

Ideal Power Inc.
Form 10-Q
August 14, 2018

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 June 30, 2018

OR

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

For the transition period from _____ to _____

Commission File Number 001-36216

IDEAL POWER INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: Ideal Power Inc. - Form 10-Q

If an emerging growth company, indicate by check mark whether 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 issuer is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ""
No x

As of August 10, 2018, the issuer had 14,000,342 shares of common stock, par value \$.001, outstanding.

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

| | | |
|---|---|------------------|
| <u>Item 1.</u> | <u>Condensed Financial Statements</u> | <u>1</u> |
| | <u>Balance Sheets at June 30, 2018 (Unaudited) and December 31, 2017</u> | <u>1</u> |
| | <u>Statements of Operations for the three and six months ended June 30, 2018 and 2017 (Unaudited)</u> | <u>2</u> |
| | <u>Statements of Cash Flows for the six months ended June 30, 2018 and 2017 (Unaudited)</u> | <u>3</u> |
| | <u>Notes to Unaudited Financial Statements</u> | <u>4</u> |
| <u>Item 2.</u> | <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>11</u> |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>17</u> |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | <u>17</u> |
| <u>PART II OTHER INFORMATION</u> | | |
| <u>Item 1.</u> | <u>Legal Proceedings</u> | <u>18</u> |
| <u>Item 1A.</u> | <u>Risk Factors</u> | <u>18</u> |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>18</u> |
| <u>Item 3.</u> | <u>Defaults Upon Senior Securities</u> | <u>18</u> |
| <u>Item 4.</u> | <u>Mine Safety Disclosures</u> | <u>18</u> |
| <u>Item 5.</u> | <u>Other Information</u> | <u>18</u> |
| <u>Item 6.</u> | <u>Exhibits</u> | <u>19</u> |
| <u>SIGNATURES</u> | | <u>20</u> |

PART I - FINANCIAL INFORMATION**ITEM 1. CONDENSED FINANCIAL STATEMENTS****IDEAL POWER INC.****Balance Sheets**

| | June 30, 2018 (unaudited) | December 31, 2017 |
|--|--|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$6,980,213 | \$10,022,247 |
| Accounts receivable, net | 170,792 | 221,084 |
| Inventories, net | 239,407 | 251,363 |
| Prepayments and other current assets | 503,808 | 283,208 |
| Total current assets | 7,894,220 | 10,777,902 |
| Property and equipment, net | 513,153 | 669,571 |
| Intangible assets, net | 2,096,692 | 2,082,014 |
| Other assets | 55,420 | 37,500 |
| Total assets | \$10,559,485 | \$13,566,987 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$517,770 | \$449,475 |
| Accrued expenses | 1,149,883 | 1,081,155 |
| Total current liabilities | 1,667,653 | 1,530,630 |
| Other long-term liabilities | 462,199 | 456,234 |
| Total liabilities | 2,129,852 | 1,986,864 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.001 par value; 10,000,000 shares authorized; 1,518,430 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively | 1,518 | 1,518 |
| Common stock, \$0.001 par value; 50,000,000 shares authorized; 14,004,465 shares issued and 14,000,342 shares outstanding at June 30, 2018 and 13,998,465 shares issued and 13,996,121 shares outstanding at December 31, 2017, respectively | 14,004 | 13,998 |

Edgar Filing: Ideal Power Inc. - Form 10-Q

| | | |
|--|---------------|---------------|
| Additional paid-in capital | 67,711,659 | 67,081,359 |
| Treasury stock, at cost; 4,123 shares at June 30, 2018 and 2,344 shares at December 31, 2017 | (9,677) | (7,489) |
| Accumulated deficit | (59,287,871) | (55,509,263) |
| Total stockholders' equity | 8,429,633 | 11,580,123 |
| Total liabilities and stockholders' equity | \$ 10,559,485 | \$ 13,566,987 |

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

-1-

IDEAL POWER INC.**Statements of Operations****(unaudited)**

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------------|------------------|----------------|
| | June 30, 2018 | 2017 | June 30, 2018 | 2017 |
| Product revenue | \$619,942 | \$253,370 | \$801,442 | \$529,040 |
| Cost of product revenue | 584,800 | 764,609 | 919,763 | 1,475,539 |
| Gross profit (loss) | 35,142 | (511,239) | (118,321) | (946,499) |
| Operating expenses: | | | | |
| Research and development | 905,541 | 1,108,368 | 1,663,324 | 2,298,537 |
| General and administrative | 817,672 | 1,170,415 | 1,709,660 | 2,076,378 |
| Sales and marketing | 69,989 | 427,336 | 324,232 | 968,869 |
| Total operating expenses | 1,793,202 | 2,706,119 | 3,697,216 | 5,343,784 |
| Loss from operations | (1,758,060) | (3,217,358) | (3,815,537) | (6,290,283) |
| Interest income, net | 35,614 | 7,034 | 36,929 | 11,575 |
| Net loss | \$(1,722,446) | \$(3,210,324) | \$(3,778,608) | \$(6,278,708) |
| Net loss per share – basic and fully diluted | \$(0.12) | \$(0.23) | \$(0.27) | \$(0.50) |
| Weighted average number of shares outstanding – basic and fully diluted | 13,992,791 | 13,989,282 | 13,991,961 | 12,443,076 |

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

IDEAL POWER INC.**Statements of Cash Flows****(unaudited)**

| | Six Months Ended | |
|---|------------------|----------------|
| | June 30, | |
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net loss | \$(3,778,608) | \$(6,278,708) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Allowance for doubtful accounts | (98,337) | 273,727 |
| Write-down of inventory | 5,458 | 712,083 |
| Depreciation and amortization | 216,920 | 224,926 |
| Write-off of capitalized patents | 15,478 | 202,343 |
| Write-off of fixed assets | 7,055 | 15,036 |
| Stock-based compensation | 630,306 | 498,006 |
| Decrease (increase) in operating assets: | | |
| Accounts receivable | 148,629 | (100,715) |
| Inventories | 6,498 | 166,529 |
| Prepayments and other current assets | (238,520) | 77,981 |
| Increase (decrease) in operating liabilities: | | |
| Accounts payable | 68,295 | (133,783) |
| Accrued expenses | 74,693 | (5,627) |
| Net cash used in operating activities | (2,942,133) | (4,348,202) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (18,525) | (18,146) |
| Acquisition of intangible assets | (79,188) | (171,134) |
| Net cash used in investing activities | (97,713) | (189,280) |
| Cash flows from financing activities: | | |
| Net proceeds from issuance of common stock | - | 13,657,331 |
| Payment of taxes related to restricted stock vesting | (2,188) | - |
| Exercise of options and warrants | - | 11,143 |
| Net cash provided by (used in) financing activities | (2,188) | 13,668,474 |
| Net increase (decrease) in cash and cash equivalents | (3,042,034) | 9,130,992 |
| Cash and cash equivalents at beginning of period | 10,022,247 | 4,204,916 |
| Cash and cash equivalents at end of period | \$6,980,213 | \$13,335,908 |

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

Ideal Power Inc.

