CLEARSIGN COMBUSTION CORP
Form 10-Q
May 06, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

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 001-35521

CLEARSIGN COMBUSTION CORPORATION

(Exact name of registrant as specified in its charter)

WASHINGTON	**26-2056298**
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization) Identification No.)

12870 Interurban Avenue South

Seattle, Washington 98168

(Address of principal executive offices)

(Zip Code)

(206) 673-4848

(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 x 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 than the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer," and "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of May 6, 2013 the issuer has 8,793,265 shares of common stock, par value $.0001, issued and outstanding.

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PART I-FINANCIAL INFORMATION

ITEM 1

ClearSign Combustion Corporation

(a Development Stage Company)

Condensed Balance Sheets

(Unaudited)

	March 31, 2013	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$6,655,000	$8,027,000
Prepaid expenses	158,000	60,000
Total current assets	6,813,000	8,087,000
Fixed assets, net	489,000	400,000
Patents and other intangible assets	780,000	618,000
Other assets	10,000	10,000
Total Assets	$8,092,000	$9,115,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$325,000	$276,000
Accrued compensation and taxes	265,000	168,000
Total current liabilities	590,000	444,000
Deferred rent	34,000	35,000
Total liabilities	624,000	479,000
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, $0.0001 par value, zero shares issued and outstanding	-	-
Common stock, $0.0001 par value, 8,782,015 and 8,752,015 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively	1,000	1,000

Additional paid-in capital	17,503,000	17,314,000
Deficit accumulated in the development stage	(10,036,000)	(8,679,000)
Total stockholders' equity	7,468,000	8,636,000
Total Liabilities and Stockholders' Equity	$ 8,092,000	$ 9,115,000

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

ClearSign Combustion Corporation

(a Development Stage Company)

Condensed Statements of Operations

(Unaudited)

	For the Three Months Ended March 31, 2013	2012	For the Period from Inception (January 23, 2008) to **March 31, 2013**
Operating expenses:			
Research and development	$ 458,000	$ 264,000	$ 2,166,000
General and administrative	903,000	600,000	7,899,000
Total operating expenses	1,361,000	864,000	10,065,000
Loss from operations	(1,361,000)	(864,000)	(10,065,000)
Other income (expense):			
Interest income	4,000	-	30,000
Interest expense	-	(1,000)	(1,000)
Total other income (expense)	4,000	(1,000)	29,000
Net Loss	$ (1,357,000)	$ (865,000)	$ (10,036,000)
Net Loss per share - basic and fully diluted	$ (0.15)	$ (0.17)	$ (2.50)
Weighted average number of shares outstanding - basic and fully diluted	8,781,348	5,153,315	4,011,703

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

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ClearSign Combustion Corporation

(a Development Stage Company)

Condensed Statement of Stockholders' Equity

(Unaudited)

For the period from Inception (January 23, 2008) to March 31, 2013

	Common Stock		Common Stock Class B		Additional	Deficit Accumulated in the Development	Total Stockholders'
	Shares	Amount	Shares	Amount	Paid-In Capital	Stage	Equity
Shares issued to founders, at no cost	1,065,000	$ -	476,000	$ -	$ 33,000	$ -	$ 33,000
Shares issued for services ($0.02 per share)	125,000	-	-	-	2,000	-	2,000
Shares issued for cash ($0.02 per share)	-	-	384,000	-	10,000	-	10,000
Shares issued for cash ($1.80 per share)	467,310	-	-	-	841,000	-	841,000
Shares issued for cash ($2.20 per share)	1,363,364	-	-	-	2,999,000	-	2,999,000
Issuance costs	-	-	-	-	(813,000)	-	(813,000)
Shares issued in initial public offering ($4.00 per share)	3,450,000	1,000	-	-	13,799,000	-	13,800,000
Issuance costs of initial public offering	-	-	-	-	(2,727,000)	-	(2,727,000)
Share based payments of warrants	-	-	-	-	240,000	-	240,000
Shares issued for services ($1.80 per share)	146,644	-	-	-	264,000	-	264,000
Shares issued for services ($2.20 per share)	733,523	-	-	-	1,614,000	-	1,614,000
Shares issued for services ($4.00 per share)	18,000	-	-	-	72,000	-	72,000
Shares issued for services ($4.94 per share)	20,799	-	-	-	103,000	-	103,000
Shares issued to retire payable ($4.00 per share)	110,000	-	-	-	440,000	-	440,000

