

Midwest Energy Emissions Corp.
Form 10-Q
November 20, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

Commission file number **000-33067**

MIDWEST ENERGY EMISSIONS CORP.

(Exact name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

87-0398271
(I.R.S. Employer
Identification No.)

670 D Enterprise Drive

Lewis Center, Ohio
(Address of principal Executive offices)

43035
(Zip Code)

(614) 505-6115

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically 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). 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 definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

State the number of shares outstanding of each of the Issuer’s classes of common stock, as of the latest practicable date: Common, \$.001 par value per share 76,246,113 outstanding as of November 20, 2017.

MIDWEST ENERGY EMISSIONS CORP.

TABLE OF CONTENTS

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
<u>Item 1. Condensed Consolidated Financial Statements.</u>	4
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	28
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk.</u>	34
<u>Item 4. Controls and Procedures.</u>	35
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings.</u>	36
<u>Item 1A. Risk Factors</u>	36
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.</u>	36
<u>Item 3. Default upon Senior Securities.</u>	36
<u>Item 4. Mine Safety Disclosure.</u>	36
<u>Item 5. Other Information.</u>	36
<u>Item 6. Exhibits.</u>	37
<u>SIGNATURES</u>	38

Table of Contents

PART I – FINANCIAL INFORMATION

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements,” as defined in Section 21E of the Securities Exchange Act of 1934, as amended, that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and reflect our current expectations regarding our future growth, results of operations, cash flows, performance and business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. Forward-looking statements are generally identified by using words such as “anticipate,” “believe,” “plan,” “expect,” “intend,” “will,” and similar expressions, but these words are not the exclusive means of identifying forward-looking statements. Forward-looking statements in this report are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. These statements are based on information currently available to us and are subject to various risks, uncertainties, and other factors, including, but not limited to, those discussed under the caption “Risk Factors” in the Company’s 2016 Form 10-K. In addition, matters that may cause actual results to differ materially from those in the forward-looking statements include, among other factors, the gain or loss of a major customer, change in environmental regulations, disruption in supply of materials, capacity factor fluctuations of power plant operations and power demands, a significant change in general economic conditions in any of the regions where our customer utilities might experience significant changes in electric demand, a significant disruption in the supply of coal to our customer units, the loss of key management personnel, availability of capital and any major litigation regarding the Company. Except as expressly required by the federal securities laws, we undertake no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances or for any other reason.

Table of Contents

ITEM 1 – FINANCIAL INFORMATION

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARIES

Index to Condensed Consolidated Financial Information

As of the and for the nine months ended September 30, 2017

	Page
<u>Condensed Consolidated Balance Sheets</u>	5
<u>Condensed Consolidated Statements of Operations</u>	6
<u>Condensed Consolidated Statements of Stockholders' Deficit</u>	7
<u>Condensed Consolidated Statements of Cash Flows</u>	8
<u>Notes to Condensed Consolidated Financial Statements</u>	9

Table of Contents

MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2017 AND DECEMBER 31, 2016
(UNAUDITED)

	September 30,	December 31,
	2017	2016
	(Unaudited)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 2,363,728	\$ 7,751,557
Accounts receivable	4,083,478	3,553,096
Inventory	805,576	609,072
Prepaid expenses and other assets	174,822	199,495
Total current assets	7,427,604	12,113,220
Property and equipment, net	2,772,078	2,569,354
Deferred tax asset	500,000	500,000
Intellectual Property/Patents, net	2,985,162	52,945
Customer acquisition costs, net	334,591	642,203
Total assets	\$ 14,019,435	\$ 15,877,722
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Accounts payable and accrued expenses	\$ 2,039,911	\$ 4,363,553
Current portion of notes payable	2,375,000	1,500,000
Current portion of equipment notes payable	60,467	39,499
Customer credits	167,000	590,206
Total current liabilities	4,642,378	6,493,258
Notes payable, net of discount and issuance costs	10,271,604	11,678,669
Convertible notes payable, net of discount and issuance costs	1,323,146	1,142,154
Warrant liability	163,000	1,313,000
Accrued interest	38,750	78,750
Equipment notes payable	183,048	143,135
Total liabilities	16,621,926	20,848,966
Stockholders' deficit		
Preferred stock, \$.001 par value: 2,000,000 shares authorized	-	-
Common stock; \$.001 par value; 150,000,000 shares authorized; 76,246,113 shares issued and outstanding as of September 30, 2017		
73,509,663 shares issued and outstanding as of December 31, 2016	76,246	73,510
Additional paid-in capital	52,109,076	49,838,469
Accumulated deficit	(54,787,813)	(54,883,223)

Total stockholders' deficit	(2,602,491)	(4,971,244)
Total liabilities and stockholders' deficit	\$ 14,019,435	\$ 15,877,722

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

Table of Contents

MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016
(UNAUDITED)

	For the Three Months Ended September 30, 2017	For the Three Months Ended September 30, 2016	For the Nine Months Ended September 30, 2017	For the Nine Months Ended September 30, 2016
Revenues				
Product sales	8,075,510	11,453,152	20,472,465	21,162,950
Equipment sales	2,975	143,166	787,081	2,699,051
Demonstrations and consulting services	369,482	175,100	546,982	674,938
Total revenues:	8,447,967	11,771,418	21,806,528	24,536,939
Costs and expenses:				
Cost of sales	5,509,204	7,821,028	14,290,902	17,612,843
Selling, general and administrative expenses	1,910,020	2,233,410	6,856,558	5,075,607
Total costs and expenses	7,419,224	10,054,438	21,147,460	22,688,450
Operating income	1,028,743	1,716,980	659,068	1,848,489
Other (expense) income				
Interest expense	(541,855)	(972,930)	(1,627,248)	(4,079,022)
Letter of credit fees	(52,667)	(61,333)	(173,333)	(164,667)
Change in value of warrant liability	56,000	(9,984,541)	919,023	(14,241,141)
Gain on legal settlements	379,000	-	317,900	-
Total other (expense) income	(159,522)	(11,018,804)	(563,658)	(18,484,830)
Net income (loss)	\$ 869,221	\$ (9,301,824)	\$ 95,410	\$ (16,636,341)
Net income (loss) per common share - basic and diluted:	\$ 0.01	\$ (0.19)	\$ 0.00	\$ (0.35)
Weighted average common shares outstanding	75,865,678	47,918,064	74,662,691	47,546,461

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

Table of Contents

MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017
(UNAUDITED)

	Common Stock Shares	Par Value	Additional Paid-in Capital	Accumulated (Deficit)	Total Stockholders' Deficit
Balance - December 31, 2016	73,509,663	\$ 73,510	\$ 49,838,469	\$ (54,883,223)	(4,971,244)
Stock issued upon debt conversion	51,236	51	25,567	-	25,618
Stock issued upon cashless warrant exercise	630,214	630	230,347	-	230,977
Stock issued per settlement agreement	130,000	130	60,970	-	61,100
Stock issued for the acquisition of patents rights	925,000	925	517,075	-	518,000
Issuance of stock options	-	-	1,275,773	-	1,275,773
Stock issued to non-employees	1,000,000	1,000	160,875	-	161,875
Net loss for the period	-	-	-	95,410	95,410
Balance - September 30, 2017	76,246,113	\$ 76,246	\$ 52,109,076	\$ (54,787,813)	\$ (2,602,491)

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

Table of Contents

**MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016
(UNAUDITED)**

	For the Nine Months Ended September 30, 2017	For the Nine Months Ended September 30, 2016
Cash flows from operating activities		
Net income (loss)	\$ 95,410	\$ (16,636,341)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock based compensation	1,437,648	967,562
Amortization of license fees	1,950	4,410
Amortization of discount of notes payable and convertible notes payable	558,781	1,282,283
Amortization of debt issuance costs	115,144	500,002
Amortization of customer acquisition costs	307,612	322,605
Amortization of Patents	83,833	-
Depreciation expense	558,036	314,906
(Gain) loss on change in value of warrant liability	(919,023)	14,241,139
Settlement Expense	61,100	-
Debt conversion costs	-	1,096,000
PIK Interest	-	607,401
Change in assets and liabilities		
(Increase) in accounts receivable	(530,382)	(4,280,516)
(Increase) decrease in inventory	(196,504)	1,949,996
Decrease (increase) in prepaid expenses and other assets	24,673	(20,129)
(Decrease) increase in accounts payable and accrued liabilities	(2,323,642)	4,240,791
Decrease in deferred revenue	-	(2,281,760)
Decrease in customer credits	(423,206)	-
Net cash (used in) provided by operating activities	(1,148,570)	2,308,349
Cash flows used in investing activities		
Purchase of property and equipment	(698,941)	(1,347,836)
Purchase of intellectual property	(2,500,000)	-
Net cash used in investing activities	(3,198,941)	(1,347,836)
Cash flows from financing activities		
Payment of promissory notes	(1,000,000)	-
Payment of equipment notes payable	(40,318)	(22,346)
Proceeds from the issuance of common stock upon warrant exercise	-	26,357

Net cash (used in) provided by financing activities	(1,040,318)	4,011
Net (decrease) increase cash and cash equivalents	(5,387,829)	964,524
Cash and cash equivalents - beginning of period	7,751,557	1,083,280
Cash and cash equivalents - end of period	\$ 2,363,728	\$ 2,047,804

SUPPLEMENTAL CASH FLOW INFORMATION:

Cash paid during the period for:

Interest	\$ 1,011,427	\$ 279,293
----------	--------------	------------

SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS

Equipment purchases included in accounts payable	\$ 1,594	\$ -
Equipment purchases included in equipment notes payable	\$ 101,199	\$ 103,428
Stock issued for interest on convertible notes payable	\$ -	\$ 103,635
Stock issued for the acquisition of patents rights	\$ 518,000	\$ -
Stock issued for settlement	\$ 61,100	\$ -
Conversion of accounts receivable to customer acquisition costs	\$ -	\$ 188,225
Conversion of accrued interest to debt	\$ -	\$ 719,733
Stock issued upon debt conversion	\$ 25,618	\$ -
Stock issued upon cashless warrant exercise	\$ 230,977	\$ -

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

Table of Contents

Midwest Energy Emissions Corp. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

Note 1 - Organization

Midwest Energy Emissions Corp.

