LUNA INNOVATIONS INC
Form 10-Q
August 10, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
COMMISSION FILE NUMBER 000-52008

LUNA INNOVATIONS INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	54-1560050
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

301 First Street SW, Suite 200
Roanoke, VA 24011
(Address of Principal Executive Offices)
(540) 769-8400
(Registrant's Telephone Number, Including Area Code)

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. ý Yes ¨ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ý Yes ¨ No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of August 9, 2016, there were 27,692,776 shares of the registrant's common stock outstanding.

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FOR THE QUARTER ENDED JUNE 30, 2016
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
Luna Innovations Incorporated
Consolidated Balance Sheets

	June 30, 2016	December 31, 2015
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$13,807,799	$17,464,040
Accounts receivable, net	11,151,791	11,034,557
Inventory	8,389,095	8,863,167
Prepaid expenses and other current assets	1,694,810	1,388,439
Total current assets	35,043,495	38,750,203
Property and equipment, net	7,362,464	6,614,238
Intangible assets, net	9,490,702	10,404,312
Goodwill	2,348,331	2,274,112
Other assets	88,948	88,948
Total assets	$54,333,940	$58,131,813
Liabilities and stockholders' equity		
Liabilities:		
Current liabilities:		
Current portion of long-term debt obligations	$1,833,333	$1,833,333
Current portion of capital lease obligations	50,335	31,459
Accounts payable	3,889,383	4,054,425
Accrued liabilities	7,524,569	8,304,686
Deferred revenue	1,027,929	1,109,759
Total current liabilities	14,325,549	15,333,662
Long-term deferred rent	1,481,824	1,564,229
Long-term debt obligations	3,375,000	4,291,667
Long-term capital lease obligations	141,457	35,237
Total liabilities	19,323,830	21,224,795
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value $0.001, 1,321,514 shares authorized, issued and outstanding at June 30, 2016 and December 31, 2015	1,322	1,322
Common stock, par value $0.001, 100,000,000 shares authorized, 27,988,103 and 27,644,832 shares issued, 27,692,776 and 27,477,181 shares outstanding at June 30, 2016 and December 31, 2015	28,241	28,178
Treasury stock at cost, 300,327 and 167,652 shares at June 30, 2016 and December 31, 2015	(341,320)	(184,934)
Additional paid-in capital	81,997,662	81,461,907
Accumulated deficit	(46,675,795)	(44,399,455)
Total stockholders' equity	35,010,110	36,907,018
Total liabilities and stockholders' equity	$54,333,940	$58,131,813

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

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Luna Innovations Incorporated
Consolidated Statements of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Revenues:				
Technology development	$4,137,382	$3,728,271	$7,860,644	$6,603,786
Products and licensing	10,509,522	6,297,475	20,773,273	8,761,062
Total revenues	14,646,904	10,025,746	28,633,917	15,364,848
Cost of revenues:				
Technology development	3,181,447	2,576,145	6,061,282	4,659,769
Products and licensing	6,294,607	3,252,627	12,558,180	4,219,317
Total cost of revenues	9,476,054	5,828,772	18,619,462	8,879,086
Gross profit	5,170,850	4,196,974	10,014,455	6,485,762
Operating expense:				
Selling, general and administrative	4,581,776	5,518,656	9,227,060	10,087,609
Research, development and engineering	1,240,655	801,221	2,791,146	1,136,111
Total operating expense	5,822,431	6,319,877	12,018,206	11,223,720
Operating loss	(651,581)	(2,122,903)	(2,003,751)	(4,737,958)
Other income (expense):				
Other (expense) income, net	(39,489)	4,264	(35,545)	4,109
Interest expense	(78,906)	(49,966)	(165,079)	(59,103)
Total other expense	(118,395)	(45,702)	(200,624)	(54,994)
Loss before income taxes	(769,976)	(2,168,605)	(2,204,375)	(4,792,952)
Income tax expense	1,000	—	26,175	2,808
Net loss	(770,976)	(2,168,605)	(2,230,550)	(4,795,760)
Preferred stock dividend	24,580	20,021	45,790	46,581
Net loss attributable to common stockholders	$(795,556)	$(2,188,626)	$(2,276,340)	$(4,842,341)
Net loss per share attributable to common stockholders:				
Basic and diluted	$(0.03)	$(0.10)	$(0.08)	$(0.26)
Weighted average common shares and common equivalent shares outstanding:				
Basic and diluted	27,557,960	21,997,768	27,517,792	18,577,006

