

CDTi ADVANCED MATERIALS, INC.

(Exact name of registrant as specified in its charter)

Delaware

State or other jurisdiction of
incorporation or organization

06-1393453

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

1641 Fiske Place

Oxnard, CA 93033

(Address of principal executive offices) (Zip Code)

CDTi ADVANCED MATERIALS, INC.

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Audited Consolidated Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
CDTi Advanced Materials, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of CDTi Advanced Materials, Inc. (the Company) as of December 31, 2020, and the related consolidated statements of comprehensive loss, stockholders' equity, and cash flows for the year ended December 31, 2020, and the related notes (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2020, and the results of its operations and its cash flows for the year ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audit. We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audit included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

Critical Audit Matters

Critical audit matters are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. We determined that there are no critical audit matters.

Rose, Snyder & Jacobs LLP

Rose, Snyder & Jacobs LLP
Encino, California

We have served as the Company's auditor since 2017
March 31, 2021



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professional services firms

CDTi ADVANCED MATERIALS, INC.

Consolidated Balance Sheet
(in thousands)

	December 31,
	2020
ASSETS	
Cash	\$ 1,823
Accounts receivable, net of allowance for doubtful accounts of \$70	746
Inventories	847
Prepaid expenses and other current assets	86
Total current assets	3,502
Property and equipment, net	140
Intangible assets, net	566
Other assets	112
Total assets	\$ 4,320
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	\$ 341
Accrued expenses and other current liabilities	932
Liability for income taxes	818
Total current liabilities	2,091
Total liabilities	2,091
Commitments and contingencies (Note 12)	
Stockholders' equity:	
Preferred stock, par value \$0.01 per share: authorized 100,000; no shares issued and outstanding	—
Common stock, par value \$0.01 per share: authorized 50,000,000 at December 31, 2020; issued and outstanding 4,101,301 shares at December 31, 2020	41
Additional paid-in capital	241,578
Accumulated other comprehensive loss	(6,017)
Accumulated deficit	(233,373)
Total stockholders' equity	2,229
Total liabilities and stockholders' equity	\$ 4,320

See accompanying notes to the consolidated financial statements.

CDTi ADVANCED MATERIALS, INC.

Consolidated Statement of Comprehensive Loss
(in thousands)

	<u>Year Ended December 31,</u>
	<u>2020</u>
Revenues	\$ 4,993
Cost of revenues	3,284
Gross profit	1,709
Operating expenses:	
Research and development	851
Selling, general and administrative	2,359
Total operating expenses	3,210
Operating loss	(1,501)
Other income, net	519
Loss before income tax	(982)
Provision for income taxes	(48)
Net loss	(1,030)
Foreign currency translation adjustments	69
Comprehensive loss	\$ (961)

See accompanying notes to the consolidated financial statements.

CDTi ADVANCED MATERIALS, INC.

Consolidated Statement of Stockholders' Equity
(in thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance at December 31, 2019	4,071	41	241,377	(6,086)	(232,343)	2,989
Net loss	—	—	—	—	(1,030)	(1,030)
Foreign currency translation adjustment	—	—	—	69	—	69
Issuance of stock, RSU vesting	30	—	—	—	—	—
Stock-based compensation	—	—	201	—	—	201
Balance at December 31, 2020	4,101	\$ 41	241,578	\$(6,017)	\$(233,373)	\$ 2,229

See accompanying notes to the consolidated financial statements.

CDTi ADVANCED MATERIALS, INC.**Consolidated Statement of Cash Flows
(in thousands)**

	<u>Year Ended December 31,</u>
	<u>2020</u>
Cash flows from operating activities:	
Net loss	\$ (1,030)
Adjustments to reconcile net loss to cash used in operating activities:	
Depreciation and amortization	256
Stock-based compensation expense	201
Loss on disposal of property and equipment	7
PPP loan forgiveness	(444)
Changes in operating assets and liabilities:	
Accounts receivable	310
Inventories	448
Prepaid expenses and other assets	(11)
Accounts payable, accrued expenses and other current liabilities	(637)
Net cash used in operating activities	<u>(900)</u>
Cash flows from investing activities:	
Purchases of property and equipment	(42)
Proceeds from the sale of property and equipment	50
Net cash provided by investing activities	<u>8</u>
Cash flows from financing activities:	
Proceeds from PPP loan	444
Net cash provided by financing activities	<u>444</u>
Effect of exchange rates on cash	<u>69</u>
Net change in cash	(379)
Cash at beginning of year	<u>2,202</u>
Cash at end of year	<u>\$ 1,823</u>

See accompanying notes to the consolidated financial statements.