Notes to Financial Statements

(unaudited)

Note 1 – Organization and Description of Business

Ideal Power Inc. (the “Company”) was incorporated in Texas on May 17, 2007 under the name Ideal Power Converters, Inc. The Company changed its name to Ideal Power Inc. on July 8, 2013 and re-incorporated in Delaware on July 15, 2013. With headquarters in Austin, Texas, it develops power conversion solutions with an initial focus on solar + storage, microgrid and stand-alone energy storage applications. The principal products of the Company are 30-kilowatt power conversion systems, including 2-port and multi-port products.

Since its inception, the Company has generated limited revenues from the sale of products and has financed its research and development efforts and operations through the sale of common stock and, prior to its initial public offering, the issuance of convertible debt. The Company’s continued operations are dependent upon its ability to obtain adequate sources of funding through future revenues, follow-on stock offerings, debt financing, co-development agreements, sale or licensing of developed intellectual property or other alternatives.

On April 16, 2018, the Company realigned into two operating divisions: Power Conversion Systems, to continue the commercialization of its Power Packing Switching Architecture™, or PPSA™, technology, and B-TRAN™, to develop its Bi-directional bi-polar junction TRANSistor (B-TRAN™) solid state switch technology.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

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

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

Recently Adopted Standards

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The FASB issued several amendments to the standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. The standard replaced most existing revenue recognition guidance in U.S. GAAP when it became effective on January 1, 2018. The adoption of this standard did not have a material effect on the Company's financial statements, nor required an adjustment to the opening balance of accumulated deficit at January 1, 2018, the date of initial adoption. See Note 12 for a discussion of the Company's revenue recognition policy.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), in order to address eight specific cash flow issues with the objective of reducing the existing diversity in practice. The updated standard is effective for financial statements issued for annual periods beginning after December 15, 2017 and interim periods within those fiscal years. The adoption of the standard did not have a significant effect on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU provides clarity and reduces both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718 to a change to the terms or conditions of a share-based payment award. The amendments in this ASU are effective for public entities for fiscal years and interim periods beginning after December 15, 2017. The ASU is applied prospectively on and after the effective date. The standard did not have a material effect on the Company's financial statements.

In July 2017, the FASB issued ASU 2017-11, Accounting for Certain Financial Instruments with Down Round Features and Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception. Part I of this ASU addresses the complexity of accounting for certain financial instruments with down round features. Per the ASU, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down round feature. The ASU is effective for public entities for fiscal years beginning after December 15, 2018 and early adoption is permitted. The Company has elected to early adopt the ASU and will recognize the value of the effect of the down round provision, if and/or when triggered. The provision is associated with stock warrants issued as part of the Company's 2017 definitive securities purchase agreement, or the Private Placement. For more details regarding the 2017 Private Placement, see Note 9 and Note 11.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet. Most prominent among the amendments is the recognition of assets and liabilities by lessees for those leases classified as operating leases under previous U.S. GAAP. Under the new standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The new standard will be effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. While the Company is continuing to assess the potential impact of this standard, it expects its lease commitment will be subject to the updated standard and recognized as a lease liability and right-of-use asset upon adoption.

Management does not believe that any other recently issued, but not yet effective, accounting standard, if adopted, would have a material impact on the Company's financial statements.

Note 3 – Accounts Receivable

Accounts receivable, net consisted of the following:

| | June 30, 2018 (unaudited) | December 31, 2017 |
|-------------------|--|----------------------|
| Trade receivables | \$ 198,265 | \$ 378,894 |

Edgar Filing: Ideal Power Inc. - Form 10-Q

| | | |
|---------------------------------|------------|------------|
| Other receivables | 1,652 | 20,589 |
| | 199,917 | 399,483 |
| Allowance for doubtful accounts | (29,125) | (178,399) |
| | \$ 170,792 | \$ 221,084 |

The Company had receivable balances from three customers that accounted for 70% of net trade receivables at June 30, 2018.

Activity in the allowance for doubtful accounts was as follows:

| | |
|------------------------------|-------------|
| Balance at December 31, 2017 | \$(178,399) |
| Write offs | 16,759 |
| Provisions | (29,485) |
| Recovery | 162,000 |
| Balance at June 30, 2018 | \$(29,125) |

Note 4 – Inventories

Inventories, net consisted of the following:

| | June 30, 2018 | December 31, 2017 |
|--------------------------|--------------------|----------------------|
| | (unaudited) | |
| Raw materials | \$ 197,779 | \$ 222,436 |
| Finished goods | 182,529 | 149,370 |
| | 380,308 | 371,806 |
| Reserve for obsolescence | (140,901) | (120,443) |
| | \$ 239,407 | \$ 251,363 |

Note 5 – Property and Equipment

Property and equipment, net consisted of the following:

| | June 30, 2018 | December 31, 2017 |
|---|--------------------|----------------------|
| | (unaudited) | |
| Machinery and equipment | \$1,023,327 | \$ 1,013,133 |
| Building leasehold improvements | 395,335 | 395,335 |
| Furniture, fixtures, software and computers | 192,480 | 218,571 |
| | 1,611,142 | 1,627,039 |
| Accumulated depreciation and amortization | (1,097,989) | (957,468) |
| | \$513,153 | \$ 669,571 |

Note 6 – Intangible Assets

Intangible assets, net consisted of the following:

| | June 30, 2018 | December 31, 2017 |
|--|------------------|----------------------|
|--|------------------|----------------------|

Edgar Filing: Ideal Power Inc. - Form 10-Q

| | (unaudited) | |
|--------------------------|--------------------|--------------|
| Patents | \$ 1,617,978 | \$ 1,554,268 |
| Other intangible assets | 732,175 | 732,175 |
| | 2,350,153 | 2,286,443 |
| Accumulated amortization | (253,461) | (204,429) |
| | \$ 2,096,692 | \$ 2,082,014 |

Amortization expense amounted to \$24,713 and \$49,032 for the three and six months ended June 30, 2018, respectively, and \$18,594 and \$36,469 for the three and six months ended June 30, 2017, respectively. Amortization expense for the succeeding five years and thereafter is approximately \$49,000 (2018), \$99,000 (2019-2022) and \$1,162,000 (thereafter).