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

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Luna Innovations Incorporated
Consolidated Statements of Cash Flows

	Six Months Ended June 30,	
	2016	2015
	(unaudited)	
Cash flows used in operating activities		
Net loss	$(2,230,550)	$(4,795,760)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	1,861,603	824,251
Share-based compensation	465,028	571,439
Bad debt expense	50,515	10,375
Change in assets and liabilities		
Accounts receivable	(167,749)	(335,811)
Inventory	474,072	(1,345,687)
Other current assets	(306,371)	(358,794)
Accounts payable and accrued expenses	(1,076,784)	(1,271,686)
Deferred revenue	(81,830)	(154,189)
Net cash used in operating activities	(1,012,066)	(6,855,862)
Cash flows (used in) provided by investing activities		
Acquisition of property and equipment	(1,294,775)	(50,175)
Intangible property costs	(244,198)	(123,578)
Cash acquired in business combination	—	374,517
Net cash (used in) provided by investing activities	(1,538,973)	200,764
Cash flows (used in) provided by financing activities		
Payments on capital lease obligations	(32,149)	(36,406)
Payments of debt obligations	(916,667)	(5,962,355)
Repurchase of common stock	(156,386)	(33,113)
Proceeds from term loan	—	6,000,000
Proceeds from the exercise of options	—	82,516
Net cash (used in) provided by financing activities	(1,105,202)	50,642
Net decrease in cash and cash equivalents	(3,656,241)	(6,604,456)
Cash and cash equivalents—beginning of period	17,464,040	14,116,969
Cash and cash equivalents—end of period	$13,807,799	$7,512,513
Supplemental disclosure of cash flow information		
Cash paid for interest	$157,371	$31,474
Cash paid for income taxes	$198,425	$2,808
Non-cash investing and financing activities		
Shares of common stock issued for business combination	—	11,872,557
Dividend on preferred stock, 39,646 shares of common stock issuable for the six months ended June 30, 2016 and 2015, respectively	$45,790	$46,581
Capital expenditures funded by capital lease borrowings	$157,246	$—

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

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Luna Innovations Incorporated
Notes to Unaudited Consolidated Financial Statements

1. Basis of Presentation and Significant Accounting Policies

Nature of Operations

Luna Innovations Incorporated (“we,” “Luna Innovations” or the “Company”), headquartered in Roanoke, Virginia, was incorporated in the Commonwealth of Virginia in 1990 and reincorporated in the State of Delaware in April 2003. We develop, manufacture and market fiber optic sensing, test & measurement products and are focused on bringing new and innovative technology solutions to measure, monitor, protect and improve critical processes in the aerospace, automotive, energy, composite, telecommunications and defense industries. Following our merger with Advanced Photonix, Inc. ("API") in 2015 (See Note 2), we also package optoelectronic semiconductors into high speed optical receivers ("HSOR" products), custom optoelectronic subsystems and Terahertz instrumentation. We are organized into two business segments, which work closely together to turn ideas into products: our Technology Development segment and our Products and Licensing segment. Our business model is designed to accelerate the process of bringing new and innovative technologies to market. We have a history of net losses from operations beginning in 2005. We have historically managed our liquidity through cost reduction initiatives, debt financings, capital markets transactions and the sale of assets.