CDTi ADVANCED MATERIALS, INC.

Notes to Consolidated Financial Statements

1. Description of Business

CDTi Advanced Materials, Inc. ("CDTi" or the "Company") is a leading provider of advanced technology for the emission catalyst, industrial catalyst and electrocatalyst markets. The Company possesses market leading expertise in catalyst design, engineering and coating for on and off-road as well as energy storage applications.

The Company has a proven ability to develop proprietary technology and materials incorporating various base metals that can enhance catalytic performance and reduce the use of costly platinum group metals ("PGMs") in catalyst coatings. The Company delivers its technology to customers through catalyst coatings as well as catalytic material supply and licensing arrangements. Customers include on and off-road emission catalyst manufacturers and distributors, as well as energy production, equipment and servicing companies.

The Company's business is driven by several factors including increasingly stringent global emission standards for internal combustion engines, demand for novel catalyst formulations that can reduce or eliminate PGMs, accelerating development of battery and fuel cell technology and global investment in hydrogen production technologies.

It has operations in the United States ("U.S."), the United Kingdom and Sweden.

2. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries. All intercompany transactions, including intercompany profits and losses and intercompany balances, have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S requires management of the Company to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. These estimates and assumptions are based on management's best estimates and judgment. On an ongoing basis, the Company evaluates its estimates and assumptions, including those related to long-lived assets, stock-based compensation, the fair value of financial instruments including warrants, allowance for doubtful accounts, inventory valuation, taxes and contingent and accrued liabilities. The Company bases its estimates on historical experience and various other factors, including the current economic environment, which it believes to be reasonable under the circumstances. Estimates and assumptions are adjusted when facts and circumstances dictate. Actual results may differ from these estimates under different assumptions and conditions. Management believes that the estimates are reasonable.

Cash

Cash consists of cash balances on hand and on deposit at banks. Cash on deposit at banks at times may exceed the Federal Deposit Insurance Corporation (FDIC) limits. The Company believes no significant concentration of credit risk exists with respect to these cash balances.

Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience and past due balances over 90 days that are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers.

Inventories

Inventories are stated at the lower of cost (FIFO method) or market (net realizable value). Finished goods inventory includes materials, labor and manufacturing overhead. The Company establishes provisions for inventory that is obsolete or when quantities on hand are in excess of estimated forecasted demand. The creation of such provisions results in a write-down of inventory to net realizable value and a charge to cost of sales.

The Company's inventory includes precious metals (platinum, palladium and rhodium) for use in the manufacturing of catalysts. The precious metals are valued at the lower of cost or market (net realizable value), consistent with the Company's other inventory.

Property and Equipment

Property and equipment is capitalized at cost and is stated at cost less accumulated depreciation and amortization. Depreciation and amortization is determined using the straight line method over the estimated useful lives of the various asset classes. Machinery and equipment are depreciated over 2 to 10 years; furniture and fixtures, computer hardware and software and vehicles are depreciated over 2 to 5 years. Leasehold improvements are amortized over the shorter of estimated useful lives or the lease term. Repairs and maintenance are charged to expense as incurred and major replacements or betterments are capitalized.

Intangible Assets

The Company's intangible assets consist of trade names and acquired patents and technology and have finite lives. Intangible assets are carried at cost, less accumulated amortization. Amortization is computed on a straight-line or accelerated basis over the estimated useful lives of the respective assets, ranging from 4 to 20 years.

Long Lived Assets

Assets such as property and equipment and amortizable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when the sum of the expected undiscounted future net cash flows of an asset or asset group is less than its carrying amount and is measured as the amount by which the carrying amount of the asset or asset group exceeds its fair value.

Warrants and Derivative Liabilities

The Company accounts for the issuance of Company derivative equity instruments in accordance with Accounting Standards Codification ("ASC") 815-40 "Derivative and Hedging". The Company reviews common stock purchase warrants at each balance sheet date based upon the characteristics and provision of each particular instrument and classifies them on the balance sheet as equity or a liability. Below are some of the factors the Company considers with the corresponding balance sheet classification:

- Equity if the awards (i) require physical settlement or net-share settlement, or (ii) give the Company a choice of net-cash settlement or settlement in the Company's own shares (physical settlement or net-share settlement), or as
- Liabilities if the awards (i) require net-cash settlement (including a requirement to net-cash settle the contract if an event occurs and if that event is outside the Company's control), or (ii) give the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement).