Conversion of shares	1,075,000	-	(860,000)	-	-	-	-
Share based compensation	177,375	-	-	-	437,000	-	437,000
Net loss	-	-	-	-	-	(8,679,000)	(8,679,000)
Balances at December 31, 2012	8,752,015	1,000	-	-	17,314,000	(8,679,000)	8,636,000
Shares issued for services ($5.00 per share)	30,000	-	-	-	150,000	-	150,000
Share based compensation	-	-	-	-	39,000	-	39,000
Net loss	-	-	-	-	-	(1,357,000)	(1,357,000)
Balances at March 31, 2013	8,782,015	$ 1,000	-	$ -	$ 17,503,000	$ (10,036,000)	$ 7,468,000

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

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ClearSign Combustion Corporation

(a Development Stage Company)

Condensed Statements of Cash Flows

(Unaudited)

	For the Three Months Ended March 31,s 2013	2012	For the Period from Inception (January 23, 2008) to March 31, 2013
Cash flows from operating activities:			
Net loss	$ (1,357,000)	$ (865,000)	$ (10,036,000)
Adjustments to reconcile net loss to net cash used in operating activities:			
Common stock issued or issuable for services	37,000	18,000	1,566,000
Share based payments	39,000	48,000	361,000
Depreciation	52,000	13,000	209,000
Deferred rent	(1,000)	18,000	34,000
Change in operating assets and liabilities:			
Prepaid expenses	15,000	(507,000)	(45,000)
Other assets	-	10,000	(10,000)
Accounts payable	49,000	439,000	819,000
Accrued compensation	97,000	205,000	380,000
Net cash used in operating activities	(1,069,000)	(621,000)	(6,722,000)
Cash flows from investing activities:			
Acquisition of fixed assets	(141,000)	(26,000)	(677,000)
Disbursements for patents and other intangible assets	(162,000)	(28,000)	(780,000)
Net cash used in investing activities	(303,000)	(54,000)	(1,457,000)
Cash flows from financing activities:			
Proceeds from issuance of common stock for cash, net of offering costs	-	-	14,882,000
Proceeds from issuance of short term promissory note	-	-	98,000
Principal payments on promissory notes	-	(13,000)	(146,000)
Net cash provided by (used in) financing activities	-	(13,000)	14,834,000
Net increase (decrease) in cash and cash equivalents	(1,372,000)	(688,000)	6,655,000
Cash and cash equivalents, beginning of period	8,027,000	930,000	-
Cash and cash equivalents, end of period	$ 6,655,000	$ 242,000	$ 6,655,000

Supplemental disclosure of cash flow information:			
Cash paid during the period for interest	$ -	$ 1,000	$ 1,000

<u>Supplemental disclosure of non-cash investing and financing activities:</u>

During the three months ended March 31, 2013, the Company:

- issued 22,500 shares of common stock valued at $113,000 to directors for services to be performed from April to December 2013.

During the period from inception (January 23, 2008) to March 31, 2013, exclusive of the above, the Company:

- issued warrants to purchase 345,000 shares of common stock valued at $128,000 as part of an underwriting fee related to the initial public offering,
- issued 110,000 shares of common stock valued at $440,000 in partial satisfaction of an account payable,
- issued 263,637 shares of common stock valued at $580,000 and warrants to purchase 136,368 shares of common stock valued at $64,000 for issuance costs related to a common stock offering,
- issued 52,375 shares of common stock valued at $115,000 to certain employees to partially satisfy compensation accrued at December 31, 2010,
- issued 68,091 shares of common stock valued at $126,000 in order to discharge $99,000 of common stock to be issued at December 31, 2010 and pay rent for the eight months ended August 31, 2011,
- issued 49,728 shares of common stock valued at $90,000 in order to discharge the common stock to be issued at December 31, 2010,
- canceled 5,825 shares valued at $10,000 in order to partially discharge common stock to be issued at December31, 2010,
- made stock grants of 50,000 and 75,000 shares to an employee valued at $275,000 which is to be earned from July 2011 to September 2016,
- swapped 860,000 shares of Class B common stock held by its founding shareholders for 1,075,000 shares of common stock,
- converted a $46,000 account payable to a vendor and acquired a fixed asset valued at $2,000 through a $48,000 interest-bearing promissory note retired in 2012,
- issued 3,555 shares of common stock valued at $8,000 in partial satisfaction of an account payable,
- issued 10,834 shares of common stock valued at $20,000 in exchange for equipment.