Unaudited Interim Financial Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United Stated of America (“U.S. GAAP”) for interim financial statements and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for annual financial statements. The unaudited consolidated financial statements have been prepared on the same basis as the annual financial statements and in the opinion of management reflect all adjustments, consisting of only normal recurring accruals considered necessary to present fairly our financial position at June 30, 2016, results of operations for the three and six months ended June 30, 2016 and 2015, and cash flows for the six months ended June 30, 2016 and 2015. The results of operations for the three and six months ended June 30, 2016, are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The consolidated interim financial statements, including our significant accounting policies, should be read in conjunction with the audited Consolidated Financial Statements and the notes thereto for the year ended December 31, 2015, included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission (“SEC”) on March 29, 2016.

Business Combinations

We apply the provisions of Accounting Standards Codification 805, Business Combinations ("ASC 805"), in the accounting for acquisitions. ASC 805 requires us to recognize separately from goodwill the assets acquired and the liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While we use our best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, these estimates are inherently uncertain and subject to refinement. Any and all adjustments have been made as of the reporting period reflected in this report. Upon the conclusion of the measurement period or final determination of the values of the assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded in our Consolidated Statements of Operations. Accounting for business combinations requires management to make significant estimates and assumptions, especially at the acquisition date, including estimates for intangible assets, contractual obligations assumed, restructuring liabilities, pre-acquisition contingencies and contingent consideration, where applicable. Although we believe the assumptions and estimates we have made have been reasonable and appropriate, they are based in part on historical experience and information obtained from management of the acquired companies and are inherently uncertain. Critical estimates in valuing certain of the intangible assets we have acquired include: future expected cash flows from product sales; customer contracts and acquired technologies; expected costs to develop

in-process research and development into commercially viable products and estimated cash flows from the projects when completed; and discount rates. Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates, or actual results.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between marketplace participants. Various valuation approaches can be used to

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determine fair value, each requiring different valuation inputs. The following hierarchy classifies the inputs used to determine fair value into three levels:

- Level 1—Quoted prices for identical instruments in active markets
- Level 2—Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets
- Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable

The carrying values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term nature of these instruments. The carrying value of our debt approximates fair value, as we consider the floating interest rate on our credit facilities with Silicon Valley Bank ("SVB") to be at market for similar instruments. Certain nonfinancial assets and liabilities are measured at fair value on a nonrecurring basis in accordance with U.S. GAAP. This includes items such as nonfinancial assets and liabilities initially measured at fair value in a business combination and nonfinancial long-lived asset groups measured at fair value for an impairment assessment. In general, nonfinancial assets including intangible assets and property and equipment are measured at fair value when there is an indication of impairment and are recorded at fair value only when any impairment is recognized.

Net Loss Per Share

Basic per share data is computed by dividing our net loss by the weighted average number of shares outstanding during the period. Diluted per share data is computed by dividing net income, if applicable, by the weighted average shares outstanding during the period increased to include, if dilutive, the number of additional common share equivalents that would have been outstanding if potential shares of common stock had been issued using the treasury stock method. Diluted per share data would also include the potential common share equivalents relating to convertible securities by application of the if-converted method.

The effect of 5.8 million and 6.4 million common stock equivalents (which include outstanding warrants, preferred stock and stock options) are not included for the three months ended June 30, 2016 and 2015, respectively, as they are anti-dilutive to earnings per share due to our net loss. The effect of 5.7 million and 5.9 million common stock equivalents are not included for the six months ended June 30, 2016 and 2015, respectively, as they are considered anti-dilutive to earnings per share due to our net loss.