At June 30, 2018 and December 31, 2017, the Company had capitalized \$489,285 and \$472,928, respectively, for costs related to patents that have not been awarded.

Note 7 – Accrued Expenses

Accrued expenses consisted of the following:

| | June 30, 2018 | December 31, 2017 |
|----------------------|--------------------|----------------------|
| | (unaudited) | |
| Accrued compensation | \$403,744 | \$ 247,343 |
| Warranty reserve | 492,132 | 426,115 |
| Other | 254,007 | 407,697 |
| | \$1,149,883 | \$ 1,081,155 |

Note 8 – Commitments and ContingenciesLease

The Company leases 14,782 square feet of office and laboratory space located in Austin, Texas. On April 20, 2018, the Company entered into an amendment to its existing operating lease which extended the lease term from May 31, 2018 to May 21, 2021. The annual base rent in the first year of the lease extension is \$184,775 and increases by \$7,391 in each succeeding year of the lease extension. In addition, the Company is required to pay its proportionate share of operating costs for the building under this triple net lease. Future minimum payments under the lease, as amended, are as follows:

| Year Ended December 31, | Amount |
|-------------------------|------------------|
| 2018 | \$92,388 |
| 2019 | 189,086 |
| 2020 | 196,477 |
| 2021 | 83,149 |
| | \$561,100 |

The Company incurred rent expense of \$60,373 and \$118,176 for the three and six months ended June 30, 2018, respectively, and \$59,718 and \$117,074 for the three and six months ended June 30, 2017, respectively.

License Agreement

In 2015, the Company entered into licensing agreements which expire on February 7, 2033. Per the agreements, the Company has an exclusive royalty-free license which enhances its intellectual property portfolio related to semiconductor power switches. The agreements include both fixed and variable payments. The variable payments are a function of the number of associated patent filings pending and patents issued under the agreements. The Company will pay \$10,000 for each patent filing pending and \$20,000 for each patent issued within 20 days of December 21, 2017 and each subsequent year of the agreement, up to a maximum of \$100,000 per year (i.e. five issued patents). At June 30, 2018, two patents associated with the agreements had been issued and the corresponding long-term liability for the estimated present value of future payments under the licensing agreement is \$462,199. The Company is accruing interest for future payments related to the issued patent associated with the agreement.

Legal Proceedings

In 2017, the Company entered into arbitration with Libra Industries, Inc. (“Libra”), its prior contract manufacturer, with both parties asserting claims against the other party. At December 31, 2017, the Company recorded a \$100,000 accrual for the arbitration based on an expired settlement offer made by the Company to Libra. On June 21, 2018, the arbitrator issued a final and binding award on all issues except as to attorney’s fees and costs. In the Final Award, the arbitrator denied Libra’s claims and awarded the Company \$163,105 on its claims. On July 15, 2018, the arbitrator issued a Supplemental Final Award on Attorney’s Fees and Costs, awarding the Company an additional \$165,346. As a result, during the three months ended June 30, 2018, the Company reversed the previously recorded \$100,000 accrual resulting in a reduction to general and administrative expense and recognized the Final Award of \$163,105 as a reduction in cost of product revenue and the Supplemental Final Award on Attorney’s Fees and Costs of \$165,347 as a reduction in general and administrative expense. At June 30, 2018, the total award of \$328,451 is included within prepayments and other current assets on the Company’s Balance Sheet. The Company received full payment on the total award on August 2, 2018.

On April 11, 2018, the Company received \$203,121 pursuant to a Judgment of Garnishment dated March 23, 2018 and related to the non-payment of an overdue accounts receivable balance by a former customer of the Company. The judgment included the past due balance of \$162,000 plus late fees and recovery of legal costs. At March 31, 2018, the Company had fully reserved the \$162,000 balance in its allowance for doubtful accounts. The Company did not reverse the allowance for doubtful accounts at March 31, 2018 as the funds could be subject to clawback during the quarter ending June 30, 2018 if the former customer filed for bankruptcy. The former customer did not file for bankruptcy during the quarter ended June 30, 2018 and, as a result, the Company reversed the allowance for doubtful accounts of \$162,000 with a corresponding reduction in sales and marketing expense, recognized interest income of \$35,064 associated with late fees and a reduction in general and administrative expense of \$6,057 for the partial recovery of legal fees.

Note 9 — Common Stock

On March 3, 2017, the Company closed on a definitive securities purchase agreement, or Private Placement, to sell the Company's common stock and preferred stock together with warrants to purchase shares of common stock. In the Private Placement, each share of common stock or preferred stock was sold together with a warrant to purchase one share of common stock at a collective price of \$2.535. Investors purchased an aggregate of 5,220,826 shares of common stock and 708,430 shares of preferred stock together with warrants to purchase 5,929,256 shares of common stock in the Private Placement for aggregate gross proceeds of \$15 million. Net cash proceeds were \$13.7 million after offering fees and expenses, including the placement agent fee of \$1.1 million.

Note 10 — Equity Incentive Plan

On May 17, 2013, the Company adopted the 2013 Equity Incentive Plan (the "Plan") and reserved shares of common stock for issuance under the Plan. The Plan is administered by the Compensation Committee of the Company's Board of Directors. At June 30, 2018, 424,963 shares of common stock were available for issuance under the Plan.

