when compared to the same prior year period.

In the second quarter 2019, we sold mobile equipment of over \$400,000 to the Kansas Department of Health in the United States, and in the third quarter we successfully trained six Kansas Department of Health locations on the use of SteraMist for the control of a microbial outbreak, including pandemic preparedness throughout Kansas.

Our overall revenue generated from our Life Sciences division declined in the third quarter of 2019 when compared to the same period in 2018, which was primarily due to one large order for a custom built-in unit for over \$600,000 in the third quarter of 2018. The overall decline was offset by growth in our revenue generated mobile equipment which grew in the third quarter 2019 when compared to the same prior year period.

In August 2019, we received an order for our seventh (7th) SteraMist® custom engineered system. This will be the second permanent room system for installation into our UK based customer's facility.

In July 2019, we announced the implementation of SteraMist® iHP™ Plasma Decontamination Chamber at the University of Houston and a partnership with Lynx Product Group.

The TSN network continues to expand the use of our SteraMist technology and our solution revenue generated from our TSN division during the third quarter of 2019 grew by 8% when compared to the same period in 2018.

Our revenue from international customers increased by 60% during the third quarter of 2019 compared to the same period in 2018. The increase in revenue was attributable to a large purchase from our distributor in Israel and strong recurring solution orders from our existing customers in Europe, Singapore and South Korea.

During the third quarter of 2019, we recorded record iHP service-based revenue in the amount of \$672,000 which translated into 101% growth when compared to the same prior year period. We also reached a major milestone with our service revenue eclipsing \$1,000,000 for the nine months ended September 30, 2019.



**Service Projects:**

In September 2019, we were engaged by Los Angeles County – USC (LAC + USC) Medical Center to remediate Aspergillus mold that had appeared within a critical sterilization area of the facility.

In August 2019, we were awarded a service project with a niche pharmaceutical company that develops, manufactures and markets generic and branded prescription pharmaceuticals as well as animal and consumer health products with a focus on injectables. The iHP Service team treated the 170,000 cubic foot space, including classified and non-classified areas.

In April 2019, we entered into an exclusive distribution agreement with an Israeli company, Cleancor Technologies Ltd. ("Cleancor"), an advanced solution company for the industrial cleaning and repair of water and fire damages. Cleancor has already diversified and started a subsidiary named Clean Bit Environmental Solutions and has begun implementing marketing strategies resulting in a robust pipeline in the health care, food industry, defense, and medical cannabis verticals.

**Events:**

We exhibited at the annual conference of the Association of Professionals in Infection Control (APIC) with our new booth creating the largest presence we have had at a tradeshow. The E-Z SteraMist Cart was on display as well as multiple educational presentations to infection preventionists. The show provided many valuable leads and our new exhibit received considerable praise. This presence added two new hospital clients in the third quarter and three already in the fourth quarter.

We exhibited at our first veterinary conference, bringing on our first animal hospital customer in the third quarter, demonstrating the versatility and ever-expanding verticals SteraMist disinfection technology may be implemented in.

**Certifications:**

As we reported earlier in the year, we added compounding pharmacy customers; which are FDA 503B outsourcing facilities that meet all rigorous national standards with quality sterile products. The FDA created this new designation of compounding pharmacy to establish a new level of patient care and safety, and these facilities must comply with strict cGMP (current good manufacturing practices) guidelines, which is the same standard that pharmaceutical manufacturers follow. We have continued to add new pharmacy customers in the third quarter of 2019. With the addition of the two new pharmacy customers in the third quarter of 2019 we now have four compounding pharmacy customers.

Earlier this year we were audited by Pfizer Global Supply Manufacturing and Supplier Quality Assessments and were reported to be "Acceptable", allowing us to continue expanding SteraMist® implementation into Pfizer facilities. Our management has further focused and allocated resources towards expanding quality control procedures and protocols based on recommendations received during the audit. Pfizer approved a press release of how SteraMist is being used in multiple facilities across the United States as a result of passing the Pfizer Global Supply Agreement Audit. In the third quarter we fulfilled new orders and finalized a new piece of custom commercial research laboratory equipment for Pfizer utilizing our BIT technology platform.

**Research Studies & Product Development**

We continue to participate in a large multi-year federal funded study, known as the "SHIELD study", that compares hospital manual cleans to a SteraMist® mechanical clean. Preliminary results collected by the current hospitals in the study is showing a decrease in the transference of pathogens resulting in HAIs and *C. difficile* infections in the rooms that used SteraMist® for their terminal clean, as compared to the rooms that have been manually cleaned. The University of Michigan, a recognized teaching university hospital, will be joining the California hospitals in this Shield Study in the fourth quarter, allowing for additional collection of data to validate the value of SteraMist technology in hospitals.