The Company assesses classification of common stock purchase warrants and other freestanding derivatives at each reporting date to determine whether a change in classification between assets and liabilities and equity is required.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance against deferred tax assets is required if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The valuation allowance should be sufficient to reduce the deferred tax assets to the amount that is more likely than not to be realized.

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Changes in recognition or measurement are reflected in the period in which the change occurs. The Company records interest and penalties related to unrecognized tax benefit in income tax expense.

Revenue Recognition

Net sales include products and shipping and handling charges, net of estimates for product returns as well as royalties earned under licensing agreements. Revenue for products and shipping and handling charges are measured as the amount of consideration the Company expects to receive in exchange for transferring products. All revenue is recognized when the Company satisfies its performance obligations under the contract. The Company recognizes revenue by transferring the promised products to the customer, with revenue recognized at the point in time the customer obtains control of the products. The Company recognizes revenue for shipping and handling charges at the time the products are delivered to or picked up by the customer. The Company estimates product returns based on historical return rates. The majority of the Company's contracts have a single performance obligation and are short term in nature. The Company recognizes revenue for its usage-based royalties when the usage has occurred.

Sales taxes and value added taxes in foreign jurisdictions that are collected from customers and remitted to governmental authorities are accounted for on a net basis and therefore excluded from the transaction price and net sales.

Research and Development

Research and development costs are generally expensed as incurred. These expenses include compensation expense for employees and contractors engaged in research, design and development activities, as well costs paid to outside parties for testing, validation and certification of our products. Also included is any depreciation related to assets utilized in the development of new products.

Stock-Based Compensation

Equity awards consist of stock options. The Company measures the compensation cost for all stock-based awards at fair value on the date of grant and recognizes it on a straight-line basis over the service period for awards expected to vest, which is generally three years.

The Company measures the fair value of stock options using the Black-Scholes option-pricing model and certain assumptions, including the expected life of the stock options, an expected forfeiture rate and the expected volatility of its common stock.

Product Warranty

The Company provides for the estimated cost of product warranties in cost of sales, at the time product revenue is recognized. Warranty costs are estimated primarily using historical warranty information in conjunction with current engineering assessments applied to the Company's expected repair or replacement costs.

Foreign Currency

The functional currency of our subsidiary Engine Control Systems Europe AB in Sweden is the Swedish krona and the Clean Diesel Technologies Limited U.K. subsidiary, is the British pound sterling. Accordingly, the assets and liabilities of the foreign locations are translated into U.S. dollars at period-end exchange rates. Revenue and expense accounts are translated at the average exchange rates for the period. The resulting foreign currency exchange adjustments are charged or credited directly to other comprehensive income or loss as a separate component of stockholders' equity. Unrealized foreign currency exchange gains and losses on certain intercompany transactions that are of a long-term investment nature (i.e. settlement is not planned or anticipated in the foreseeable future) are also recorded in other comprehensive income or loss in stockholders' equity. Accumulated other comprehensive loss contained only foreign currency translation adjustments as of December 31, 2020

The Company has exposure to multiple currencies. The primary exposure is between the U.S. dollar, the Euro, British pound sterling and Swedish krona. Gains and losses arising from transactions denominated in currencies other than the functional currency of the entity are included in other income (expense) in the consolidated statements of comprehensive loss. Gains and losses arising from transactions denominated in foreign currencies are primarily related to inter-company loans that have been determined to be temporary in nature, cash, accounts receivable and accounts payable denominated in non-functional currencies.

Fair Value Measurements

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset and liability. As a basis for considering such assumptions, a fair value hierarchy has been established that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable including quoted prices for similar instruments in active markets and quoted prices for identical or similar instruments in markets that are not active; and
- Level 3: Unobservable inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing.