Recently Issued Accounting Pronouncements

In April 2016, the Financial Accounting Standards Board ("FASB") amended the FASB Accounting Standards Codification and created a new Topic 606, and issued Accounting Standards Update ("ASU") No. 2016-10, Revenue from contracts with customers: Identifying Performance Obligations and Licensing. This amendment prescribes that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendment supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the Accounting Standards Codification, and is effective for annual and interim reporting periods beginning after December 15, 2017. We are currently determining the transition method and assessing the impact the amendments may have on our financial condition, results of operations or cash flows as a result of adopting this standard.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting. The amendments apply to several aspects of accounting for share-based compensation including the recognition of excess tax benefits and deficiencies and their related presentation in the statement of cash flows as well as accounting for forfeitures. ASU No. 2016-09 is effective for fiscal years beginning after December 15, 2016, including interim periods and allows for prospective, retrospective or modified retrospective adoption, depending on the area covered in the update, with early adoption permitted. We are currently determining the transition method and assessing the impact the amendments may have on our financial condition, results of operations or cash flows as a result of adopting this standard.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires a lessee to recognize in its statement of financial position an asset and liability for most leases with a term greater than 12 months. Lessees should recognize a liability to make lease payments and a right-of-use asset representing the lessee's right to use the underlying asset for the lease term. The amendment is effective for fiscal years ending after December 15, 2018, including interim periods within those fiscal years. We are currently evaluating the impact the adoption of this standard will have on our consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which simplifies the presentation of deferred taxes by requiring that deferred tax assets and liabilities be classified as noncurrent in any classified balance sheet rather than being separated into current and non-current amounts. The amendment is effective for reporting periods beginning

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after December 15, 2016. We do not expect the adoption of this standard to have a significant impact on our consolidated financial statements.

In September 2015, the FASB issued ASU No. 2015-16, Simplifying the Accounting for Measurement Period Adjustments, which requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendment is effective for fiscal years beginning after December 15, 2015 and requires acquirer to record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, an entity is to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. We adopted this standard for periods beginning January 1, 2016 and did not experience a significant impact on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest- Imputation of Interest, which requires debt issuance costs to be presented on the balance sheet as a direct deduction from the associated debt liability. The guidance is effective for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2015. Early adoption is permitted. We adopted this standard for periods beginning January 1, 2016 and did not experience a significant impact on our consolidated financial statements.

2. Merger with API

On May 8, 2015, we completed our merger with API (the "Merger") pursuant to the Agreement and Plan of Merger (the "Merger Agreement") for a total purchase consideration of $15.9 million. In accordance with the terms of the Merger Agreement, API shareholders received 0.31782 shares of our common stock for each share of API common stock they owned. The Merger has been accounted for under the acquisition method of accounting in accordance with ASC 805, with Luna treated as the accounting acquirer. We incurred $1.7 million and $3.5 million in Merger-related costs for the three and six months ended June 30, 2015, respectively. Merger-related costs are included within selling, general and administrative expenses in the Consolidated Statement of Operations. We did not incur Merger-related costs for the three and six months ended June 30, 2016.

The total purchase consideration of $15.9 million consisted of the following:

	Purchase Consideration
Fair value of Luna common stock issued to API shareholders	$ 15,671,775
Fair value of vested API options assumed by Luna	187,879
Total purchase consideration	$ 15,859,654

Under the acquisition method of accounting, the total estimated purchase consideration is allocated to the acquired tangible and intangible assets and assumed liabilities based on their estimated fair values as of the acquisition date. Any excess of the fair value of assets acquired and liabilities assumed over the fair value of the acquisition consideration is recognized as a gain by the acquirer. We completed an allocation of the purchase consideration with the assistance of a third-party valuation expert, as represented in the table below.

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	Allocation of Purchase Consideration
Cash	$ 374,517
Accounts receivable	3,314,994
Inventory	5,246,000
Other current assets	541,726
Property and equipment	3,601,850
Identifiable intangible assets	11,100,000
Goodwill	2,348,331
Other assets	86,953
Accounts payable and accrued expenses	(5,508,789)
Debt	(5,212,355)
Other liabilities	(33,573)
Total purchase consideration	$ 15,859,654

The identifiable intangible assets acquired and their estimated lives were as follows:

	Estimated Fair Value	Estimated Useful Life
Developed technology	$4,500,000	2-10 years
In-process research and development	3,900,000	Indefinite
Customer base	1,300,000	9-11 years
Trade names	1,000,000	10 years
Backlog	400,000	1 year
	$11,100,000	

