

BIOLARGO, INC.
Form 10QSB/A
March 10, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

AMENDMENT No. 2 to

FORM 10-QSB

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007.

or

.. **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 000-19709

BIOLARGO, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

Delaware
*(State or other jurisdiction of
incorporation or organization)*

65-0159115
*(I.R.S. Employer
Identification No.)*

2603 Main Street, Suite 1155

Irvine, California 92614

(Address, including zip code, of principal executive offices)

(949) 235-8062

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock, \$0.0067 par value.

Check whether the Registrant (1) 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of the Registrant's Common Stock outstanding as of Aug 23, 2007 was 39,654,643 shares.

DOCUMENTS INCORPORATED BY REFERENCE: None

Transitional Small Business Disclosure Format (Check one): Yes No

Table of Contents

BIOLARGO, INC.

FORM 10-QSB

INDEX

PART I

| | | |
|---------------|--|-----------|
| Item 1 | <u>Financial Statements</u> | 1 |
| Item 2 | <u>Management's Discussion and Analysis</u> | 17 |
| Item 3 | <u>Controls and Procedures</u> | 25 |

PART II

| | | |
|---------------|---|-----------|
| Item 1 | <u>Legal Proceedings</u> | 26 |
| Item 2 | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 26 |
| Item 3 | <u>Defaults Upon Senior Securities</u> | 27 |
| Item 4 | <u>Submission of Matters to a Vote of Security Holders</u> | 27 |
| Item 5 | <u>Other Information</u> | 27 |
| Item 6 | <u>Exhibits</u> | 28 |
| | <u>Signatures</u> | 28 |
| | <u>Exhibit Index</u> | |

Exhibit 31.1
Exhibit 31.2
Exhibit 32

Table of Contents**GENERAL NOTE**

THIS AMENDMENT NO. 2 TO THE QUARTERLY REPORT ON FORM 10-QSB FOR THE PERIOD ENDED JUNE 30, 2007, OF BIOLARGO, INC. (THE COMPANY) IS BEING FILED FOR THE FOLLOWING PURPOSES: (1) TO RECALCULATE THE VALUE OF CERTAIN WARRANTS ISSUED BY THE COMPANY AS PART OF CERTAIN PRIVATE OFFERINGS OF THE COMPANY'S SECURITIES WHICH GIVES RISE TO ADDITIONAL INTEREST EXPENSE; (2) TO VALUE AN OPTION GRANTED TO OUR CHIEF EXECUTIVE OFFICER, RESULTING IN ADDITIONAL OPTION COMPENSATION EXPENSE RECORDED OVER THE VESTING PERIOD OF THE OPTION RATHER THAN EXPENSING IT ALL AT ONCE ON THE ANNIVERSARY DATE; AND (3) AFTER A RE-EVALUATION OF THE ACCOUNTING TREATMENT AND PRESENTATION OF THE ACQUISITION OF ASSETS FROM IOWC TECHNOLOGIES, INC., WE HAVE MODIFIED OUR ACCOUNTING AND PRESENTATION OF SUCH ACQUISITION IN ACCORDANCE WITH THE FAIR VALUE RULES OF THE FASB.

PART I**Item 1. Financial Statements****BIOLARGO, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2006 AND JUNE 30, 2007****ASSETS**

| | December 31, 2006 | June 30, 2007 (unaudited) |
|--|------------------------------|--|
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 229,334 | \$ 84,327 |
| Prepaid expenses | 16,500 | |
| Total current assets | 245,834 | 84,327 |
| OTHER ASSET | | |
| Licensing rights, net of amortization | | 11,166,220 |
| Assigned agreement, net of amortization | | 382,923 |
| TOTAL ASSETS | \$ 245,834 | \$ 11,633,470 |
| CURRENT LIABILITIES | | |
| Accounts payable and accrued expenses | \$ 2,311,500 | \$ 801,055 |
| Accrued option compensation expense | | 158,961 |
| Convertible notes payable, current portion | 2,373,070 | |
| Prepaid interest related to above convertible notes, current portion net of amortization | (284,025) | |
| Note payable, related party | 900,000 | |
| Note payable | 25,000 | 25,000 |
| Debentures payable, net | 21,151 | 21,151 |
| Total current liabilities | 5,346,696 | 1,006,167 |

LONG-TERM LIABILITIES

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

| | | |
|---|--------------------|----------------------|
| Convertible notes payable, net of current portion | 484,000 | 1,096,950 |
| Prepaid interest related to above convertible notes, net of current portion and amortization | (255,875) | (700,885) |
| Total long-term liabilities | 228,125 | 396,065 |
| TOTAL LIABILITIES | 5,574,821 | 1,402,232 |
| COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS | | |
| STOCKHOLDERS DEFICIT | | |
| Convertible Preferred Series A, \$.00067 par value, 50,000,000 shares authorized, -0- shares issued and outstanding at June 30, 2007 and at December 31, 2006 | | |
| Common Stock, \$.00067 par value, 200,000,000 shares authorized, 39,355,166 and 3,135,822 shares issued at June 30, 2007 and December 31, 2006, respectively | 52,256 | 76,523 |
| Additional paid-in capital | 24,372,650 | 42,758,508 |
| Accumulated deficit | (29,753,893) | (32,603,793) |
| Total stockholders deficit | (5,328,987) | 10,231,238 |
| TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT | \$ 245,834 | \$ 11,633,470 |

See accompanying notes to consolidated financial statements.

Table of Contents**BIOLARGO, INC. AND SUBSIDIARIES****STATEMENTS OF OPERATIONS FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED****JUNE 30, 2006 AND 2007****(UNAUDITED)**

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|--|---------------------|--|---------------------|
| | 2006 (unaudited) | 2007 (unaudited) | 2006 (unaudited) | 2007 (unaudited) |
| Revenue | \$ | \$ | \$ | \$ |
| Total revenue | | | | |
| Costs and expenses | | | | |
| Selling, general and administrative | 207,449 | 841,553 | 550,157 | 1,460,848 |
| Research and development | 73,529 | 23,511 | 84,298 | 42,003 |
| Amortization expense | | 184,534 | | 184,534 |
| Total costs and expenses | 280,978 | 1,049,598 | 634,455 | 1,687,385 |
| Loss from operations | (280,978) | (1,049,598) | (634,455) | (1,687,385) |
| Other income and (expense) | | | | |
| Interest expense | (30,815) | (141,619) | (118,976) | (1,194,820) |
| Reduction to note payable | 220,000 | | 220,000 | |
| Reversal of accruals related to prior periods | | 32,305 | | 32,305 |
| Net other income and (expense) | 189,185 | (109,314) | 101,024 | (1,162,515) |
| Net loss | \$ (91,793) | \$ (1,158,912) | \$ (533,431) | \$ (2,849,900) |
| Loss per common share basic and diluted | | | | |
| Loss per share | \$ (0.04) | \$ (0.04) | \$ (0.22) | \$ (0.16) |
| Weighted average common share equivalents outstanding | 2,499,130 | 30,777,550 | 2,456,730 | 17,631,060 |

See accompanying notes to consolidated financial statements.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES
STATEMENTS OF STOCKHOLDERS DEFICIT
FOR THE SIX-MONTH PERIOD ENDED JUNE 30, 2007
(UNAUDITED)

| | Preferred Stock | | Common Stock | | | Retained Deficit | Total |
|--|------------------|--------------------|------------------|--------------------|----------------------------|------------------|----------------|
| | Number of Shares | Par Value \$.00067 | Number of Shares | Par Value \$.00067 | Additional Paid-In Capital | | |
| BALANCE DECEMBER 31, 2006 | | \$ | 3,135,822 | \$ 52,256 | \$ 24,372,650 | \$ (29,753,893) | \$ (5,328,987) |
| CONVERSION OF NOTE OBLIGATIONS (INCLUDING ADDITIONAL INTEREST EXPENSE) | | | 6,985,441 | 4,680 | 3,125,610 | | 3,130,290 |
| SHARES ISSUED FOR SERVICES (INCLUDING ADDITIONAL COSTS AND EXPENSES) | | | 1,803,615 | 1,209 | 938,752 | | 939,961 |
| CONVERSION OF BOARD OF DIRECTOR AND OFFICER PAYABLES | | | 1,623,359 | 1,088 | 607,671 | | 608,759 |
| ISSUANCE OF WARRANTS IN CONJUNCTION WITH CONVERTIBLE NOTE OFFERINGS | | | | | 380,300 | | 380,300 |
| SHARES ISSUED FOR ACQUISITION OF ASSETS FROM IOWC | | | 22,139,012 | 14,833 | 11,718,844 | | 11,733,677 |
| CONVERSION OF AUGUSTINE NOTE PAYABLE OBLIGATION | | | 2,031,553 | 1,361 | 715,777 | | 717,138 |
| CONVERSION OF NEW MILLENIUM NOTE PAYABLE OBLIGATION (RELATED PARTY) | | | 1,636,364 | 1,096 | 898,904 | | 900,000 |
| NET LOSS FOR THE SIX-MONTH PERIOD ENDED JUNE 30, 2007 | | | | | | (2,849,900) | (2,849,900) |
| BALANCE JUNE 30, 2007 | | \$ | 39,355,166 | \$ 76,523 | \$ 42,758,508 | \$ (32,603,793) | \$ 10,231,238 |

See accompanying notes to consolidated financial statements.

Table of Contents**BIOLARGO, INC. AND SUBSIDIARIES****STATEMENTS OF CASH FLOWS FOR THE SIX-MONTH PERIODS ENDED****JUNE 30, 2006 AND 2007****(UNAUDITED)**

| | For the six-month period ended June 30, | |
|---|--|------------------|
| | 2006 | 2007 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | \$ (533,431) | \$ (2,849,900) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Conversion of note payable obligations and additional non-cash interest expense | | 1,216,904 |
| Conversion of consultant obligations and additional non-cash expense | | 160,625 |
| Non-cash interest expense related to value of warrants issued in conjunction with our convertible notes | | 219,316 |
| Non-cash compensation expense related to options to employees | | 158,961 |
| Amortization of intangible assets | | 184,534 |
| Decrease in prepaid expenses | (42,500) | (16,500) |
| Increase in accounts payable and accrued expenses | 82,055 | 168,053 |
| Net cash used in operating activities | (493,876) | (758,007) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| No cash used in or provided by investing activities | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Reduction of note payable, related party | (220,000) | |
| Funds from convertible notes payable | 777,500 | 613,000 |
| Net cash provided by financing activities | 557,500 | 613,000 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | 63,624 | (145,007) |
| CASH AND CASH EQUIVALENTS BEGINNING | 283,462 | 229,334 |
| CASH AND CASH EQUIVALENTS ENDING | \$ 347,086 | \$ 84,327 |
| SUPPLEMENTAL DISCLOSURES OF CASHFLOW INFORMATION | | |
| Cash paid during the period for: | | |
| Interest | \$ | \$ |
| Income taxes | \$ | \$ |
| Conversion of note payable, related party to shares of the company's common stock | \$ | \$ 900,000 |
| Conversion of convertible notes payable to shares of the company's common stock | \$ | \$ 2,373,120 |
| Conversion of accrued expenses to shares of the company's common stock: | | |
| Board of director and officer payable | \$ | \$ 608,759 |
| Consultant payable | \$ | \$ 740,296 |

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING AND INVESTING ACTIVITIES

| | | |
|--|----|---------------|
| Issuance of warrants in conjunction with convertible note offerings | \$ | \$ 380,300 |
| Issuance of shares of the Company's common stock in conjunction with the acquisition of assets from IOWC | \$ | \$ 11,733,676 |

See accompanying notes to consolidated financial statements.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Accounting Policies-Basis of Presentation

In the opinion of management, the accompanying balance sheets and related interim statements of operations, cash flows, and stockholders deficit include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Actual results and outcomes may differ from management's estimates and assumptions. Estimates are used when accounting for stock-based transactions, account payables and accrued expenses and taxes, among others.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-QSB should be read in conjunction with Management's Discussion and Analysis and financial statements and notes thereto included in the BioLargo, Inc. Annual Report on Form 10-KSB, as amended, for the year ended December 31, 2006.