Fair Value of Financial Instruments

ASC Topic 825, "Financial Instruments", requires disclosure of the fair value of financial instruments for which the determination of fair value is practicable. The fair values of the Company's cash, trade accounts receivable, prepaid expenses and other current assets, accounts payable and accrued expenses and other current liabilities approximate carrying values due to the short maturity of these instruments. The fair value for the warrants classified as liability and the bifurcated derivative liabilities were calculated using level 3 inputs, including Black-Scholes option-pricing model as well as Monte Carlo Simulation model. These inputs are disclosed in Note 9 "Fair Value Measurements"

3. Inventories

Inventories consist of the following (in thousands):

	<u>December 31,</u>
	<u>2020</u>
Raw materials	\$ 211
Finished goods	636
	<u>\$ 847</u>

4. Property and Equipment

Property and equipment consists of the following (in thousands):

	<u>December 31,</u>
	<u>2020</u>
Furniture and fixtures	\$ 461
Computer hardware and software	42
Machinery and equipment	2,483
	<u>2,986</u>
Less accumulated depreciation	(2,846)
	<u>\$ 140</u>

Depreciation expense was \$0.1 million for the year ended December 31, 2020.

5. Intangible Assets

Intangible assets consist of the following (in thousands):

	<u>Useful Life</u>	<u>December 31,</u>
	<u>in Years</u>	<u>2020</u>
Trade name	15 - 20	\$ 1,208
Patents and know-how	5 - 12	1,266
		<u>2,474</u>
Less accumulated amortization		(1,908)
		<u>\$ 566</u>

The Company recorded amortization expense related to amortizable intangible assets of \$0.2 million for the year ended December 31, 2020.

Estimated amortization expense for existing intangible assets for each of the next five years is as follows (in thousands):

Years ending December 31:	
2021	\$ 162
2020	143
2023	71
2024	71
2025	62
Thereafter	57
	<u>\$ 566</u>

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following (in thousands):

	<u>December 31,</u>
	<u>2020</u>
Accrued salaries and benefits	\$ 123
Accrued warranty(1)	33
Warrant liability (2)	9
PGM liability	276
Other	491
	<u>\$ 932</u>

(1) For additional information, refer to Note 7, "Accrued Warranty".

(2) For additional information, refer to Note 9, "Fair Value Measurements".

7. Accrued Warranty

The Company establishes reserves for future product warranty costs that are expected to be incurred pursuant to specific warranty provisions with its customers. The Company generally warrants its products against defects between one and five years from date of shipment, depending on the product. The warranty reserves are established at the time of sale and updated throughout the warranty period based upon numerous factors including historical warranty return rates and expenses over various warranty periods. Historically, warranty returns have not been material.

The following summarizes the activity in the Company's accrual for product warranty (in thousands):

	<u>Year Ended</u>
	<u>December 31,</u>
	<u>2020</u>
Balance at beginning of period	\$ 51
Accrued warranty expense	0
Warranty claims paid/reduction in reserve	(18)
Balance at end of period	<u>\$ 33</u>

8. Warrants

From time to time, the Company issues warrants to purchase its common stock. Warrants have been issued for consulting services, in connection with the Company's issuance of debt and sales of its common stock.

Warrants activity is summarized as follows:

	Shares	Weighted Average Exercise Price	Range of Exercise Prices
Outstanding at December 31, 2019	163,186\$	23.63	\$11.00 - \$66.25
Issued	—	—	—
Exercised	—	—	—
Expired	(21,656\$	42.72	\$42.50 - \$66.25
Outstanding at December 31, 2020	141,530\$	20.71	\$11.00 - \$42.50
Exercisable at December 31, 2020	141,530\$	20.71	\$11.00 - \$42.50

Warrant Liability

The Company's warrant liability is carried at fair value and is classified as Level 3 in the fair value hierarchy because the warrants are valued based on unobservable inputs. (For additional information, see Note 9).

9. Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value in accordance with a hierarchy which requires an entity to maximize the use of observable inputs which reflect market data obtained from independent sources and minimize the use of unobservable inputs. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable including quoted prices for similar instruments in active markets and quoted prices for identical or similar instruments in markets that are not active; and

Level 3: Unobservable inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing.

Assets and liabilities measured at fair value on the Company's balance sheet on a recurring basis include the following at December 31, 2020 (in thousands):

Warrant Liability	Level 1	Level 2	Level 3
December 31, 2020	—	—	\$ 9

There were no transfers in and out of Level 1 and Level 2 fair value measurements during the year ended December 31, 2020.