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

ClearSign Combustion Corporation

(a Development Stage Company)

Notes to Unaudited Condensed Financial Statements

Note 1 – Organization and Description of Business

ClearSign Combustion Corporation (ClearSign or the Company) is a development stage company located in Seattle, Washington and incorporated in the state of Washington on January 23, 2008. The Company was formed to design, develop and market technologies that improve both the energy efficiency and emission control characteristics of combustion systems. The Company's Electrodynamic Combustion Control™ or ECC™ technology introduces a computer-controlled electric field into the combustion region which may better control gas-phase chemical reactions and improve system performance and cost-effectiveness.

Note 2 – Summary of Significant Accounting Policies

<u>Basis of Presentation</u>

The accompanying unaudited condensed 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 condensed balance sheet at December 31, 2012 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 our annual report on Form 10-K for the year ended December 31, 2012. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year or any other future periods.

<u>Development Stage Enterprise</u>

The Company is a development stage company as defined in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 915, *Development Stage Entities*. The Company is devoting substantially all of its present efforts to design and develop new technologies in combustion systems and its planned principal operations have not yet commenced. The Company has not generated any revenues from operations and has no assurance of any future revenues. All losses accumulated since January 23, 2008 have been considered as part of the Company's development stage activities.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents. Cash is maintained with a commercial bank where accounts are generally guaranteed by the Federal Deposit Insurance Corporation up to $250,000. The Company’s deposits may at times exceed this limit.

Fixed Assets

Fixed assets are recorded at cost. Depreciation is computed using the straight-line method over the estimated lives of the respective assets. Leasehold improvements are depreciated over the life of the lease or their useful life, whichever is shorter. All other fixed assets are depreciated over thirty months to four years. Maintenance and repairs are expensed as incurred.

Patents and Trademarks

Patents and trademarks are recorded at cost. Amortization is computed using the straight-line method over the estimated useful lives of the assets once they are awarded, which has not yet occurred.

Impairment of Long-Lived Assets

The Company tests long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable through the estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair values are reduced for the cost of disposal. As of March 31, 2013 and December 31, 2012, the Company determined that there was no impairment.

Fair Value of Financial Instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are categorized based on whether or not the inputs are observable in the market and the degree that the inputs are observable. The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The Company's financial instruments primarily consist of cash and cash equivalents, accounts payable and accrued expenses. As of the balance sheet dates, the estimated fair values of the financial instruments were not materially different from their carrying values as presented on the balance sheets. This is primarily attributed to the short maturities of these instruments. The Company did not identify any other non-recurring assets and liabilities that are required to be presented in the balance sheets at fair value.

Research and Development

The cost of research and development is expensed as incurred. Research and development costs consist of salaries, benefits, share based compensation, consulting fees, rent, utilities, depreciation, and consumables.

Deferred Rent

Operating lease agreements which contain provisions for future rent increases or periods in which rent payments are reduced or abated are recorded in monthly rent expense in the amount of the total payments over the lease term divided by the number of months of the lease term. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent which is reflected on the accompanying balance sheet.

Income Taxes

The Company accounts for income taxes using an asset and liability approach which allows for the recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain.

Tax benefits from an uncertain tax position are recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate resolution.

Stock-Based Compensation

The costs of all employee stock options, as well as other equity-based compensation arrangements, are reflected in the financial statements based on the estimated fair value of the awards on the grant date. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. Stock compensation for stock granted to non-employees is determined as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

Stock Issuance Costs

Stock issuance costs are recorded as a reduction of the related proceeds through a charge to stockholders' equity.

Common Stock

The Company records common stock issuances when all of the legal requirements for the issuance of such common stock have been satisfied.

Net Loss per Common Share

Basic loss per share is computed by dividing loss available to common stockholders by the weighted-average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include additional common shares available upon exercise of stock options and warrants using the treasury stock method, except for periods for which no common share equivalents are included because their effect would be anti-dilutive. Potentially dilutive shares outstanding amounted to 1,124,733 and 575,743 at March 31, 2013 and 2012, respectively.

Recently Issued Accounting Pronouncements

Management does not believe that any recently issued, but not yet effective standards, if adopted, will have a material effect on the financial statements.

Emerging Growth Company

The Company is an emerging growth company as defined under the Jumpstart Our Business Startups Act of 2012 (JOBS Act). An emerging growth company may delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. The Company will remain an emerging growth company until December 31, 2017, although it will lose that status sooner if its revenues exceed $1 billion, if it issues more than $1 billion in non-convertible debt in a three year period, or if the market value of its common stock that is held by non-affiliates exceeds $700 million as of any June 30.