During the six months ended June 30, 2018, the Company granted 122,039 stock options to Board members and 300,000 stock options to its Chief Executive Officer under the Plan. The estimated fair value of these stock options, calculated using the Black-Scholes option valuation model, was \$330,713, of which \$270,712 was recognized during the six months ended June 30, 2018.

During the six months ended June 30, 2018, the Company also granted 117,500 restricted stock units and 12,000 performance stock units to employees. The estimated fair value of these awards, based on the Company's stock price on the date of grant, was \$158,110, of which \$19,923 was recognized during the six months ended June 30, 2018.

A summary of the Company's stock option activity and related information is as follows:

| | Stock Options | Weighted Average Exercise Price | Weighted Average Remaining Life (in years) |
|----------------------------------|------------------|--|---|
| Outstanding at December 31, 2017 | 1,232,236 | \$ 6.44 | 6.8 |
| Granted | 422,039 | \$ 1.31 | |
| Forfeited/Expired/Exchanged | (124,728) | \$ 5.23 | |
| Outstanding at June 30, 2018 | 1,529,547 | \$ 5.12 | 7.3 |
| Exercisable at June 30, 2018 | 1,264,680 | \$ 5.12 | 7.2 |

At June 30, 2018, there was \$689,640 of unrecognized compensation cost related to non-vested equity awards granted under the Plan. That cost is expected to be recognized over a weighted average period of 0.7 years.

Note 11 — Warrants

In connection with the Private Placement, investors received warrants to purchase 5,929,256 shares of common stock. The warrants have an exercise price of \$2.41 per share and will expire three years from the date of issuance. The placement agent also received 237,170 warrants to purchase shares of common stock as part of its placement agent fee. The placement agent warrant has an exercise price of \$2.89 per share and also has a three-year term. The warrants contain a provision to protect investors from potential future dilutive events, or a down-round provision. The Company elected to early adopt ASU 2017-11 and will recognize the value of the effect of the down-round provision if and/or when triggered. The Company had 7,481,079 warrants outstanding at both June 30, 2018 and December 31, 2017 with a weighted average exercise price of \$2.79 per share. At June 30, 2018 all warrants are exercisable, although for the Company's two largest beneficial owners their warrants may be exercised only to the extent that the total number of shares of common stock then beneficially owned by these shareholders does not exceed 9.99% of the outstanding shares of the Company's common stock.

Note 12 — Revenue

Revenue Recognition

Revenue is recognized in accordance with ASC Topic 606 upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that typically are for products only although contracts could include various combinations of products and services, which are generally distinct and accounted for as separate performance obligations. Revenue is recognized net of taxes collected from customers, which are subsequently remitted to governmental authorities. The Company generally sells its products FOB shipping and recognizes revenue when products are shipped. Revenue from services, which consist of commissioning services, if any, is recognized as services are performed.

The Company had revenue from two customers which accounted for 48% and 12% of net revenue for the six months ended June 30, 2018 and revenue from three customers which accounted for 18%, 13% and 13% of net revenue for the six months ended June 30, 2017.

Deferred Revenues

Edgar Filing: Ideal Power Inc. - Form 10-Q

We record deferred revenues when cash payments are received in advance of our performance. Based on our review of customer credit, we may require full or partial payment before the products or services are delivered to the customer.

Activity in the deferred revenue account was as follows:

| | |
|---------------------------------|----------|
| Balance at December 31, 2017 | \$- |
| Deferral of revenue | 50,070 |
| Recognition of unearned revenue | (42,850) |
| Balance June 30, 2018 | \$7,220 |

-9-

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

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

- our history of losses;
- our ability to achieve profitability;
- our limited operating history;
- our ability to successfully market and sell our products;
- the size and growth of markets for our current and future products;
- our expectations regarding the growth and expansion of our customer base;
- regulatory developments that may affect our business;

our ability to successfully develop new technologies, including our bi-directional bipolar junction transistor, or B-TRAN™;

- our expectations regarding the completion of testing of new products under development and the timing of the introduction of those new products;

- the expected performance of new and existing products, including future products incorporating our B-TRAN™;
 - the performance of third-party manufacturers who supply and manufacture our products;

our expectations of the reliability of our products over the applicable warranty term and the future costs associated with warranty claims;

our ability to cost effectively manage product life cycles, inclusive of product launches and end of product life situations;

- the rate and degree of market acceptance for our current and future products;

our ability to successfully obtain certification for our products, including in new markets, and the timing of the receipt of any necessary certifications;

- our ability to successfully license our technology;

our ability to obtain, maintain, defend and enforce intellectual property rights protecting our current and future products;

- our expectations regarding the decline in prices of battery energy storage systems;

- our ability to manage our cost structure;

- general economic conditions and events and the impact they may have on us and our potential customers;

- our ability to obtain adequate financing in the future, as and when we need it;

- our success at managing the risks involved in the foregoing items; and

- other factors discussed in this report.

The forward-looking statements are based upon management's beliefs and assumptions and are made as of the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements included in this report. You should not place undue reliance on these forward-looking statements.

Unless otherwise stated or the context otherwise requires, the terms “Ideal Power,” “we,” “us,” “our” and the “Company” refer to Ideal Power Inc.

-10-

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q as well as our audited 2017 financial statements and related notes included in our Annual Report on Form 10-K. In addition to historical information, the discussion and analysis here and throughout this Form 10-Q contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited, to those set forth under "Risk Factors" in Part II, Item 1A of this report.

OVERVIEW

Ideal Power is located in Austin, Texas. We design, market and sell electrical power conversion products using our proprietary technology called Power Packet Switching Architecture™, or PPSA™. PPSA™ is a power conversion technology that improves upon existing power conversion technologies in key product metrics, such as size and weight while providing built-in isolation and bi-directional and multi-port capabilities. PPSA™ utilizes standardized hardware with application specific embedded software. Our products are designed to be used in both on-grid and off-grid applications.

We sell our products primarily to systems integrators as part of a larger turn-key systems which enable end users to manage their electricity consumption by reducing demand charges or fossil fuel consumption, integrating renewable energy sources and forming their own microgrid. Our products are made by contract manufacturers to our specifications, enabling us to scale production to meet demand on a cost-effective basis without requiring significant expenditures on manufacturing facilities and equipment. As our products establish a foothold in key power conversion markets, we may begin to focus on licensing our proprietary PPSA™-based product designs to OEMs to reach more markets and customers. We may seek to build a portfolio of relationships that generate license fees and royalties from OEMs for sales of their products which integrate PPSA™.