10. Stock-Based Compensation

The Clean Diesel Technologies, Inc. Stock Incentive Plan (formerly known as the Clean Diesel Technologies, Inc. 1994 Incentive Plan), as amended (the "Plan"), provides for the awarding of incentive stock options, non-qualified stock options, stock appreciation rights, restricted shares, performance awards, bonuses or other forms of share-based awards, or combinations of these to the Company's directors, officers, employees, consultants and advisors (except consultants or advisors in capital-raising transactions) as determined by the board of directors. At the Company's Annual Meeting of Shareholders held on May 23, 2012, the Company's shareholders approved certain amendments to the Plan, the most significant of which changed the Plan name, removed the evergreen provision and established a maximum number of 1.4 million shares to be reserved for issuance under the Plan, disallowed the repricing of outstanding stock options without shareholder approval, removed the ability to issue cash bonus awards under the Plan and modified the change in control provisions within the Plan.

Effective December 16, 2016, the Company adopted the Clean Diesel Technologies, Inc. 2016 Omnibus Incentive Plan (the "Omnibus Plan"), pursuant to the approval of the Omnibus Plan by the Company's stockholders by written consent dated October 24, 2016. The Omnibus plan was adopted by the Company's Board of Directors (the "Board") on October 11, 2016. Under the Omnibus Plan, the Company is authorized to grant equity-based awards in the form of stock options, restricted common stock, restricted stock units, stock appreciation rights, and other stock-based awards to employees (including executive officers), directors and consultants of the Company and its subsidiaries. The Omnibus Plan authorized the issuance of 2,250,000 shares of the Company's common stock.

Total stock-based compensation expense was \$0.2 million for the year ended December 31, 2020.

Stock Options

Stock option activity is summarized as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (thousands)
Outstanding at December 31, 2020	338,900	\$ 6.77	8.3	\$ —
Granted	315,000	0.18	—	—
Exercised	—	—	—	—
Canceled	(4,000)	1.50	—	—
Outstanding at December 31, 2020	<u>649,900</u>	<u>\$ 3.61</u>	<u>8.4</u>	<u>\$ —</u>
Vested and expected to vest at December 31, 2020	<u>649,900</u>	<u>\$ 3.61</u>	<u>8.4</u>	<u>\$ —</u>
Exercisable at December 31, 2020	<u>402,335</u>	<u>\$ 5.59</u>	<u>8.0</u>	<u>\$ —</u>

The aggregate intrinsic value represents the difference between the exercise price and the Company's closing stock price on the last trading day of the year.

Stock options granted under the Plan typically expire ten years from the date of grant and are issued at a price equal to the fair market value of the underlying stock on the date of grant. The Company's board of directors may establish such vesting and other conditions with respect to options as it deems appropriate.

The Company estimates the fair value of stock options using a Black-Scholes option-pricing model. The weighted-average assumptions and grant date fair value for the options granted during year ended December 31, 2020 were as follows:

Expected volatility		57.0 %
Risk-free interest rate		0.3 %
Dividend yield		—
Expected life in years		5.0
Weighted average grant date fair value	\$	0.07

The expected term of the options has historically been based upon the historical term until exercise or expiration of all granted options. Due to the significant change in the Company following the Merger and significant change in the terms of the options granted, CDTI's pre-Merger historical exercise data was not considered to provide a reasonable basis for estimating the expected term for current option grants. As such, the expected term of stock options granted in 2015 and later was determined using the "simplified method" as allowed under ASC 718-10-S99, "Compensation—Stock Compensation: Overall: SEC Materials." The "simplified method" calculates the expected term as the average of the vesting term and original contractual term of the options. The expected volatility is based on the volatility of the Company over the corresponding expected term of the option. The risk-free interest rate is the constant maturity rate published by the U.S. Federal Reserve Board that corresponds to the expected term of the option. The dividend yield is assumed as 0% because the Company has not paid dividends and does not expect to pay dividends in the future.