Note 3 – Fixed Assets

Fixed assets are summarized as follows:

	March 31, 2013	December 31, 2012
Machinery and equipment	$564,000	$ 444,000
Office furniture and equipment	71,000	71,000
Leasehold improvements	29,000	29,000
Accumulated depreciation	(209,000)	(157,000)
	455,000	387,000
Construction in progress	34,000	13,000
	$489,000	$ 400,000

Note 4 – Stockholders' Equity

Common Stock and Preferred Stock

The Company is authorized to issue 62,500,000 shares of common stock and 2,000,000 shares of preferred stock. Preferences, limitations, voting powers and relative rights of any preferred stock to be issued may be determined by the Company's Board of Directors. The Company has not issued any shares of preferred stock.

In April and May 2012, the Company completed an initial public offering (IPO) whereby 3,450,000 shares of common stock were issued at $4.00 per share, which included the exercise of the overallotment allowance by the underwriter, MDB Capital Group LLC (MDB). Gross proceeds from the IPO totaled $13.8 million and net cash proceeds approximated $11.2 million. Expenses of the offering approximated $2.7 million, including underwriter fees of $1.2 million paid to MDB along with 345,000 warrants to purchase ClearSign's common stock at $5.00 per share exercisable from April 2013 to April 2017 valued at $128,000, qualified independent underwriter fees of $110,000, underwriter legal fees of $125,000, underwriter expenses of $35,000, and issuer legal fees of $822,000, which was paid in part through the issuance of 110,000 shares of the Company's common stock to its legal counsel at a price of $4.00 per share.

Equity Incentive Plan

The Company has an Equity Incentive Plan (the Plan) which provides for the granting of options to purchase shares of common stock, stock awards to purchase shares at no less than 85% of the value of the shares, and stock bonuses to officers, employees, board members, consultants, and advisors. The Compensation Committee of the Board of Directors is authorized to administer the Plan and establish the grant terms, including the grant price, vesting period and exercise date. As of March 31, 2013, the number of shares reserved for issuance under the Plan totaled 985,434 shares. The Plan provides for periodic increases in the number of authorized shares available for issuance under the Plan on the first day of each of the Company's fiscal quarters. The Plan provides for quarterly increases in the available number of authorized shares equal to the lesser of 10% of any new shares issued by the Company during the quarter immediately prior to the adjustment date or such lesser amount as the Board of Directors shall determine.

In January 2013, the Company granted 203,990 stock options under the Plan to certain employees. The stock options have an exercise price of $4.88 per share, the grant date fair value, a contractual life of 10 years, and vest over four years. The fair value of stock options granted in January 2013 estimated on the date of grant using the Black-Scholes option valuation model was $302,000. The recognized compensation expense associated with these grants for the three months ended March 31, 2013 was $19,000.

In January 2013, the Company granted 30,000 shares of common stock under the Plan to its three independent directors in accordance with agreements for board service in 2013. The fair value of the stock at the time of grant was $5.00 per share for a total value of $150,000 which the Company will recognize in general and administrative expense on a quarterly basis in 2013, including $37,000 for the three months ended March 31, 2013.

Outstanding stock option grants at March 31, 2013 and December 31, 2012 totaled 563,365 and 359,375 with 263,337 and 242,188 being vested and exercisable at March 31, 2013 and December 31, 2012, respectively. Stock grants made to date through March 31, 2013 and December 31, 2012 totaled 175,799 shares and 145,799 shares, respectively. Of these amounts, 56,000 and 60,000 at March 31, 2013 and December 31, 2012, respectively, are subject to declining repurchase rights by the Company at $0.0001 per share through September 30, 2016. The recognized compensation expense associated with these grants for the three months ended March 31, 2013 and 2012 totaled $39,000 and $48,000, respectively. At March 31, 2013, the number of shares reserved under the Plan but unissued totaled 246,270. At March 31, 2013, there was $463,000 of total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted average period of 3.4 years.