On April 16, 2018, the Company realigned into two separate operating divisions: Power Conversion Systems to focus on its PPSA™ technology and B-TRAN to develop its bi-directional bi-polar junction transistor (B-TRAN™) solid state switch technology.

We were founded on May 17, 2007. To date, operations have been funded primarily through the sale of common stock and, prior to our initial public offering, the issuance of convertible debt. Total revenue generated from inception to date as of June 30, 2018 amounted to \$14.0 million with approximately 19% of that revenue coming from government

grants. We may pursue additional research and development grants, if and when available, for the purpose of developing new products and improving current products.

Power Conversion Systems Division

Our Technology

PPSA™ uses indirect power flow in which power flows through input switches and is temporarily stored in our proprietary AC link inductor. Our proprietary fast switching algorithms enable the transfer of quantum packets of power between ports in our system. As the AC link becomes charged, it disconnects from its input switches, resonates without being connected to either the input or output switches, and then reconnects to its output switches when it reaches the correct voltage and frequency for the application. PPSA™ is a power conversion technology that differentiates itself from traditional power conversion technology in key product metrics, such as size and weight while providing built-in isolation and bi-directional and multi-port capabilities. At June 30, 2018, we had been granted 38 US patents and five foreign patents related to PPSA™.

Products

We currently sell three power conversion systems, or PCS, utilizing our patented PPSA™ technology. These products are described as follows:

The 30kW Stabiliti™ series has two product offerings, two-port (AC-DC) and multi-port (AC-DC-DC) models, which are both UL1741 Supplement A, or UL1741 SA, certified. These products are intended to be used for the commercial and industrial stand-alone energy storage, electric vehicle fast charging and microgrid markets, including solar plus storage microgrids. They are bi-directional and operate in both grid-tied and grid-forming modes with near seamless transfer between operating modes. Grid-forming mode provides customers the ability to form and manage a microgrid. The products operate in both 50Hz and 60Hz environments.

The 30kW SunDial Plus™, which is also UL1741 SA certified, is intended to be used for the commercial and industrial grid-tied solar plus storage market. The SunDial™ Plus is a PV string inverter with a second DC port to connect batteries to a solar PV array. This product includes a built-in 6 string PV combiner and DC disconnects and is grid-tied, AC export only. The product operates in both 50Hz and 60Hz environments.

Business Strategy

Our business strategy is to promote and expand the uses of PPSA™ initially through product development and product sales. To bring our products to market, we plan to seek out best-in-class partners who will distribute, white-label or integrate our innovative products into higher value systems resulting in multiple strategic sales channels for our PPSA™-based products and product designs. As our products gain broader acceptance in the power conversion market, we intend to license our proprietary PPSA™-based product designs to OEMs within our target markets, as well as license our technologies for other markets which we do not plan to enter directly. The basis for this approach is the belief that OEMs may achieve higher product margins and gain more market share by providing PPSA™-based products, which are differentiated from the traditional product offerings in the industry, to their customers. We believe such strategic relationships with key OEM licensees would enable us to reap the benefits of PPSA™ and gain market share more quickly than by strictly manufacturing and distributing our products.

Target Markets

Currently, our primary target markets are solar + storage and, to a lesser extent, microgrids. We also intend to be opportunistic with regard to other markets, including the stand-alone energy storage and electric vehicle fast charging markets.

Solar + Storage and Microgrid Markets

Solar PV has one of the lowest levelized costs of energy for new electrical generation capacity and we expect this to remain true in the near term. We expect distributed PV to continue to be a high growth business as system costs have fallen dramatically over the past several years. Accordingly, we expect the economics of generating PV for local consumption to remain strong for several more years, especially given the investment tax credit, or ITC, extension passed by Congress and signed into law in 2015 for solar energy production. Our SunDial™ Plus product was launched to directly address this market. One shortcoming of distributed, behind-the-meter PV systems is that they require connection to the utility power grid in order to operate. For example, a business with PV on its roof will not, in most cases, benefit from the ability to generate power should the utility power grid go down. Another shortcoming of distributed PV systems is the instability they cause on the local power lines. Utility power grids were not designed to manage power inflow from the end of the lines. As a result, distributed generation sources can lead to wide swings in

line voltages when clouds pass and power output falls off, requiring the utility to ramp up its power generation to make up for the shortfall in solar. We believe the proliferation of PV, its intermittency and the elimination of net metering in many states may drive growth in the solar + storage market.

Whether for emergency backup power or for baseload generation in remote locations with weak or no electric grids, microgrids are an emerging business case for solar paired with energy storage. A distributed PV system connected to a battery energy storage system, or BESS that includes one of our Stabiliti™ multi-port PCS enable a business to benefit from the ability to form and manage a local microgrid powered by the PV system and BESS even when the utility power grid is down. This capability is attractive to electricity consumers who need to power critical loads even in a blackout. In remote locations where there is no reliable electric grid or a dependence on diesel generators, which may be as diverse as a military battlefield or remote tropical island resort, or in locations where local electric rates are high due to aging and inefficient generation technology, a trend towards self-generation microgrids is developing. These sites can use solar, batteries and other forms of generation all brought together by one or more of our Stabiliti™ PCS to form and manage a microgrid using maximum solar generation for lowest cost. As such, we believe our products may become increasingly attractive to co-locate BESS with distributed PV.

According to its research, IHS Markit Technology believes that systems will be deployed in two principal configurations. One configuration is to have separate BESS and PV systems tied together through the AC wiring, which is supported by our legacy products. A second, emerging configuration is to place the BESS and the PV system behind a single PCS with two DC inputs. Our Stabiliti™ and SunDial™ Plus were designed specifically to enable this configuration which we believe is the lower cost and more efficient configuration. By tying the solar and batteries together as a DC-coupled system, the batteries become eligible for ITC and accelerated depreciation further enhancing the project economics.