Note 2. Business and Organization

Outlook

BioLargo, Inc. (the Company) had no continuing business operations until the completion of the acquisition of the BioLargo technology on April 30, 2007, and operated as a public shell prior to such date. On April 30, 2007, the Company completed its acquisition of the BioLargo technology from IOWC Technologies, Inc. (IOWC) and issued to IOWC 22,139,120 shares of the Company's common stock.

The Company will need working capital resources to maintain the Company's status and to fund other anticipated costs and expenses during the year ending December 31, 2007 and beyond, as well as to fund the exploitation of the BioLargo technology. The Company's ability to continue as a going concern is dependent on the Company's ability to raise capital to, at a minimum, meet its corporate maintenance requirements and fund the operations necessary to commercially exploit the BioLargo technology. It would need additional outside capital until and unless that technology is able to generate positive working capital sufficient to fund the Company's cash flow requirements from operations.

These financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of the Company's business. As reflected in the accompanying financial statements, the Company had a net loss of \$2,849,900 for the six-month period ended June 30, 2007, negative cash flow from operating activities of \$758,007 for the six-month period ended June 30, 2007, and an accumulated stockholders' deficit of \$32,603,793 as of June 30, 2007. Also, as of June 30, 2007, the Company had limited liquid and capital resources. The foregoing factors raise substantial doubt about the Company's ability to continue as a going concern. Ultimately, the Company's ability to continue as a going concern is dependent upon its ability to attract new sources of capital, exploit the technology acquired so it attains a reasonable threshold of operating efficiencies and achieves profitable operations. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Cash and cash equivalents totaled \$84,327 at June 30, 2007. The Company had no revenues in the three and six-month periods ended June 30, 2007, and its financing activities funded operations.

During the six-month period ended June 30, 2007, the Company sold an aggregate \$613,000 principal amount of its convertible promissory notes. Of this amount \$516,000 was sold pursuant to the offering commenced in the fall of 2006 (the Fall 2006 Offering) due and payable September 13, 2008 to 22 investors (see Note 3). The remaining \$97,000 was sold pursuant to the offering commenced in the spring of 2007 (the Spring 2007 Offering) due and payable June 30, 2009 to six investors (see Note 3).

As of June 30, 2007, the Company had \$1,121,950 aggregate principal amount of its promissory notes that mature at various times during 2007, 2008 and 2009. This amount consists of (i) convertible notes totaling \$1,096,950 (see Note 3); and (ii) a promissory note totaling \$25,000 due to a former professional for legal services (see Note 9). The Company currently intends to require the conversion of the \$1,096,950 aggregate principal amount of notes upon maturity, in which case the Company will not require funds to repay or redeem such notes.

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

On March 15, 2007, the Company's stockholders approved, and effective as of the close of business on March 21, 2007, the Company completed a 1-for-25 reverse split of its common stock (the "Reverse Split").

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Additionally, on March 15, 2007, the Company's stockholders approved and the Company has filed, an amendment to the Company's certificate of incorporation increasing the Company's authorized capital stock to 200,000,000 shares of common stock and 50,000,000 shares of preferred stock. Unless specifically stated otherwise, all references in the financial statements to the Company's common stock are stated on a post-Reverse Split basis.

Organization

On March 15, 2007 the Company's stockholders approved, and the Company has completed, a corporate name change, changing its name from NuWay Medical, Inc. to BioLargo, Inc. The amendment to the certificate of incorporation reflecting the name change was filed on March 16, 2007 with the Secretary of State of the State of Delaware. In connection with this name change, on March 21, 2007 the Company's common stock began trading under a new symbol, **BLGO**, on the Pink Sheets.

The Company was initially organized as Repossession Auction, Inc. under the laws of the State of Florida in 1989. In 1991, the Company merged into a Delaware corporation bearing the same name. In 1994, the Company's name was changed to Latin American Casinos, Inc. to reflect its focus on the gaming and casino business in South and Central America, and in 2001 the Company changed its name to NuWay Energy, Inc. to reflect its new emphasis on the oil and gas development industry. During October 2002, the Company's name was changed to NuWay Medical, Inc. coincident with the divestiture of its non-medical assets and the retention of new management.

Transactions Involving the BioLargo Technology

Leading up to the completion of the acquisition of the BioLargo technology in April 2007, the Company engaged in several transactions with IOWC and its founder, sole stockholder, and sole director, Kenneth R. Code.

Letter of Intent

In July 2005, the Company entered into a letter of intent (**LOI**) with IOWC. The LOI set out the terms for the acquisition of certain assets of IOWC consisting of certain intellectual property, including two United States patents and two licenses and/or distributor agreements pursuant to which IOWC had licensed certain of its technologies for use in products designed for distribution in the food, medical and biohazardous material transportation industries. In connection with the transactions contemplated by the LOI, the Company agreed to issue up to 51% of its common stock to IOWC. The LOI provided that the transactions contemplated by the LOI would be completed pursuant to the terms of an asset purchase agreement as well as a research and development agreement. In addition, the LOI required certain stockholders approvals as a condition to the closing of the transactions contemplated by the LOI including approval of the issuance of the shares of the Company's common stock to IOWC, a reverse stock split and an increase in the authorized capital stock of the Company.

As the parties worked toward preparing the documentation called for by the LOI and as the Company began to prepare the proxy materials needed for its stockholders meeting, it became increasingly clear to the parties that the length of time and the costs involved in preparing documentation for a stockholders meeting would likely jeopardize the chances that the transactions contemplated by the LOI could be completed in a manner benefiting both parties. Accordingly, in late 2005 the parties began to explore alternative strategies that would enable them to begin to realize the benefits of the transactions contemplated by the LOI while at the same time allowing the Company to call a meeting of its stockholders for the purpose of approving the issuance of shares of its common stock in connection with the acquisition of the BioLargo technology.

Marketing and Licensing Agreement

In furtherance of the proposed transactions with IOWC, on December 31, 2005, the Company entered into the Marketing and Licensing Agreement (the **M&L Agreement**) with IOWC and Mr. Code.

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

Pursuant to the M&L Agreement, the Company's newly formed subsidiary, BioLargo Life Technologies, Inc. (BLTI), acquired certain rights to develop, market, sell and distribute products that were developed, and were then in development, by IOWC relating to the BioLargo technology.

Licenses Granted to BLTI. Pursuant to the terms of the M&L Agreement, IOWC granted to BLTI a license, with respect to the BioLargo technology, to further develop the technology, to further develop existing and new products based on that technology, and to produce, market, sell and distribute any such products, through its own means, or by contract or assignment to third parties or otherwise, including without limitation:

Technology Development Rights. Exclusive worldwide rights to expand and improve upon the existing BioLargo technology, to conduct research and development activities based on the BioLargo technology, and to contract with third parties for such research and development activities; and any improvements on the BioLargo technology, or any new technology resulting such efforts of BLTI, shall be owned solely by BLTI.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Product Development Rights. Exclusive worldwide rights to expand and improve upon the existing products incorporating the BioLargo technology, to conduct research and development activities to create new products for market, and to contract with third parties for such research and development activities. Any new products created by BLTI resulting from these efforts shall be owned solely by BLTI.

Marketing Rights. Exclusive right to market, advertise, and promote the BioLargo technology in any market and in any manner it deems commercially reasonable.

Manufacturing Rights. A transferable, worldwide exclusive right to manufacture, or have manufactured, products incorporating the BioLargo technology.

Selling Rights. A transferable, worldwide exclusive right to sell BioLargo technology and products incorporating the BioLargo technology.

Distribution Rights. A transferable, worldwide exclusive right to inventory and distribute products incorporating the BioLargo technology.

Licensing Rights. A transferable, worldwide exclusive right to license the BioLargo technology to third parties.

Assigned Agreements. Pursuant to the terms of the M&L Agreement, IOWC and Mr. Code also assigned to BLTI its rights and obligations with respect to the following Agreements (collectively, the Assigned Agreements):

Agreement dated October 15, 2004 by and between Kenneth R. Code, IOWC, BioLargo Technologies, Inc., or IOWC's assigns, and Craig Sundheimer and Lloyd M. Jarvis (the Sundheimer Agreement);

Agreement dated January 15, 2005 by and between Kenneth R. Code, IOWC and Food Industry Technologies, Inc.; and

Letter of Intent dated November 15, 2004 by and between Kenneth R. Code and IOWC and GTS Research, Inc. Pursuant to the terms of the M&L Agreement, the Company is entitled to receive any and all royalties, payments, license fees, and other consideration generated by the Assigned Agreements as of January 1, 2006. As part of the assignment, IOWC agreed to transfer the 20% interest it acquired in BioLargo, LLC pursuant to the Sundheimer Agreement. In October 2006, the Company terminated the Sundheimer Agreement, for cause. See also Note 9. Subsequently, the Company and IOWC agreed that IOWC's 20% interest in BioLargo, LLC would not be transferred by IOWC to BLTI, but that BLTI would have the option to acquire such 20% interest for nominal consideration for seven years (the Option Agreement).

Consulting Agreement

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

On June 20, 2006, the Company entered into a Consulting Agreement with Mr. Code (the Consulting Agreement). Pursuant to the Consulting Agreement, the Company engaged the services of Mr. Code, effective January 1, 2006, to advise the Company in research and development and technical support, and to provide other services and assistance to the Company in matters relating to the BioLargo technology and the rights acquired by the Company in the M&L Agreement.

The Consulting Agreement contained provisions requiring Mr. Code to devote substantially all of his business time to the Company; prohibiting Mr. Code from directly or indirectly engaging in any business activity that would be competitive with the business of the Company or its affiliates, including BLTI; providing that during the term of the Consulting Agreement and for one year post-termination, Mr. Code will not solicit the Company's employees or customers; and other standard provisions typical for a consulting agreement. The Consulting Agreement also provided that the Company retains the exclusive right to use or distribute all creations which may be created during the term of the Consulting Agreement. The Consulting Agreement, as amended on December 20, 2006 and as of March 30, 2007, terminated when the Company entered into an Employment Agreement with Mr. Code on April 30, 2007. During the term of the Consulting Agreement, Mr. Code was paid \$15,400 per month, prorated for partial months, and was entitled to reimbursement for authorized business expenses incurred in the performance of his duties.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Research and Development Agreement

On August 11, 2006, the Company and BLTI entered into a Research and Development Agreement with IOWC and Mr. Code (the "R&D Agreement"), which agreement was amended on August 14, 2006. Pursuant to the R&D Agreement, IOWC and Mr. Code agreed to provide research and development services and expertise in the field of disposable absorbent products to the Company.

