

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, 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)

Delaware

(State or other jurisdiction of
incorporation or organization)

14-1999058

(I.R.S. Employer
Identification No.)

4120 Freidrich Lane, Suite 100

Austin, Texas 78744

(Address of principal executive offices)

(Zip Code)

(512) 264-1542

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period than 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 definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

As of November 9, 2018, the issuer had 13,997,256 shares of common stock, par value \$.001, outstanding.

TABLE OF CONTENTS

| | | |
|--------------------------|--|------------------|
| <u>PART I</u> | <u>FINANCIAL INFORMATION</u> | <u>3</u> |
| <u>Item 1.</u> | <u>Condensed Financial Statements</u> | <u>3</u> |
| | Balance Sheets at September 30, 2018 (Unaudited) and December 31, 2017 | 3 |
| | Statements of Operations for the three and nine months ended September 30, 2018 and 2017 (Unaudited) | 4 |
| | Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 (Unaudited) | 5 |
| | Notes to Unaudited Financial Statements | 6 |
| <u>Item 2.</u> | <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>13</u> |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>18</u> |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | <u>19</u> |
| <u>PART II</u> | <u>OTHER INFORMATION</u> | <u>20</u> |
| <u>Item 1.</u> | <u>Legal Proceedings</u> | <u>20</u> |
| <u>Item 1A.</u> | <u>Risk Factors</u> | <u>20</u> |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>22</u> |
| <u>Item 3.</u> | <u>Defaults Upon Senior Securities</u> | <u>22</u> |
| <u>Item 4.</u> | <u>Mine Safety Disclosures</u> | <u>22</u> |
| <u>Item 5.</u> | <u>Other Information</u> | <u>22</u> |
| <u>Item 6.</u> | <u>Exhibits</u> | <u>22</u> |
| <u>SIGNATURES</u> | | <u>23</u> |

PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

**IDEAL POWER INC.
Balance Sheets**

| | September 30, 2018 | December 31, 2017 |
|---|-------------------------------|------------------------------|
| | <u>(unaudited)</u> | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 5,538,765 | \$ 10,022,247 |
| Accounts receivable, net | 279,299 | 221,084 |
| Inventories, net | 131,765 | 251,363 |
| Prepayments and other current assets | 83,382 | 283,208 |
| Total current assets | <u>6,033,211</u> | <u>10,777,902</u> |
| Property and equipment, net | 458,856 | 669,571 |
| Intangible assets, net | 2,109,981 | 2,082,014 |
| Other assets | 55,420 | 37,500 |
| Total Assets | <u>\$ 8,657,468</u> | <u>\$ 13,566,987</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 737,083 | \$ 449,475 |
| Accrued expenses | 1,068,418 | 1,081,155 |
| Total current liabilities | <u>1,805,501</u> | <u>1,530,630</u> |
| Other long-term liabilities | 465,181 | 456,234 |
| Total liabilities | <u>2,270,682</u> | <u>1,986,864</u> |
| Commitments and contingencies (see Note 8) | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.001 par value; 10,000,000 shares authorized; 1,518,430 shares issued and outstanding at September 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 13,999,756 shares outstanding at September 30, 2018 and 13,998,465 shares issued and 13,996,121 shares outstanding at December 31, 2017, respectively | 14,004 | 13,998 |
| Additional paid-in capital | 67,919,163 | 67,081,359 |
| Treasury stock, at cost; 4,709 shares at September 30, 2018 and 2,344 shares at December 31, 2017 | (10,105) | (7,489) |
| Accumulated deficit | (61,537,794) | (55,509,263) |
| Total stockholders' equity | <u>6,386,786</u> | <u>11,580,123</u> |
| Total Liabilities and Stockholders' Equity | <u>\$ 8,657,468</u> | <u>\$ 13,566,987</u> |