Midwest Energy Emissions Corp. (the "Company") is organized under the laws of the State of Delaware with 150,000,000 authorized shares of common stock, par value \$.001 per share and 2,000,000 authorized shares of preferred stock, par value \$0.001 per share.

MES, Inc.

MES, Inc. is incorporated in the State of North Dakota. MES, Inc. is a wholly owned subsidiary of Midwest Energy Emissions Corp. and is engaged in the business of developing and commercializing state of the art control technologies relating to the capture and control of mercury emissions from coal fired boilers in the United States and Canada.

Note 2 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required for complete financial statements and should be read in conjunction with the audited consolidated financial statements and

accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

In management's opinion, the unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly the financial position as of September 30, 2017, and results of operations, changes in stockholders' deficit and cash flows for all periods presented. The interim results presented are not necessarily indicative of results that can be expected for a full year.

Use of Estimates

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

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments and other short-term investments with maturity of three months or less, when purchased, to be cash equivalents. The Company maintains its cash in three accounts with one financial institution, which at times may exceed federally insured limits.

Table of Contents

Accounts Receivable

Trade accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectability of specific customer accounts: customer credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. At September 30, 2017 and December 31, 2016, the allowance for doubtful accounts was zero.

Inventory

Inventories are stated at the lower of cost (first-in, first-out basis) or market (net realizable value).

Property and Equipment

Property and equipment are stated at cost. When retired or otherwise disposed, the related carrying value and accumulated depreciation are removed from the respective accounts and the net difference less any amount realized from disposition, is reflected in earnings. For consolidated financial statement purposes, property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives of 2 to 5 years.

Expenditures for repairs and maintenance which do not materially extend the useful lives of property and equipment are charged to operations. Management periodically reviews the carrying value of its property and equipment for impairment.

Recoverability of Long-Lived and Intangible Assets

The Company has adopted ASC 360-10, *Property, Plant and Equipment* (“ASC 360-10”). ASC 360-10 requires that long-lived assets and certain identifiable intangibles held and used by the Company be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Events relating to recoverability may include significant unfavorable changes in business conditions, recurring losses or a forecasted inability to achieve break-even operating results over an extended period. The Company evaluates the recoverability of long-lived assets based upon forecasted undiscounted cash flows. Should impairment in value be indicated, the carrying value of the long-lived and or intangible assets would be adjusted, based on estimates of future discounted cash flows. During the quarter ended September 30, 2017, as a result of recurring losses and an accumulated deficit, the Company identified a triggering event requiring a test for the recoverability of long-lived assets and intangible assets. Assessing the recoverability of long-lived assets and intangible assets requires significant judgments and estimates by management. Management concluded that the fair value of long-lived assets and intangible assets exceeded their carrying value and as such, no impairment charges were recognized for the quarters ended September 30, 2017 and 2016, respectively.

A significant decrease in the market price of a long-lived asset, adverse change in the use or condition of a long-lived asset, adverse change in the business climate or legal or regulatory factors impacting a long-lived asset and intangible assets and continued operating losses, accumulated deficit and cash flow deficiencies among other indicators, could cause a future assessment to be performed which may result in an impairment of long-lived assets and intangible assets resulting in a material adverse effect on the financial position and results of operations of the Company.

Table of Contents

Stock-Based Compensation

The Company accounts for stock-based compensation awards in accordance with the provisions of ASC 718, *Compensation—Stock Compensation* (“ASC 718”), which requires equity-based compensation, be reflected in the consolidated financial statements over the period of service which is typically the vesting period based on the estimated fair value of the awards.

Derivative Liabilities

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks; however, the Company has certain financial instruments that are embedded derivatives associated with capital raises and common stock purchase warrants. The Company evaluates all its financial instruments to determine if those contracts or any potential embedded components of those contracts qualify as derivatives to be separately accounted for in accordance with FASB ASC 815-10. This accounting treatment requires that the carrying amount of any embedded derivatives be recorded at fair value at issuance and marked-to-market at each balance sheet date. In the event that the fair value is recorded as a liability, as is the case with the Company, the change in the fair value during the period is recorded as either income or expense. Upon conversion or exercise, the derivative liability is marked to fair value at the conversion date and then the related fair value is reclassified to equity.

Fair Value of Financial Instruments

The fair value hierarchy has three levels based on the inputs used to determine fair value, which are as follows:

- *Level 1* — Unadjusted quoted prices available in active markets for the identical assets or liabilities at the measurement date.
- *Level 2* — Unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- *Level 3* — Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management’s estimates of market participant assumptions.

The fair value hierarchy requires the use of observable market data when available. In instances where the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability.

Cash and cash equivalents were the only asset measured at fair value on a recurring basis by the Company at September 30, 2017 and December 31, 2016 and is considered to be Level 1. Warrant liability is considered to be Level 3, and is the only liability measured at fair value on a recurring basis as of September 30, 2017 and December 31, 2016.

Table of Contents

Financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, customer credits and short-term debt. The carrying amounts of these financial instruments approximated fair value at September 30, 2017 and December 31, 2016 due to their short-term maturities. The fair value of the convertible promissory notes payable at September 30, 2017 and December 31, 2016 approximated the carrying amount as the notes were issued during the three years ended December 31, 2016 at interest rates prevailing in the market and interest rates have not significantly changed as of September 30, 2017. The fair value of the convertible promissory notes payable was determined on a Level 2 measurement.

The Company has entered into certain financial instruments and contracts; such as, equity financing arrangements for the issuance of common stock, which include anti-dilution arrangements and detachable stock warrants that are i) not afforded equity classification, ii) embody risks not clearly and closely related to host contracts, or iii) may be net-cash settled by the counterparty. These instruments are recorded as derivative liabilities, at fair value at the issuance date. Subsequent changes in fair value are recorded through the consolidated statements of operations.

The Company's derivative liabilities are related to detachable common stock purchase warrants ("warrants") issued in conjunction with debt and warrants issued to the placement agents for financial instrument issuances. We estimate fair values of the warrants that do contain "Down Round Protections" utilizing valuation models and techniques that have been developed and are widely accepted that take into account the additional value inherent in "Down Round Protection." These widely accepted techniques include "Modified Binomial", "Monte Carlo Simulation" and the "Lattice Model." The "core" assumptions and inputs to the "Modified Binomial" model are the same as for "Black-Scholes", such as trading volatility, remaining term to maturity, market price, strike price, and risk free rates; all Level 2 inputs. Fair value measurements are classified according to the lowest level input or value-driver that is significant to the valuation. A measurement may therefore be classified within Level 3 even though there may be significant inputs that are readily observable. However, a key input to a "Modified Binomial" model (in our case, the "Monte Carlo Simulation", for which we engaged an independent valuation firm to perform) is the probability of a future capital raise. By definition, this input assumption does not meet the requirements for Level 1 or Level 2 outlined above; therefore, the entire fair value calculation is deemed to be Level 3 under accounting requirements due to this single Level 3 assumption. This input to the Monte Carlo Simulation model was developed with significant input from management based on its knowledge of the business, current financial position and the strategic business plan with its best efforts.

As discussed above, financial liabilities are considered Level 3 when their fair values are determined using pricing models or similar techniques and at least one significant model assumption or input is unobservable. For the Company, the Level 3 financial liability is the derivative liability related to the warrants that include "Down Round Protection" and they were valued using the "Monte Carlo Simulation" technique. This technique, while the majority of inputs are Level 2, necessarily incorporates various assumptions associated with a Capital Raise which are unobservable and, therefore, a Level 3 input.

The table below provides a summary of the changes in fair value of the warrant liability measured at fair value on a recurring basis:

Balance at January 1, 2017	\$ 1,313,000
Exercise of warrants	(230,977)
Change in value of warrant liability	(919,023)
Balance at September 30, 2017	\$ 163,000

Table of Contents

Revenue Recognition

The Company records revenue from sales in accordance with ASC 605, *Revenue Recognition* (“ASC 605”). The criteria for recognition are as follows:

1. Persuasive evidence of an arrangement exists;

Determination of criteria (3) and (4) is based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectability of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments is provided for in the same period the related sales are recorded.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's consolidated financial statements are based on a more-likely-than-not recognition threshold. The Company did not have any unrecognized tax benefits at September 30, 2017 and December 31, 2016. When necessary, the Company would accrue penalties and interest related to unrecognized tax benefits as a component of income tax expense.