The R&D Agreement provides that the Company will own, and will have the exclusive right to commercially exploit, the intellectual property developed, created, generated, contributed to or reduced to practice pursuant to the R&D Agreement. In addition, IOWC and Mr. Code have agreed that during the term of the R&D Agreement and for one year after termination they will not compete with, and will not provide services to any person or entity which competes with, any aspect of the Company's business.

During the term of the R&D Agreement, but only after mutually acceptable research facilities are established for the performance of IOWC's services (as of this date, no acceptable research facilities have been established), IOWC shall be paid (i) a fee of \$5,500 per month for each month during which no services are being performed pursuant to the R&D Agreement to offset for laboratory and/or office and IOWC employee expenses and (ii) such additional amounts as the parties may agree in connection with specific research projects conducted pursuant to the R&D Agreement.

As further consideration to Mr. Code to enter into the R&D Agreement, on August 14, 2006 the Company issued to Mr. Code 620,637 shares of its common stock, as adjusted to reflect the Reverse Split (the "Code Stock"), or approximately 19.9% of the Company's then issued and outstanding common stock immediately following the issuance of the Code Stock.

In connection with the completion of the acquisition of the BioLargo technology in April 2007, the M&L Agreement, Consulting Agreement, and R&D Agreement were terminated. No payments were made to IOWC in connection with this R&D Agreement.

Acquisition of the BioLargo Technology

On April 30, 2007, the Company completed the acquisition of the BioLargo technology. The following summary of the Asset Purchase Agreement dated April 30, 2007 between the Company, IOWC and Mr. Code (the "Asset Purchase Agreement") is qualified in its entirety by reference to the complete terms and conditions contained in the Asset Purchase Agreement itself.

Acquisition of Assets; Purchase Price. Pursuant to the terms of the Asset Purchase Agreement, Mr. Code and IOWC sold, transferred and assigned to the Company all of their rights, title and interests to:

United States Patent Number 6,146,725, relating to an absorbent composition to be used in the transport of specimens of bodily fluids; and United States Patent Number 6,328,929, relating to method of delivering disinfectant in an absorbent substrate; and related patent applications and national filings;

all proprietary knowledge, trade secrets, confidential information, computer software and licenses, formulae, designs and drawings, quality control data, processes (whether secret or not), methods, inventions and other similar know-how or rights relating to or arising out of the patents;

all license and distribution agreements to which either Mr. Code or IOWC is presently a party; and

certain records,
in exchange for 22,139,012 shares of the Company's common stock (the IOWC Shares). Mr. Code and certain other co-inventors of intellectual property had previously assigned all of their right title and interest to six patent applications filed with the United States Patent and Trademark Office and two additional patent applications filed under the International Patent Cooperation Treaty. The R&D Agreement, and the Consulting Agreement were terminated concurrent with the closing of the Asset Purchase Agreement. The IOWC Shares were issued to IOWC at the Closing. Such shares constitute full payment for the obligations of the Company owed to Mr. Code and IOWC for the license rights, assigned agreements, patents and related intellectual property acquired by the Company from Mr. Code and IOWC.

The Company evaluated the transferred set of activities, assets, inputs, outputs and processes acquired from IOWC and determined that the acquisition did not constitute a business. The fair value of the purchase price was calculated by using the weighted average of the daily closing price of the Company's common stock from the date of the letter of intent until the closing of the acquisition multiplied by the number of shares issued to IOWC, resulting in a fair value of \$11,733,676. The Company allocated this amount into identifiable intangible assets, consisting of licensing rights in the amount of \$11,336,571 and an assigned agreement in the amount of \$397,105.

Representations and Warranties. As part of the Asset Purchase Agreement, Mr. Code and IOWC, jointly and severally, have made certain representations and warranties to the Company with respect to, among other things:

good, valid and marketable title to the assets being sold free and clear of any and all material liens and encumbrances;

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

absence of the need for third party consents;

further assurances to take action to vest good title in the name of the Company

sufficiency of the assets for the future conduct of business by the Company;

intellectual property matters;

the absence of litigation and proceedings;

compliance with laws; and

limitations on the resale of the IOWC Shares in accordance with securities laws

The Asset Purchase Agreement also contains additional representations and warranties of Mr. Code and/or IOWC, and of the Company, standard for asset purchase transactions required to be publicly disclosed by reporting companies.

The representations and warranties of the parties contained in the Asset Purchase Agreement will survive for four years after the closing at which time they will expire.

Indemnification. Under the Asset Purchase Agreement, IOWC and Mr. Code have agreed, jointly and severally, to indemnify the Company and each of its officers, directors, employees, agents and affiliates, and each of their successors and assigns from and against any and all costs, losses, claims, liabilities, fines, penalties, consequential damages (other than lost profits), and expenses (including interest which may be imposed in connection therewith and court costs and reasonable fees and disbursements of counsel) incurred in connection with, arising out of, resulting from or incident to:

liabilities or claims arising out of the assets or the business of IOWC before the closing;

liabilities or claims after the closing relating to IOWC or Mr. Code;

breach of the representations or warranties made by IOWC or Mr. Code;

default in any agreements made by IOWC or Mr. Code;

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

taxes of any kind that arise out of or result from the transactions contemplated by the Asset Purchase Agreement; and

liabilities or claims relating to employee matters.

The Company has agreed to indemnify IOWC and Mr. Code and IOWC's officers, directors, employees, agents and affiliates, and each of their successors and assigns from and against any and all costs, losses, claims, liabilities, fines, penalties, consequential damages (other than lost profits), and expenses (including interest which may be imposed in connection therewith and court costs and reasonable fees and disbursements of counsel) incurred in connection with, arising out of, resulting from or incident to:

breach of the representations and warranties made by the Company; and

default in any agreement made by the Company.

The Asset Purchase Agreement provides the mechanism by which the parties must notify each other of any claims, the methods for resolution of such and requires the parties to arbitrate any unresolved claims.

Miscellaneous. The Asset Purchase Agreement also contains customary provisions relating to governing law, assignment of rights and obligations, attorneys' fees, force majeure and other matters standard for asset purchase transactions.

Code Employment Agreement

As part of the completion of the acquisition of the BioLargo technology, the Company entered into an employment agreement dated April 30, 2007 with Mr. Code (the "Code Employment Agreement"). The consulting agreement with Mr. Code dated June 20, 2006 as amended as of December 20, 2006 and as of March 30, 2007 was terminated when the Company entered into the employment agreement with Mr. Code.

The Code Employment Agreement provides that Mr. Code will serve as the Chief Technology Officer of the Company, and receive (i) base compensation of \$184,800 annually (with an automatic 10% annual increase); and (ii) a bonus in such amount as the Compensation Committee of the Board of Directors of the Company (the "Compensation Committee") may determine from time to time. In addition, Mr. Code will be eligible to participate in incentive plans, stock option plans, and similar arrangements as

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

determined by the Company's Board of Directors. When such benefits are made available to the senior employees of the Company, Mr. Code is also eligible to receive health insurance premium payments for himself and his immediate family, a car allowance of \$800 per month, paid vacation of four weeks per year plus an additional two weeks per year for each full year of service during the term of the agreement up to a maximum of ten weeks per year, life insurance equal to three times his base salary and disability insurance. The Code Employment Agreement has a term of five years, unless earlier terminated in accordance with its terms.

The Code Employment Agreement also provides that Mr. Code's employment may be terminated by the Company due to disability, for cause or without cause. Disability as used in the Employment Agreement means physical or mental incapacity or illness rendering Mr. Code unable to perform his duties on a long-term basis (i) as evidenced by his failure or inability to perform his duties for a total of 120 days in any 360 day period, or (ii) as determined by an independent and licensed physician whom Company selects, or (iii) as determined without recourse by the Company's disability insurance carrier.

If Mr. Code's employment is terminated for cause he will be eligible to receive his accrued base compensation and vacation compensation through the date of termination. If Mr. Code's employment is terminated without cause, then he will be eligible to receive the greater of (i) one year's compensation plus an additional one half year for each year of service since the effective date of the employment agreement or (ii) one year's compensation plus an additional one half year for each year remaining in the term of the agreement.

The Code Employment Agreement requires Mr. Code to keep certain information confidential, not to solicit customers or employees of the Company or interfere with any business relationship of the Company, and to assign all inventions made or created during the term of the Code Employment Agreement as work made for hire.

In connection with the closing of the acquisition of the BioLargo technology and the execution of the Code Employment Agreement, Mr. Code was also elected to the Board of both BioLargo and BLTI.

Calvert Employment Agreement

In connection with the acquisition of the BioLargo technology, the Company also entered into a new employment agreement dated April 30, 2007 with Dennis Calvert, the Company's President and Chief Executive Officer (the Calvert Employment Agreement). The previous employment agreement with Mr. Calvert, dated December 11, 2002, was terminated.

The Calvert Employment Agreement provides that Mr. Calvert will serve as the President and Chief Executive Officer of the Company, and receive (i) base compensation of \$184,800 annually (with an automatic 10% annual increase); and (ii) a bonus in such amount as the Compensation Committee may determine from time to time. In addition, Mr. Calvert will be eligible to participate in incentive plans, stock option plans, and similar arrangements as determined by the Company's Board of Directors. When such benefits are made available to the senior employees of the Company, Mr. Calvert is also eligible to receive health insurance premium payments for himself and his immediate family, a car allowance of \$800 per month, paid vacation of four weeks per year plus an additional two weeks per year for each full year of service during the term of the agreement up to a maximum of ten weeks per year, life insurance equal to three times his base salary and disability insurance.

The Calvert Employment Agreement provides that Mr. Calvert will be granted an option (the Option) to purchase 7,733,259 shares of the Company's common stock. The Option shall be a non-qualified stock option, shall be exercisable at \$0.18 per share, shall be exercisable for ten years from the date of grant and shall vest over time as follows:

| | |
|--|-----------|
| First anniversary of the date of this Agreement | 2,577,753 |
| Second anniversary of the date of this Agreement | 2,577,753 |
| Third anniversary of the date of this Agreement | 2,577,753 |

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

Notwithstanding the foregoing, any portion of the Option which has not yet vested shall be immediately vested in the event of, and prior to, a change of control, as defined in the Calvert Employment Agreement. Consistent with the foregoing, the precise terms and conditions of the agreement evidencing the Option to be entered into between the Company and Mr. Calvert shall be as determined by the Board of Directors and/or the Compensation Committee.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The Calvert Employment Agreement has a term of five years, unless earlier terminated in accordance with its terms. The Calvert Employment Agreement provides that Mr. Calvert's employment may be terminated by the Company due to disability, for cause or without cause. Disability as used in the Calvert Employment Agreement means physical or mental incapacity or illness rendering Mr. Calvert unable to perform his duties on a long-term basis (i) as evidenced by his failure or inability to perform his duties for a total of 120 days in any 360 day period, or (ii) as determined by an independent and licensed physician whom Company selects, or (iii) as determined without recourse by the Company's disability insurance carrier. If Mr. Calvert's employment is terminated for cause he will be eligible to receive his accrued base compensation and vacation compensation through the date of termination. If Mr. Calvert's employment is terminated without cause, then he will be eligible to receive the greater of (i) one year's compensation plus an additional one half year for each year of service since the effective date of the employment agreement or (ii) one year's compensation plus an additional one half year for each year remaining in the term of the agreement.