Warrants

The Company has the following warrants outstanding at March 31, 2013:

	Total Outstanding Warrants		
Exercise Price	Warrants	Weighted Average Exercise Price	Life (in years)
$ 0.00	80,000	$ 1.80	7.89
$ 0.00	136,368	$ 2.20	3.11
$ 0.00	345,000	$ 5.00	4.07
	561,368		

Note 5 – Related Party Transactions

For the three months ended March 31, 2013 and 2012 and for the period from inception (January 23, 2008) to

March 31, 2013, the Company paid consulting fees of $30,000, $30,000 and $329,000, respectively, to the Alternative Energy Resource Alliance, a non-profit organization whose executive director is David Goodson. In exchange, Mr. Goodson provides services as the Company's Chief Science Officer. Mr. Goodson is a director and co-founder of the Company and, through an irrevocable trust, a significant beneficial owner of the Company's common stock.

Note 6 – Commitments and Contingencies

The Company has a triple net lease for office and laboratory space for the period November 2011 to February 2017. Under the terms of the lease, the Company paid no rent for the period November 2011 to February 2012. Rent payments commenced in March 2012 and will escalate annually by 3%. The Company records monthly rent expense equal to the total of the payments over the lease term divided by the number of months of the lease term. Therefore, rent expense of $17,000 was accrued for the three months ended March 31, 2012 and for the three months ended March 31, 2013 the deferred rent was reduced by $1,000. Under the terms of the lease, the Company will also pay monthly triple net operating costs which currently approximates $2,000 per month. Minimum future payments under these leases at March 31, 2013 are as follows:

2013	$81,000
2014	111,000
2015	115,000
2016	118,000
2017	20,000
	$445,000

For the three months ended March 31, 2013 and 2012, rent expense amounted to $34,000 and $36,000, respectively.

Effective January 1, 2012, the Company entered into an Employment Agreement (the Agreement) with Richard Rutkowski, its Chief Executive Officer. Unless earlier terminated, the Agreement will continue for a term of three years. Compensation includes an annual salary of $355,000 with annual cost-of-living adjustments, annual cash and equity bonuses based on performance standards established by the Compensation Committee of the Board of Directors, medical and dental benefits for Mr. Rutkowski and his family, disability insurance, and term life insurance for the benefit of his dependents. Mr. Rutkowski's employment may be terminated by the Company without cause under certain circumstances, as defined in the Agreement. If Mr. Rutkowski's employment is terminated without cause, a severance payment would be due in the amount of compensation that would have been due had his employment not been terminated or one year of the current annual compensation, whichever is greater.

The Company has agreements with its three independent directors to compensate them annually after the Company's common stock commenced trading publicly. The obligation totals $300,000 per year of which $150,000 is to be paid with the Company's common stock at fair value.

The Company's former legal advisors, Perkins Coie LLP, previously advised the Company that they believe TWB Investment Partnership II, L.P., a party related to Perkins Coie LLP, has the right to acquire 25,250 shares of the Company's common stock at $0.02 per share pursuant to an engagement letter dated December 4, 2007. The claim was denied since, among other defenses, management believes it entered into a full settlement of all amounts owed to Perkins Coie LLP in November 2011.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION

CONTAINED IN THIS REPORT

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and the provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. You can find many (but not all) of these statements by looking for words such as “approximates,” “believes,” “hopes,” “expects,” “anticipates,” “estimates,” “projects,” “intends,” “plans,” “would,” “should,” “could,” “may,” or other similar expressions in th 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 limited cash and our history of losses;
· our ability to achieve profitability;
· our limited operating history;
· emerging competition and rapidly advancing technology in our industry that may outpace our technology;
· customer demand for the products and services we develop;
· the impact of competitive or alternative products, technologies and pricing;
· our ability to manufacture any products we develop;
· 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;
· our ability to continue as a going concern;
· 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.

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 unaudited condensed financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q as well as our audited financial statements and related notes included in our annual report on Form 10-K. In addition to historical information, this 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.

OVERVIEW

We are a development stage company located in Seattle, Washington. We were formed for the purpose of developing a technology that improves both the energy efficiency and emissions control characteristics of combustion systems. To date, our operations have been funded through sales of our common stock. We have earned no revenue since inception on January 23, 2008.

Plan of Operation

We are pursuing development of our technology to enable future sales. These activities entail laboratory research, where we have successfully demonstrated our proprietary technology operating in our research facility with thermal output of 1,000,000 BTUs per hour, and business development and marketing activities with established manufacturers and other entities that use boilers, burners, refinery heaters, and other combustion systems. We intend to create co-development collaborations which would enable us to work closely with established companies in specific industries to apply developed solutions in laboratory and field settings. In April 2013, we announced our intention to enter into a development agreement with Grandeg, a European manufacturer of commercial wood pellet boiler systems. Under the agreement, we will develop solutions based on our ECC technology for both retrofit into existing Grandeg biomass boilers as well as for integration into new product designs. Grandeg has indicated its intent to provide up to $500,000 in funding to support a phased initial project that is expected to begin upon execution of a definitive agreement with the goal of releasing a first commercial solution to the market during 2014. While a definitive agreement is expected to be executed by June 2013, there is no assurance that terms will be reached or a final agreement executed.