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

IDEAL POWER INC.
Statements of Operations
(unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-----------------------|--|-----------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Product revenue | \$ 342,661 | \$ 444,640 | \$ 1,144,103 | \$ 973,680 |
| Cost of product revenue | 552,127 | 418,529 | 1,471,890 | 1,894,068 |
| Gross profit (loss) | <u>(209,466)</u> | <u>26,111</u> | <u>(327,787)</u> | <u>(920,388)</u> |
| Operating expenses: | | | | |
| Research and development | 854,364 | 1,075,849 | 2,517,688 | 3,374,386 |
| General and administrative | 921,276 | 899,882 | 2,630,936 | 2,976,260 |
| Sales and marketing | 264,705 | 271,844 | 588,937 | 1,240,713 |
| Total operating expenses | <u>2,040,345</u> | <u>2,247,575</u> | <u>5,737,561</u> | <u>7,591,359</u> |
| Loss from operations | (2,249,811) | (2,221,464) | (6,065,348) | (8,511,747) |
| Interest income (expense), net | (112) | 3,865 | 36,817 | 15,440 |
| Net loss | <u>\$ (2,249,923)</u> | <u>\$ (2,217,599)</u> | <u>\$ (6,028,531)</u> | <u>\$ (8,496,307)</u> |
| Net loss per share – basic and fully diluted | <u>\$ (0.16)</u> | <u>\$ (0.16)</u> | <u>\$ (0.43)</u> | <u>\$ (0.66)</u> |
| Weighted average number of shares outstanding – basic and fully diluted | <u>13,996,299</u> | <u>13,990,202</u> | <u>13,993,423</u> | <u>12,964,452</u> |

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

IDEAL POWER INC.
Statements of Cash Flows
(unaudited)

| | Nine Months Ended September 30, | |
|--|--|----------------------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net loss | \$ (6,028,531) | \$ (8,496,307) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Allowance for doubtful accounts | (98,677) | 226,557 |
| Write-down of inventory | 67,515 | 703,220 |
| Depreciation and amortization | 297,007 | 339,493 |
| Write-off of capitalized patents | 15,478 | 268,789 |
| Write-off of fixed assets | 7,128 | 53,445 |
| Stock-based compensation | 837,810 | 833,637 |
| Decrease (increase) in operating assets: | | |
| Accounts receivable | 40,462 | (234,980) |
| Inventories | 52,083 | 214,466 |
| Prepayments and other current assets | 181,906 | 159,366 |
| Increase (decrease) in operating liabilities: | | |
| Accounts payable | 287,608 | (59,653) |
| Accrued expenses | (3,790) | 67,722 |
| Net cash used in operating activities | <u>(4,344,001)</u> | <u>(5,924,245)</u> |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (19,613) | (44,819) |
| Acquisition of intangible assets | (117,252) | (220,865) |
| Net cash used in investing activities | <u>(136,865)</u> | <u>(265,684)</u> |
| Cash flows from financing activities: | | |
| Net proceeds from issuance of stock | - | 13,657,331 |
| Payment of taxes related to stock award vesting | (2,616) | (1,574) |
| Exercise of options and warrants | - | 11,143 |
| Net cash provided by (used in) financing activities | <u>(2,616)</u> | <u>13,666,900</u> |
| Net increase (decrease) in cash and cash equivalents | (4,483,482) | 7,476,971 |
| Cash and cash equivalents at beginning of period | 10,022,247 | 4,204,916 |
| Cash and cash equivalents at end of period | <u>\$ 5,538,765</u> | <u>\$ 11,681,887</u> |

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 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.

Liquidity and Going Concern

As reflected in the accompanying condensed financial statements, the Company had a net loss of \$6.0 million and used \$4.3 million of cash in operating activities for the nine months ended September 30, 2018. At September 30, 2018, the Company had net working capital of \$4.2 million and the Company’s principal source of liquidity consisted of \$5.5 million of cash and cash equivalents.

In order to meet the Company’s operating requirements, it will need to raise additional capital from third parties. There can be no assurance that the Company will be successful in obtaining third party financing. If external financing sources are not available or are inadequate to fund operations, or forecasted revenue growth does not materialize, the Company will be required to reduce operating costs, which could jeopardize future strategic initiatives and business plans.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The ability of the Company to continue as a going concern is dependent on its ability to raise additional capital and to develop profitable operations through implementation of its current business initiatives, however, there can be no assurances that the Company will be able to do so. The accompanying condensed financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

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:

| | September 30, 2018 | December 31, 2017 |
|---------------------------------|-------------------------------|------------------------------|
| | (unaudited) | |
| Trade receivables | \$ 285,924 | \$ 378,894 |
| Other receivables | - | 20,589 |
| | <u>285,924</u> | <u>399,483</u> |
| Allowance for doubtful accounts | (6,625) | (178,399) |
| | <u>\$ 279,299</u> | <u>\$ 221,084</u> |

The Company had receivable balances from three customers that accounted for 44% of net trade receivables at September 30, 2018.