The Calvert Employment Agreement requires Mr. Calvert to keep certain information confidential, not to solicit customers or employees of the Company or interfere with any business relationship of the Company, and to assign all inventions made or created during the term of the Calvert Employment Agreement as work made for hire.

Change in Control; Election of Mr. Code as Director

The acquisition of the BioLargo technology resulted in a change of control of the Company. In connection with the completion of the acquisition of the BioLargo technology, the Company issued 22,139,012 shares of its common stock, as adjusted for the Reverse Split, to IOWC (the IOWC Shares). IOWC is controlled by Mr. Code. The IOWC Shares, together with 620,637 shares of common stock, as adjusted for the Reverse Split, previously issued to Mr. Code under the Consulting Agreement, constitute approximately 57.8% of the Company's issued and outstanding stock as of April 30, 2007.

Under Delaware law, Mr. Code has the power to elect each of the members of our Board of Directors. Mr. Code also has the power to control the outcome of most matters requiring stockholder approval. In connection with the completion of the acquisition of the BioLargo technology on April 30, 2007, Mr. Code was elected as a director of the Company. Additionally, the Code Employment Agreement provides that during the term of the Code Employment Agreement the Company shall cause to have Mr. Code nominated for election as a director to serve on the Board of Directors. Mr. Code also serves as the Company's Chief Technology Officer, which is an executive officer position.

Mr. Code is the founder and principal stockholder of IOWC, a company which is engaged in the research and development of advanced disinfection technology and substantially all of whose assets the Company purchased in April 2007. From December 2000 to the present, Mr. Code has been President of IOWC. From December 2000 through October 2003, Mr. Code also served as a director and Vice Chairman of BioLargo Technologies Inc., where he was engaged in pre-commercial efforts to seat inorganic disinfection technologies into the non-woven air-laid industry. Mr. Code has authored several publications concerning, and has filed several patent applications applying, disinfection technology. Mr. Code graduated from the University of Calgary, Alberta, Canada.

The Board of the Directors of the Company has determined that Mr. Code is not independent as defined under NASDAQ Marketplace rules. Mr. Code does not serve on any committees of the Board.

Note 3. Sale of Unregistered Securities

The Company has raised money pursuant to several private offerings of its securities, the details of which are provided below.

Spring 2007 Offering

Pursuant to a private offering that commenced in May 2007 (the Spring 2007 Offering) and which is continuing as of the date of this Report, the Company is offering up to \$1,000,000 of its convertible notes (the Spring 2007 Notes), which are due and payable on June 30, 2009. Interest accrues at 10% compounding annually and is payable at the Company's option, in cash or stock at an initial conversion rate of \$0.70 per share.

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

Purchasers of the Spring 2007 Notes received, for no additional consideration, stock purchase warrants (the Spring 2007 Warrants) entitling the holder to purchase a number of shares of Company s Common Stock equal to the number of shares of Common Stock into which the principal amount of the investor s Spring 2007 Note is convertible. The Spring 2007 Warrants are exercisable at \$1.30 per share and will expire on June 30, 2010.

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

The Spring 2007 Notes are convertible into shares of the Company's common stock at an initial conversion price of \$0.70 per share. The Spring 2007 Notes can be converted voluntarily by the noteholders at any time. The Spring 2007 Notes can be converted mandatorily by the Company (i) on or after September 30, 2007, if the Company has received one or more written firm commitments, or has closed on one or more transactions, or a combination of the foregoing, of at least \$3 million gross proceeds of equity or debt; or (ii) on the Maturity Date. Accordingly, under such circumstances, the Spring 2007 Notes may be repaid in cash on the Maturity Date or may be converted, at the sole option of the Company, into shares of the Company's common stock, on the Maturity Date.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

From the inception of the offering on May 31, 2007, through June 30, 2007, the Company received gross and net proceeds of \$97,000 from six investors and issued Spring 2007 Notes which allow conversion into an aggregate of 138,574 shares of the Company's common stock, and Spring 2007 Warrants exercisable into an aggregate of 138,574 shares of the Company's common stock. Since July 1, 2007, the Company has raised additional funds through this offering. (See Note 10.)

The Spring 2007 Notes have not been converted and remain outstanding, and they are recorded on the balance sheet as Long-Term Liabilities.

Fall 2006 Offering

In September 2006, the Company commenced a private offering that terminated in April 2007 (the Fall 2006 Offering). The Company sold an aggregate \$1,000,000 principal amount of its promissory notes (the Fall 2006 Notes) due and payable September 13, 2008 to 43 investors, convertible into 1,454,546 shares of the Company's common stock. Of this amount, the Company sold an aggregate \$484,000 principal amount of Fall 2006 Notes as of December 31, 2006; an aggregate \$324,000 principal amount of Fall 2006 Notes during the three-month period ended March 31, 2007; and an aggregate \$192,000 principal amount of Fall 2006 Notes during the three-month period ended June 30, 2007. Each Fall 2006 Offering Note bears interest at a rate of 10% per annum, such interest to be paid, at the Company's option, in cash or stock at an initial conversion rate of \$0.6875 per share. Purchasers of the Fall 2006 Notes received, for no additional consideration, a stock purchase warrant (the Fall 2006 Warrant) entitling the holder to purchase a number of shares of the Company's common stock into which the principal amount of the investor's Fall 2006 Note is convertible. The Fall 2006 Warrant is exercisable at an initial price of \$1.25 per share, and will expire on September 13, 2009.

The Fall 2006 Notes may be subordinated in an amount up to \$5 million of additional debt financing that the Company may incur prior to the Maturity Date. The Fall 2006 Notes are convertible into shares of the Company's common stock at an initial conversion price of \$0.6875 per share. The Fall 2006 Notes can be converted voluntarily by the noteholders at any time prior to the Maturity Date. The Fall 2006 Notes can be converted mandatorily by the Company (i) on or after September 13, 2007, if the Company has received one or more written firm commitments, or has closed on one or more transactions, or a combination of the foregoing, of at least \$3 million gross proceeds of equity or debt; or (ii) on the Maturity Date. Accordingly, under such circumstances, the Fall 2006 Notes may be repaid in cash on the Maturity Date or may be converted, at the sole option of the Company, into shares of the Company's common stock, on the Maturity Date.

The Fall 2006 Notes have not been converted and remain outstanding, and are recorded on the balance sheet as Long-Term Liabilities.

2005 First Offering

In January 2005, pursuant to a private offering that commenced in October 2004 and terminated in January 2005 (the First Offering), the Company received gross and net proceeds of \$25,000 from an outside investor and issued its convertible promissory note (the First Offering Note) due and payable one year from the date of issuance. The First Offering Note bears interest at a rate of 10% per annum, payable on the maturity date. The First Offering Note can be converted, in whole or in part, into shares of the Company's Series A Preferred stock, at an exercise price of \$0.10 per share, as adjusted to reflect the Reverse Split, at any time prior to maturity by either the Company or the lender. Each share of Series A Preferred Stock may be converted by the holder into one share of the Company's common stock. If the noteholder converts the First Offering Note into Series A Preferred Stock, on or after the note's original maturity date the noteholder may require the Company to buy back the shares of Series A Preferred Stock for 110% of the principal amount of the note (the Buy Back Provision). If the Company is unable to do so, the Company's president, Dennis Calvert, has agreed to buy back the shares on the same terms. If shares of Series A Preferred Stock are converted into common stock, the holder has the right to include (piggyback) the shares of common stock in a registration of securities filed by the Company, other than on Form S-4 or Form S-8.

On March 21, 2007, the Company converted a First Offering Note in the aggregate amount of \$30,710, which consisted of \$25,000 aggregate principal amount and \$5,710 of accrued but unpaid interest, with a conversion price of \$0.10 per share, into an aggregate of 307,102 shares of the Company's common stock.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

2005 Second Offering

During 2005, pursuant to a private offering that commenced in January 2005 and terminated in August 2005 (the Second Offering), the Company received gross proceeds of \$731,120 and net proceeds of \$710,870 from 26 outside investors and issued its convertible promissory note (the Second Offering Note) due and payable one year from the date of issuance. The Second Offering Note bears interest at a rate of 10% per annum, payable on the maturity date. The Second Offering Note can be converted, in whole or in part, into 3,177,589 shares of the Company's common stock, at an exercise price ranging from \$0.10 to \$0.40 per share, as adjusted to reflect the Reverse Split, at any time prior to maturity by either the Company or the holder. The holder has the right to include (piggyback) the shares of common stock in a registration of securities filed by the Company, other than on Form S-4 or Form S-8.

On March 21, 2007, the Company converted \$850,550 in Second Offering Notes, which included \$731,120 aggregate principal amount and \$119,430 of accrued but unpaid interest, with various maturity dates and with various conversion prices, into an aggregate of 4,120,720 shares of the Company's common stock.

2005 Third Offering

Pursuant to another private offering, which commenced in September 2005 and terminated in February 2006, on December 31, 2005, the Company sold an aggregate amount of \$299,500 of its promissory notes (the Third Offering Notes) due and payable January 31, 2007 to twelve individual investors. Each Third Offering Note bears interest at a rate of 10% per annum, and can be converted, in whole or in part, into shares of the common stock of the Company at an initial exercise price of \$0.625 per share, as adjusted to reflect the Reverse Split. Purchasers of the Third Offering Notes also received, for no additional consideration, a warrant (the Third Offering Warrant) entitling the holder to purchase a number of shares of the Company's common stock equal to the number of shares of common stock into which the principal amount of the investor's Third Offering Note is convertible. The Third Offering Warrant is exercisable at an initial exercise price of \$1.25 per share, as adjusted to reflect the Reverse Split, and expires on January 31, 2008. The Company sold additional notes under this offering subsequent to December 31, 2005.

On March 6, 2006, the Company issued additional notes from its private 2005 Third Offering, in the aggregate principal amount of \$802,500, due and payable January 31, 2007, to 44 individual investors. Of this amount \$777,500 gross and net proceeds were received in 2006, and the balance had been received in 2005.

On March 21, 2007, the Company converted an aggregate principal amount of \$1,102,000 of Third Offering Notes and \$117,931 of accrued but unpaid interest into an aggregate of 1,951,922 shares of the Company's common stock, at a conversion price of \$0.625 per share.

The Company recorded an additional non-cash interest expense of \$895,014 related to the conversion of an aggregate principle amount of \$1,953,120 in note payable obligations, because the conversion common stock price set forth in these notes was less than the market price of the Company's common stock on the date of conversion.

All of these offerings and sales were made in reliance on the exemption from registration contained in Section 4(2) of the Securities Exchange Act and/or Regulation D promulgated thereunder as not involving a public offering of securities.