In April and May 2012, we completed an initial public offering (IPO) of our common stock whereby we sold 3,450,000 shares of common stock at $4.00 per share, which included the exercise of the underwriter's overallotment option, resulting in gross proceeds of $13.8 million and, after reflecting certain costs paid with common stock, net proceeds of $11.6 million. The net proceeds have been used as follows through March 31, 2013: approximately $6,000,000 for the purchase of short-term certificates of deposit, $624,000 increased cash and money market funds, $3,580,000 for operations, $412,000 for capital expenditures primarily related to research and development machinery and equipment, $657,000 for patents, $238,000 for the payment of accrued compensation, and $129,000 for the repayment of short term indebtedness. We anticipate that in total the net proceeds will be used as follows: $4 million for research and development including related capital expenditures, $2 million for protection of intellectual property, $1.75 million for exploration of market opportunities, and the balance for working capital and general corporate purposes. In addition, we may use a portion of the net proceeds from the IPO to acquire complementary products, technologies or businesses; however, we do not have plans for any acquisitions at this time. We expect the net proceeds from the IPO to be sufficient to fund our activities at least through April 2014. Our anticipated costs include employee salaries and benefits, compensation paid to consultants, capital costs for research and other equipment, costs associated with development activities including travel and administration, legal expenses, sales and marketing costs, general and administrative expenses, and other costs associated with an early stage, publicly-traded technology company. We anticipate increasing the number of employees by up to approximately 20-30 employees; however, this is highly dependent on the nature of our development efforts. We anticipate adding employees in the areas of research and development, sales and marketing, and general and administrative functions required to support our efforts. We expect to incur consulting expenses related to technology development and other efforts as well as legal and related expenses to protect our intellectual property. We expect capital expenditures to be between $0.5 and $1.0 million annually, but these are highly dependent on the nature of the operations where co-development activities are ongoing.

The amount that we spend for any specific purpose may vary significantly, and could depend on a number of factors including, but not limited to, the pace of progress of our commercialization and development efforts, actual needs with respect to product testing, development and research, market conditions, and changes in or revisions to our marketing strategies.

Research and development of new technologies is, by its nature, unpredictable. Although we will undertake development efforts with commercially reasonable diligence, there can be no assurance that the net proceeds from the IPO will be sufficient to enable us to develop our technology to the extent needed to create future sales to sustain operations. If the net proceeds from the IPO are insufficient for this purpose, we will consider other options to continue our path to commercialization, including, but not limited to: additional financing through follow-on stock offerings, debt financing, co-development agreements, sale or licensing of developed intellectual or other property, or other alternatives.

If management is unable to implement its proposed business plan or employ alternative financing strategies, it does not presently have any alternative proposals. In that case, we may be required to scale back our development plans by reducing expenditures for employees, consultants, business development and marketing efforts, and other envisioned expenditures or curtail or even suspend our operations.

We cannot assure that our technology will be accepted, that we will ever earn revenues sufficient to support our operations, or that we will ever be profitable. Furthermore, we have no committed source of financing and we cannot assure that we will be able to raise money as and when we need it to continue our operations. If we cannot raise funds as and when we need them, we may be required to severely curtail, or even to cease, our operations.

CRITICAL ACCOUNTING POLICIES

The following discussion and analysis of financial condition and results of operations is based upon our financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Certain accounting policies and estimates are particularly important to the understanding of our financial position and results of operations and require the application of significant judgment by our management or can be materially affected by changes from period to period in economic factors or conditions that are outside of our control. As a result, they are subject to an inherent degree of uncertainty. In applying these policies, our management uses their judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical operations, our future business plans and projected financial results, the terms of existing contracts, our observance of trends in the industry, information provided by our customers and information available from other outside sources, as appropriate. See Note 2 to our unaudited condensed financial statements for a more complete description of our significant accounting policies.