Developed technologies acquired primarily consist of API's existing technologies related to HSOR products, Optoelectronic systems, modules and components, and Terahertz solutions. The developed technologies of API were valued using both the "relief-from-royalty" method and the "multi-period excess earnings" method, under the income approach. This multi-period excess earnings method reflects the present value of the projected cash flows that are expected to be generated by the developed technologies less charges representing the contribution of other assets to those cash flows. A discount rate of 32.5% was used to discount the cash flows to the present value.

In-process research and development represents the estimated fair values of incomplete API research and development projects that had not reached technological feasibility as of the closing date of the Merger. On September 1, 2015, technologies associated with $1.6 million of in-process research and development were placed into service. In the future, the fair value of each project at the date of the closing of the Merger will be either amortized or impaired depending on whether the projects are completed or abandoned. The fair value of in-process research and development was determined using the multi-period excess earnings method. A discount rate of 37.5% was used to discount the cash flows to the present value.

Customer relationships represent the fair value of projected cash flows that will be derived from the sale of products to API's existing customers as of the closing date of the Merger. Customer relationships were valued utilizing both a multi-period excess earnings method and the "distributor" method, under the income approach. Under this premise, the margin of a distributor within the industry is deemed to be the margin attributable to customer relationships. This isolates the cash flows attributable to the customer relationships that a market participant would be willing to pay for.

A discount rate of 32.5% was used to discount the cash flows to the present value.

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Trade names and trademarks are considered a type of guarantee of a certain level of quality or performance represented by the Picometrix brand. Trade names and trademarks were valued using the "relief-from-royalty" method of income approach. This method is based on the assumption that in lieu of ownership, a market participant would be willing to pay a royalty in order to exploit the related benefits of this asset. A discount rate of 24.5% was used to discount the cash flows to the present value.

Customer backlog represents the fair value of projected cash flows that will be derived from the sale of products under existing contracts and customer orders as of the closing date of the Merger. The fair value of the customer backlog was determined using the multi-period excess earnings method. A discount rate of 21.5% was used to discount the cash flows to the present value.

Goodwill

Goodwill represents the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed in connection with the Merger. During 2015 and the first six months of 2016, we recognized various measurement period adjustments to the value of assets acquired and liabilities assumed in the Merger. These adjustments primarily related to the estimated value of trade names acquired, certain deferred compensation and claims reserve liabilities assumed, with an offsetting increase to the recorded value of goodwill.

Goodwill as of January 1, 2014	$—
Goodwill recorded at acquisition date of API	614,184
Measurement period adjustments	1,659,928
Goodwill as of December 31, 2015	$2,274,112
Measurement period adjustments	74,219
Goodwill as of June 30, 2016	$2,348,331

Pro forma consolidated results of operations

The following unaudited pro forma financial information presents combined results of operations for each of the periods presented as if the Merger had been completed on January 1, 2015. The pro forma information includes adjustments to depreciation expense for property and equipment acquired, amortization expense for the intangible assets acquired, interest expense for the new debt facility, and elimination of the Merger-related transaction expenses recognized in each period. The pro forma data is for informational purposes only and is not necessarily indicative of the consolidated results of operations of the combined business had the Merger actually occurred on January 1, 2015 or the results of future operations of the combined business. For instance, planned or expected operational synergies following the Merger are not reflected in the pro forma information. Consequently, actual results will differ from the unaudited pro forma information presented below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Revenue	$14,647	$12,444	$28,634	$24,232
Net loss	$(739)	$(1,818)	$(2,116)	$(3,889)

4. Inventory

Inventory consists of finished goods, work-in-process and raw materials valued at the lower of cost (determined on the first-in, first-out basis) or market. We write down inventory for estimated obsolescence or unmarketable inventory in an amount

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equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions.
Components of inventory were as follows:

	June 30, 2016 (unaudited)	December 31, 2015
Finished goods	$3,837,604	$ 1,938,466
Work-in-process	1,304,509	1,227,270
Raw materials	3,246,982	5,697,431
Total inventory	$8,389,095	$ 8,863,167

5. Accrued Liabilities

Accrued liabilities at June 30, 2016 and December 31, 2015 consisted of the following:

	June 30, 2016 (unaudited)	December 31, 2015
Accrued compensation	$4,508,246	$ 4,719,533
Claims reserve	1,577,123	1,752,904
Accrued sub-contracts	421,199	351,847
Accrued professional fees	101,419	133,847
Accrued income tax	—	160,438
Deferred rent	153,946	137,889
Royalties	152,763	351,003
Warranty reserve	179,925	173,687
Accrued liabilities - other	429,948	523,538
Total accrued liabilities	$7,524,569	$ 8,304,686

6. Debt

Silicon Valley Bank Facility

We currently have a Loan and Security Agreement with SVB under which we have a term loan with an original borrowing amount of $6.0 million (the "Term Loan" or "Credit Facility"). Prior to the amendment to the Credit Facility in connection with our Merger with API as described above, the Term Loan was to be repaid by us in 48 monthly installments, plus accrued interest payable monthly in arrears, and unless earlier terminated, was scheduled to mature on May 1, 2015. The Term Loan carried a floating annual interest rate equal to SVB's prime rate then in effect plus 2%.

On May 8, 2015, we entered into the Sixth Loan Modification Agreement with SVB, under which we executed a new term loan in the principal amount of $6.0 million and used the proceeds principally to repay the previously outstanding indebtedness of API and other transaction related costs. The Term Loan bears interest at a floating rate of prime plus 2% and is to be repaid in 48 monthly installments of $125,000 plus accrued interest. In September 2015, we entered into the Waiver and Seventh Loan Modification Agreement, which provides an additional $1 million of available financing for purchases of equipment through December 31, 2015, provides a waiver of any breach of the minimum liquidity covenant in periods prior to the amendment, and requires us to maintain at each month end a ratio of cash plus 60% of accounts receivable greater than or equal to 1.5 times the outstanding principal balance of the

Term Loan. In addition, the Waiver and Seventh Loan Modification requires us to achieve a minimum Adjusted EBITDA, as defined therein, on a quarterly basis. The Credit Facility also requires us to observe a number of additional operational covenants, including protection and registration of intellectual property rights,

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and certain customary negative covenants. As of June 30, 2016, we were in compliance with all covenants under the Credit Facility.

Amounts due under the Credit Facility are secured by substantially all of our assets, including intellectual property, personal property and bank accounts. In addition, the Credit Facility contains customary events of default, including nonpayment of principal, interest or other amounts, violation of covenants, material adverse change, an event of default under any subordinated debt documents, incorrectness of representations and warranties in any material respect, bankruptcy, judgments in excess of a threshold amount, and violations of other agreements in excess of a threshold amount. If any event of default occurs SVB may declare due immediately all borrowings under the Credit Facility and foreclose on the collateral. Furthermore, an event of default under the Credit Facility would result in an increase in the interest rate on any amounts outstanding. As of June 30, 2016, there were no events of default on the Credit Facility.

As of June 30, 2016, we have drawn all of the additional $1.0 million of available financing. The balance under the Term Loan at June 30, 2016 and December 31, 2015, was $5.2 million and $6.1 million, respectively. The effective rate of our Term Loan at June 30, 2016 was 5.5%.