Note 4. Warrants

During the six-month period ended June 30, 2007, the Company issued warrants in conjunction with its sale of unregistered securities which allow for the purchase of an aggregate 884,143 shares of the Company's common stock.

To determine interest expense related to its outstanding warrants, the fair value of each award grant is estimated on the date of grant using the Black-Scholes option-pricing model and the calculated value is amortized over the life of the warrant. The principal assumptions we used in

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

applying the option-pricing models were as follows:

| | December 31, 2006 | June 30, 2007 |
|-------------------------|------------------------------|--------------------------|
| Risk free interest rate | 4.93% | 4.52% |
| Expected volatility | 280% | 276 - 310% |
| Expected dividend yield | | |
| Forfeiture rate | | |
| Expected life in years | 1.00 | 1.25 1.5 |

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

The risk-free interest rate is based on U.S Treasury yields in effect at the time of grant. Expected volatilities are based on historical volatility of our common stock. The expected term is presumed to be the mid-point between the vesting date and the end of the contractual term.

The aggregate fair value of the warrants issued and outstanding as of June 30, 2007 totaled \$700,884, net of accumulated amortization of \$433,316, which is recorded on the Company's balance sheet as prepaid interest related to our convertible notes. The Company recorded an aggregate of \$118,675 and \$219,316 of interest expense related to the amortization of the prepaid interest related to our convertible notes in the three- and six-month period ended June 30, 2007 and \$0 interest expense in the three- and six-month period ended June 30, 2006.

The Company had certain warrants outstanding to purchase its common stock, at various prices, as described in the following table:

| | Number of Shares | Price Range |
|-------------------------------------|------------------------|--------------------|
| Outstanding as of December 31, 2006 | 3,046,878 | \$ 0.125 to \$5.00 |
| Issued | 884,143 | \$ 1.25 to \$1.30 |
| Expired | | |
| Exercised | | |
| | | |
| Outstanding as of June 30, 2007 | 3,931,021 | \$ 0.125 to \$5.00 |

During 2006, the Company issued warrants to purchase 1,988,000 shares of the Company's common stock to investors as part of two private offerings. In connection with the 2005 Third Offering, the Company issued warrants to purchase 1,284,000 shares of the Company's common stock to 44 investors. The warrants allow for the holder to purchase shares of the Company's common stock at an exercise price of \$1.25 per share, and expire January 31, 2008. In connection with the Fall 2006 Offering the Company issued warrants to purchase 704,000 shares of the Company's common stock to 21 investors. The warrants allow for the holders to purchase shares of the Company's common stock at an exercise price of \$1.25 per share, and expire on September 13, 2009.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 5. Intangible Assets/Long-lived Assets

Our intangible assets consist of the licensing rights and an assigned agreement which were acquired in the April 30, 2007 from IOWC. (See Note 2)

Licensing rights are stated on the balance sheet net of accumulated amortization of \$170,352 as of June 30, 2007. Amortization expense for the six month periods ended June 30, 2007 was \$170,352. At June 30, 2007 the weighted average remaining amortization period for the Licensing rights was approximately 11 years.

The assigned agreement is stated on the balance sheet net of accumulated amortization of \$14,182 at June 30, 2007. Amortization expense for the six month period ended June 30, 2007 was \$14,182. At June 30, 2007 the assigned agreement has a remaining amortization period of 4.5 years, which is the remaining contractual life of the acquired assigned agreement.

Note 6. Accounts Payable and Accrued Expenses

Accounts Payable and Accrued Expenses included the following:

| | December 31, 2006 | June 30, 2007 |
|----------------------------|----------------------|------------------|
| Accounts payable | \$ 32,305 | \$ |
| Accrued expense | 746,963 | 303,233 |
| Accrued interest | 923,472 | 424,669 |
| Officer payable | 337,736 | 36,653 |
| Board of Director payable | 270,963 | 36,500 |
| Total Accrued Expenses | \$ 2,311,500 | \$ 801,055 |

With respect to Accrued Expense, on March 21, 2007 the Company converted \$704,296 related to consulting services, which were converted into 1,803,615 shares of the Company's common stock, at prices agreed upon with each consultant ranging between \$0.25 to \$0.625 per share. An expense totaling \$199,666 was recorded in the six-month period ended June 30, 2007 as the conversion common stock price was less than the market price of the Company's common stock at the date of conversion.

With respect to Accrued Interest, on March 21, 2007 the Company converted \$246,124 related to Accrued Interest from the Company's note obligations, which were converted into an aggregate of 866,854 shares of the Company's common stock, at a price range of \$0.10 - \$0.625 per share under the terms of the note obligations. The accrued interest as of June 30, 2007, includes \$380,658 of accrued and unpaid interest related to a note held by New Millennium Capital Partners, LLC (New Millennium), which was not included in the conversion of the principal and which balance will remain outstanding and will not accrue additional interest (see Note 7). The remaining accrued interest relates to the outstanding convertible promissory notes.

With respect to Officer and Board of Director Payable, on March 15, 2007, the Company converted \$608,759 of Officer and Board of Director payables to five of its current or former officers and directors into 1,623,359 shares of the Company's common stock at \$0.375 per share, the closing price of a share of the Company's common stock on the March 15, 2007 conversion date various conversion rates.

Note 7. Augustine Loan

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

On April 11, 2007, Augustine II, LLC (Augustine Fund) converted an aggregate \$717,138, which consists of \$420,000 in principal and \$297,138 of accrued but unpaid interest of a convertible note, as amended (Augustine Note) into 2,031,553 shares of the Company s common stock. The Augustine Note had a maturity date of May 1, 2007. The Augustine Note provided for a conversion price equal to the last bid price of the five trading days preceding the date of conversion, or \$0.353 per share. The Augustine Note and the loan agreement in respect of the Augustine Note limited the Augustine Fund to hold not more than 4.9% of the Company s issued and outstanding common stock at any given time. In connection with the conversion of the Augustine Note, the Company waived this limitation.

Note 8. Related Party Transactions

In March 2003, New Millennium purchased from a third party (i) a \$1,120,000 promissory note (New Millennium Note) assumed by the Company pursuant to a licensing transaction in October 2002, and (ii) 167,285 shares of the Company s common stock, as adjusted to reflect the Reverse Split. In exchange, New Millennium issued a \$900,000 promissory note to the third party, secured by the 167,285 shares of the Company s common stock.

On April 28, 2006, the Company and New Millennium agreed to amend the terms of the New Millennium Note to (i) extend the due date to January 15, 2008; (ii) waive any payments of interest until it becomes due; (iii) reduce the principal amount from \$1,120,000 to \$900,000, equal to a 19.6% reduction; and (iv) correspondingly reduce the accrued but unpaid interest due under the terms of the note from \$317,956 to \$255,636, also equal to a 19.6% reduction.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

On April 13, 2007, New Millennium converted the \$900,000 principal amount of the New Millennium Note into 1,636,364 shares of the Company's common stock. The New Millennium Note was converted at a price of \$0.55 per share, which was the last bid price on the date of conversion. New Millennium is controlled by Dennis Calvert, the Company's President and Chief Executive Officer. Accrued but unpaid interest in the amount of \$380,658 as of the conversion date of April 13, 2007 remains outstanding on the New Millennium Note, which amount is not due to be paid until January 15, 2008. No additional interest will be accrued on this obligation.

Note 9. Other Loans

In February 2005, the Company amended its obligations to Dr. James Seay under its promissory note dated November 20, 2003 in the principal amount of \$50,000 and which matured on February 18, 2004. On the maturity date of the note, the Company was obligated to pay Dr. Seay \$65,000. The Company paid Dr. Seay \$30,000 and the balance of \$35,000 remained outstanding. The amendment to the note entered into on February 10, 2005, (i) extends the maturity date of the note to February 3, 2006, (ii) provides for interest to accrue at a rate of 10% per annum (15% upon default), and (iii) allows for the conversion of the note into 280,000 shares of the Company's common stock, or \$0.125 per share, as adjusted to reflect the Reverse Split. In February 2006, this note was further extended to the sooner of June 30, 2006, or the date the Company's stockholders approve an amendment to the Company's certificate of incorporation increasing the number of authorized shares of common stock. This was approved on March 15, 2007 and, accordingly, on March 29, 2007, the Company converted the principal amount of the note, plus accrued and unpaid interest in the amount of \$6,588, into 332,704 shares of common stock at a share price of \$0.125 per share.

On November 1, 2004 the Company converted \$25,000 of obligations owed to a former provider of professional services into a promissory note, which amount accrues interest at 5% per annum. As of June 30, 2007 the principal amount of the note, together with \$3,853 in accrued but unpaid interest, had not been repaid. Subsequent to the end of the quarter ended June 30, 2007, the Company and the noteholder agreed to extend the maturity date of the note to June 30, 2008, that the Company would make monthly amortized payments, and to increase the interest rate from five to six percent per annum. The parties have not yet documented this agreement. As of the date of filing of this Reports, the Company has not yet made the first installment payment under the amended agreement.

During 2004, the Company raised \$60,000 pursuant to a private offering and issued convertible promissory notes due and payable one year from the date of issuance. The maturity date of the notes were subsequently extended. As of December 31, 2006, the principal amount of the notes, together with \$11,284 in accrued but unpaid interest, had not been repaid. On March 29, 2007, the principal amount of these notes, along with \$12,512 in accrued and unpaid interest, were converted into 580,095 shares of the Company's common stock.

Note 10. Stock-Based Compensation and Other Employee Benefit Plans

We recognize compensation expense for stock option awards on a straight-line basis over the applicable service period of the award, which is the vesting period. Share-based compensation expense is based on the grant date fair value estimated in accordance with the provisions of SFAS 123R, using the Black-Scholes Option Pricing Model. The following methodology and assumptions were used to calculate share based compensation for the six month period June 30, 2007:

| | June 30, 2007 |
|-------------------------|--------------------------|
| Risk free interest rate | 4.50% |
| Expected volatility | 310% |
| Expected dividend yield | |
| Forfeiture rate | |
| Expected life in years | 7 |

Expected price volatility is the measure by which our stock price is expected to fluctuate during the expect term of an option. Expected volatility is derived from the historical daily change in the market price of our common stock, as we believe that historical volatility is the best indicator of

future volatility.

Following the guidance of Staff Accounting Bulletin No. 107, we follow the shortcut method to determine the expected term of plain vanilla options issued to employees and Directors. The expected term is presumed to be the mid-point between the vesting date and the end of the contractual term.

The risk-free interest rate used in the Black-Scholes calculation is based on the prevailing U.S Treasury yield as determined by the U.S. Federal Reserve. We have never paid any cash dividends on our common stock and do not anticipate paying cash dividends on our common stock in the foreseeable future.

Stock-based compensation expense recognized in the consolidated statements of operations is based on awards ultimately expected to vest, reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant, and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Historically, we have not had significant forfeitures of unvested stock options granted to employees and Directors. A significant number of our stock option grants are fully vested at issuance or have short vesting provisions. Therefore, we have estimated the forfeiture rate of our outstanding stock options as zero.