We have added three new products to our growing line of products:

- A single applicator build-in unit for decontamination chambers and cage washers, which was recently successfully validated at the University of Houston.
- A decontamination cart for a Pfizer facility. We will be designing and engineering a second SteraMist mobile decontamination cart for this same facility by the second quarter of next year.
- A stainless-steel mobile 90-degree applicator and the answer to the mobile treatment and decontamination of BSC cabinets and isolators. The 90-degree applicator product has led to a partnership with a large design and manufacturing company of washing and contamination control systems and we plan on installing an all-in-one disinfection solution to Gnotobiotic Housings with such partner.

At the annual meeting of the American Association for Laboratory Animal Science ("AALAS") this October in Denver, the University of Iowa and Iowa State University presented a study about our technology and the effect of iHP on pinworms. Members of the University of Iowa and Iowa State University were available in the poster section of the conference and answered questions from the many AALAS members about our excellent results. A published paper will be shortly released in a major scientific journal.

In 2019, we have also focused on improving our SteraMist Environment System and the development of our own proprietary software that will be integrated into the next generation of SteraMist equipment, both mobile and permanent. The new software will improve communication between our equipment and the end user's system, provide improved reporting results and simplify the overall usage of the system itself. During the first quarter of 2019, we reached feasibility with the software being developed. We are now in the final testing and validation phase of the new Environment System prototype, prior to leading to mass commercialization.

The United States Department of Agriculture (USDA) submitted another paper for publication titled "Cold Plasma Enhances the Efficacy of ionized Hydrogen Peroxide in Reducing Populations of *Salmonella* Typhimurium and *Listeria innocua* on Grape Tomatoes, Apples, Cantaloupe and Romaine Lettuce" In July 2019, the author presented the paper, and a poster was shown at the International Association of Food Protection (IAFP). This was a successful introduction of SteraMist to this audience and many are interested in further testing and research of the technology. The poster and presentation focused on the urgent need of a decontamination technology, such as SteraMist to enhance microbial safety of fresh produce. Greater reductions were documented when ionized hydrogen peroxide was passed through the plasma arc and greater than 5 log reductions of *Salmonella* were achieved. We are looking forward to the publication of this paper in a recognized international food safety journal.

We are in the design phase with our partner Arkema and their client (a Global food storage and safety company) which consists of a new engineered concept for the decontamination of large industrial food warehouse facilities. The concept is a six (6) applicator fully automated fogging system permanently mounted on a hydraulic lift that is capable of coverage in such high-volume spaces.

#### **Registrations & Intellectual Property (IP):**

In February 2019, we added our Canadian label to the Organic Materials Review Institute ("OMRI") certifying that our product meets the Canadian organic standards. On May 15, 2019, our BIT solution disinfectant was listed and certified with the OMRI in compliance with the USDA National Organic Program. Thus, our product is now listed as an OMRI Listed® product and appears on the OMRI Products List® and the OMRI Canada Products List®.

We have been actively pursuing registration in mainland China. We successfully passed the Chinese Center for Disease Control and Prevention ("Chinese CDC") requirements for registration and have hired a Chinese CDC consultant. In addition, we have strengthened our intellectual property in the region, submitting trademarks and patent registrations. We have identified a Chinese customer that we expect will generate significant revenue in 2019. We successfully passed all eighteen (18) testing measures required, including many microbiological test. All of our toxicity studies demonstrated that our BIT fog was classified as an actual non-toxic substance. In the second quarter of 2019, we were made aware of the final materials needed for the dossier that is required by the Chinese CDC for registration of our product. The finalization of our dossier was made in the third quarter of 2019, which included the successful shipping and custom clearance to the region, and all the necessary custom declaration forms have been certified and the pre-CDC approval has been commented on by the Chinese CDC. We are waiting for the final CDC stamps which is the last step in this three-year long registration process. We expect the final stamped registration to be received during the fourth quarter of 2019.

Our 90-degree surface mounted applicator device was allowed and published in the Philippines. We have submitted this design patent in multiple countries and expect the others to follow shortly in publication. This additional design patent adds nicely to our other design patents, including our permanent modular applicator, decontamination cart, and our two decontamination chambers.

In August and September 2019, we published and filed two new utility patents. We had previously reported in 2017 and 2018 the filing of these two utility patents, and both the system claims (US15/858,446) and the method claims (US16/127,915) were published with the USPTO in the third quarter of 2019.

In November 2019, we registered two new design patents entitled "Surface Mounted Applicator Device" in Europe and Japan.