Development Stage Enterprise. The Company is a development stage company as defined in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 915, *Development Stage Entities*. The Company is devoting substantially all of its present efforts to design and develop new technologies in combustion systems and its planned principal operations have not yet commenced. The Company has not generated any revenues from operations and has no assurance of any future revenues. All losses accumulated since January 23, 2008 have been considered as part of the Company's development stage activities.

Research and Development. The cost of research and development is expensed as incurred. Research and development costs consist of salaries, benefits, share based compensation, consulting fees, rent, utilities, depreciation, and consumables.

Stock-Based Compensation. The costs of all employee stock options, as well as other equity-based compensation arrangements, are reflected in the financial statements based on the estimated fair value of the awards on the grant date. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. Stock compensation for stock granted to non-employees is determined as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

Fair Value of Financial Instruments. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are categorized based on whether or not the inputs are observable in the market and the degree that the inputs are observable. The categorization of financial assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The Company's financial instruments primarily consist of cash and cash equivalents, accounts payable and accrued expenses. As of the balance sheet dates, the estimated fair values of the financial instruments were not materially different from their carrying values as presented on the balance sheets. This is primarily attributed to the short maturities of these instruments. The Company did not identify any other non-recurring assets and liabilities that are required to be presented in the balance sheets at fair value.

RESULTS OF OPERATIONS

Comparison of the Three Months Ending March 31, 2013 and 2012

Operating Expenses. Operating expenses, consisting of research and development (R&D) and general and administrative (G&A) expenses, increased by approximately $497,000 to $1,361,000 for the three months ended March 31, 2013, referred to herein as Q1 2013, compared to the same period in 2012 (Q1 2012). The Company increased its R&D expenses by $194,000 to $458,000 for Q1 2013. R&D expenses rose primarily due to increased compensation of $143,000 related to increased personnel levels and $35,000 of increased depreciation expense. G&A expenses increased by $303,000 to $903,000 in Q1 2013 resulting primarily from the expense of operating as a public company, which totaled $296,000 in Q1 2013.

Loss from Operations. Due to the increase in operating expenses, our loss from operations increased during Q1 2013 by approximately $497,000 to $1,361,000.

Net Loss. Primarily as a result of the increase in operating expenses, our net loss for Q1 2013 was approximately $1,357,000 as compared to a net loss of $865,000 for Q1 2012, resulting in an increased net loss of $492,000.

Liquidity and Capital Resources

At March 31, 2013, our cash and cash equivalent balance totaled $6,655,000 compared to $8,027,000 at December 31, 2012. We expect this sum to be sufficient to fund our activities at least through April 2014. Although we are pursuing co-development agreements, there is no assurance that they will be adequate to fund our operations and to commercialize our technology. To the extent co-development agreement funding is insufficient to raise adequate funds, we may undertake offerings of our securities, debt financing, selling or licensing our developed intellectual or other property, or other alternatives. In that regard, the Company filed a Form S-3 shelf registration with the Securities and Exchange Commission (SEC) on May 6, 2013 that, once declared effective by the SEC, will allow the Company to issue up to an aggregate of thirty million dollars of common stock, preferred stock or warrants from time to time as market conditions permit. This equity funding would be used to enable further investment in our technology and product development and to maintain a strong balance sheet as we pursue strategic joint development and marketing relationships and prepare to pursue significant opportunities in various segments of the market. This information does not constitute an offer of any securities for sale.

At March 31, 2013, our current assets were in excess of current liabilities resulting in working capital of $6,223,000 compared to $7,643,000 at December 31, 2012.

Operating activities for the three months ended March 31, 2013 resulted in cash outflows of $1,069,000 which were due primarily to the loss for the period of $1,357,000, offset by net changes in working capital, exclusive of cash, of $161,000 related to an increase in accrued compensation, services paid with common stock and stock options of $76,000, and other non-cash expenses of $42,000. Operating cash outflows for the three months ended March 31, 2012 of $621,000 were primarily due to the loss for the period of $865,000, offset by net changes in working capital, exclusive of cash, of $147,000 related to capitalized costs associated with our IPO, $66,000 of services paid with common stock and stock options, and other non-cash expenses of $31,000.

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Investing activities for the three months ended March 31, 2013 resulted in cash outflows of $303,000 for acquisition of fixed assets and development of patents and other intangible assets. Investing activities for the three months ended March 31, 2012 resulted in cash outflows of approximately $54,000 for acquisition of fixed assets and development of patents and other intangible assets.

Financing activities for the three months ended March 31, 2013 and 2012 were immaterial.

Off-Balance Sheet Transactions

We do not have any off-balance sheet transactions.