Activity in the allowance for doubtful accounts was as follows:

| | |
|-------------------------------|-------------------|
| Balance at December 31, 2017 | \$ (178,399) |
| Write offs | 73,097 |
| Provisions | (63,683) |
| Recovery | 162,360 |
| Balance at September 30, 2018 | <u>\$ (6,625)</u> |

Note 4 – Inventories

Inventories, net consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|--------------------------|-------------------------------|------------------------------|
| | (unaudited) | |
| Raw materials | \$ 191,407 | \$ 222,436 |
| Finished goods | 66,700 | 149,370 |
| | <u>258,107</u> | <u>371,806</u> |
| Reserve for obsolescence | (126,342) | (120,443) |
| | <u>\$ 131,765</u> | <u>\$ 251,363</u> |

Note 5 – Property and Equipment

Property and equipment, net consisted of the following:

| | September 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 | 193,568 | 218,571 |
| | <u>1,612,230</u> | <u>1,627,039</u> |
| Accumulated depreciation and amortization | (1,153,374) | (957,468) |
| | <u>\$ 458,856</u> | <u>\$ 669,571</u> |

Note 6 – Intangible Assets

Intangible assets, net consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|--------------------------|-------------------------------|------------------------------|
| | (unaudited) | |
| Patents | \$ 1,656,042 | \$ 1,554,268 |
| Other intangible assets | 732,175 | 732,175 |
| | <u>2,388,217</u> | <u>2,286,443</u> |
| Accumulated amortization | (278,236) | (204,429) |
| | <u>\$ 2,109,981</u> | <u>\$ 2,082,014</u> |

Amortization expense amounted to \$24,775 and \$73,807 for the three and nine months ended September 30, 2018, respectively, and \$22,822 and \$59,291 for the three and nine months ended September 30, 2017, respectively. Amortization expense for patents for the succeeding five years and thereafter is approximately \$25,000 (2018), \$100,000 (2019-2022) and \$1,172,000 (thereafter).

At September 30, 2018 and December 31, 2017, the Company had capitalized \$512,515 and \$472,928, respectively, for costs related to patents that have not been awarded.

Note 7 – Accrued Expenses

Accrued expenses consisted of the following:

| | September 30, 2018 | December 31, 2017 |
|----------------------|-------------------------------|------------------------------|
| | (unaudited) | |
| Accrued compensation | \$ 310,998 | \$ 247,343 |
| Warranty reserve | 432,117 | 426,115 |
| Other | 325,303 | 407,697 |
| | <u>\$ 1,068,418</u> | <u>\$ 1,081,155</u> |

Note 8 – Commitments and Contingencies

Lease

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 | \$ 46,194 |
| 2019 | 189,086 |
| 2020 | 196,477 |
| 2021 | 83,149 |
| | <u>\$ 514,906</u> |

The Company incurred rent expense of \$63,675 and \$181,850 for the three and nine months ended September 30, 2018, respectively, and \$58,543 and \$175,617 for the three and nine months ended September 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 September 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 \$465,181. The Company is accruing interest for future payments related to the issued patent associated with the agreement.

Note 9 — Common Stock and Net Loss Per Share

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.

The Company applies Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 260, "Earnings per Share." Basic earnings (loss) per share is computed by dividing earnings (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include additional common shares available upon exercise of equity awards and warrants using the treasury stock method. In periods with a net loss, no common share equivalents are included because their effect would be anti-dilutive. At September 30, 2018 and 2017, potentially dilutive shares outstanding amounted to 9,249,626 and 9,005,714, respectively.

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 September 30, 2018, 430,963 shares of common stock were available for issuance under the Plan.

During the nine months ended September 30, 2018, the Company granted 122,039 stock options to Board members and 300,000 stock options to an executive under the Plan. The estimated fair value of these stock options, calculated using the Black-Scholes option valuation model, was \$330,713, of which \$300,713 was recognized during the nine months ended September 30, 2018.

During the nine months ended September 30, 2018, the Company also granted 117,500 restricted stock units and 12,000 performance stock units to employees, of which 6,000 performance stock units were forfeited during the three months ended September 30, 2018 as the related performance conditions were not achieved. The estimated fair value of these awards, based on the Company's stock price on the date of grant and net of subsequent forfeitures, was \$150,730, of which \$37,842 was recognized during the nine months ended September 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 September 30, 2018 | 1,529,547 | \$ 5.12 | 7.1 |
| Exercisable at September 30, 2018 | 1,397,562 | \$ 5.22 | 7.0 |

At September 30, 2018, there was \$482,136 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 September 30, 2018 and December 31, 2017 with a weighted average exercise price of \$2.79 per share. At September 30, 2018 all warrants are exercisable, although for the Company's two largest beneficial owners their warrants received in connection with the Private Placement 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 35% and 11% of net revenue for the nine months ended September 30, 2018 and revenue from two customers which accounted for 19% and 10% of net revenue for the nine months ended September 30, 2017.