The Company and its subsidiaries file a consolidated income tax return in the U.S. federal jurisdiction and three state jurisdictions. The Company is no longer subject to U.S. federal examinations for years prior to 2013 or state tax

examinations for years prior to 2012.

Basic and Diluted Income (Loss) per Common Share

Basic net income (loss) per common share is computed using the weighted average number of common shares outstanding. Diluted income (loss) per share reflects the potential dilution from common stock equivalents, such as stock issuable pursuant to the exercise of stock options and warrants. There were no dilutive potential common shares as of September 30, 2017 and 2016, because the market price of the Company's common share is below the conversion price of the outstanding common stock equivalents and basic and diluted losses per common share are the same. For the nine months ended September 30, 2017, basic and diluted earnings per share approximated each other. Dilutive potential common shares as of September 30, 2017 and 2016 were approximately 3.1 million shares and 60.20 million shares, respectively. Anti-dilutive potential common shares as of September 30, 2017 and 2016 were approximately 16.1 million shares and .6 million shares, respectively.

Table of Contents

Concentration of Credit Risk

Financial instruments that subject the Company to credit risk consist of cash and equivalents on deposit with financial institutions and accounts receivable. The Company's cash as of September 30, 2017 and December 31, 2016 is on deposit in a non-interest-bearing transaction account that is subject to FDIC deposit insurance limits. For the quarters ended September 30, 2017 and 2016, 100% of the Company's revenue related to eight customers, respectively. For the nine months ended September 30, 2017 and 2016, 100% of the Company's revenue related to eight and six customers, respectively. At September 30, 2017 and December 31, 2016, 100% of the Company's accounts receivable related to eight and six customers, respectively.

Contingencies

Certain conditions may exist which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company, or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, the estimated liability would be accrued in the Company's consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they arise from guarantees, in which case the guarantees would be disclosed.

Recently Issued Accounting Standards

In May, 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606) Summary - The FASB has made available Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers: Topic 606. ASU 2014-09 affects any entity using U.S. GAAP that either enters into

contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (e.g., assets within the scope of Topic 360, Property, Plant, and Equipment, and intangible assets within the scope of Topic 350, Intangibles-Goodwill and Other) are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this ASU. The core principle of the guidance is 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. To achieve that core principle, an entity should apply the following steps:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Table of Contents

For a public entity, the amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

In February, 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-11, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize a lease liability and right-of-use asset at the commencement date for all leases, with the exception of short term leases. For public business entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

In March, 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-09, *Stock Compensation (Topic 718)*. This amendment is intended to improve and simplify the accounting for employee share-based payments including areas such as (a) income tax consequences (b) classification of awards as either equity or liabilities and (c) classification on the statement of cash flows.. For public business entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The Company has adopted this standard in 2017 and the impact on the Company's consolidated financial statements was not material.

In July 2017, the FASB issued ASU 2017-11, *Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*. ASU 2017-11 allows companies to exclude a down round feature when determining whether a financial instrument (or embedded conversion feature) is considered indexed to the entity's own stock. As a result, financial instruments (or embedded conversion features) with down round features may no longer be required to be accounted for as derivative liabilities. A company will recognize the value of a down round feature only when it is triggered and the strike price has been adjusted downward. For equity-classified freestanding financial instruments, an entity will treat the value of the effect of the down round as a dividend and a reduction of income available to common shareholders in computing basic earnings per share. For convertible instruments with embedded conversion features containing down round provisions, entities will recognize the value of the down round as a beneficial conversion discount to be amortized to earnings. The guidance in ASU 2017-11 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, and the guidance is to be applied using a full or modified retrospective approach. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

Note 3 - Inventory

The Company held product supply inventory valued at \$677,905 and \$414,384 and other inventory valued at \$127,671 and \$194,688 as of September 30, 2017 and December 31, 2016, respectively.

Table of Contents**Note 4 - Property and Equipment, Net**

Property and equipment at September 30, 2017 and December 31, 2016 are as follows:

	September 30, 2017	December 31, 2016
Equipment & Installation	\$ 1,965,659	\$ 1,823,594
Trucking equipment	1,043,924	926,614
Computer equipment and software	116,006	111,518
Office equipment	28,361	27,155
Total equipment	3,153,950	2,888,881
Less: accumulated depreciation	1,910,659	1,420,755
Construction in process	1,528,787	1,101,228
Property and equipment, net	\$ 2,772,078	\$ 2,569,354

The Company uses the straight-line method of depreciation over 2 to 5 years. During the nine months ended September 30, 2017 and 2016 depreciation expense was \$558,036, and \$314,906, respectively.

Note 5 - License Agreement

On January 15, 2009, the Company entered into an "Exclusive Patent and Know-How License Agreement Including Transfer of Ownership" (the "License Agreement") with the Energy and Environmental Research Center Foundation, a non-profit entity ("EERCF"). Under the terms of the License Agreement, the Company had been granted an exclusive license by EERCF with respect to certain patented technology to develop, make, have made, use, sell, offer to sell, lease, and import the technology in any coal-fired combustion systems (power plant) worldwide and to develop and perform the technology in any coal-fired power plant in the world. Amendments No. 4 and No. 5 to the License Agreement were made effective as of December 16, 2013 and August 14, 2014, respectively, expanding the number of patents covered, eliminated certain contract provisions and compliance issues and restructured the fee payments and buyout provisions while granting EERCF equity in the Company. The License Agreement applied to various domestic and foreign patents and patent applications which has formed the basis of the Company's mercury control technology.

Under the terms of the License Agreement, the Company paid EERCF \$100,000 in 2009 for the license to use the patents and at the option of the Company can pay \$2,500,000 and issue 925,000 shares of common stock for the

assignment of the patents or pay the greater of the license maintenance fees or royalties on product sales for continued use of the patents (see below). The license maintenance fees are \$25,000 due monthly beginning in January 1, 2014 and continuing each month thereafter. The running royalties are \$100 per one megawatt of electronic nameplate capacity and \$100 per three megawatt per hour for the application to thermal systems to which licensed products or licensed processes are sold by the Company, associate and sublicensees. Running royalties are payable by the Company within 30 days after the end of each calendar year to the licensor and may be credited against license maintenance fees paid. In January 2017 \$722,380 was paid to the EERCF for 2016 royalties, and this was accrued as of December 31, 2016.

Table of Contents

On April 24, 2017, the Company closed on the acquisition from EERCF of all patent rights, including all patents and patents pending, domestic and foreign, relating to the foregoing technology. A total of 42 domestic and foreign patents and patent applications were included in the acquisition. In accordance with the terms of the License Agreement, the patent rights were acquired for the purchase price of (i) \$2,500,000 in cash, and (ii) 925,000 shares of common stock of which 628,998 shares were issued to EERCF and 296,002 were issued to the inventors who had been designated by EERCF. Therefore, the Company has not accrued royalty expense as of September 30, 2017. As a result of the acquisition of the patent rights, no additional monthly license maintenance fees and annual running royalties shall be due and owing to the EERCF following closing which fees and royalties have now been eliminated.

The Company was required to pay EERCF 35% of all sublicense income received by the Company, excluding royalties on sales by sublicensees. Sublicense income is payable by the Company within 30 day after the end of each calendar year to the licensor. On April 24, 2017, this requirement ended upon the Company's payment for the assignment and acquisition of the patent rights. There was no sublicense income in the quarters ended September 30, 2017 or September 30, 2016, respectively.

License and patent costs capitalized as of September 30, 2017 and December 31, 2016 are as follows:

	September 30, 2017	December 31, 2016
Patents	\$ 3,068,995	\$ -
License	-	100,000
Less: Accumulated Amortization	(83,833)	(47,055)
License, Net	\$ 2,985,162	\$ 52,945

The Company is currently amortizing its patents over their estimated useful life of 15 years. Amortization expense for the nine months ended September 30, 2017 and 2016 was \$85,783 and \$4,410, respectively. Amortization expense for the quarters ended September 30, 2017 and 2016 was \$49,310 and \$4,410, respectively. Estimated annual amortization for each of the next five years is approximately \$201,500.