11. Income Taxes

Income (loss) from operations before income taxes include the following components (in thousands):

		Year Ended December 31,
		2020
U.S.-based operations	\$	(1,820)
Non U.S.-based operations		838
	\$	<u>(982)</u>

Income tax expense (benefit) attributable to income from operations is summarized as follows (in thousands):

	Current	Deferred	Total
Year ended December 31, 2020:			
U.S. Federal	\$ —	\$ —	—
State and local	6	—	6
Foreign	42	—	42
Total	<u>\$ 48</u>	<u>\$ —</u>	<u>48</u>

Income taxes attributable to income from operations differ from the amounts computed by applying the U.S. federal statutory rate of 21% to income from operations before income taxes as shown below (in thousands):

	Year Ended December 31,
	2020
Expected tax provision	\$ (205)
Net tax effects of:	
Foreign tax rate differential	(15)
State taxes, net of federal benefit	(90)
Return to provision adjustment	80
Change in tax rates	(165)
Permanent difference on convertible notes and warrants	3
Other	26
Change in deferred tax asset valuation allowance	414
	<u>\$ 48</u>

Deferred tax assets and liabilities consist of the following (in thousands):

	December 31,
	2020
Deferred tax assets:	
Research and development credits	\$ 2,486
Other credits	—
Operating loss carry forwards	7,732
Interest	335
Inventories	410
Allowance for doubtful accounts	20
Depreciation	121
Deferred research and development expenses for income tax	(3)
Non-cash compensation	1,047
Other	426
Total gross deferred tax assets	12,574
Valuation allowance	(12,466)
Net deferred tax assets	<u>\$ 108</u>
Deferred tax liabilities:	
Other identifiable intangible assets	\$ (102)
Total gross deferred tax liabilities	(102)
Net deferred tax assets (liabilities)	<u>\$ 6</u>

The Company had approximately \$26.5 million and \$22.1 million of federal and state income tax net operating loss carryforwards at December 31, 2020, respectively. The foreign net operating losses can be carried forward indefinitely. Future utilization of the federal and state net operating losses and credit carryforwards is subject to a substantial annual limitation due to ownership change limitations as required by Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the "Code"), as well as similar state limitations.

Of the \$26.5 million federal loss carryforwards approximately \$4.9 million of the loss will be subject to an annual limitation of \$0.4 million within the next 5 years and \$0.2 million for the next 15 years. In addition, approximately \$6.9 million of the loss will be subject to an annual limitation of \$0.9 million within the next 5 years and \$0.1 million for the following 15 years. The federal net operating loss carryforwards will expire in fiscal year 2040. As a result of the "ownership change" the federal research and development credits have been limited and based on the limitation the Company does not anticipate being able to use any of these credits that existed as of the date of the Merger in future tax years.

Of the \$22.1 million of state net operating loss carryforwards approximately \$1.4 million of the loss will be subject to an annual limitation of \$0.1 million for the next 20 years. The state net operating loss carryforwards will expire in fiscal year 2040. The Company has state research and development credits of \$3.1 million. The Company has a full valuation allowance against the related deferred tax assets for its U.S. and U.K. entities as it is more likely than not that they will not be realized by the Company.

In assessing the potential realization of deferred tax assets, consideration is given to whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the Company attaining future taxable income during the periods in which those temporary differences become deductible. In addition, the utilization of net operating loss carryforwards may be limited due to restrictions imposed under applicable federal and state tax laws due to a change in ownership. Based upon the level of historical operating losses and future projections, management believes it is more likely than not that the Company will not realize the deferred tax assets.

The Company has not recognized a deferred tax liability on undistributed earnings of its foreign subsidiaries, because these earnings are intended to be permanently reinvested. The amount of the unrecognized deferred tax liability depends on judgment required to analyze the withholding tax due, the applicable tax law and factual circumstances in effect at the time of any such distributions. Therefore, the Company believes it is not practicable at this time to reliably determine the amount of unrecognized deferred tax liability related to its undistributed earnings; however, these undistributed earnings are immaterial. If circumstances change and it becomes apparent that some or all of the undistributed earnings of a subsidiary will be remitted and income taxes have not been recognized by the parent entity, the parent entity shall accrue as an expense of the current period income taxes attributable to that remittance.

The following changes occurred in the amount of unrecognized tax benefits including related interest and penalties, included in the income taxes payable on the consolidated balance sheet (in thousands):

	Year Ended December 31,
	2020
Balance at beginning of year	\$ 786
Additions for current year tax provisions	32
Additions/Reduction for tax positions of prior years	—
Reduction for prior year tax provisions	—
Balance at end of year	<u>\$ 818</u>

If recognized, the entire amount of the unrecognized tax benefits would affect the effective tax rate. As of December 31, 2020, the Company had \$0.2 million accrued for payment of interest and penalties related to unrecognized tax benefits.