Deferred Revenues

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 | | 96,786 |
| Recognition of revenue | | (87,755) |
| Balance September 30, 2018 | \$ | <u>9,031</u> |

Note 13 — Legal Proceedings

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 Award, 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 nine months ended September 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. 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. During the nine months ended September 30, 2018, the Company reversed the allowance for doubtful accounts of \$162,000, originally recorded in 2017, 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.

Neither of these legal proceedings impacted the statement of operations for the three months ended September 30, 2018.

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," "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.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the 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™ 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 September 30, 2018 amounted to \$14.3 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 September 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. Earlier this year, 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 September 30, 2018, we had 32 US and nine 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 nine months ended September 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 September 30, 2018 to the three months ended September 30, 2017

Revenues. Revenues for the three months ended September 30, 2018 of \$342,661 were \$101,979, or 23%, lower than the \$444,640 we earned in revenues for the three months ended September 30, 2017 due to lower sales of our Stabilti™ product and a customer rescheduling, with our approval, a SunDial™ Plus shipment to October.

Cost of Revenues. Cost of revenues increased for the three months ended September 30, 2018 to \$552,127 compared to \$418,529 for the three months ended September 30, 2017. Cost of revenues for the three months ended September 30, 2018 was impacted by an unfavorable adjustment to the Company's product warranty accrual of \$165,000, an unfavorable purchase price variance (PPV) on sales of the SunDial™ Plus of \$43,593 and a write-off of legacy product finished goods of \$41,600, partially off-set by lower volumes.

Gross Profit (Loss). Gross loss for the three months ended September 30, 2018 was \$209,466 compared to a gross profit of \$26,111 for the three months ended September 30, 2017.

Research and Development Expenses. Research and development expenses decreased by \$221,485, or 21%, to \$854,364 in the three months ended September 30, 2018 from \$1,075,849 in the three months ended September 30, 2017. The decrease was due primarily to the impact of cost reduction activities including lower personnel, development and certification costs and the timing of semiconductor fabrication expenditures.

General and Administrative Expenses. General and administrative expenses increased by \$21,394, or 2%, to \$921,276 in the three months ended September 30, 2018 from \$899,882 in the three months ended September 30, 2017.

Sales and Marketing Expenses. Sales and marketing expenses decreased by \$7,139, or 3%, to \$264,705 in the three months ended September 30, 2018 from \$271,844 in the three months ended September 30, 2017.

Loss from Operations. Our loss from operations for the three months ended September 30, 2018 was \$2,249,811 compared to loss from operations of \$2,221,464 for the three months ended September 30, 2017.

Interest Income (Expense), Net. Net interest expense was \$112 for the three months ended September 30, 2018 compared to net interest income of \$3,865 for the three months ended September 30, 2017.

Net Loss. Our net loss for the three months ended September 30, 2018 was \$2,249,923 as compared to a net loss of \$2,217,599 for the three months ended September 30, 2017.

Comparison of the nine months ended September 30, 2018 to the nine months ended September 30, 2017

Revenues. Revenues for the nine months ended September 30, 2018 of \$1,144,103 were \$170,423, or 18%, higher than the \$973,680 we earned in revenues for the nine months ended September 30, 2017 due to higher sales of our Sun Dial™ Plus product.

Cost of Revenues. Cost of revenues decreased by \$422,178, or 22%, to \$1,471,890 for the nine months ended September 30, 2018 compared to \$1,894,068 for the nine months ended September 30, 2017. The decrease was due primarily to a non-cash write-down of legacy product inventory in the nine months ended September 30, 2017 of \$703,220 partially offset by a net unfavorable adjustment to the Company's warranty accrual of \$150,000 and the impact of higher sales volumes.

Gross Loss. Gross loss for the nine months ended September 30, 2018 was \$327,787 compared to a gross loss of \$920,388 for the nine months ended September 30, 2017 due to the decline in cost of revenues.

Research and Development Expenses. Research and development expenses decreased by \$856,698, or 25%, to \$2,517,688 in the nine months ended September 30, 2018 from \$3,374,386 in the nine months ended September 30, 2017. The decrease was due primarily to the impact of cost reduction activities including lower personnel, development and certification costs.