Table of Contents**Note 6 –Notes Payable**

The Company has the following notes payable outstanding as of September 30, 2017 and December 31, 2016:

	2017	2016
Secured convertible promissory notes which mature on July 31, 2018, bear interest at 10% per annum, and are convertible into one share of common stock, par value \$0.001 per share, with the initial conversion ratio equal to \$0.50 per share.	\$ 1,550,000	\$ 1,575,000
Secured promissory note which matures on June 15, 2018 and bears interest at 12% per annum.	1,646,686	2,646,686
Unsecured promissory note which matures on December 15, 2020, and bears interest at LIBOR (1.32% and 0.99% as of September 30, 2017 and December 31, 2016, respectively) + 500 per annum.	13,000,000	13,000,000
Total notes payable before discount and debt issuance costs	16,196,686	17,221,686
Less discounts	(2,028,735)	(2,587,519)
Less debt issuance costs	(198,201)	(313,344)
Total notes payable	13,969,750	14,320,823
Less current portion	2,375,000	1,500,000
Notes payable, net of current portion	\$ 11,594,750	\$ 12,820,823

As of September 30, 2017, scheduled principal payments due on notes payable are as follows:

Twelve months ended September 30,	
2018	\$ 2,375,000
2019	4,425,000
2020	3,000,000
2021	6,396,686
	\$ 16,196,686

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

From July 30, 2013 through December 24, 2013, the Company sold convertible notes and warrants to unaffiliated accredited investors totaling \$1,902,500. The notes have a term of three years, bear interest at 10% per annum, and are convertible into one share of common stock, par value \$0.001 per share, with the initial conversion ratio equal to \$0.50 per share. For each dollar invested, the investor received two warrants to purchase one shares of common stock of the Issuer at an exercise price of \$0.75 per share. The notes may be converted at any time and from time to time in whole or in part prior to the maturity date thereof. These securities were sold in reliance upon the exemption provided by Section 4(2) of the Securities Act and the safe harbor of Rule 506 under Regulation D promulgated under the Securities Act. Interest expense for the nine months ended September 30, 2017 and 2016, was \$116,875 and \$257,194, respectively. A discount on the notes payable of \$841,342 was recorded based on the value of the warrants issued using a Black-Scholes options pricing model. Amortized interest expense for the nine months ended September 30, 2017 and 2016 on this discount was \$115,182 and \$114,511, respectively. As of September 30, 2017 and December 31, 2016, total principal of \$1,550,000 and \$1,575,000 was outstanding on these notes.

New AC Midwest Secured Note

Page 18

Table of Contents

On November 29, 2016 the Company closed on the transactions contemplated by a new Restated Financing Agreement entered into with AC Midwest on November 1, 2016 whereby at closing AC Midwest, which held various warrants to acquire shares of the Company's common stock, exercised on a cashless basis a portion of its warrants for 10,000,000 shares of the Company's common stock and exchanged previous AC Midwest Notes, together with all accrued and unpaid interest thereon, and the remaining unexercised portion of its warrants, for (i) a new secured note in the principal amount of \$9,646,686 (the "New AC Midwest Secured Note"), and (ii) a subordinated unsecured note in the principal amount of \$13,000,000 (the "AC Midwest Subordinated Note"). The New AC Midwest Secured Note, which will mature on December 15, 2018 and is guaranteed by MES, is nonconvertible and bears interest at a rate of 12.0% per annum, payable quarterly in arrears on or before the last day of each fiscal quarter beginning December 31, 2016. Commencing on June 15, 2017 and continuing on each September 15, December 15, March 15 and June 15 thereafter, the Company shall pay principal on the New AC Midwest Secured Note in equal installments of (i) \$500,000 per quarter for the 2017 calendar year, (ii) \$625,000 on March 15, 2018, (iii) with a final payment of all outstanding principal together with such other amounts as shall then be due and owing from the Company to AC Midwest under the New AC Midwest Secured Note on the maturity date. The New AC Midwest Secured Note is secured, like the previous AC Midwest Notes which were exchanged and cancelled, by all of the assets of the Company and MES. Interest expense for the nine months ended September 30, 2017 was \$220,182. As of September 30, 2017 and December 31, 2016, total principal of \$1,646,686 and \$2,646,686 was outstanding on this note.

AC Midwest Subordinated Note

The AC Midwest Subordinated Note, which will mature on December 15, 2020 and is guaranteed by MES, is nonconvertible and bears interest equal to the three-month LIBOR rate plus 5.0% per annum, payable quarterly on or before the last day of each fiscal quarter beginning December 31, 2016. The interest rate shall be subject to adjustment each quarter based on the then current LIBOR rate. Commencing on June 15, 2017 and continuing on each September 15, December 15, March 15 and June 15 thereafter, the Company shall pay principal on the AC Midwest Subordinated Note in equal installments of (i) \$500,000 per quarter for the 2017 calendar year, (ii) \$625,000 per quarter for the 2018 calendar year, and (iii) thereafter \$750,000 per quarter, with a final payment of all outstanding principal together with such other amounts as shall then be due and owing from the Company to AC Midwest on the maturity date. Notwithstanding the foregoing, until the New AC Midwest Secured Note and a letter of credit note issued by the Company to AC Midwest on January 28, 2016 in the amount of \$2,000,000 (the "LC Note") are paid in full, AC Midwest will not be entitled to receive any payment on account of the AC Midwest Subordinated Note (other than regularly scheduled interest payments). Interest expense on the AC Midwest Subordinated Note for the nine months ended September 30, 2017 was \$606,639. As of September 30, 2017 and December 31, 2016, total principal of \$13,000,000 was outstanding on this note. The Company determined that the rate of interest on the AC Midwest Subordinated Note was a below market rate of interest and determined that a discount of \$2,400,000 should be recorded. This discount is based on an applicable market rate for unsecured debt for the Company of 15% and will be amortized as interest expense over the life of the loan. Amortized discount recorded as interest expense for the nine months ended September 30, 2017 was \$443,602. The LC Note was issued to evidence any indebtedness owed by the Company arising from any draws made under a letter of credit arranged for the Company by AC Midwest with its bank. Although no amounts have yet to be drawn on the letter of credit, the letter of credit remains available.

Table of Contents**Note 7 – Equipment Notes Payable**

The Company has the following equipment notes payable outstanding as of September 30, 2017 and December 31, 2016:

	2017	2016
On September 30, 2015, the Company entered into a retail installment purchase contract in the amount of \$57,007, secured by a 2016 Dodge Ram 5500 purchased on that date. This installment loan bears interest at a fixed rate of 4.22% and the Company shall make 60 monthly payments of \$1,056 beginning October 30, 2015.	\$ 35,634	\$ 43,860
On December 15, 2015, the Company entered into a retail installment purchase contract in the amount of \$56,711, secured by a 2016 Dodge Ram 5500 purchased on that date. This installment loan bears interest at a fixed rate of 4.22% and the Company shall make 60 monthly payments of \$1,050 beginning January 15, 2016.	38,206	46,304
On March 8, 2016, the Company entered into a retail installment purchase contract in the amount of \$46,492, secured by a 2016 Dodge Ram 2500 purchased on that date. This installment loan bears interest at a fixed rate of 5.62% and the Company shall make 72 monthly payments of \$764 beginning April 8, 2016.	36,259	41,483
On May 26, 2016, the Company entered into a retail installment purchase contract in the amount of \$56,936, secured by a 2016 Dodge Ram 5500 purchased on that date. This installment loan bears interest at a fixed rate of 4.89% and the Company shall make 60 monthly payments of \$1,072 beginning June 26, 2016.	43,084	50,987
On January 23, 2017, the Company entered into a retail installment purchase contract in the amount of \$58,926, secured by a 2017 Dodge Ram 5500 purchased on that date. This installment loan bears interest at a fixed rate of 4.74% and the Company shall make 60 monthly payments of \$1,105 beginning February 23, 2017.	51,849	-
On February 29, 2017, the Company entered into a retail installment purchase contract in the amount of \$42,275, secured by a 2017 Dodge Ram 2500 purchased on that date. This installment loan bears interest at a fixed rate of 4.74% and the Company shall make 60 monthly payments of \$793 beginning March 29, 2017.	38,483	-
Total equipment notes payable	243,515	182,634

Less Current Portion	60,467	39,499
Equipment notes payable, net of current portion	\$ 183,048	\$ 143,135

As of September 30, 2017, scheduled principal payments due on equipment notes payable are as follows:

For the year ended September 30,	
2018	\$ 60,467
2019	62,687
2020	65,686
2021	42,018
2022	12,657
	\$ 243,515

Table of Contents**Note 8 – Warrant Liability**

On August 14, 2014, the Company issued to Drexel Hamilton, LLC (“Drexel”) in association with a financing transaction with AC Midwest: (i) a 5-year warrant to purchase up to 800,000 shares of common stock at \$1.00 per share; and (ii) a 5-year warrant to purchase up to 1,000,000 shares of common stock at \$0.50 per share, both subject to adjustments similar to the Warrant issued to the Lender. On February 19, 2016, the exercise price of both of these warrants was reduced to \$0.35. These warrants were valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model. The fair value of the warrant liability on the issuance date for the warrants issued to Drexel were valued at \$1,251,200 and were recorded as transaction costs associated with Financing Agreement. As of December 31, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of the remaining 936,164 warrants was adjusted to \$1,067,000. During the nine months ended September 30, 2017, 224,444 of these warrants were exercised and \$230,977 was recorded as paid in capital for the shares issued. As of March 31, 2017, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$786,000 and a gain for the change in value of the liability of \$167,000 was recognized. As of June 30, 2017, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$164,000 and a gain for the change in value of the liability of \$505,023 was recognized. As of September 30, 2017, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$119,000 and a gain for the change in value of the liability of \$45,000 was recognized. The significant assumptions considered by the model were the remaining term of the warrants, operational forecasts provided by the Company, a risk free treasury rate for 1.55% and 1.47% and an expected volatility rate of 96.6% and 112.2% at September 30, 2017 and December 31, 2016, respectively.