### **Financial Operations Overview**

Our financial position as of September 30, 2019 and December 31, 2018 was as follows:

	September 30, 2019 (Unaudited)	December 31, 2018
Total shareholders' equity	\$ 1,431,000	\$ 2,995,000
Cash and cash equivalents	\$ 1,144,000	\$ 2,005,000
Accounts receivable, net	\$ 1,174,000	\$ 2,146,000
Inventories, net	\$ 2,406,000	\$ 2,682,000
Prepaid expenses	\$ 286,000	\$ 302,000
Deposits	\$ 219,000	\$ 109,000
Current liabilities (excluding convertible notes)	\$ 1,109,000	\$ 1,700,000
Convertible notes payable, net	\$ 5,000,000	\$ 4,982,000
Long-term liabilities (excluding convertible notes)	\$ 1,053,000	\$ 402,000
Working Capital (excluding convertible notes)	\$ 4,120,000	\$ 5,544,000
Working Capital (including convertible notes)	\$ (880,000)	\$ 5,544,000

During the nine months ended September 30, 2019, our liquidity positions were affected by the following:

- Net cash used in operations of approximately \$573,000.
- Costs incurred to develop software of approximately \$126,000.
- Costs incurred related to new utility patents of approximately \$22,000.
- Purchase of property and equipment of approximately \$141,000.

### **Results of Operations for the Three Months Ended September 30, 2019 Compared to the Three Months Ended September 30, 2018**

	Three Months Ended September 30, (Unaudited)	
	2019	2018
Sales, Net	\$ 1,600,000	\$ 1,948,000
Gross Profit	\$ 1,140,000	\$ 1,035,000
Total Operating Expenses	\$ 1,328,000	\$ 1,349,000
Loss from Operations	\$ (188,000)	\$ (314,000)
Total Other Income (Expense)	\$ (49,000)	\$ (59,000)
Net Loss	\$ (237,000)	\$ (373,000)
Basic Net Loss per Share	\$ (0.00)	\$ (0.00)
Diluted Net Loss per Share	\$ (0.00)	\$ (0.00)

#### Net Revenue

##### *Sales*

Our revenue for the three months ended September 30, 2019 and 2018 was approximately \$1,600,000 and \$1,948,000, respectively, representing a decrease of approximately \$348,000 or 18%, in the current year period. The decrease in sales in the current year period was attributable to a large custom equipment order that occurred in the same prior year period. In the third quarter of 2019, we achieved a record level of service revenue and solution orders from our existing customer base. We continued to increase our customer base and saw positive trends in our repeat orders for solution and consumables by our growing customer base.

Our products are early in the product and customer adoption cycle. We continue to see strong reorders for solution from our existing customers. The purchase of additional equipment is at a slower pace due to the assessment and integration of our technology into our customers' on-going operations. Our new customer pipeline is very strong. As customers mature through the product and adoption cycle and our sales pipeline converts to sale wins, we expect to have more predictable sales quarter over quarter.

*Product and Service Revenue*

	For the three months ended September 30, (Unaudited)	
	2019	2018
SteraMist Product	\$ 928,000	\$ 1,613,000
Service and Training	672,000	335,000
<b>Total</b>	<b>\$ 1,600,000</b>	<b>\$ 1,948,000</b>

*Revenue by Geographic Region*

	For the three months ended September 30, (Unaudited)	
	2019	2018
United States	\$ 1,288,000	\$ 1,754,000
International	312,000	194,000
<b>Total</b>	<b>\$ 1,600,000</b>	<b>\$ 1,948,000</b>

*Cost of Sales*

Cost of sales was approximately \$460,000 and \$912,000 for the three months ended September 30, 2019 and 2018, respectively, a decrease of \$452,000, in the current year period. The primary reason for the decrease is due to a large custom equipment order that occurred in the same prior year period that carried a high cost and low gross profit margin. In addition, the product mix in our sales for the three months ended September 30, 2019 contributed to a higher gross profit. Our gross profit as a percentage of sales for the three months ended September 30, 2019 was 71.2% compared to 53.1% in the same prior period.

*Professional Fees*

Professional fees were approximately \$83,000 and \$79,000 for the three months ended September 30, 2019 and 2018, respectively, an increase of approximately \$4,000, or 5%, in the current year period. Professional fees are comprised mainly of legal, accounting and financial consulting fees.

*Depreciation and Amortization*

Depreciation and amortization were approximately \$183,000 and \$154,000 for the three months ended September 30, 2019 and 2018, respectively, an increase of \$29,000, or 19%, in the current year period. The increase in depreciation expense is attributable to additional property, equipment and leasehold improvements acquired in 2018 and 2019.

### *Selling Expenses*

Selling expenses were approximately \$314,000 and \$369,000 for the three months ended September 30, 2019 and 2018, respectively, a decrease of \$55,000, or 15%, in the current year period. We continue to invest and allocate resources into our sales, marketing and advertising initiatives and have increased efforts in the current year in order to further develop our brand recognition and grow our base of customers. The decline in selling expenses is primarily due to our customer mix in sales and the related impact to commissions. Selling expenses represent salaries and wages for sales professionals, trade show fees, commissions, advertising and marketing expenses.

### *Research and Development*

Research and development expenses were approximately \$88,000 and \$130,000 for the three months ended September 30, 2019 and 2018, respectively, a decrease of \$42,000, or 32%, in the current year period. The primary reason for the decrease is attributable to the timing of costs related to testing and studies that occurred in the same prior period.