The following table presents a summary of debt outstanding as of June 30, 2016 and December 31, 2015:

	June 30, 2016 (unaudited)	December 31, 2015
Silicon Valley Bank Term Loan	$5,208,333	$ 6,125,000
Less: current portion	1,833,333	1,833,333
Total long-term debt	$3,375,000	$ 4,291,667

The schedule of remaining principal payments under our term loan is as follows:

2016	916,661
2017	1,833,336
2018	1,833,336
2019	625,000
	$5,208,333

7. Capital Stock and Share-Based Compensation

We recognize share-based compensation expense based upon the fair value of the underlying equity award on the date of the grant. For restricted stock awards and restricted stock units, we recognize expense based upon the price of our underlying stock at the date of the grant. We have elected to use the Black-Scholes-Merton option pricing model to value any option or warrant awards granted. We recognize share-based compensation for such awards on a straight-line basis over the requisite service period of the awards taking into account the effects of the employees' expected exercise and post-vesting employment termination behavior. To compute the volatility used in this model we use the historical volatility of our common stock over the expected life of options granted. The risk-free interest rate is based on U.S. Treasury interest rates, the terms of which are consistent with the expected life of the stock options. The expected life and estimated post-employment termination behavior is based upon historical experience of homogeneous groups within our company. We also assume an expected dividend yield of zero for all periods, as we have never paid a dividend on our common stock and do not have any plans to do so in the future.

The fair value of each option granted during the six months ended June 30, 2016 and 2015 was estimated as of the grant date using the Black-Scholes-Merton option pricing model with the following assumptions:

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	Six Months Ended June 30,	
	2016	2015
Risk-free interest rate	1.5%	1.88%
Expected life of options (in years)	7.5	7.5
Expected stock price volatility	73%	103%
Executive turnover rates	—%	—%
Non-executive turnover rates	14%	40%
Expected dividend yield	—%	—%

A summary of the activity for our 2003 Stock Plan, 2006 Equity Incentive Plan and 2016 Equity Incentive Plan is presented below for the six months ended June 30, 2016:

	Options Outstanding				Options Exercisable		
	Number of Shares	Price per Share Range	Weighted Average Exercise Price	Aggregate Intrinsic Value (1)	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (1)
Balance, January 1, 2016	3,800,728	$0.61 - $8.43	$ 2.17	$ 111,314	3,045,150	$ 2.39	$ 103,603
Granted	20,000	$ 1.15	$ 1.15				
Canceled	(525,726)	$1.18 - $7.30	$ 2.35				
Balance, June 30, 2016	3,295,002	$0.61 - $7.30	$ 2.14	$ 64,918	2,891,233	$ 1.93	$ 62,644

(1) The intrinsic value of an option represents the amount by which the market value of the stock exceeds the exercise price of the option of in-the-money options only. The aggregate intrinsic value is based on the closing price of our common stock on the NASDAQ Capital Market, as applicable, on the respective dates.

At June 30, 2016, the outstanding stock options to purchase an aggregate of 3.3 million shares had a weighted-average remaining contractual term of 5.2 years, and the exercisable stock options to purchase an aggregate of 2.9 million shares had a weighted-average remaining contractual term of 4.9 years.

For the six months ended June 30, 2016 and 2015 we recognized $0.5 million and $0.6 million in share-based compensation expense, respectively, which is included in our selling, general and administrative expense in the accompanying consolidated financial statements. We expect to recognize $0.5 million in share-based compensation expense over the weighted-average remaining service period of 1.0 years for stock options outstanding as of June 30, 2016.

The following table summarizes the unvested value of our restricted stock awards:

	Number of Unvested Shares	Weighted Average Grant Date Fair Value	Aggregate Value of Unvested Shares
Balance at January 1, 2016	$ 669,625	$ 1.23	$ 823,639
Granted	319,000	$ 1.15	572,700
Vested	(303,246)	$ 1.25	(379,058)
Repurchased	(73,675)	$ 1.14	(83,990)
Balance at June 30, 2016	$ 611,704	$ 1.18	$ 933,291

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The following details our equity transactions during the six months ended June 30, 2016:

	Preferred Stock		Common Stock		Treasury Stock		Additional Paid-in Capital
	Shares	$	Shares	$	Shares	$	$
Balance at January 1, 2016	1,321,514	1,322	27,477,181	28,178	167,652	(184,934)	81,461,907
Share-based compensation	—	—	—	—	—	—	465,028
Non-cash compensation	—	—	—	24	—	—	24,976
Stock dividends to Carilion Clinic[(1)]	—	—	—	39	—	—	45,751
Repurchase of common stock	—	—	—	—	132,675	(156,386)	—
Balance at June 30, 2016	1,321,514	1,322	27,477,181	28,241	300,327	(341,320)	81,997,662

(1) The stock dividends payable in connection with Carilion Clinic's Series A Preferred Stock will be issued subsequent to June 30, 2016. For the period from January 12, 2010, the original issue date of the Series A Preferred Stock, through June 30, 2016, the Series A Preferred Stock issued to Carilion has accrued $1,003,954 in dividends. The accrued and unpaid dividends as of June 30, 2016 will be paid by the issuance of 512,755 shares of our common stock upon Carilion's written request.

Stock Repurchase Program

In May 2016, our board of directors authorized us to repurchase up to $2,000,000 of our common stock through May 31, 2017. Our stock repurchase program does not obligate us to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. The following chart details our share repurchases during each month since the adoption of the stock repurchase program:

	Total Number of Shares Repurchased	Average Price Paid per Share
April 2016	—	—
May 2016	—	—
June 2016	59,000	$ 1.22

We currently maintain these repurchased shares as treasury stock.

8. Operating Segments

Our operations are divided into two operating segments—"Technology Development" and "Products and Licensing". The Technology Development segment provides applied research to customers in our areas of focus. Our engineers and scientists collaborate with our network of government, academic and industry experts to identify technologies and ideas with promising market potential. We then compete to win fee-for-service contracts from government agencies and industrial customers who seek innovative solutions to practical problems that require new technology. The Technology Development segment derives its revenues primarily from services.

The Products and Licensing segment derives its revenues from product sales, funded product development and technology licenses.

Through June 30, 2016, our Chief Executive Officer and his direct reports collectively represented our chief operating decision makers, and they evaluated segment performance based primarily on revenues and operating income or loss. The accounting policies of our segments are the same as those described in the summary of significant accounting policies (see Note 1 to our Financial Statements, "Organization and Summary of Significant Accounting Policies," presented in our Annual Report on Form 10-K as filed with the SEC on March 29, 2016).

The table below presents revenues and operating loss for reportable segments:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2016 (unaudited)	2015	2016 (unaudited)	2015
Revenues:				
Technology development	$4,137,382	$3,728,271	$7,860,644	$6,603,786
Products and licensing	10,509,522	6,297,475	20,773,273	8,761,062
Total revenues	$14,646,904	$10,025,746	$28,633,917	$15,364,848
Technology development operating income (loss)	$313,208	$(1,096,127)	$(177,108)	$(2,947,684)
Products and licensing operating loss	(964,789)	(1,026,776)	(1,826,643)	(1,790,274)
Total operating loss	$(651,581)	$(2,122,903)	$(2,003,751)	$(4,737,958)
Depreciation, technology development	$91,127	$104,217	$186,784	$203,854
Depreciation, products and licensing	$263,514	$189,276	$517,011	$225,803
Amortization, technology development	$44,501	$37,434	$117,838	$57,222
Amortization, products and licensing	$522,660	$328,242	$1,039,969	$337,371

The table below presents assets for reportable segments:

	June 30, 2016 (unaudited)	December 31, 2015
Total segment assets:		
Technology development	$16,672,200	$21,203,211
Products and licensing	37,587,521	36,928,602
Total assets	$54,333,940	$58,131,813
Property plant and equipment, and intangible assets, technology development	$2,798,472	$2,917,448
Property plant and equipment, and intangible assets, products and licensing	$16,328,806	$16,375,215

There are no material inter-segment revenues for any period presented.

The U.S. government accounted for 28% and 37% of total consolidated revenues for the three months ended June 30, 2016 and 2015, respectively, and for 28% and 45%