Stand-Alone Storage Market

The stand-alone energy storage market is served by BESS. BESS are racks of batteries coupled with a system controller and a power conversion system, such as those manufactured by us, to enable electric power to be captured, stored, and used in conjunction with electric power grids. These systems can be large, megawatt-scale systems operated by utilities to better manage their system resources, or smaller kilowatt-scale systems used by businesses and designed to enable these businesses to manage their power use and mitigate utility imposed "peak demand charges", which are charges utilities levy on their business customers for delivery of power at peak usage times of the day, such as mid-afternoons in the summer. The growth of peak demand charges has been substantial over the past decade and now can make up 50% or more of a commercial utility bill in certain markets. This is a trend that is likely to continue as more intermittent resources are added to the utility power grid causing grid instability. Utilities and aggregators of distributed generation resources are also expected to adopt BESS due to the proliferation of renewables and to take advantage of additional value streams such as energy arbitrage, frequency regulation and ancillary services, infrastructure upgrade deferral and locational capacity.

There are strong economic incentives available to commercial and industrial consumers in major US markets such as California and New York in the form of reduced time-of-use and/or demand charges for installing a BESS and managing when power is drawn from the grid or reducing peak consumption. There is also strong regulatory support for such systems. For example, California has issued a mandate for over 1,800 megawatts of new energy storage to be installed by 2020. Other states, including New York and Massachusetts, have also issued mandates for energy storage and we expect this trend to continue.

We expect the cost of commercial and industrial BESS to continue to decline due primarily to lower battery costs and, as a result, expect significant expansion in the addressable market for these systems. We also believe the combination of lower BESS costs, third-party financing, increases in utility demand charges, and the entrance of large, established companies to the BESS space may contribute to accelerating market growth for stand-alone energy storage.

Other Markets

In addition to the markets discussed above, we may also have opportunities for market expansion into electric vehicle fast chargers in certain applications where our products' compact size and multi-port capabilities can unlock value for the system integrator particularly in locations where battery storage is coupled with the charging system to eliminate demand charges or expand the charging systems response capabilities. During the quarter ended June 30, 2018, one of our customers received certification for an electric vehicle fast charger utilizing our two-port Stabiliti™ product and has plans to utilize our multi-port Stabiliti™ product in an electric vehicle fast charger with buffer storage. Another customer is developing an electric vehicle fast charger utilizing our multi-port Stabiliti™ product for an electric vehicle fast charger with buffer storage. We may have additional opportunities for growth in this market in the future.

Although our technology may be suitable for other vertical markets within the global power conversion market landscape, we do not currently offer products for sale directly to other power conversion markets such as the variable-frequency drive, uninterruptible power supply, rail, wind or electric vehicle traction drive markets.

We plan to continue to monitor all power conversion markets for opportunities to create solutions for customers and unlock the broader value of our patented technology.

Future Innovations

Our existing products incorporate multiple insulated gate bipolar transistors, or IGBTs, which are power switches used in the process to convert power from one current form to another. IGBTs switch power in only one direction (DC to AC or AC to DC) and require the use of a blocking diode to prevent power from flowing back through the system. To enable our existing products to perform bi-directional power conversion, for each IGBT and diode used in our products, we must include a second IGBT and diode. These additional components have slight voltage drops that affect the electrical efficiency of our products and generate heat that must be dissipated. We have patented and are developing a new, highly efficient power switch called a B-TRAN™ that we believe will allow us to substitute one B-TRAN™ for two pairs of IGBTs and diodes used in our current products. Based on third party device software simulations and initial prototype testing, we believe that the B-TRANS™ can significantly improve electrical efficiency in our power converters. The higher efficiency would substantially reduce the heat generated by the operation of our products. As a result, products incorporating B-TRANS™ will require less space for heat dissipation which would allow us to increase power density, or power per pound, and reduce material costs.

B-TRAN Division

Our Technology

In 2016, one of our semiconductor fabricators successfully tested single-sided B-TRAN™ silicon dies and the results were consistent with third party simulations that predict significant performance and efficiency improvements over conventional power switches such as SCRs, IGBTs and MOSFETs. In the second half of 2017, we shifted our focus to de-risking the proof of concept phase of the B-TRAN™ development timeline, as this phase of development was taking longer than anticipated due to the complexity of manufacturing complicated, two-sided power semiconductor devices. To facilitate this, we engaged a second semiconductor fabricator, on a parallel path, to produce, on an accelerated schedule, a B-TRAN™ that is less complex to manufacture for proof of concept and initial testing. In the first quarter of 2018, we successfully completed proof of concept testing of double-sided B-TRAN™ prototypes, validating the ability to make B-TRAN™ semiconductor power switches using conventional silicon semiconductor fabrication equipment and processes. Test results on the standard double-sided prototypes measured B-TRAN™ electrical losses at less than 40% that of conventional power switches such as silicon IGBTs.

In the second quarter of 2018, a domestic semiconductor fabricator was qualified and engaged for development runs on the standard version of the B-TRAN™. As a result, we now have the next run of devices with two fabricators in process. These runs incorporate the results of prior runs and testing into the B-TRAN™ design and their manufacturing process. With the double-sided transistor behavior and low conduction losses confirmed and corrections and improvements in the manufacturing process implemented, the next goal is the completion of the fabrication of prototype engineering samples for engineering evaluation and evaluation by potential customers and partners. These samples will include a packaging design based on our previous work and a driver. We have completed the first design for the driver with a prototype driver already built and tested for basic functionality. The coupling of device samples with a driver will form the basis of an intelligent module required for potential customer and partner evaluation.

At June 30, 2018, we have 31 US and eight foreign issued patents covering the operation, control and manufacturing of the B-TRAN™ device.

Products

As our B-TRAN™ technology is currently under development, we do not yet offer commercial B-TRAN™ products.

Business Strategy and Target Markets

We plan to first utilize the B-TRAN™ in our own power conversion products and then introduce it into the multi-billion dollar power semiconductor market utilizing a licensing model. We believe our new B-TRAN™ technology can potentially address a significant portion of the power semiconductor market that currently relies on power semiconductor devices such as IGBTs. Potential addressable markets for B-TRAN™-based products include solar photovoltaic inverters, microgrid power conversion systems, electric vehicle drivetrains, bi-directional energy storage, solid-state DC and AC contactors and breakers, variable frequency drives and other power conversion and control applications that could benefit from B-TRAN™'s enhanced switching performance.