### *Equity Compensation Expense*

Equity compensation expense was \$0 for the three months ended September 30, 2019 and 2018.

### *Consulting Fees*

Consulting fees were approximately \$32,000 and \$20,000 for the three months ended September 30, 2019 and 2018 respectively, representing an increase of \$12,000, or 60%, in the current period. The reason for the increase in consulting fees in the current period is due to the timing of certain projects that occurred in the third quarter of 2019 that did not occur in same prior year period.

### *General and Administrative Expense*

General and administrative expense was approximately \$628,000 and \$599,000 for the three months ended September 30, 2019 and 2018, respectively, an increase of \$29,000, or 5%, in the current year period. General and administrative expense includes salaries and payroll taxes, rent, insurance expense, utilities, office expense and product registration costs.

### *Other Income and Expense*

Amortization of debt discount was approximately \$0 and \$8,000 for the three months ended September 30, 2019 and 2018, respectively. Amortization of debt discount for the three months ended September 30, 2019 and 2018, consists of the amortization of debt discount on the \$6,000,000 principal amount of Notes issued in March and May 2017. The debt discount was amortized over the life of the Notes utilizing the effective interest method.

Interest income was approximately \$1,000 and \$2,000 for the three months ended September 30, 2019 and 2018, respectively.

Interest expense was approximately \$50,000 and \$53,000 for the three months ended September 30, 2019 and 2018, respectively. Interest expense for the three months ended September 30, 2019 and 2018 consisted of the interest incurred on the \$6,000,000 principal amount of Notes issued in March and May 2017.

### *Net Loss*

Net loss was approximately \$237,000 and \$373,000 for the three months ended September 30, 2019 and 2018, respectively, a decrease of \$136,000, or 36%, in the current year period. The primary reasons for the decreased net loss are attributable to:

- Higher gross profit of approximately \$105,000;
- Lower operating expenses of approximately \$21,000; and
- Lower other expenses of approximately \$10,000.

**Results of Operations for the Nine Months Ended September 30, 2019 Compared to the Nine Months Ended September 30, 2018**

	Nine Months Ended September 30, (Unaudited)	
	2019	2018
Sales, Net	\$ 4,492,000	\$ 4,507,000
Gross Profit	\$ 2,875,000	\$ 2,545,000
Total Operating Expenses <sup>(1)</sup>	\$ 4,466,000	\$ 4,222,000
Loss from Operations	\$ (1,591,000)	\$ (1,677,000)
Total Other Income (Expense)	\$ (165,000)	\$ (245,000)
Net Loss	\$ (1,756,000)	\$ (1,922,000)
Basic Net Loss per Share	\$ (0.01)	\$ (0.02)
Diluted Net Loss per Share	\$ (0.01)	\$ (0.02)

(1) Includes approximately \$87,000 and \$13,000 in non-cash equity compensation expense for the nine months ended September 30, 2019 and 2018, respectively.

**Net Revenue**

*Sales*

Our revenue for the nine months ended September 30, 2019 and 2018 was approximately \$4,492,000 and \$4,507,000, respectively, representing a decrease of approximately \$15,000 or 0.3%. The decrease in sales in the current year period was attributable to a large custom equipment order that occurred in the same prior year period. For the nine months ended September 30, 2019 we achieved a record level of service revenue and solution orders from our existing customer base. We continued to increase our customer base and saw positive trends in our repeat orders for solution and consumables by our growing customer base.

Our products are early in the product and customer adoption cycle. We continue to see strong reorders for our solution from our existing customers. The purchase of additional equipment is at a slower pace due to the assessment and integration of our technology into our customers on-going operations. Our new customer pipeline is very strong. As customers mature through the product and adoption cycle and our sales pipeline converts to sale wins, we expect to have more predictable sales quarter over quarter.

*Product and Service Revenue*

	For the nine months ended September 30, (Unaudited)	
	2019	2018
SteraMist Product	\$ 3,461,000	\$ 3,723,000
Service and Training	1,031,000	784,000
Total	\$ 4,492,000	\$ 4,507,000

*Revenue by Geographic Region*

	For the nine months ended September 30, (Unaudited)	
	2019	2018
United States	\$ 3,852,000	\$ 3,545,000
International	640,000	962,000
Total	\$ 4,492,000	\$ 4,507,000

### *Cost of Sales*

Cost of sales was approximately \$1,617,000 and \$1,962,000 for the nine months ended September 30, 2019 and 2018, respectively, a decrease of \$345,000 or 18%, in the current year period. The primary reason for the decrease is due to a large custom equipment order that occurred in the same prior year period that carried a high cost and low gross profit margin. Our gross profit as a percentage of revenue for the nine months ended September 30, 2019 was 64.0% compared to 56.4% in the same prior period. The increase in gross profit is attributable to the product mix in sales.