As of June 30, 2007, the Company had issued and outstanding a non-qualified option to Dennis Calvert, CEO, to purchase 7,733,259 shares of the Company's common stock at \$0.18 per share which were issued on April 30, 2007. This option vests over three years in equal amounts on the anniversary date. The option expires 10 years from the date of issuance. The fair value of this option was \$2,861,306 and for the three- and six-month period ended June 30, 2007 we recognized \$158,961 of compensation expense and \$0 for the three- and six-month period ended June 30, 2006.

Note 11. Subsequent Events

Shares Issued for Consulting Services

On July 16, 2007 the Company converted an aggregate \$194,660 of accrued payables to thirteen of its current or former consultants into an aggregate of 299,477 shares of the Company's common stock at \$0.65 per share. The conversion was for services performed in 2007.

Sales of Unregistered Securities

From July 1, 2007, through August 27, 2007 the Company received gross and net proceeds of \$122,000 from two investors and issued Spring 2007 Notes, which allow conversion into an aggregate 177,143 shares of the common stock, and Spring 2007 Warrants exercisable into 177,143 shares of the Company's common stock. For details of the terms and conditions of the Spring 2007 Offering, see Note 3.

The offerings and the sales of securities pursuant to the Spring 2007 Offering and the conversions described above are being made in reliance on the exemption from registration contained in Section 4(2) of the Securities Act of 1933 and/or Regulation D promulgated thereunder as not involving a public offering of securities.

Table of Contents

BIOLARGO, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Settlement Agreement

On July 10, 2007, the Company entered into a settlement agreement (Settlement Agreement) with Craig Sundheimer and Lloyd Jarvis (collectively, Sundheimer) with respect to the prior termination of their license agreement with IOWC, assigned to the Company pursuant to the Asset Purchase Agreement by and between the Company and IOWC. (See Note 2.)

The Settlement Agreement requires Sundheimer to pay \$18,125 to the Company upon its execution. This payment was received and will be recorded as other income in July 2007. In addition to the initial payment, the Settlement Agreement requires Sundheimer pay to the Company 10% percent of sales by Sundheimer from the sale of super-absorbent pads and other related products to Blood Systems Inc., and of all sales from January 1, 2006 through December 31, 2011. Sundheimer made the first payment for sales to Blood Systems, Inc. for sales through July 10, 2007. This additional payment, in the amount of \$19,832, was received in July 2007, and will be recorded as other income in July 2007.

Table of Contents

Item 2. Management's Discussion and Analysis

This Quarterly Report on Form 10-QSB of BioLargo, Inc. (the Company) contains forward-looking statements. These forward-looking statements include predictions regarding, among other things:

our business plan;

the commercial viability of our technology and products incorporating our technology;

the effects of competitive factors on our technology and products incorporating our technology;

expenses we will incur in operating our business;

our liquidity and sufficiency of existing cash;

the success of our financing plans; and

the outcome of pending or threatened litigation.

You can identify these and other forward-looking statements by the use of words such as may, will, expects, anticipates, believes, estimate, continues, or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

Such statements, which include statements concerning future revenue sources and concentrations, selling, general and administrative expenses, research and development expenses, capital resources, additional financings and additional losses, are subject to risks and uncertainties, including, but not limited to, those discussed elsewhere in this Form 10-QSB, that could cause actual results to differ materially from those projected.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under the heading Risk Factors in our Annual Report on Form 10-KSB, as amended, for the year ended December 31, 2006. Unless otherwise expressly stated herein, all statements, including forward-looking statements, set forth in this Form 10-QSB are as of June 30, 2007, unless expressly stated otherwise, and we undertake no duty to update this information.

As used in this Report, the terms we, us, our and Company refers to BioLargo, Inc., and its wholly-owned subsidiaries, BioLargo Life Technologies, Inc., a California corporation, which is sometimes referred to separately as BLTI, and NuWay Sports, LLC, a California limited liability company.

General Note

On March 15, 2007, our stockholders approved, and effective as of the close of business on March 21, 2007, we completed a 1-for-25 reverse split of our common stock (the Reverse Split).

Additionally, on March 15, 2007, our stockholders approved, and we have filed, an amendment to our certificate of incorporation increasing our authorized capital stock to 200,000,000 shares of common stock and 50,000,000 shares of preferred stock. Unless specifically stated otherwise, all references in this Report to our common stock are stated on a post-Reverse Split basis.

Introduction

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

By leveraging our suite of patented and patent-pending intellectual property, which we refer to as the BioLargo technology, our business strategy is to harness and deliver nature's best disinfectant - iodine - in a safe, efficient, environmentally sensitive and cost-effective manner. Our BioLargo technology works by combining minerals with water from any source and delivering molecular iodine on demand, in controlled dosages, in order to balance efficacy of disinfectant performance with concerns about toxicity. When our BioLargo technology is incorporated in absorbent products, they also experience increased holding power and may experience increased absorption.

Our BioLargo technology creates a value-added proposition to existing products and can be used to create new products. Our BioLargo technology can be incorporated into absorbents, washes and sprays, and into various products and applications across multiple industry verticals. Our BioLargo technology has the potential to replace other disinfectants such as chlorines and bromines, which may be harmful to the environment. Our business model is to license our BioLargo technology to others, rather than to manufacture our own products.

We have been engaged in the research and product development of the BioLargo technology since July 2005, when we entered into a letter of intent with the inventor of the BioLargo technology, Kenneth Reay Code, who is now a director, our Chief Technology Officer and our principal stockholder. Between December 2006 and April 2007, we operated under a Marketing and Licensing Agreement with Mr. Code and a company he controls, IOWC Technologies, Inc. (IOWC). On April 30, 2007, we completed the acquisition of the BioLargo technology from IOWC.

Table of Contents

Our current focus is to develop opportunities to license our BioLargo technology to others in various vertical markets. We do not currently intend to manufacture our own products, although we will contract with others to manufacture the chemicals and minerals that comprise the BioLargo technology. See *Plan of Operations* below.

We had no continuing business operations until the completion of the acquisition of the BioLargo technology on April 30, 2007, and operated as a public shell prior to such date.

Plan of Operation

Overview

We intend to focus our efforts primarily on the further research and development, and the licensing of the BioLargo technology. We may also develop certain products incorporating the BioLargo technology ourselves, on a more limited basis, for use in certain applications and industries.

Commercialization of the BioLargo Technology

We plan to pursue our primary revenues from licensing the BioLargo technology. Subject to adequate financing, we may also produce some of our own products, although we do not presently intend to do so. Subject to regulatory compliance where applicable, the BioLargo technology is presently available for incorporation into certain products, including absorbent pads and materials to be used for clean up of or as a precautionary measure from spills of liquids, including hazardous materials. We are actively working with manufacturers, other technology developers and potential customers to develop additional products for distribution.

Our current business plan calls for us to license our BioLargo technology to others for incorporation into existing and newly-created products across numerous industry verticals. Currently, we do not intend to manufacture our own products. We intend to work with manufacturers on a contract-for-hire basis, or on a project by project basis with the potential for these manufacturers to create a product supplier relationship for potential licensees of products incorporating the BioLargo technology. These collaborative efforts will focus on design and specifications for production of pre-commercial samples of products and for actual commercial products. However, while we have been engaged in extensive negotiations with numerous potential licensees and other users of products incorporating the BioLargo technology, there are no such agreements in place to date and therefore we cannot forecast when we will first generate revenues, if at all.

We intend to pursue commercial opportunities in both the United States and Europe initially.

Sales and Marketing

We intend to devote a significant part of our resources to sales and marketing of the BioLargo technology to potential licensees. This is a continuation of the initial efforts we undertook during 2006. While specific efforts will vary based on market conditions and opportunities that present themselves from time to time, the following discussion of recent efforts is indicative of the types of efforts we expect to undertake on an ongoing basis. Our sales and marketing efforts are subject to obtaining adequate third-party financing, for which no commitments are yet in place.

In April 2006, we engaged Robert Stewart, Ph.D., to serve as our regulatory specialist for required activities involving the Environmental Protection Agency (EPA) and the Federal Drug Administration. During this period, we also focused on establishing relationships with key agents who work on a commission basis to assist us in marketing to large corporations and other organizations. In May 2006, we hired a consultant to assist us on our marketing and sales efforts.

From February through April 2006, we began discussions with five major research universities to further our research for specific applications. These various discussions are ongoing and focus on engaging those universities to perform research on the BioLargo technology for soil and sand remediation, animal studies, United States Department of Defense applications, and embedded anti-microbial applications in textiles. In September 2006, we hired UCLA to research applications of the BioLargo technology for beach and soil remediation. An initial report regarding this research was presented in October 2006 at the National Beaches Conference sponsored by the EPA.

Throughout 2006, we engaged in various efforts to continue testing, developing and pre-marketing products incorporating the BioLargo technology. For example, in January 2006, we contracted with a third party manufacturer to produce samples for presentation purposes of absorbent pads. We also engaged a particle, formulations, blending and specialty manufacturing company to work with us in product development and sample fabrication. In June 2006, we hired a third-party laboratory to perform a series of independent test and issue their reports to assist us in validating the BioLargo technology to a Good Laboratory Practice standard.

Table of Contents

Throughout 2006, we also were actively involved in initial marketing activities for the BioLargo technology. For example, in February 2006, we presented the BioLargo technology to a number of major corporations for potential licensing discussions. Following an April 2006 international conference of industry for infection control in Prague, Czech Republic, attended by Mr. Code, we pursued with Mr. Code presentations to one of the largest companies in the embedded anti-microbial industry. In June 2006, we began discussions with a number of large healthcare companies about incorporating the BioLargo technology in their products. The potential areas of focus include wound dressings, drapes, wipes, bandages, diapers disinfecting and sterilization solutions, among other possible uses in their various products.

Also in June 2006, we participated in a conference for all government agencies throughout California and have since discussed the BioLargo technology for possible governmental use in sewage spills, water quality, rainwater runoff contamination problems and beach clean-up efforts. Also in June 2006, we participated in a national military defense conference sponsored by the National Defense Industry Association for all military services, including the Department of Homeland Security, and have since discussed the BioLargo technology for possible application in the areas of military hospitals, pandemic prevention, agricultural protection, hazardous waste, food protection, decontamination of porous and non-porous materials, disaster relief and national world class laboratory access. Subsequently, we have presented the BioLargo technology with other governmental officials and agencies. In September 2006, we attended a national Agro Terrorism Conference sponsored by the Federal Bureau of Investigation and the Joint Terrorism Task Force.

During 2007, we entered into negotiations regarding testing and product development with several leading companies in their field, which negotiations are ongoing.

Meetings are continuing with numerous potential licensees or purchasers or other users of products incorporating the BioLargo technology in a range of applications. A number of prospective licensees are engaged in materials and product testing efforts, as well as discussions with us about product designs and various uses of the BioLargo technology. However, it is essential to note that we do not yet have any agreements in place with any of these potential licensees, purchasers or other users, or any other potential licensees, purchasers or other users, regarding any products incorporating the BioLargo technology, and no assurance can be given if any such efforts will prove successful or result in commercialization of the BioLargo technology.