Trends, Events and Uncertainties

Our former legal advisors, Perkins Coie LLP, previously advised us that they believe TWB Investment Partnership II, L.P., a party related to Perkins Coie LLP, has the right to acquire 25,250 shares of our common stock at $0.02 per share pursuant to an engagement letter dated December 4, 2007. We denied the claim since, among other defenses, we believe we entered into a full settlement of all amounts owed to Perkins Coie LLP in November 2011.

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

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 (the “Act”) 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 and our Chief Financial Officer, has concluded that, as of March 31, 2013, our disclosure controls and procedures are effective.

There have been no material changes in our internal controls over financial reporting that occurred during the quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II-OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 1A. RISK FACTORS

We incorporate herein by reference the risk factors included under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012 which we filed with the Securities and Exchange Commission on February 22, 2013.

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

In November 2011 we filed a registration statement, number 333-177946, with the Securities and Exchange Commission to register an offering of 3 million shares of our common stock, with an option granted to the underwriter to sell an additional 450,000 shares of our common stock (the "overallotment"). The registration statement was declared effective on April 24, 2012. The offering closed on April 30, 2012 and the offering of the overallotment closed on May 15, 2012. The common stock was offered at a price of $4.00 per share. All of the shares of common stock, including the overallotment, were sold. We raised a total of $13,800,000 in gross proceeds in the offering and received approximately $11,200,000 after expenses. Through March 31, 2013, the net proceeds from the offering were used as follows: approximately $6,000,000 for the purchase of short-term certificates of deposit, $624,000 increased cash and money market funds, $3,580,000 for operations, $412,000 for capital expenditures primarily related to research and development machinery and equipment, $657,000 for patents, $238,000 for the payment of accrued compensation, and $129,000 for the repayment of short term indebtedness. None of the proceeds were used for construction of plant, building and facilities, the purchase of real estate, or the acquisition of any business.

We anticipate that the $11.2 million of net proceeds will be used as follows: approximately $4 million for research and development including related capital expenditures, $2 million for protection of intellectual property, $1.75 million for exploration of market opportunities, and the balance for working capital and general corporate purposes. We expect this to be sufficient to fund our activities at least through April 2014.

On May 2, 2013, we issued 11,250 shares of common stock having a value of $103,000 to John McFarland, an investor relations consultant, in exchange for services rendered and to be rendered in 2013. We relied on Section 4(2) of the Securities Act of 1933 (the "Act") in issuing the common stock inasmuch as there was no form of general solicitation or general advertising in the offer and sale of the securities and we provided to Mr. McFarland access to the information that registration would otherwise provide.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Approval of the 2013 Consultant Stock Plan

On May 2, 2013, the Company's shareholders approved the C1earSign Combustion Corporation 2013 Consultant Stock Plan (the "Plan"), to be administered by the Compensation Committee of the Company's Board of Directors. The Plan authorizes the issuance of up to 75,000 shares of the Company's Common Stock to individuals providing the Company with consulting services.

The above description of the Plan is qualified in its entirety by the terms and conditions of the Plan attached hereto as Exhibit 10.1.

ITEM 6. EXHIBITS

Exhibit Number	Document
3.1	Articles of Incorporation of ClearSign Combustion Corporation, amended on February 2, 2011 (1)
3.1.1	Articles of Amendment to Articles of Incorporation of ClearSign Combustion Corporation filed on December 22, 2011 (1)
3.2	Bylaws (1)
10.1	ClearSign Combustion Corporation 2013 Consultant Stock Plan*
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer*
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer*
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer*
101	The following financial statements from the registrant's Quarterly Report on Form 10-Q for the three months ended March 31, 2013, formatted in XBRL: (i) Condensed Balance Sheets (Unaudited); (ii) Condensed Statements of Operations (Unaudited); (iii) Condensed Statement of Stockholders' Equity (Unaudited); (iv) Condensed Statements of Cash Flows (Unaudited); (v) Notes to Unaudited Condensed Financial Statements.*

*Filed herewith

(1) Incorporated by reference from the registrant's registration statement on Form S-1, as amended, file number 333-177946, originally filed with the Securities and Exchange Commission on November 14, 2011.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	CLEARSIGN COMBUSTION CORPORATION (Registrant)	
Date: May 6, 2013	By:	/s/ Richard F. Rutkowski Richard F. Rutkowski Chief Executive Officer
	By:	/s/ James N. Harmon James N. Harmon Chief Financial Officer

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