### *Professional Fees*

Professional fees were approximately \$297,000 and \$271,000 for the nine months ended September 30, 2019 and 2018, respectively, an increase of approximately \$26,000, or 10%, in the current year period. Professional fees are comprised mainly of legal, accounting and financial consulting fees. The primary reason for the increase is attributable to legal fees incurred in connection with advancing our new trademarks and new utility patents on a domestic and international basis.

### *Depreciation and Amortization*

Depreciation and amortization were approximately \$539,000 and \$469,000 for the nine months ended September 30, 2019 and 2018, respectively, an increase of approximately \$70,000, or 15%, in the current year period. The increase in depreciation expense is attributable to additional property, equipment and leasehold improvements acquired in 2018 and 2019.

### *Selling Expenses*

Selling expenses were approximately \$1,274,000 and \$1,004,000 for the nine months ended September 30, 2019 and 2018, respectively, an increase of \$270,000, or 27%, in the current year period. We continue to invest and allocate resources into our sales, marketing and advertising initiatives and have increased efforts in the current year in order to further develop our brand recognition and grow our base of customers. We are hoping to see positive results in our revenue in the fourth quarter of the year directly related to the onboarding of different national sales groups during the first half of 2019. Our selling expenses increased in the current period as a result of the following:

- Higher salaries due to increases in headcount in our sales department.
- Onboarding and training of new sales independent sales representatives.
- Customer mix in sales and the related commissions impact.
- Increased tradeshow for the nine months ended September 30, 2019 compared to the same prior year period which has contributed to growth in our sales pipeline in all divisions
- The acquisition of a new high-tech 30x40 tradeshow booth
- Continual efforts in advertising within targeted publications, Google search engine optimized campaigns, and organic brand awareness.
- Continued investment in our Social Media presence across all platforms which has shown growth in followers, impressions, and engagements.

Selling expenses represent selling salaries and wages, trade show fees, commissions, advertising and marketing expenses.

### *Research and Development*

Research and development expenses were approximately \$249,000 and \$372,000 for the nine months ended September 30, 2019 and 2018, respectively, a decrease of \$123,000, or 33%, in the current year period. The primary reason for the decrease is attributable to the timing of costs related to testing and studies that occurred in the same prior period.

### *Equity Compensation Expense*

Equity compensation expense was approximately \$87,000 and \$13,000 for the nine months ended September 30, 2019 and 2018, respectively. The reason for the increase is attributable to warrants and options issued to officers and employees in the current year period.

### *Consulting Fees*

Consulting fees were approximately \$87,000 and \$93,000 for the nine months ended September 30, 2019 and 2018, respectively, representing a decrease of \$6,000 or 6%, in the current year period.

### *General and Administrative Expense*

General and administrative expense was approximately \$1,932,000 and \$1,999,000 for the nine months ended September 30, 2019 and 2018, respectively, a decrease of \$67,000, or 3%, in the current year period. The decrease in general and administrative expenses is primarily due to lower payroll costs and reduced bad debt expense. General and administrative expense includes salaries and payroll taxes, rent, insurance expense, utilities, office expense and product registration costs.

### *Other Income and Expense*

Amortization of debt discount was approximately \$18,000 and \$24,000 for the nine months ended September 30, 2019 and 2018, respectively. Amortization of debt discount for the nine months ended September 30, 2019 and 2018, consists of the amortization of debt discount on the \$6,000,000 principal amount of Notes issued in March and May 2017. The debt discount was amortized over the life of the Notes utilizing the effective interest method.

Induced conversion costs of approximately \$57,000 for the nine months ended September 30, 2018 were incurred in connection with conversion of \$700,000 convertible note payable.

Interest income was approximately \$2,000 and \$5,000 for the nine months ended September 30, 2019 and 2018, respectively.

Interest expense was approximately \$150,000 and \$169,000 for the nine months ended September 30, 2019 and 2018, respectively. Interest expense for the nine months ended September 30, 2019 and 2018 consisted of the interest incurred on the \$6,000,000 principal amount of Notes issued in March and May 2017.

### *Net Loss*

Net loss was approximately \$1,756,000 and 1,922,000 for the nine months ended September 30, 2019 and 2018, respectively, a decrease of \$166,000, or 9%, in the current year period. The primary reasons for the decreased net loss are attributable to:

- Higher gross profit of approximately \$330,000;
- Lower other expenses of approximately \$80,000, offset by.
- Higher operating expenses of approximately \$244,000

### ***Liquidity and Capital Resources***

As of September 30, 2019, we had cash and cash equivalents of approximately \$1,144,000. Our working capital before consideration of the convertible notes payable of \$5,000,000 was \$4,120,000. Working capital after consideration of the convertible notes payable was (\$880,000). Our principal capital requirements are to fund operations, invest in research and development and capital equipment, and the continued costs of public company filing requirements. We have historically funded our operations through debt and equity financings.

In March and May 2017, we raised gross proceeds of \$6,000,000 through a private placement of the Notes. We issued the Notes in two tranches of \$5,300,000 and \$700,000, respectively, which originally were scheduled to mature on August 31, 2018 and November 8, 2018, respectively, unless earlier redeemed, repurchased or converted.