On February 19, 2016, in connection to Amendment No. 2 and Amendment No. 3, the Company issued Drexel: a 5-year warrant to purchase up to 300,000 shares of common stock at \$0.35 per share as compensation for services rendered. 200,000 of these warrants were valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model as of November 16, 2015. The fair value of the warrant liability on the issuance date for the warrants to be issued was \$55,200 which was recorded as debt issuance costs. As of December 31, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of the remaining 205,000 warrants was adjusted to \$246,000. As of March 31, 2017, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$205,000 and a gain for the change in value of the liability of \$41,000 was recognized. As of June 30, 2017, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$55,000 and a gain for the change in value of the liability of \$150,000 was recognized. As of September 30, 2017, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$44,000 and a gain for the change in value of the liability of \$11,000 was recognized.

Note 9 – Commitments and Contingencies

Property Leases

On June 1, 2011, the Company entered into a lease for warehouse space in Centralia, Washington, commencing August 1, 2011. The lease ended June 30, 2017.

On January 27, 2015, the Company entered into a 13-month lease for office space in Lewis Center, Ohio, commencing February 1, 2015. The lease provides for the option to extend the lease for up to five additional years. Rent was abated for the first month of the lease. To date, the lease has been extended twice through February 2018. Monthly rent is \$1,386 through February 2018.

Table of Contents

On July 1, 2015, the Company entered into a five year lease for warehouse space in Corsicana, Texas. Rent is \$3,750 monthly throughout the term of the lease and is waived from July 1, 2016 through September 30, 2016. The Company is also responsible for the pro rata share of the projected monthly expenses for the property taxes. The current pro rata share is \$881.79.

On September 1, 2015, the Company entered into a three year lease for office space in Grand Forks, North Dakota. Rent is \$3,500 monthly for the first year and decreases to \$2,500 throughout the remainder of the term of the lease.

Future minimum lease payments under these non-cancelable leases are approximately as follows:

For the twelve months ended September 30	
2018	\$ 79,000
2019	45,000
2020	34,000
	\$ 158,000

Rent expense was approximately \$84,000 and \$106,000 for the nine months ended September 30, 2017 and 2016, respectively.

Fixed Price Contract

The Company's multi-year contracts with its commercial customers contain fixed prices for product. These contracts expire through 2019 and expose the Company to the potential risks associated with rising material costs during that same period. The Company has entered into long-term contracts for the supply of certain materials through 2017 to offset the impact of potentially rising material costs.

Customer Contract Matter

The Company is in the process of attempting to resolve a claim made by one of its customers pertaining to certain price guarantees provided in the supply agreement with such customer and maximum contract year billings. Although management disputes such claim, the Company is currently negotiating with such customer in an attempt to amicably resolve this matter. Although there can be no assurance that this matter will be resolved to the Company's satisfaction

or at all, the Company does not expect an unfavorable outcome, based on negotiations with the customer to date, and has not accrued any loss reserves.

Legal proceedings

The Company is involved in various claims and legal proceedings arising from the normal course of business. While the ultimate liability, if any, from these proceedings is presently indeterminable, in the opinion of management, these matters should not have a material adverse effect on the Company's consolidated financial statements.

Note 10 – Equity

The Company was established with two classes of stock, common stock – 150,000,000 shares authorized at a par value of \$0.001 and preferred stock – 2,000,000 shares authorized at a par value of \$0.001.

Table of Contents

Common Stock

On January 13, 2017, the Company issued 36,842 shares of common stock upon the cashless exercise of warrants to purchase 50,000 shares of common stock for \$0.35 per share based on a market value of \$1.33 per share as determined under the terms of the warrant.

On January 18, 2017, the Company issued 36,112 shares of common stock upon the cashless exercise of warrants to purchase 50,000 shares of common stock for \$0.35 per share based on a market value of \$1.26 per share as determined under the terms of the warrant.

On February 6, 2017, the Company issued 21,191 shares of common stock upon the cashless exercise of warrants to purchase 29,179 shares of common stock for \$0.35 per share based on a market value of \$1.2785 per share as determined under the terms of the warrant.

On February 7, 2017, the Company issued 35,169 shares of common stock upon the cashless exercise of warrants to purchase 50,000 shares of common stock for \$0.35 per share based on a market value of \$1.18 per share as determined under the terms of the warrant.

On March 30, 2017, the Company issued 16,915 shares of common stock upon the cashless exercise of warrants to purchase 24,316 shares of common stock for \$0.35 per share based on a market value of \$1.21 per share as determined under the terms of the warrant.

On March 30, 2017, the Company issued 51,236 shares of common stock upon the conversion of a note with principal and accrued interest totaling \$25,618, that bears interest at 10% per annum, and was convertible into one share of common stock, par value \$0.001 per share, with a conversion ratio equal to \$0.50 per share.

On April 5, 2017, the Company issued 45,488 shares of common stock upon the cashless exercise of warrants to purchase 64,444 shares of common stock for \$0.35 per share based on a market value of \$1.19 per share as determined under the terms of the warrant.

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

On April 12, 2017, the Company issued 43,200 shares of common stock upon the cashless exercise of warrants to purchase 60,000 shares of common stock for \$0.35 per share based on a market value of \$1.25 per share as determined under the terms of the warrant.

On May 2, 2017, the Company issued 345,071 shares of common stock upon the cashless exercise of warrants to purchase 500,910 shares of common stock for \$0.35 per share based on a market value of \$1.125 per share as determined under the terms of the warrant.

On May 3, 2017, the Company issued 50,226 shares of common stock upon the cashless exercise of warrants to purchase 72,948 shares of common stock for \$0.35 per share based on a market value of \$1.1237 per share as determined under the terms of the warrant.

On May 16, 2017, the Company issued 130,000 shares of common stock pursuant to a Settlement Agreement with two unrelated third parties which shares were valued at \$0.47 per share based on the market value as of May 16, 2017.

Effective as of April 24, 2017, the Company issued 925,000 shares of common stock in connection with the closing on the acquisition of certain patent rights from Energy & Environmental Research Center Foundation (“EERCF”) for the purchase price of \$2,500,000 paid to EERCF in cash, 628,998 shares of common stock to EERCF and 296,002 shares to inventors designated by EERCF. The shares issued were valued at \$0.56 per share, representing the value as of the closing date.

Table of Contents

Pursuant to the terms of a consulting agreement entered into on July 31, 2017, effective as of July 1, 2017, the Company issued 1,000,000 shares of common stock to Dathna Partners, LLC which shall be earned in the following manner: 250,000 shares will be earned by the consultant and deemed immediately vested on the effective date, and the remaining 750,000 shares will be earned by the consultant and deemed vested, in 12 equal monthly installments of 62,500 shares beginning on July 31, 2017 and monthly thereafter until June 30, 2018. The shares issued were valued at \$0.37 per share, representing the value as of the issuance date.

Note 11 - Stock Based Compensation

On January 10, 2014, the Board of Directors of the Company approved and adopted, subject to stockholder approval, which was obtained at the annual stockholders meeting held on November 16, 2014, the Midwest Energy Emissions Corp. 2014 Equity Incentive Plan (the "2014 Equity Plan"). The number of shares of the Company's Common Stock that may be issued under the 2014 Equity Plan is 2,500,000 shares, subject to the adjustment for stock dividends, stock splits, recapitalizations and similar corporate events. Eligible participants under the 2014 Equity Plan shall include officers, employees of or consultants to the Company or any of its subsidiaries, or any person to whom an offer of employment is extended, or any person who is a non-employee director of the Company. On October 9, 2014, the Board of Directors approved and adopted the First Amendment to the plan, subject to stockholder approval, which was obtained at the annual stockholders meeting held on November 18, 2014, which increased the number of shares issuable under the plan to 7,500,000.

On February 9, 2017, the Board of Directors of the Company adopted the Midwest Energy Emissions Corp. 2017 Equity Incentive Plan (the "2017 Equity Plan"), which was approved by stockholders at the annual stockholders meeting held on June 6, 2017. The 2017 Equity Plan provides for the grant of incentive stock options (subject to applicable stockholder approval), nonqualified stock options, restricted stock awards, stock appreciation rights, restricted share units, performance awards and other type of awards described therein. Eligible recipients under the 2017 Equity Plan include the Company's officers, directors, employees and consultants of the Company or one of its subsidiaries. The maximum number of shares of common stock that may be issued under the 2017 Equity Plan is 8,000,000. The 2017 Equity Plan will be administered by the Board or one or more committees appointed by the Board. The 2017 Equity Plan replaces the 2014 Equity Plan which was terminated by the Board of Directors on April 28, 2017.

The Company accounts for stock-based compensation awards in accordance with the provisions of ASC 718, which addresses the accounting for employee stock options which requires that the cost of all employee stock options, as well as other equity-based compensation arrangements, be reflected in the consolidated financial statements over the vesting period based on the estimated fair value of the awards.