The Company operates in multiple tax jurisdictions, both within and outside of the United States. Although the timing of the resolution and/or closure of audits is not certain, the Company does not believe it is reasonably possible that its unrecognized tax benefits would materially change in the next twelve months. The following tax years remain open to examination by the major domestic taxing jurisdictions to which it is subject:

	<u>Open Tax Years</u>
United States—Federal	2017 – 2020
United States—State	2016 – 2020
Canada	2015 – 2020
Sweden	2018 – 2020
United Kingdom	2016 - 2020

12. Commitments and Contingencies

Lease Commitments

The Company leases its facilities under operating leases that are considered month to month. The Company recognizes its minimum lease payments, including escalation clauses, on a straight-line basis over the minimum lease term of the lease. Rent expense was \$0.3 million during the year ended December 31, 2020.

Litigation

The Company is involved in legal proceedings from time to time in the ordinary course of its business. Management does not believe that any of these claims and proceedings against it is likely to have, individually or in the aggregate, a material adverse effect on the Company's consolidated financial condition, results of operations or cash flows. Accordingly, the Company cannot determine the final amount, if any, of its liability beyond the amount accrued in the consolidated financial statements as of December 31, 2020, nor is it possible to estimate what litigation-related costs will be in the future.

Applied Utility Systems, Inc.

The Company is undergoing a sales and use tax audit by the State of California (the "State") with respect to Applied Utility Systems, Inc., a former subsidiary of the Company that was sold in 2009, for the period of 2007 through 2009. The audit has identified a project performed by the Company during that time period for which sales tax was not collected and remitted and for which the State asserts that proper documentation of resale may not have been obtained and that the Company owes sales tax of \$1.5 million, inclusive of interest. The Company contends and believes that it received sufficient and proper documentation from its customer to support not collecting and remitting sales tax from that customer and is actively disputing the audit report with the State. On August 12, 2013, the Company appeared at an appeals conference with the State Board of Equalization ("BOE"). On July 21, 2014, the Company received a Decision and Recommendation ("D&R") from the BOE. The D&R's conclusion was that the basis for the calculation of the aforementioned \$1.5 million tax due should be reduced from \$12.2 million to \$9.0 million with a commensurate reduction in the tax owed to the State. Regardless of this finding, the Company continues to believe that it will prevail in this matter, as it believes that the State did not adequately address the legal arguments related to the Company's acceptance of the valid resale certificate from its customer. The Company has not agreed to these findings, and therefore, it will be appealing at a higher level at the BOE. Based on a re-audit, the BOE lowered the tax due to \$0.9 million, inclusive of interest. The Company continues to disagree with these findings based on the aforementioned reasons. However, in October 2015, the Company offered to settle this case for \$0.1 million, which is based on the expected cost of continuing to contest this audit. Accordingly, an accrual was charged to discontinued operations during the year ended December 31, 2015 to reflect the offer to settle this case. Should the Company not prevail with the offer to settle this case, it plans to continue with the appeals process. Further, should the Company not prevail in this case, it will pursue reimbursement from the customer for all assessments from the State.

13. Geographic Information

Net sales by geographic region based on location of sales organization is as follows (in thousands):

	Year Ended December 31,
	2020
United States	\$ 931
Canada	283
Central and South America	78
Europe	3,507
Asia	194
Total international	4,062
Total revenues	\$ 4,993

Property and equipment, net and total assets by geographic region as of December 31, 2020 is as follows (in thousands):

	Property and Equipment, net	Total Assets
	2020	2020
United States	\$ 139	\$ 2,057
Europe	1	2,263
Total international	1	2,263
Total	\$ 140	\$ 4,320

14. Concentrations

For the year ended December 31, 2020, one customer represents 14% of the Company's revenues, however no customers account for more than 10% of the accounts receivable balance as of December 31, 2020.

For the year ended December 31, 2020, the Company had one supplier that accounted for approximately 28% of the Company's material purchases.

15. Other Significant Events

The pandemic that was declared in March 2020 following the outbreak of COVID 19 had a significant impact on the Company's business. The long-lasting economic effects of this pandemic are still unknown.

The Company obtained a loan under the Paycheck Payroll Program (PPP) under the Coronavirus Aid, Relief, and Economic Security (CARES) Act in the amount of \$0.4 million in 2020. The proceeds of this loan were used to pay eligible expenses, and the loan is therefore expected to be forgiven. \$0.4 million was recorded as other income in 2020.

16. Subsequent Events

The Company has evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through March 31, 2021, the date the financial statements were available to be issued.