In 2018, a portion of Notes aggregating \$1,000,000 principal were either converted to equity or paid.

On March 30, 2019, the remaining holders of the Notes agreed to extend the maturity dates of their Notes with an aggregate principal amount of \$5,000,000 to April 3, 2020. As a result, the Company has a working capital deficiency of \$880,271 at September 30, 2019 and does not currently have sufficient resources to satisfy this debt when due. Accounting principles define this as raising doubt about the Company's ability to continue as a going concern. The Company plans to raise additional capital in order to satisfy this debt when due.

For the nine months ended September 30, 2019 and 2018, we incurred losses from operations of approximately \$1,591,000 and \$1,677,000, respectively. The cash used in operations was approximately \$573,000 and \$ 1,246,000 for the nine months ended September 30, 2019 and 2018, respectively.

Our revenues can fluctuate due to the following factors, among others:

- Ramp up and expansion of our internal sales force and manufacturers' representatives;
- Length of our sales cycle;
- Expansion into new territories and markets; and
- Timing of orders from distributors.

We could incur additional operating losses and an increase of costs related to the continuation of product and technology development and administrative activities.

Management has taken and will endeavor to continue to take a number of actions in order to improve our results of operations and the related cash flows generated from operations in order to strengthen our financial position, including the following items:

- Expanding our label with the EPA to further our product registration internationally;
- Continued expansion of our internal sales force and manufacturer representatives in an effort to drive domestic revenue in all hospital-healthcare verticals;
- Continued expansion of our internal sales force and manufacturer representatives in an effort to drive global revenue in the life science verticals;
- Expansion of international distributors; and
- Continued growth of TSN, our new Forensic Restoration FRST sub-division and new growth in the food safety market which includes using SteraMist for increasing the storage time of pre- and post-harvest produce, and increasing transportation shelf life by installing SteraMist in semitrucks and ships that are transporting food.

We believe that our existing balance of cash and cash equivalents and amounts expected to be provided by operations will provide us with sufficient financial resources to meet our cash requirements for operations, working capital and capital expenditures over the next twelve months. We cannot make any assurances that management's strategies will be effective or that any additional financing will be completed on a timely basis, on acceptable terms or at all. Our inability to successfully implement our strategies or to complete any other financing may mean that we would have to significantly reduce costs and/or delay projects, which would adversely affect our business, customers and program development, and would adversely impact us.

Until such time, if ever, as we can generate substantial product revenue, we expect to finance our cash needs through a combination of equity or debt financings. Sufficient funds may not be available to us at all or on attractive terms when needed from these sources. To the extent that we raise additional capital through the future sale of equity or debt, the ownership interests of our stockholders will be diluted, and the terms of these securities may include liquidation or other preferences that adversely affect the rights of our existing common stockholders. We may require additional capital beyond our currently anticipated amounts.

### *Operating Activities*

Cash used in operating activities for the nine months ended September 30, 2019 and 2018 was approximately \$573,000 and \$1,246,000, respectively. Cash used in operating activities decreased approximately \$673,000 compared to the prior year period primarily as a result of the collection of accounts receivable and the decline in inventory.

### *Investing Activities*

Cash used in investing activities for the nine months ended September 30, 2019 and 2018 was approximately \$288,000 and \$127,000, respectively. Cash used in investing activities increased \$161,000 compared to the prior year period primarily due to software development costs and the acquisition of fixed assets.

### *Financing Activities*

Cash used in financing activities for the nine months ended September 30, 2019 and 2018 were \$0.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The estimation process requires assumptions to be made about future events and conditions, and as such, is inherently subjective and uncertain. Actual results could differ materially from our estimates.

The SEC defines critical accounting policies as those that are, in management's view, most important to the portrayal of our financial condition and results of operations and most demanding of our judgment. We consider the following policies to be critical to an understanding of our condensed consolidated financial statements and the uncertainties associated with the complex judgments made by us that could impact our results of operations, financial position and cash flows.

#### *Revenue Recognition*

We recognize revenue in accordance with FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, when there is persuasive evidence that an arrangement exists, title and risk of loss have passed, delivery has occurred, or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to our customers upon shipment.

#### Disaggregation of Revenue

Product revenue includes sales from our standard and customized equipment, solution and accessories sold with our equipment. Revenue is recognized upon transfer of control of promised products to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services.

Service and training revenue include sales from our high-level decontamination and service engagements, validation of our equipment and technology and customer training. Service revenue is recognized as the agreed upon services are rendered to our customers in an amount that reflects the consideration we expect to receive in exchange for those services.

#### Costs to Obtain a Contract with a Customer

We apply a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within selling expenses.

## Contract Balances

As of September 30, 2019, and December 31, 2018 we did not have any unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

## Arrangements with Multiple Performance Obligations

Our contracts with customers may include multiple performance obligations. We enter into contracts that can include various combinations of products and services, which are primarily distinct and accounted for as separate performance obligations.