Table of Contents

A summary of stock option activity for the quarter ended September 30, 2017 is presented below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value
December 31, 2015	6,720,458	1.35	3.7	-
Grants	1,600,000	0.99	4.6	-
Exercises	(100,000)	0.37	-	-
Expirations	(5,001)	22.00	-	-
Cancellations	(665,000)	-	-	-
December 31, 2016	7,550,457	1.29	3.2	-
Grants	1,600,000	0.98	4.8	-
Expirations	(2,273)	15.40	-	-
Cancellations	(375,000)	-	-	-
September 30, 2017	8,773,184	1.25	3.1	-
Options exercisable at:				
December 31, 2016	6,700,457	1.31	3.0	
September 30, 2017	7,873,184	1.27	2.9	

The Company utilized the Black-Scholes options pricing model. The significant assumptions utilized for the Black Scholes calculations consist of an expected life of equal to the expiration term of the option, historical volatility of 112.2%, and a risk free interest rate of 3%.

On May 1, 2016, the Company issued nonqualified stock options to acquire 25,000 shares each of the Company's common stock to Christopher Greenberg, Brian Johnson and Christopher Lee, each then a director of the Company, under the Company's 2014 Equity Plan. The options granted are exercisable at \$0.42 per share, representing the fair market value of the common stock as of the date of the grant as determined under the 2014 Equity Plan. On April 27, 2017 Brian Johnson and Christopher Lee resigned as directors of the Company. The options granted to them remain exercisable for 90 days following their resignation after which such options shall terminate. Based on a Black-Scholes valuation model, these options were valued at \$19,376 in accordance with FASB ASC Topic 718. Compensation expense for the three months ended September 30, 2017 and 2016 on the issued options was \$0 and \$4,845, respectively. Compensation expense for the nine months ended September 30, 2017 and 2016 on the issued options was \$6,460 and \$8,075, respectively.

On October 4, 2016 the Company granted nonqualified stock options to acquire 25,000 shares of the Company's common stock to Todd Ferrell. The options granted are exercisable at \$1.36 per share, representing the fair market value of the common stock as of the date of grant. These options will vest and become exercisable on February 1, 2018 and will expire five years from the grant date. Based on a Black-Scholes valuation model, these options were valued at \$22,157 in accordance with FASB ASC Topic 718. Compensation expense for the three months ended September 30, 2017 and 2016 on the issued options was \$3,909 and \$0, respectively. Compensation expense for the nine months ended September 30, 2017 and 2016 on the issued options was \$11,727 and \$0, respectively.

On February 1, 2017, the Company issued nonqualified stock options to acquire 50,000 shares each of the Company's common stock to Brian Johnson, Christopher Lee and Allan Grantham and nonqualified stock options to acquire 100,000 shares of the Company's common stock to Christopher Greenberg, each then a director of the Company, under the Company's 2014 Equity Plan. The options granted are exercisable at \$1.20 per share, representing the fair market value of the common stock as of the date of the grant as determined under the 2014 Equity Plan. The options are fully vested and exercisable as of the date of grant and will expire five years thereafter. As a result of the resignations of Brian Johnson and Christopher Lee on April 27, 2017, the options granted to them remain exercisable for 90 days following their resignation after which such options shall terminate. Based on a Black-Scholes valuation model, these options were valued at \$233,817 in accordance with FASB ASC Topic 718.

Table of Contents

On February 10, 2017, the Company issued nonqualified stock options to acquire 25,000 shares each of the Company's common stock to Nicholas Lentz and Johnny Battle, nonqualified stock options to acquire 50,000 shares of the Company's common stock to John Pavlish, nonqualified stock options to acquire 150,000 shares of the Company's common stock to Richard Gross and nonqualified stock options to acquire 500,000 shares of the Company's common stock to James Trettel under the Company's 2017 Equity Plan. The options granted are exercisable at \$1.15 per share, representing the fair market value of the common stock as of the date of the grant as determined under the 2017 Equity Plan. The options are fully vested and exercisable as of the date of grant and will expire five year thereafter. Based on a Black-Scholes valuation model, these options were valued at \$712,050 in accordance with FASB ASC Topic 718.

On April 27, 2017, the Company issued nonqualified stock options to acquire 125,000 shares each of the Company's common stocks to Brian Johnson and Christopher Lee under the Company's 2017 Equity Plan. The options granted are exercisable at \$0.96 per share, representing the fair market value of the common stock as of the date of the grant as determined under the 2017 Equity Plan. Notwithstanding their resignations as directors, the options are fully vested and exercisable as of the date of grant and will expire five years thereafter. Based on a Black-Scholes valuation model, these options were valued at \$194,732 in accordance with FASB ASC Topic 718.

On June 1, 2017, the Company issued nonqualified stock options to acquire 100,000 shares of the Company's common stock to Patrick Mongoven under the Company's 2017 Equity Plan. The options granted are exercisable at \$1.01 per share, which is greater than the fair market value of the common stock on the date of grant and represents the fair market value of the common stock on March 1, 2017. The options are fully vested and exercisable as of the date of grant and will expire five years thereafter. Based on a Black-Scholes valuation model, these options were valued at \$81,903 in accordance with FASB ASC Topic 718.

On September 18, 2017, the Company issued nonqualified stock options to acquire 250,000 shares of the Company's common stock to Gary Graves under the Company's 2017 Equity Plan. The options granted are exercisable at \$0.35 per share, representing the fair market value of the common stock on the date of grant as determined under the 2017 Equity Plan. Fifty percent (50.0%) of the options are fully vested and exercisable as of the date of grant and the remaining fifty percent (50.0%) shall vest and become exercisable upon Mr. Graves' position and title changes as described in his letter of employment or December 20, 2017, whichever occurs first. Based on a Black-Scholes valuation model, these options were valued at \$70,170 in accordance with FASB ASC Topic 718.

Note 12 - Warrants

Unless sold and issued, warrants are subject to the provisions of FASB ASC 815-10, the Company utilized a Black-Scholes options pricing model to value the warrants sold and issued. This model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until the warrants are

exercised. When calculating the value of warrants issued, the Company uses a volatility factor of 96.6%, a risk free interest rate and the life of the warrant for the exercise period. When sold and issued warrants were valued in accordance with FASB ASC 815-10, the fair value was determined using a Monte Carlo Simulation Model.

Table of Contents

The following table summarizes information about common stock warrants outstanding at September 30, 2017:

Exercise Price	Number Outstanding	Outstanding		Exercisable		
		Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Weighted Average Exercise Price
\$ 1.25	13,950	0.00	1.25	13,950	1.25	1.25
1.00	-	0.00	1.00	-	1.00	1.00
0.90	75,000	1.82	0.90	75,000	0.90	0.90
0.87	1,303,300	1.61	0.87	1,303,300	0.87	0.87
0.75	683,415	1.05	0.75	683,415	0.75	0.75
0.65	590,000	1.14	0.65	590,000	0.65	0.65
0.35	4,572,098*	1.70	0.35	4,572,098	0.35	0.35
	7,237,763	1.74		7,237,763		

Note * 916,720 warrants exercisable at \$0.35 contain dilution protections that increase the number of shares purchasable at exercise upon the issuance of securities at a price below the current exercise price.

Note 13 – Tax

For the quarter ended September 30, 2017, the Company had a net operating loss carryforward offset by a valuation allowance and, accordingly, no current provision for income taxes has been recorded. At September 30, 2017, the Company's net operating loss carryforward was approximately \$16.1 million and a deferred tax asset of \$500,000 has been recorded due to sufficient evidence available to support the realization of certain tax assets in future years. Our deferred tax asset primarily related to net operating losses and a valuation allowance has been established due to the uncertainty of the utilization of all of these assets in future periods. The net operating loss carryforward will begin to expire in 2030.

Section 382 of the Internal Code allows post-change corporations to use pre-change net operating losses, but limit the amount of losses that may be used annually to a percentage of the entity value of the corporation at the date of the ownership change. The applicable percentage is the federal long-term tax-exempt rate for the month during which the change in ownership occurs.

Table of Contents

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Background

Midwest Energy Emissions Corp. (the “Company”, “we”, “us” and “our”) develops and deploys patented, proprietary technologies to remove mercury emissions from coal-fired power plants. The U.S. EPA MATS (Mercury and Air Toxics Standards) rule requires that all coal and oil-fired power plants in the U.S., larger than 25MWs, must limit mercury in its emissions to below certain specified levels, according to the type of coal burned. Power plants were required to begin complying with MATS on April 16, 2015, unless they were granted a one-year extension to begin to comply. MATS, along with many state and provincial regulations, form the basis for mercury emission capture at coal fired plants across North America. Under the MATS regulation, Electric Generating Units (“EGUs”) are required to remove about 90% of the mercury from their emissions. We believe that we continue to meet the requirements of the industry as a whole and our technologies have been shown to achieve mercury removal levels compliant with all state, provincial and federal regulations at a lower cost and with less plant impact than our competition.

As is typical in this market, we are paid by the EGU based on how much of our material is injected to achieve the needed level of mercury removal. Our current clients pay us as material is delivered to their facility. Clients will use our material whenever their EGUs operate, although EGUs are not always in operation. EGUs typically may not be in operation due to maintenance reasons or when the price of power in the market is less than their cost to produce power. Thus, our revenues from EGU clients will not typically be a consistent stream but will fluctuate, especially seasonally as the market demand for power fluctuates.