Critical Accounting Policies

There have been no significant changes during the six months ended June 30, 2018 to the critical accounting policies disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Results of Operations

Comparison of the three months ended June 30, 2018 to the three months ended June 30, 2017

Revenues. Revenues for the three months ended June 30, 2018 of \$619,942 were \$366,572, or 145%, higher than the \$253,370 we earned in revenues for the three months ended June 30, 2017 due to higher sales of our Sun Dial™ Plus product.

Cost of Revenues. Cost of revenues decreased for the three months ended June 30, 2018 to \$584,800 compared to \$764,609 for the three months ended June 30, 2017. Cost of revenues for the three months ended June 30, 2018 was impacted by higher unit sales volumes, higher manufacturing costs and a \$78,105 unfavorable adjustment to the Company's first-generation and second-generation product warranty accruals less a \$163,105 favorable award related to arbitration between the Company and its former contract manufacturer. Cost of revenues for the three months ended June 30, 2017 was impacted by the non-cash write-down of inventory of \$358,988 and an unfavorable \$98,457 adjustment to the Company's first-generation product warranty accruals.

Gross Profit (Loss). Gross profit for the three months ended June 30, 2018 was \$35,142 compared to a gross loss of \$511,239 for the three months ended June 30, 2017.

Research and Development Expenses. Research and development expenses decreased by \$202,827, or 18%, to \$905,541 in the three months ended June 30, 2018 from \$1,108,368 in the three months ended June 30, 2017. The decrease was due primarily to lower personnel costs.

General and Administrative Expenses. General and administrative expenses decreased by \$352,743, or 30%, to \$817,672 in the three months ended June 30, 2018 from \$1,170,415 in the three months ended June 30, 2017. The decrease was primarily due to lower patent write-offs of \$197,179 and lower legal fees of \$135,777. In the three months ended June 30, 2017, we abandoned certain patent filings to focus on filings with the highest strategic value. In the three months ended June 30, 2018, we recovered \$171,404 in legal expenses related to the resolution of legal proceedings in our favor.

Sales and Marketing Expenses. Sales and marketing expenses decreased by \$357,347, or 84%, to \$69,989 in the three months ended June 30, 2018 from \$427,336 in the three months ended June 30, 2017. In the three months ended June 30, 2018, we recovered \$162,000 related to a receivable we fully reserved in the three months ended June 30, 2017.

Loss from Operations. Our loss from operations for the three months ended June 30, 2018 was \$1,758,060 compared to \$3,217,358 loss from operations for the three months ended June 30, 2017.

Interest Income, net. Net interest income was \$35,614 for the three months ended June 30, 2018 compared to \$7,034 for the three months ended June 30, 2017. The increase was the result of late fees associated with the recovery of a delinquent customer receivable.

Net Loss. Our net loss for the three months ended June 30, 2018 was \$1,722,446 as compared to a net loss of \$3,210,324 for the three months ended June 30, 2017. The decrease is attributable to reduced operating expenses as the result of cost reduction activities, the favorable resolution of legal proceedings and higher non-cash charges associated with inventory write-downs, patent impairments and bad debt expense in 2017.

Comparison of the six months ended June 30, 2018 to the six months ended June 30, 2017

Revenues. Revenues for the six months ended June 30, 2018 of \$801,442 were \$272,402, or 51%, higher than the \$529,040 we earned in revenues for the six months ended June 30, 2017 due to higher sales of our Sun Dial™ Plus product.

Cost of Revenues. Cost of revenues decreased by \$555,776, or 38%, to \$919,763 for the six months ended June 30, 2018 compared to \$1,475,539 for the six months ended June 30, 2017. The decrease was due primarily to a non-cash write-down of inventory of \$708,204 in the six months ended June 30, 2017 partially offset by higher sales volumes.

Gross Loss. Gross loss for the six months ended June 30, 2018 was \$118,321 compared to a gross loss of \$946,499 for the six months ended June 30, 2017. The gross loss in the six months ended June 30, 2018 was due to higher manufacturing costs, as the Company expedited production to meet the growth in customer orders, as well as a net \$100,000 unfavorable adjustment to the Company's warranty accrual.

Research and Development Expenses. Research and development expenses decreased by \$635,213, or 28%, to \$1,663,324 in the six months ended June 30, 2018 from \$2,298,537 in the six months ended June 30, 2017. The decrease was due primarily to lower personnel costs and other cost reduction activities described below.

General and Administrative Expenses. General and administrative expenses decreased by \$366,718, or 18%, to \$1,709,660 in the six months ended June 30, 2018 from \$2,076,378 in the six months ended June 30, 2017. The decrease was primarily due to lower patent write-offs of \$186,865, as we abandoned certain patent filings in 2017 to focus on filings with the highest strategic value, lower legal and consulting fees of \$93,670 and other cost reduction activities.

Sales and Marketing Expenses. Sales and marketing expenses decreased by \$644,637, or 67%, to \$324,232 in the six months ended June 30, 2018 from \$968,869 in the six months ended June 30, 2017. The decrease was due to a \$372,064 decline in bad debt expense and lower professional fees of \$238,531 and personnel costs of \$131,434, partially offset by higher stock-based compensation costs of \$162,914 due to significant forfeitures in 2017. In the six months ended June 30, 2018, we recovered \$162,000 related to a receivable we fully reserved in the six months ended June 30, 2017.

Loss from Operations. Our loss from operations for the six months ended June 30, 2018 was \$3,815,537 compared to \$6,290,283 loss from operations for the six months ended June 30, 2017.

Interest Income, net. Net interest income was \$36,929 for the six months ended June 30, 2018 compared to \$11,575 for the six months ended June 30, 2017. The increase was the result of late fees associated with the recovery of a delinquent customer receivable.

Net Loss. Our net loss for the six months ended June 30, 2018 was \$3,778,608 as compared to a net loss of \$6,278,708 for the six months ended June 30, 2017. The decrease is attributable to reduced operating expenses as the result of cost reduction activities, the favorable resolution of legal proceedings and higher non-cash charges associated with inventory write-downs, patent impairments and bad debt expense in 2017.