## Significant Judgments

Our contracts with customers for products and services often dictate the terms and conditions of when the control of the promised products or services is transferred to the customer and the amount of consideration to be received in exchange for the products and services.

## *Fair Value Measurement*

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.

Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and convertible debt. All these items were determined to be Level 1 fair value measurements.

The carrying amounts of cash and cash 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.

## *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. At times, these deposits may be in excess of insured limits.

## *Accounts Receivable*

Our accounts receivable are credit worthy customers or, for certain international customers, are supported by pre-payments. For those customers to whom we extend credit, we perform periodic evaluations of them and maintain allowances for potential credit losses as deemed necessary. We have a policy of reserving for doubtful accounts based on our best estimate of the amount of potential credit losses in existing accounts receivable. We periodically review our accounts receivable to determine whether an allowance is necessary based on an analysis of past due accounts and other factors that may indicate that the realization of an account may be in doubt. Account balances deemed to be uncollectible are charged to the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

### *Inventories*

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

We expense costs to maintain certification to cost of goods sold as incurred.

We review inventory on an ongoing basis, considering factors such as deterioration and obsolescence. We record an allowance for estimated losses when the facts and circumstances indicate that particular inventories may not be usable. Our reserve for obsolete inventory was \$100,000 at September 30, 2019 and December 31, 2018.

### *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. Leasehold improvements are amortized using the straight-line method over the lives of the respective leases or service lives of the improvements, whichever is shorter.

### *Leases*

In February 2016, the FASB issued ASC 842, Leases, to require lessees to recognize all leases, with certain exceptions, on the balance sheet, while recognition on the statement of operations will remain similar to current lease accounting. Subsequently, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*, ASU No. 2018-11, *Targeted Improvements*, ASU No. 2018-20, *Narrow-Scope Improvements for Lessors*, and ASU 2019-01, *Codification Improvements*, to clarify and amend the guidance in ASU No. 2016-02. ASC 842 eliminates real estate-specific provisions and modifies certain aspects of lessor accounting. This standard is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted. We adopted ASC 842 as of January 1, 2019 using the modified retrospective basis with a cumulative effect adjustment as of that date. In addition, we elected the package of practical expedients permitted under the transition guidance within the new standard, which allowed us to carry forward the historical determination of contracts as leases, lease classification and not reassess initial direct costs for historical lease arrangements. Accordingly, previously reported financial statements, including footnote disclosures, have not been recast to reflect the application of the new standard to all comparative periods presented.

Operating lease assets are included within operating lease right-of-use assets, and the corresponding operating lease liabilities are recorded as current portion of long-term operating lease, and within other long-term liabilities as long-term operating lease, net of current portion on our condensed consolidated balance sheet as of September 30, 2019.

We have elected not to present short-term leases on the consolidated balance sheet as these leases have a lease term of 12 months or less at lease inception and do not contain purchase options or renewal terms that we are reasonably certain to exercise. All other lease assets and lease liabilities are recognized based on the present value of lease payments over the lease term at commencement date. Because most of our leases do not provide an implicit rate of return, we used our incremental borrowing rate based on the information available at adoption date in determining the present value of lease payments.

### *Capitalized Software Development Costs*

In accordance with ASC 985-20 regarding the development of software to be sold, leased, or marketed, the Company expenses such costs as they are incurred until technological feasibility has been established, at and after which time those costs are capitalized until the product is available for general release to customers. The periodic expense for the amortization of capitalized software development costs will be included in costs of sales.

### *Accrued Warranties*

Accrued warranties represent the estimated costs, if any, that will be incurred during the warranty period of our products. We estimate the expected costs to be incurred during the warranty period and record the expense to the consolidated statement of operations at the date of sale. Our manufacturer assumes the warranty against product defects for one year from date of sale, which we extend to our customers upon sale of the product. We assume responsibility for product reliability and results.

### *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 that are, on a more likely than not basis, not expected to be realized in accordance with ASC guidance for income taxes.

### *Loss Per Share*

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

### *Equity Compensation Expense*

We account for equity compensation expense using the Black Scholes model in accordance with FASB ASC 718, "Compensation—Stock Compensation." Under the provisions of FASB ASC 718, equity compensation expense is estimated at the grant date based on the award's fair value.

On July 7, 2017, our shareholders approved the 2016 Equity Incentive Plan (the "2016 Plan"). The 2016 Plan authorizes the grant of stock options, stock appreciation rights, restricted stock, restricted stock units and performance units/shares. Up to 5,000,000 shares of common stock are authorized for issuance under the 2016 Plan. Shares issued under the 2016 Plan may be either authorized but unissued shares, treasury shares, or any combination thereof. Provisions in the 2016 Plan permit the reuse or reissuance by the 2016 Plan of shares of common stock for numerous reasons, including, but not limited to, shares of common stock underlying canceled, expired, or forfeited awards of stock-based compensation and stock appreciation rights paid out in the form of cash. Equity compensation expense will typically be awarded in consideration for the future performance of services to us. All recipients of awards under the 2016 Plan are required to enter into award agreements with the Company at the time of the award; awards under the 2016 Plan are expressly conditioned upon such agreements.