Because of the global implications of the BioLargo technology, we intend to augment our U.S. operations with an operational and marketing presence in the EU, subject to obtaining adequate funding, which we are actively seeking but for which no commitment has yet been obtained.

As of the date of filing this Report, none of the sales and marketing efforts discussed above has generated any revenue, there are no agreements in place and therefore we cannot forecast when we will first generate revenues, if at all.

Research and Development, Intellectual Property Protection and Third-Party Testing

We currently anticipate that research and development costs over the next 12 months could range significantly, between \$300,000 and \$1,000,000, and will be subject to third-party financing which we will require in order to execute our business plan. Although we are actively pursuing such financing, no such commitment is in place at present. We would invest any such funds primarily on continued testing of the BioLargo technology in certain applications and the development of additional production methods for use of the BioLargo technology.

In connection with the closing of the acquisition of the BioLargo technology in April 2007, we obtained full rights, title and interest to two U.S. patents previously owned by Mr. Code and IOWC. Mr. Code, IOWC and co-inventors of certain intellectual property had previously assigned to us six United States Patent and Trademark Office (USPTO) patent applications and two additional International Patent Cooperation Treaty (PCT) patent applications. We intend to continue to expand and enhance our suite of intellectual property through ongoing focus on product development, new intellectual property development and patent applications, and further third-party testing and validations for specific areas of focus for commercial exploitation. We currently anticipate that additional patent applications will be filed during the next 12 months with the USPTO and the PCT, and we are uncertain of the cost of such patent filings, as it will depend upon the number of such applications prepared and filed. The prosecution of patents and ongoing maintenance and defense of patents is expensive and will require substantial ongoing capital resources. However we cannot give any assurance that adequate capital will be available or will be available, if at all, on favorable terms.

Table of Contents

Ongoing research and development, and third-party testing, is a critical part of our business plan. These efforts can be time consuming and some of these efforts are costly, requiring adequate capital resources to continue such efforts. However we cannot give any assurance that adequate capital will be available or will be available, if at all, on favorable terms.

Results of Operations Comparison of the three-month period ended June 30, 2007 and 2006

Revenue

We had no revenues from operations during the three- and six-month periods ended June 30, 2007 and June 30, 2006.

Selling, General and Administrative Expense

Selling, general and administrative expenses were \$842,000 and \$1,461,000 for the three- and six-month periods ended June 30, 2007, respectively, compared to \$207,000 and \$550,000 for the three- and six-month periods ended June 30, 2006, respectively. The largest components of these expenses were:

a. Salaries and Payroll-related Expenses: These expenses were \$246,000 and \$302,000 for the three- and six-month periods ended June 30, 2007, compared to \$46,000 and \$92,000 for the three- and six-month periods ended June 30, 2006, an increase of \$200,000 and \$210,000, respectively. The increase is primarily attributable to stock option compensation expense and to an increase in the salary related to Dennis Calvert, our President and Chief Executive Officer, per his employment agreement, salary related to Mr. Provenzano, our Secretary, and salary related to Mr. Code per his employment agreement which became effective April 30, 2007.

b. Consulting Expenses: These expenses were \$102,000 and \$242,000 for the three- and six-month periods ended June 30, 2007, compared \$86,000 and \$219,000 for the three- and six-month periods ended June 30, 2006, an increase of \$16,000 and \$23,000, respectively. Our utilization of consultants is consistent with executing our business plan to commercialize the BioLargo technology; to provide applications of the BioLargo technology for potential licensees or other customers in various vertical markets; with advising us in various respects regarding the BioLargo business and opportunities; further product development and design; financial, valuation and marketing services; licensing, initial marketing and pre-sale research and activities; and various other consulting services.

c. Professional Fees: These expenses were \$223,000 and \$511,000 for the three- and six-month periods ended June 30, 2007, compared to \$36,000 and \$150,000 for the three- and six-month periods ended June 30, 2006, an increase of \$187,000 and \$361,000, respectively. The increase is primarily attributable to an increase in (i) our need for legal work related to the BioLargo technology, including the multiple patent applications, as well as obtaining stockholder approvals and preparing for the closing of the transactions with IOWC and Mr. Code; (ii) investment banking fees; (iii) accounting fees; and (iv) audit services.

d. Other Expense: These expenses were \$194,000 and \$200,000 for the three and six-month periods ended June 30, 2007, compared to \$0 and \$0 for the three- and six-month periods ended June 30, 2006. These expenses were the result of converting Account Payables and Accrued Expenses, because the conversion common stock price was less than the market price of our common stock on the date of conversion.

Interest expense

Interest expense totaled \$142,000 and \$1,195,000 for the three and six-month period ended June 30, 2007, compared to \$32,000 and \$119,000 for the three and six-month period ended June 30, 2006, an increase of \$111,000 and \$1,076,000, respectively. This increase is attributed difference in conversion price to the stock price at the date of grant for certain promissory note conversions and to the amortization of the value of warrants issued in conjunction with our convertible notes and additional accrued interest related to the outstanding convertible notes.

Research and Development

Research and development expenses were \$24,000 and \$42,000 for the three- and six-month periods ended June 30, 2007, as compared to \$63,000 and \$83,000 for the three- and six-month periods ended June 30, 2006. Our level of research and product development is consistent with our plan to provide applications of the BioLargo technology for potential licensees or other customers in various vertical markets.

Net Loss

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

Net loss for the three- and six-month periods ended June 30, 2007 was \$1,159,000 and \$2,850,000, or a loss of \$0.04 and \$0.16 per share, respectively. Comparatively, for the three- and six-month periods ended June 30, 2006, net loss was \$92,000 and \$533,000, or a loss of \$0.04 and \$0.22 per share, respectively.

Liquidity and Capital Resources

We have been, and we will be, limited in terms of our capital resources. Cash and cash equivalents totaled \$84,327 at June 30, 2007. We had no revenues in the six-month period ended June 30, 2007 and were forced to use cash from financing activities to fund operations. Our cash position is insufficient to meet our continuing anticipated expenses or fund anticipated operating expenses. Accordingly, we will be required to raise additional capital to sustain operations and implement our post-acquisition business plan.

Table of Contents

The financial statements accompanying this Report have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. As reflected in the accompanying financial statements, we had a net loss of \$2,849,900 for the six-month period ended June 30, 2007, negative cash flow from operating activities of \$758,007 for the six-month period ended June 30, 2007, and a stockholders' deficit of \$32,603,793 as of June 30, 2007. The foregoing factors raise substantial doubt about our ability to continue as a going concern. Ultimately, our ability to continue as a going concern is dependent upon our ability to attract new sources of capital, attain a reasonable threshold of operating efficiencies and achieve profitable operations by commercializing products incorporating the BioLargo technology. Our financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

In order to meet operating expenses and other financial obligations, we have been forced to use cash on hand to fund our operations. We have also continued to sell convertible promissory notes to investors. During the six-month period ended June 30, 2007, we raised \$613,000 gross and net proceeds. Of this amount \$516,000 was included in the Fall 2006 private offering which terminated on April 25, 2007. The remaining \$97,000 was included in the Spring 2007 private offering. As described below, the notes issued in our 2005 offerings were converted into shares of our common stock in March 2007. (See Part II, Item 2, Unregistered Sales of Equity Securities and Use of Proceeds, and Item 5, Other Information.) The Fall 2006 and Spring 2007 Notes remain outstanding.

As of June 30, 2007, we had outstanding approximately \$1,567,769 aggregate principal amount, together with accrued and unpaid interest, with respect to various promissory notes; and approximately \$376,387 aggregate amount of payables owed to directors, an officer and consultants.

Recently, we have taken significant steps to reduce our financial obligations. Following stockholder approval on March 15, 2007 for the recapitalization of our stock and the Reverse Split, we converted an aggregate principal amount of \$1,953,120 and aggregate accrued but unpaid interest in the amount of \$282,156, in respect of convertible notes held by 92 investors. These notes had various maturity dates and provided for various conversion prices ranging from \$0.10 to \$0.625 per share and were converted into an aggregate 6,985,441 shares of our common stock. We also converted an aggregate \$608,759 of accrued payables to five of our current or former officers and directors into an aggregate 1,623,359 shares of our common stock. These conversions were effected at \$0.375 per share, the closing price of a share of our common stock on the March 15, 2007 conversion date.

We also converted an aggregate \$740,296 of accrued payables to 18 of our current or former consultants into an aggregate 1,803,615 shares of our common stock, as adjusted to reflect the Reverse Split. These conversions were effected at various previously agreed upon prices ranging from \$0.20 to \$0.625 per share, as adjusted to reflect the Reverse Split.

On April 11, 2007, Augustine II, LLC (Augustine Fund) converted an aggregate \$717,138 of principal and accrued but unpaid interest on a convertible promissory note (Augustine Note) into 2,031,553 shares of our common stock. The Augustine Note had a maturity date of May 1, 2007. The Augustine Note provided for a conversion price equal to the last bid price of the five trading days preceding the date of conversion, or \$0.353 per share. The Augustine Note and the loan agreement in respect of the Augustine Note limited the Augustine Fund to hold not more than 4.9% of our issued and outstanding common stock at any given time. In connection with the conversion of the Augustine Note, we waived this limitation.

On April 13, 2007, the board of directors and New Millennium Capital Partners, LLC, (New Millennium), an entity owned and controlled by our President, Mr. Calvert, agreed to convert the principal amount of a \$900,000 promissory note (the New Millennium Note) held by New Millennium into 1,636,364 shares of our common stock. The New Millennium Note had a maturity date of January 15, 2008, and was converted at a price of \$0.55 per share, which was the last bid price on the date of conversion. New Millennium is controlled by Dennis Calvert, our President and Chief Executive Officer. As of April 13, 2007, accrued but unpaid interest in the amount of \$380,658 remains outstanding on the New Millennium Note. No additional interest will accrue on this outstanding balance.

As a result of the foregoing transactions, as of June 30, 2007, we converted an aggregate \$5,201,469 of obligations, consisting primarily of principal amount of notes, accrued and unpaid interest, salaries, fees and payables, into an aggregate 14,080,332 shares of our common stock. Of the \$5,201,469 in obligations converted, \$153,054 related to obligations incurred 2007, and the remaining \$5,048,415 related to obligations incurred prior to December 31, 2006.

Table of Contents

Subsequent to the end of the quarter ended June 30, 2007, on July 16, 2007, we converted an aggregate \$194,660 of accrued payables to 13 of our current or former consultants into an aggregate 299,477 shares of our common stock, at \$0.65 per share, which was the last bid price on the date of conversion. The payables are for services performed in 2007.

In order to meet our continuing obligations, we will be required to raise substantial additional capital to sustain our expanded operations following the acquisition of the BioLargo technology, including without limitation, hiring additional personnel, additional scientific and third-party testing, costs associated with obtaining regulatory approvals and filing additional patent applications to protect our intellectual property, as well as to meet our liabilities as they become due for the next 12 months, including the Fall 2006 Notes when they mature in 2008, unless we convert the Fall 2006 Notes, which we may do at our option, into shares of our common stock.