General and Administrative Expenses. General and administrative expenses decreased by \$345,324, or 12%, to \$2,630,936 in the nine months ended September 30, 2018 from \$2,976,260 in the nine months ended September 30, 2017. The decrease was primarily due to lower non-cash charges for patent abandonments and stock-based compensation and the favorable impact of cost reduction activities, including lower personnel costs, partly offset by higher legal fees.

Sales and Marketing Expenses. Sales and marketing expenses decreased by \$651,776, or 53%, to \$588,937 in the nine months ended September 30, 2018 from \$1,240,713 in the nine months ended September 30, 2017. The decrease was due to a \$325,235 decline in bad debt expense, including a \$162,000 recovery in the nine months ended September 30, 2018, and the impact of costs reduction activities including lower professional fees of \$221,871 and personnel costs of \$175,095, partially offset by higher stock-based compensation costs of \$167,429 due to significant forfeitures in 2017.

Loss from Operations. Our loss from operations for the nine months ended September 30, 2018 was \$6,065,348 compared to loss from operations of \$8,511,747 for the nine months ended September 30, 2017.

Interest Income, net. Net interest income was \$36,817 for the nine months ended September 30, 2018 compared to \$15,440 for the nine months ended September 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 nine months ended September 30, 2018 was \$6,028,531 as compared to a net loss of \$8,496,307 for the nine months ended September 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 September 30, 2018, we had cash and cash equivalents of \$5,538,765. Our net working capital and long-term debt at September 30, 2018 were \$4,227,710 and \$0, respectively.

Operating activities in the nine months ended September 30, 2018 resulted in cash outflows of \$4,344,001, which were due primarily to the net loss for the period of \$6,028,531, partly offset by non-cash items of \$1,126,261, related primarily to stock-based compensation of \$837,810 and depreciation and amortization of \$297,007, and favorable balance sheet timing of \$558,269. Operating activities in the nine months ended September 30, 2017 resulted in cash outflows of \$5,924,245, which were due primarily to the net loss for the period of \$8,496,307, partly offset by non-cash items of \$2,425,141, related primarily to stock-based compensation of \$833,637, inventory write-downs of \$703,220, depreciation and amortization of \$339,493, patent impairments of \$268,789 and bad debt expense of \$226,557 as well as favorable balance sheet timing of \$146,921.

Investing activities in the nine months ended September 30, 2018 and 2017 resulted in cash outflows of \$136,865 and \$265,684, 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 nine months ended September 30, 2018 resulted in cash outflows of \$2,616 related to the payment of taxes associated with the vesting of stock awards. Financing activities in the nine months ended September 30, 2017 resulted in cash inflows of \$13,666,900 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.

In order to meet our operating requirements, we will need to obtain additional financing from third parties. There can be no assurance that we will be successful in obtaining third party financing with commercially reasonable terms or at all. If we are unable to obtain such financing or it is inadequate to fund our operations, we will be required to reduce operating costs, which could jeopardize future strategic initiatives and business plans.

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 September 30, 2018, our disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

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

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.

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, or the Final 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.

We must raise additional funds to finance our operations and remain a going concern.

We had a net loss of \$6.0 million and used \$4.3 million of cash in operating activities for the nine months ended September 30, 2018. At September 30, 2018, we had net working capital of \$4.2 million and our principal source of liquidity consisted of \$5.5 million of cash and cash equivalents. We expect that our net losses will continue for at least the next several quarters in order to meet our operating requirements. Such losses may fluctuate, the fluctuations may be substantial, and we may never become profitable. We will need to raise additional capital through financings from third parties to successfully execute our current operating plan. There can be no assurance that we will be able to raise capital when needed or on terms favorable to us and our stockholders. If external financing sources are not available or are inadequate to fund operations, or forecasted revenue growth does not materialize, we will be required to reduce operating costs, which could jeopardize future strategic initiatives and business plans.

If we are unable to regain compliance with the listing requirements of The NASDAQ Stock Market, our common stock may be delisted from Nasdaq which could have a material adverse effect on our financial condition and could make it more difficult for you to sell your shares.

Our common stock is listed on The NASDAQ Stock Market, and we are therefore subject to its continued listing requirements, including requirements with respect to the market value of publicly-held shares, market value of listed shares, minimum bid price per share, and minimum stockholder's equity, among others, and requirements relating to board and committee independence. If we fail to satisfy one or more of the requirements, we may be delisted from the Nasdaq.