Liquidity and Capital Resources

We do not currently generate enough revenue to sustain our operations. We have funded our operations through the sale of common stock and, prior to our initial public offering, the issuance of convertible debt.

At June 30, 2018, we had cash and cash equivalents of \$6,980,213. Our net working capital and long-term debt at June 30, 2017 were \$6,226,567 and \$0, respectively.

Operating activities in the six months ended June 30, 2018 resulted in cash outflows of \$2,942,133, which were due primarily to the net loss for the period of \$3,778,608, partly offset by non-cash items of \$776,880, related primarily to stock-based compensation of \$630,306 and, depreciation and amortization of \$216,920. Operating activities in the six months ended June 30, 2017 resulted in cash outflows of \$4,348,202, which were due primarily to the net loss for the period of \$6,278,708, partly offset by non-cash items of \$1,926,121, related primarily to inventory write-downs of \$712,083, stock-based compensation of \$498,006, bad debt expense of \$273,727, depreciation and amortization of \$224,926 and patent impairments of \$202,343.

Investing activities in the six months ended June 30, 2018 and 2017 resulted in cash outflows of \$97,713 and \$189,280, respectively, for the acquisition of fixed assets and intangible assets.

In the second quarter of 2017, we began implementing a cost reduction plan with the goal of reducing our cash outflows for operating and investing activities. This plan included the simplification of our product roadmap to focus on our 30kW SunDial™ Plus and Stabilti™ products for the solar plus storage and microgrid markets and eliminate activities that did not present significant near-term revenue opportunities. In addition, we discontinued our legacy products, including our 125kW product, and postponed our development and certification efforts related to other applications and international markets.

Financing activities in the six months ended June 30, 2018 were not significant. Financing activities in the six months ended June 30, 2017 resulted in cash inflows of \$13,668,474 related primarily to our Private Placement net proceeds of \$13,657,331. In the Private Placement, each share of common stock or preferred stock was sold together with a warrant to purchase one share of common stock at a collective price of \$2.535. Investors purchased an aggregate of 5,220,826 shares of common stock and 708,430 shares of preferred stock together with warrants to purchase 5,929,256 shares of common stock in the Private Placement for aggregate gross proceeds of \$15.0 million. Net cash proceeds are after offering fees and expenses, including the placement agent fee of \$1.1 million.

Off-Balance Sheet Transactions

We do not have any off-balance sheet transactions.

Trends, Events and Uncertainties

There are no material changes from trends, events or uncertainties disclosed in our 2017 Annual Report on Form 10-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

Limitations on the Effectiveness of Controls

Control systems, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control systems' objectives are being met. Further, the design of any system of controls must reflect the fact that there are resource constraints, and the benefits of all controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of error or mistake. Control systems can also be circumvented by the individual acts of some persons, by collusion of two or more people,

or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

-17-

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no material changes from the legal proceedings disclosed in our 2017 Annual Report on Form 10-K except as follows:

On June 21, 2018, an arbitrator issued a final and binding award on all issues except as to attorney's fees and costs, related to arbitration between us and Libra Industries, Inc. (Libra), our prior contract manufacturer, and. In the Final Award, the arbitrator denied Libra's claims and awarded us \$163,105 for our claims. On July 15, 2018, the arbitrator issued a Supplemental Final Award on Attorney's Fees and Costs, awarding us an additional \$165,346. We received full payment of the award, totaling \$328,451, on August 2, 2018.

On April 11, 2018, we received \$203,121 pursuant to a Judgment of Garnishment dated March 23, 2018 and related to the non-payment of an overdue accounts receivable balance by a former customer. The judgment included the past due balance of \$162,000 plus late fees and partial recovery of legal costs.

ITEM 1A. RISK FACTORS

There are no material changes from the risk factors disclosed in our 2017 Annual Report on Form 10-K except as follows:

Our actions to separate our business into two divisions may result in additional costs.

As discussed above in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Overview," we realigned our business into two separate operating divisions. Our Power Conversion Systems division focuses on our PPSA™ technology, while our B-TRAN division focuses on our B-TRAN™ solid state switch technology. We took several corporate actions in connection with the creation of these two operating divisions, including reassigning our former president and chief executive officer, R. Daniel Brdar, to the position of B-TRAN Chief Commercial Officer and hiring Dr. Lon E. Bell as our president and chief executive officer in addition to his role as chairman of our board of directors. This separation may result in additional costs and expenses and may cause

logistical and operational complexities that will divert management's attention both during and after separation. We cannot assure you that the separation of our business into two divisions will not have a material adverse impact on our results of operations.

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

On March 3, 2017, we closed on a definitive securities purchase agreement to sell to certain accredited investors shares of our common stock and preferred stock together with warrants to purchase shares of common stock, or the Private Placement. We filed with the SEC a Registration Statement on Form S-3 (Registration No. 333-217088) covering the resale of the registrable securities on March 31, 2017, and it was declared effective on April 21, 2017.

Net cash proceeds were \$13.7 million after offering fees and expenses We have utilized, and expect to continue to utilize, net proceeds from the offering for working capital and general corporate purposes.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

| Exhibit Number | Document |
|-----------------------|---|
| <u>10.1*</u> | <u>Amendment No. 1 to lease effective April 17, 2018, by and between Ideal Power Inc. and Agellan Commercial REIT US L.P. (Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on April 26, 2018)</u> |
| <u>31.1</u> | <u>Certification of Principal Executive Officer pursuant to Exchange Act Rule, 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**</u> |
| <u>31.2</u> | <u>Certification of Principal Financial Officer pursuant to Exchange Act Rule, 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**</u> |
| <u>32.1</u> | <u>Certification pursuant to 18 U.S.C. 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002***</u> |
| 101.INS | XBRL Instant Document ** |
| 101.SCH | XBRL Taxonomy Extension Schema Document ** |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document ** |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document ** |
| 10.LAB | XBRL Taxonomy Extension Label Linkbase Document ** |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document ** |

* Incorporated herein by reference to the indicated filing

** Filed herewith

***Furnished herewith

SIGNATURES

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

Dated August 14, 2018 **IDEAL POWER INC.**

By:/s/ Lon E. Bell
Lon E. Bell
Chief Executive Officer

By:/s/ Timothy W. Burns
Timothy W. Burns
Chief Financial Officer