The MATS regulation has been subject to legal challenge, and in June 2015, the U.S. Supreme Court held that the EPA unreasonably failed to consider costs in determining whether it is “appropriate and necessary” to regulate hazardous air pollutants, including mercury, from power plants. The Court remanded the case back to the U.S. Court of Appeals for the District of Columbia Circuit for further proceedings, but left the rule in place. In December 2015, the D.C. Circuit remanded the rule back to the EPA for further consideration while allowing MATS to remain in effect pending the EPA’s finding; the Supreme Court later denied a petition challenging the lower court’s decision to remand without vacating. On April 14, 2016, EPA issued a final supplemental finding reaffirming the MATS rule on the ground that it is supported by the cost analysis the Supreme Court required. That supplemental finding is under review by the D.C. Circuit, and the Company is unable to predict with certainty the outcome of these proceedings. On April 18, 2017, EPA asked the court to place that litigation in abeyance, stating that the Agency is reviewing the supplemental finding to determine whether it should be reconsidered in whole or in part. The court granted EPA’s abeyance request on April 27, 2017, and ordered EPA to file 90-day status reports starting July 26, 2017. The Company is unable to predict how EPA will proceed, but any changes to the MATS rule could have a negative impact on our business.

We remain focused on positioning the Company for short and long-term growth. In the nine months ended September 30, 2017, we focused on continual operational improvement at our customer sites. We continue to make refinements to all of our key products, as we continue to focus on the customer and its operations. As described below, we achieved substantial increases in profitability compared to the prior year. On April 24, 2017 the Company acquired the Patent Rights from the EERCF for the purchase price of \$2,500,000 in cash and 925,000 shares of common stock. This acquisition positions the Company to continue its growth across North America, including the licensing of systems using a two-part process here in the United States and Canada.

Table of Contents

Results of Operations

Revenues

Sales - We generated revenues of approximately \$8,448,000 and \$11,771,000 for the quarters ended September 30, 2017 and 2016, respectively and \$21,807,000 and \$24,537,000 for the nine months ended September 30, 2017 and 2016, respectively.

Total sorbent product sales for the three months ended September 30, 2017 and 2016 were \$8,076,000 and \$11,453,000, respectively. Total sorbent product sales for the nine months ended September 30, 2017 and 2016 were \$20,472,000 and \$21,163,000, respectively. The decrease in product sales is primarily due to optimization efforts undertaken by us over the past year with our customers as well as lower capacity factors seen at some customer sites resulting in decreased product needed to keep our customers in MATS compliance.

Equipment sales for the three months ended September 30, 2017 and 2016 were \$3,000 and \$143,000, respectively. Equipment sales for the nine months ended September 30, 2017 and 2016 were \$787,000 and \$2,699,000, respectively. The higher equipment sales during 2016 are primarily related to the commissioning of one customer project that included both a front end and back end product injection systems.

Other revenues for the three months ended September 30, 2017 and 2016 were \$369,000 and \$175,000, respectively. Other revenues for the nine months ended September 30, 2017 and 2016 were \$547,000 and \$675,000, respectively.

Cost and Expenses

Costs and expenses were \$7,419,000 and \$10,054,000 during the three months ended September 30, 2017 and 2016, respectively, and were \$21,147,000 and \$22,688,000 for the nine months ended September 30, 2017 and 2016, respectively. The decrease in costs and expenses from the prior year is primarily attributable to a decrease in costs of sales during the current quarter compared to the same period in the prior year. These decreases are associated with the decrease in revenues in the quarter ended September 30, 2017.

Cost of sales during the three months ended September 30, 2017 and 2016 was \$5,509,000 and \$7,821,000, respectively, and were \$14,291,000 and \$17,613,000 for the nine months ended September 30, 2017 and 2016, respectively. The decrease in cost is primarily attributable to the decrease in product sales in 2017. The margin on sales for the nine months ended September 30, 2017 improved from the same period in the prior year primarily due to decreased royalty costs and raw material costs.

Selling, general and administrative expenses were \$1,910,000 and \$2,233,000 for the quarters ended September 30, 2017 and 2016, respectively, and were \$6,857,000 and \$5,076,000 for the nine months ended September 30, 2017 and 2016, respectively. The increase in selling, general and administrative expenses for the nine months ended September 30, 2017 is primarily attributed to increases in salary and benefit costs from the prior year and stock based compensation associated with stock options issued to officers, directors and employees

Other Expenses

Interest expense related to the financing of capital was \$542,000 and \$973,000 during the quarters ended September 30, 2017 and 2016, respectively, and were \$1,627,000 and \$4,079,000 for the nine months ended September 30, 2017 and 2016, respectively. The decrease in interest expense is primarily due to the decrease in the amortization debt issuance costs and discount on notes payable from the same period in the prior year. During the quarters ended September 30, 2017 and 2016, a gain of \$56,000 and a loss of \$9,985,000, respectively, on the change in value of warrant liability was recorded. During the nine months ended September 30, 2017 and 2016, a gain of \$919,000 and a loss of \$14,241,000, respectively, on the change in value of warrant liability was recorded.

Table of Contents

Net Income (Loss)

For the quarter ended September 30, 2017 we had net income of approximately \$869,000 compared to a net loss of approximately \$9,302,000 for the quarter ended September 30, 2016. For the nine months ended September 30, 2017 and 2016 we had net income of \$95,000 and a net loss of \$16,636,000, respectively. The change in net income is primarily due to the gain recorded in 2017 compared to the loss recorded in 2016 on the change in value of warrant liability together with the decrease in interest expense, partially offset by a decrease in operating income for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016.

Taxes

Our deferred tax assets are primarily related to net operating losses and a valuation allowance has been established due to the uncertainty of the utilization of all of these assets in future periods. As of December 31, 2016, a benefit for income taxes of \$500,000 was recorded due to sufficient evidence available to support the realization of certain tax assets in future years. The net operating loss carryforwards will begin to expire in 2030.

Non-GAAP Financial Measures

Adjusted EBITDA

To supplement our consolidated financial statements presented in accordance with GAAP and to provide investors with additional information regarding our financial results, we consider and are including herein Adjusted EBITDA, a Non-GAAP financial measure. We view Adjusted EBITDA as an operating performance measure and, as such, we believe that the GAAP financial measure most directly comparable to it is net income (loss). We define Adjusted EBITDA as net income adjusted for income taxes, depreciation, amortization, stock based compensation, and other non-cash income and expenses. We believe that Adjusted EBITDA provides us an important measure of operating performance because it allows management, investors, debtholders and others to evaluate and compare ongoing operating results from period to period by removing the impact of our asset base, any asset disposals or impairments, stock based compensation and other non-cash income and expense items associated with our reliance on issuing equity-linked debt securities to fund our working capital.

Our use of Adjusted EBITDA has limitations as an analytical tool, and this measure should not be considered in isolation or as a substitute for an analysis of our results as reported under GAAP, as the excluded items may have

significant effects on our operating results and financial condition. Additionally, our measure of Adjusted EBITDA may differ from other companies' measure of Adjusted EBITDA. When evaluating our performance, Adjusted EBITDA should be considered with other financial performance measures, including various cash flow metrics, net income and other GAAP results. In the future, we may disclose different non-GAAP financial measures in order to help our investors and others more meaningfully evaluate and compare our future results of operations to our previously reported results of operations.

Table of Contents

We prepare and publicly release quarterly unaudited financial statements prepared in accordance with GAAP. The following table shows our reconciliation of Net Income to Adjusted EBITDA for the quarters and nine months ended September 30, 2017 and 2016, respectively:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(In thousands)		(In thousands)	
Net income (loss)	\$ 869	\$ (9,302)	\$ 95	\$ (16,637)
Non-GAAP adjustments:				
Depreciation and amortization	327	249	951	642
Interest and letter of credit fees	595	973	1,801	4,079
Income taxes	15	20	21	24
Stock based compensation	201	385	1,438	968
Change in warrant liability	(56)	9,985	(919)	14,242
Settlement gains and losses	(379)	-	(318)	-
Adjusted EBITDA	\$ 1,572	\$ 2,310	\$ 3,069	\$ 3,318

We are including below our unaudited reconciliation of Net Income to Adjusted EBITDA on a quarterly basis for the quarters ended December 31, 2016, March 31, 2017, June 30, 2017 and September 30, 2017:

	Quarter Ended (Unaudited)			
	9/30/2017	6/30/2017	3/31/2017	12/31/2016
	(In thousands)			
Net income (loss)	\$ 869	\$ 671	\$ (1,445)	\$ (246)
Non-GAAP adjustments:				
Depreciation and amortization	327	322	302	271
Interest and letter of credit fees	595	606	600	896
Income taxes	15	6	-	(497)
Stock based compensation	201	282	955	191
Change in warrant liability	(56)	(655)	(208)	439
Gain on debt restructuring	-	-	-	(407)
Settlement gains and losses	(379)	61	-	-
Adjusted EBITDA	\$ 1,572	\$ 1,293	\$ 204	\$ 647

Liquidity and Capital Resources

Our principal source of liquidity is cash generated from operating activities. As of September 30, 2017, our cash and cash equivalents totaled \$2,364,000.