On September 7, we received notice, or the Minimum Bid Price Notice, from Nasdaq that we are not currently in compliance with the \$1.00 minimum closing bid price requirement of Nasdaq Listing Rule 5550(a)(2). The Minimum Bid Price Notice indicated that, consistent with Nasdaq Listing Rule 5810(c)(3)(A), we have until March 6, 2019 to regain compliance with the minimum bid price requirement by having the closing bid price of our common stock meet or exceed \$1.00 per share for at least ten consecutive business days. If we do not regain compliance with the minimum bid price requirement by March 6, 2019, we may be eligible to transfer the listing of our common stock from The NASDAQ Stock Market to the Nasdaq Capital Market if, at the time of such transfer, we meet the initial listing requirement for market value of publicly held shares (\$1 million) and all other initial listing standards for the Nasdaq Capital Market (except for the minimum bid price requirement) and provide Nasdaq with written notice of our intention to cure the minimum bid price requirement deficiency. In response, Nasdaq may provide us an additional 180 day period to satisfy the minimum bid price requirement. However, if it appears to the Nasdaq staff that we will not be able to cure the deficiency, or if we are not eligible, Nasdaq will provide notice to us that our common stock will be subject to delisting as described below. The Minimum Bid Price Notice had no immediate effect on the listing of our common stock and our common stock will continue to trade on the Nasdaq Stock Market under the symbol "IPWR" at this time.

If we fail to regain compliance with the minimum bid price requirement during the applicable compliance period, we will receive notification from Nasdaq that our common stock is subject to delisting. At that time we may then appeal the delisting determination to a Hearings Panel. Such notification will have no immediate effect on our listing on The NASDAQ Stock Market, nor will it have an immediate effect on the trading of our common stock pending such hearing. There can be no assurance, however, that we will be able to regain compliance with Nasdaq's minimum bid price requirement. If we regain compliance with the Nasdaq's minimum bid price requirement, there can be no assurance that we will be able to maintain compliance with the continued listing requirements for The NASDAQ Stock Market, or that our common stock will not be delisted from The NASDAQ Stock Market in the future. In addition, we may be unable to meet other applicable listing requirements of The NASDAQ Stock Market, in which case our common stock could be delisted notwithstanding our ability to demonstrate compliance with the minimum bid price requirements.

Delisting from The NASDAQ Stock Market may adversely affect our ability to raise additional financing through the public or private sale of equity securities, may significantly affect the ability of investors to trade our securities and may negatively affect the value and liquidity of our common stock. Delisting also could have other negative results, including the potential loss of employee confidence, the loss of institutional investors or interest in business development opportunities. If we are delisted from The NASDAQ Stock Market and we are not able to list our common stock on another exchange, our common stock could be quoted on the OTC Bulletin Board or in the "pink sheets." As a result, we could face significant adverse consequences including, among others:

- a limited availability of market quotations for our securities;
- a determination that our common stock is a "penny stock" which will require brokers trading in our common stock to adhere to more stringent rules and possibly result in a reduced level of trading activity in the secondary trading market for our securities;
- a limited amount of news and little or no analyst coverage for us;
- we would no longer qualify for exemptions from state securities registration requirements, which may require us to comply with applicable state securities laws; and
- a decreased ability to issue additional securities (including pursuant to short-form registration statements on Form S-3) or obtain additional financing in the future.

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>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 * |

* 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 November 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

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002**

I, Lon E. Bell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Ideal Power 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 15-d-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; and
5. The registrant's other certifying officer(s) 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 the 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, 2018

/s/ Lon E. Bell

Lon E. Bell

Chief Executive Officer (Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002**

I, Timothy W. Burns, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Ideal Power 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 15-d-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; and
5. The registrant's other certifying officer(s) 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 the 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, 2018

/s/ Timothy W. Burns

Timothy W. Burns

Chief Financial Officer (Principal Financial and
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 periodic report of Ideal Power Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2018 as filed with the Securities and Exchange Commission (the "Report"), we, Lon E. Bell, Chief Executive Officer (Principal Executive Officer) and Timothy W. Burns, Chief Financial Officer (Principal Financial and Accounting Officer) of the Company, hereby certify as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

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

Date: November 14, 2018

/s/ Lon E. Bell

Lon E. Bell

Chief Executive Officer (Principal Executive Officer)

/s/ Timothy W. Burns

Timothy W. Burns

Chief Financial Officer (Principal Financial and
Accounting Officer)