### *Concentrations of Credit Risk*

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash and cash equivalents. We maintain cash balances at financial institutions which exceed the current Federal Deposit Insurance Corporation limit of \$250,000 at times during the year.

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

We assess 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, we measure recoverability of these assets by comparing the carrying amounts to the future undiscounted cash flows the assets are expected to generate. If our 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. We base the calculations of the estimated fair value of our long-lived assets on the income approach. For the income approach, we use an internally developed discounted cash flow model that includes, 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.

#### *Recent Accounting Pronouncements*

In January 2017, the FASB issued ASU No. 2017-04, *Simplifying the Test for Goodwill Impairment*, to simplify the test for goodwill impairment by removing Step 2. An entity will, therefore, perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, recognizing an impairment charge for the amount by which the carrying amount exceeds the fair value, not to exceed the total amount of goodwill allocated to the reporting unit. An entity still has the option to perform a qualitative assessment to determine if the quantitative impairment test is necessary. ASU No. 2017-04 is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Adoption of ASU No. 2017-04 is prospective.

#### ***Recently Issued Accounting Pronouncements***

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

#### ***Off-Balance Sheet Arrangements***

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

#### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

We are a smaller reporting company as defined by Rule 405 under the Securities Act of 1933, as amended, and Rule 12b-2 under the Exchange Act, and are not required to disclose the information required by this Item 3 pursuant to Item 305(e) of Regulation S-K.

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

##### ***Evaluation of Disclosure Controls and Procedures***

Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report on Form 10-Q. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective.

##### ***Changes in Internal Control over Financial Reporting***

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) under the Exchange Act during the period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

##### ***Limitations on Effectiveness of Controls and Procedures***

In designing and evaluating the disclosure controls and procedures and internal control over financial reporting, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures and internal control over financial reporting must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

## PART II: OTHER INFORMATION

### Item 1. Legal Proceedings.

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business. We currently are not a party to any legal proceedings, the adverse outcome of which, in management's opinion, individually or in the aggregate, would have a material adverse effect on our results of operations, financial position or cash flows. Regardless of the outcome, any litigation could have an adverse impact on us due to defense and settlement costs, diversion of management resources and other factors.

### Item 1A. Risk Factors.

While, as a smaller reporting company, we are not required to provide the information required by this Item 1A, you should carefully review and consider the risk factors contained in our other reports and periodic filings with the SEC, including without limitation the risk factors contained under the caption "Item 1A—Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2018. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations.

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

None.

### Item 3. Defaults Upon Senior Securities.

None.

### Item 4. Mine Safety Disclosures.

Not applicable.

### Item 5. Other Information.

None.

### Item 6. Exhibits.

The documents listed in the Exhibit Index of this Form 10-Q are incorporated herein by reference.

**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.**

Date: November 14, 2019

By: /s/ Halden S. Shane

Halden S. Shane  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 14, 2019

By: /s/ Nick Jennings

Nick Jennings  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)



**EXHIBIT INDEX**

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
<a href="#">31.1</a>	Certification of Halden S. Shane, Chief Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
<a href="#">31.2</a>	Certification of Nick Jennings, Chief Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
<a href="#">32.1#</a>	Certification of Halden S. Shane, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
<a href="#">32.2#</a>	Certification of Nick Jennings, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	XBRL Instance Document.					X
101.SCH	XBRL Taxonomy Extension Schema Document.					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.					X
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.					X

+ Indicates a management contract or compensatory plan.

# This certification is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act), or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended (Securities Act), or the Exchange Act.

**CERTIFICATION OF PERIODIC REPORT UNDER SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002**

I, Halden S. Shane, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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 control 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.

Date: November 14, 2019

By: /s/ Halden S. Shane  
Halden S. Shane  
Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION OF PERIODIC REPORT UNDER SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002**

I, Nick Jennings, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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 control 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.

Date: November 14, 2019

By: */s/ Nick Jennings*

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Nick Jennings  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting 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, 2019, as filed with the Securities and Exchange Commission on November 14, 2019 (the "Report"), I, Halden S. Shane, Chief Executive Officer of the Company, certify as of the date hereof, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

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.

Date: November 14, 2019

By: */s/ Halden S. Shane*

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Halden S. Shane  
Chief Executive Officer  
(Principal Executive 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, 2019, as filed with the Securities and Exchange Commission on November 14, 2019 (the "Report"), I, Nick Jennings, Chief Financial Officer of the Company, certify as of the date hereof, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

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.

Date: November 14, 2019

By: /s/ Nick Jennings  
Nick Jennings  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

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