Total assets were \$14,019,000 at September 30, 2017 versus \$15,878,000 at December 31, 2016. The change in total assets is primarily attributable to the decrease in cash offset by an increase in intangible assets.

Total liabilities were \$16,622,000 at September 30, 2017 versus \$20,849,000 at December 31, 2016. The decrease in total liabilities is primarily due to the decrease in accounts payable, accrued expenses, warrant liability and the decrease in notes payable.

Operating activities used \$1,149,000 of cash during the nine months ended September 30, 2017 compared to providing \$2,308,000 during the nine months ended September 30, 2016. The change in cash used by operating activities is primarily attributable to the decrease in accounts payable during the nine months ended September 30, 2017.

Table of Contents

Investing activities used \$3,199,000 and \$1,348,000 during the nine months ended September 30, 2017 and 2016, respectively. In 2017, the Company paid \$2,500,000 for the acquisition of the EERCF Patent Rights. In 2016, additions of property and equipment associated with the expansion of our operations in preparation for MATS compliance activities of our customers were responsible for these expenditures.

Financing activities used \$1,040,000 during the nine months ended September 30, 2017 compared to providing \$4,000 during the nine months ended September 30, 2016 due to the repayment of principal of convertible promissory notes. Financing activities during the nine months ended September 30, 2017 was due to the repayment of principal of convertible promissory notes and payment of equipment notes payable.

Off-Balance Sheet Arrangements

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, and results of operations, liquidity or capital expenditures.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial conditions and results of operation are based upon the accompanying consolidated financial statements which have been prepared in accordance with the generally accepted accounting principles in the U.S. The preparation of the consolidated financial statements requires that we make estimates and assumptions that affect the amounts reported in assets, liabilities, revenues and expenses. Management evaluates on an on-going basis our estimates with respect to the valuation allowances for accounts receivable, income taxes, accrued expenses and equity instrument valuation, for example. We base these estimates on various assumptions and experience that we believe to be reasonable. The following critical accounting policies are those that are important to the presentation of our financial condition and results of operations. These policies require management's most difficult, complex, or subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain.

The following critical accounting policies affect our more significant estimates used in the preparation of our consolidated financial statements. In particular, our most critical accounting policies relate to the recognition of revenue, and the valuation of our stock-based compensation.

Accounts Receivable

Trade accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectability of specific customer accounts: customer credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

Table of Contents

Revenue Recognition

The Company records revenue from sales in accordance with ASC 605, *Revenue Recognition* (“ASC 605”). The criteria for recognition are as follows:

1. Persuasive evidence of an arrangement exists;

Determination of criteria (3) and (4) will be based on management’s judgments regarding the fixed nature of the selling prices of the products delivered and the collectability of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments will be provided for in the same period the related sales are recorded.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise’s consolidated financial statements are based on a more-likely-than-not recognition threshold. The Company did not have any unrecognized tax benefits at September 30, 2017 and December 31, 2016. When necessary, the Company would accrue penalties and interest related to unrecognized tax benefits as a component of income tax expense.

The Company and its subsidiaries file a consolidated income tax return in the U.S. federal jurisdiction and three state jurisdictions. The Company is no longer subject to U.S. federal examinations for years prior to 2013 or state tax examinations for years prior to 2012.

Stock-Based Compensation

We have adopted the provisions of *Share-Based Payments*, which requires that share-based payments be reflected as an expense based upon the grant-date fair value of those grants. Accordingly, the fair value of each option grant, non-vested stock award and shares issued under our employee stock purchase plan, were estimated on the date of grant. We estimate the fair value of these grants using the Black-Scholes model which requires us to make certain estimates in the assumptions used in this model, including the expected term the award will be held, the volatility of the underlying common stock, the discount rate, dividends and the forfeiture rate. The expected term represents the period of time that grants and awards are expected to be outstanding. Expected volatilities were based on historical volatility of our stock. The risk-free interest rate approximates the U.S. treasury rate corresponding to the expected term of the option. Dividends were assumed to be zero. Forfeiture estimates are based on historical data. These inputs are based on our assumptions, which we believe to be reasonable but that include complex and subjective variables. Other reasonable assumptions could result in different fair values for our stock-based awards. Stock-based compensation expense, as determined using the Black-Scholes option-pricing model, is recognized on a straight-line basis over the service period, net of estimated forfeitures. To the extent that actual results or revised estimates differ from the estimates used, those amounts will be recorded as an adjustment in the period that estimates are revised.

Table of Contents

Warrant Liability

On August 14, 2014, Company issued the Lender a warrant to purchase 12,500,000 shares of the Company's common stock at \$1.00 per share, subject to the adjustments (see Note 13 for changes to the terms of these warrants). The Company also issued to Drexel for the transaction: (i) a 5-year warrant to purchase up to 800,000 shares of common stock at \$1.00 per share; and (ii) a 5-year warrant to purchase up to 1,000,000 shares of common stock at \$0.50 per share, both subject to adjustments similar to the Warrant issued to the Lender. On February 19, 2016, the exercise price of both of these warrants was reduced to \$0.35. During the year ended December 31, 2016, Drexel and its assigns exercised 1,060,929 warrants. During the nine months ended September 30, 2017, Drexel and its assigns exercised 224,444 warrants (see Note 8).

On February 19, 2016, in connection to Amendment No. 2 and Amendment No. 3, the Company issued Drexel: a 5-year warrant to purchase up to 300,000 shares of common stock at \$0.35 per share as compensation for services rendered. During the year ended December 31, 2016, Drexel and its assigns exercised 95,000 warrants.

These warrants are valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model as of each reporting period date and the change in value can have a significant impact on the Company's bottom line. The significant assumptions considered by the model were the remaining term of the warrants, operational forecasts provided by the Company, the fair value per share stock price, a risk free treasury rate and an expected volatility rate at each measurement date.

Warrants

Unless sold and issued warrants are subject to the provisions of FASB ASC 815-10, the Company utilized a Black-Scholes options pricing model to value the warrants sold and issued. This model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until the warrants are exercised. When calculating the value of warrants issued, the Company uses a volatility factor of 74.9%, a risk free interest rate and the life of the warrant for the exercise period. When sold and issued warrants were valued in accordance with FASB ASC 815-10, the fair value was determined using a Monte Carlo Simulation Model.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

Table of Contents

ITEM 4 – CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure. Based on that evaluation, our principal executive officer and principal financial officer concluded, as of the end of the period covered by this report, that the Company's disclosure controls and procedures were not effective as a result of material weaknesses in our internal control over financial reporting. The ineffectiveness of our disclosure controls and procedures was due to the following material weaknesses in our internal control over financial reporting, which are common to many small companies: (i) lack of a sufficient complement of personnel commensurate with the Company's reporting requirements; and (ii) insufficient written documentation or training of our internal control policies and procedures which provide staff with guidance or framework for accounting and disclosing financial transactions.

Despite the existence of the material weaknesses above, we believe that the consolidated financial statements contained in this Form 10-Q fairly present our financial position, results of operations and cash flows as of and for the periods presented in all material respects.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15 (f) under the Exchange Act) during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. During 2016, certain actions were taken to address certain aspects of the material weaknesses disclosed above. We continue to actively plan for and implement additional control procedures to improve our overall control environment and expect these efforts to continue throughout 2017 and into 2018.

Table of Contents

PART II – OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

None

ITEM 1A – RISK FACTORS

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

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

Pursuant to the terms of a consulting agreement entered into on July 31, 2017, effective as of July 1, 2017, we issued 1,000,000 shares of common stock which shall be earned in the following manner: 250,000 shares will be earned by the consultant and deemed immediately vested on the effective date, and the remaining 750,000 shares will be earned by the consultant and deemed vested, in 12 equal monthly installments of 62,500 shares beginning on July 31, 2017 and monthly thereafter until June 30, 2018. The foregoing shares were issued in reliance upon the exemption from registration pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended.

ITEM 3 - DEFAULT UPON SENIOR SECURITIES

Not applicable.

ITEM 4 - MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 - OTHER INFORMATION

None

Page 36

Table of Contents

ITEM – 6 EXHIBITS

Exhibit

Number Description

<u>31.1*</u>	<u>Certification by Chief Executive Officer, required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act</u>
<u>31.2*</u>	<u>Certification by Chief Financial Officer, required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act</u>
<u>32.1*</u>	<u>Certification by Chief Executive Officer, required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code</u>
<u>32.2*</u>	<u>Certification by Chief Financial Officer, required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code</u>
101*	The following financial information from our Quarterly Report on Form 10-Q for the nine months ended September 30, 2017 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Stockholders' Deficit, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements

* Filed herewith.

Table of Contents

SIGNATURES

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

**MIDWEST ENERGY EMISSIONS
CORP.**

Dated: November 20, 2017

By: */s/ Richard MacPherson*
Richard MacPherson
President and Chief Executive Officer

(Principal Executive Officer)

Dated: November 20, 2017

By */s/ Richard H. Gross*
Richard H. Gross
Chief Financial Officer

(Principal Financial Officer)