Accordingly, we commenced a private offering on May 31, 2007 (the Spring 2007 Offering), pursuant to which we are offering up to \$1,000,000 of our convertible notes (the Spring 2007 Notes), which are due and payable on June 30, 2009. Interest on the Spring 2007 Notes accrues at 10% compounding annually and is payable at our option, in cash or stock at an initial conversion rate of \$0.70 per share. Purchasers of the Spring 2007 Notes receive, for no additional consideration, stock purchase warrants (the Spring 2007 Warrants) entitling the holder to purchase a number of shares of our common stock equal to the number of shares of Common Stock into which the principal amount of the investor's Spring 2007 Note is convertible. The Spring 2007 Offering is continuing as of the date of the filing of this Report.

From May 31, 2007 through August 27, 2007, we received gross and net proceeds of \$221,000 from eight investors and issued Spring 2007 Notes which allow conversion into an aggregate of 315,717 shares of our common stock and Warrants exercisable for 315,717 shares of our common stock. Of these amounts, during the three-month period ended June 30, 2007 we received gross and net proceeds of \$97,000 from six investors and issued Spring 2007 Notes which allow conversion into an aggregate of 138,572 shares of our common stock and Warrants exercisable into an aggregate of 138,572 shares of our common stock.

In addition, we are actively pursuing numerous alternatives to secure funds for our current and longer-term financial requirements, including additional raises of capital from investors in the form of convertible debt or equity. Negotiations are underway with various sources of such capital. There can be no assurance that we will be able to raise any additional capital. It is also unlikely that we will be able to qualify for bank debt until such time as our operations are considerably more advanced and we are able to demonstrate the financial strength to provide confidence for a lender, which we do not currently believe is likely to occur in the foreseeable future.

Significant Debt Obligations

Significant debt obligations at June 30, 2007 included:

- (i) Fall 2006 Notes and Spring 2007 Notes totaling \$1,096,950;
- (ii) \$25,000 remaining principal amount of a promissory note, together with accrued and unpaid interest in the amount of \$3,853, relating to professional fees;
- (iii) approximately \$21,151 outstanding remaining on a settlement agreement with former convertible debenture holders, which amount remains outstanding;
- (iv) \$380,658 of interest due to New Millennium pursuant to the agreement to convert the New Millennium Note.

For the six-month period ended June 30, 2007, there was \$44,011 of accrued and unpaid interest recorded related to these obligations.

Augustine Fund Note

On June 10, 2003 we entered into a Term Loan Agreement (Loan Agreement) with the Augustine Fund, pursuant to which the Augustine Fund agreed to lend us \$420,000, payable in installments of \$250,000, \$100,000, and \$70,000 (the Augustine Loan). We used the proceeds of the Augustine Loan for working capital.

Principal and interest, at an annual rate of 10%, of the Augustine Loan, was originally due on February 29, 2004. In addition, the Loan Agreement contains certain requirements that we make mandatory prepayments of the Augustine Loan from the proceeds of any asset sales outside of the ordinary course of business, and, on a quarterly basis, from positive cash flow. In addition, we may prepay all or any portion of the Augustine Loan at any time without premium or penalty.

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

As additional consideration for making the Augustine Loan, the Augustine Fund received five-year warrants to purchase up to 246,336 shares of our common stock at an exercise price of \$4.00 per share, as both amounts are adjusted to reflect the Reverse Split. We could require that the warrants be exercised if certain conditions were satisfied. Since these conditions were not fully satisfied by

Table of Contents

the maturity date, the Loan Agreement provides that the Augustine Fund may, at any time following the maturity date and so long as the warrants remain exercisable, elect to exercise all or any portion of the warrants pursuant to a cashless exercise, whereby the Augustine Fund would be issued the net amount of shares of our common stock, taking into consideration the difference between the exercise price of the warrants and the fair market value of our common stock at the time of exercise, without having to pay anything to us for such exercise.

As security for the Augustine Loan, New Millennium pledged 100,000 shares of our common stock, as adjusted to reflect the Reverse Split, owned by New Millennium, and, in addition, we have granted the Augustine Fund a security interest in our 51% membership ownership interest in our now inactive wholly-owned subsidiary, NuWay Sports, LLC.

Prior to the original maturity date of the Augustine Loan, we spoke with representatives of the Augustine Fund and advised them that we were unable to pay the amount due under the Augustine Loan by the February 29, 2004 maturity date. On March 30, 2004, the Augustine Fund agreed to extend the maturity date of the Loan Agreement to August 2004. In addition to the extension of the maturity date, the Augustine Fund was given the option of having the Augustine Loan satisfied in cash or by the conversion of any remaining principal balance and any accrued interest on the Augustine Loan to shares of our common stock at a 15% discount to market, so long as Augustine Fund's holdings do not exceed 4.9% of the total issued and outstanding shares of our common stock at any time. In addition, the warrants held by the Augustine Fund to purchase 246,336 shares of our common stock were re-priced to an exercise price of \$0.875 per share, as adjusted to reflect the Reverse Split. Exercise of the warrants is also subject to the limit that the Augustine Fund does not hold more than 4.9% of the issued and outstanding shares of our common stock. On March 7, 2005, we agreed to extend the maturity date of the Augustine Loan to May 2006, in exchange for the issuance of a warrant that gives the Augustine Fund the right to purchase 320,000 shares of our common stock at \$0.125 per share for a period of five years, as both amounts are adjusted to reflect the Reverse Split. On July 29, 2005, we finalized the terms of this amendment to the Augustine Loan and executed formal documentation, in which the parties agreed to further extend the maturity date to May 2006.

On October 18, 2006, we agreed to extend the maturity date of the Augustine Loan to May 1, 2007. Accordingly, as of March 31, 2007, the principal amount of the loan, together with approximately \$294,042 in accrued but unpaid interest, had not been repaid.

On April 11, 2007, the Augustine Fund converted an aggregate \$717,138 of principal and accrued but unpaid interest on the Augustine Note into 2,031,553 shares of our common stock. The Augustine Note had a maturity date of May 1, 2007. The Augustine Note provided for a conversion price equal to the last bid price of the five trading days preceding the date of conversion, or \$0.353 per share. The Augustine Note and the loan agreement in respect of the Augustine Note limited the Augustine Fund to hold not more than 4.9% of our issued and outstanding common stock at any given time. In connection with the conversion of the Augustine Note, we waived this limitation.

Obligation to New Millennium

In March 2003, New Millennium purchased from a third party (i) a \$1,120,000 promissory note we had assumed pursuant to a licensing transaction in October 2002, and (ii) 167,285 shares of our common stock, as adjusted to reflect the Reverse Split. In exchange, New Millennium issued a \$900,000 promissory note to the third party, secured by the 167,285 shares of our common stock, as adjusted to reflect the Reverse Split.

On April 28, 2006, New Millennium agreed to amend the terms of the \$1,120,000 promissory note to (i) extend the due date to January 15, 2008; (ii) waive any payments of interest until it becomes due; (iii) reduce the principal amount from \$1,120,000 to \$900,000, equal to a 19.6% reduction; and (iv) correspondingly reduce the accrued but unpaid interest due under the terms of the note from \$317,956 to \$255,636, also equal to a 19.6% reduction.

On April 13, 2007, we agreed to convert the \$900,000 principal amount of the New Millennium Note into 1,636,364 shares of our common stock, at a price of \$0.55 per share, which was the last bid price on the date of conversion. Accrued but unpaid interest in the amount of \$380,658 as of the conversion date of April 13, 2007 remains outstanding on the New Millennium Note, which amount is not due to be paid until January 15, 2008. No additional interest will accrue on this obligation.

Obligation to Dennis Calvert

On March 15, 2007, the board of directors and Mr. Calvert agreed to convert unpaid accrued compensation due Mr. Calvert for periods prior to January 1, 2007, in the amount of \$337,796, into 900,790 shares of common stock at a price of \$0.375 per share, which was the last bid price on the date of conversion. Since January 1, 2007, Mr. Calvert has been paid his monthly salary per his employment agreement.

Table of Contents***Obligation to Dr. Seay***

In February 2005, we amended our obligations to Dr. James Seay under our promissory note dated November 20, 2003 in the principal amount of \$50,000 and which matured on February 18, 2004. On the maturity date of the note, we were obligated to pay Dr. Seay \$65,000. We paid Dr. Seay \$30,000 and the balance of \$35,000 remained outstanding. The amendment to the note entered into on February 10, 2005, (i) extended the maturity date of the note to February 3, 2006, (ii) provided for interest to accrue at a rate of 10% per annum (15% upon default), and (iii) allowed for the conversion of the note into 280,000 shares of our common stock, or \$.012 per share, as adjusted to reflect the Reverse Split. In February 2006, this note was further extended to the sooner of June 30, 2006, or the date our stockholders approve an amendment to our certificate of incorporation increasing the number of authorized shares of common stock. This was approved on March 15, 2007 and, accordingly, on March 29, 2007, we converted the principal amount of the note, plus accrued and unpaid interest in the amount of \$6,588, into 332,704 shares of common stock.

Obligation Relating to Professional Fees

On November 1, 2004 the Company converted \$25,000 of obligations owed to a former provider of professional services into a promissory note, which amount accrues interest at 5% per annum. As of June 30, 2007 the principal amount of the note, together with \$3,853 in accrued but unpaid interest, had not been repaid. Subsequent to the end of the quarter ended June 30, 2007, the Company and the noteholder agreed to extend the maturity date of the note to June 30, 2008, that the Company would make monthly amortized payments, and to increase the interest rate from five to six percent per annum. The parties have not yet documented this agreement. As of the date of filing of this Reports, the Company has not yet made the first installment payment under the amended agreement.

Critical Accounting Policies

Our discussion and analysis of our results of operations and liquidity and capital resources are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, valuation of intangible assets and investments, and share-based payments. We base our estimates on anticipated results and trends and on various other assumptions that we believe are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results that differ from our estimates could have a significant adverse effect on our operating results and financial position. We believe that the following significant accounting policies and assumptions may involve a higher degree of judgment and complexity than others.

The methods, estimates and judgments we use in applying these most critical accounting policies have a significant impact on the results of our reports in our financial statements.

We anticipate that any generated revenue will principally be derived from royalties and license fees from our intellectual property. Licensees typically pay a license fee in one or more installments and ongoing royalties based on their sales of products incorporating or using our licensed intellectual property. License fees are recognized over the estimated period of future benefit to the average licensee.

We have established a policy relative to the methodology to determine the value assigned to each intangible acquired with or licensed by us and/or services or products received for non-cash consideration of our common stock. The value is based on the market price of our common stock issued as consideration, at the date of the agreement of each transaction or when the service is rendered or product is received, as adjusted for applicable discounts.

It is our policy to expense share based payments as of the date of grant in accordance with Financial Accounting Statements Board Statement number 123R Share-Based Payment. Application of this pronouncement requires significant judgment regarding the assumptions used in the selected option pricing model, including stock price volatility and employee exercise behavior. Most of these inputs are either highly dependent on the current economic environment at the date of grant or forward-looking expectations projected over the expected term of the award. As a result, the actual impact of adoption on future earnings could differ significantly from our current estimate.

Recent Accounting Pronouncements

In June 2006, FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) which defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by

Table of Contents

the taxing authority. A tax position that meets the more-likely-than-not criterion shall be measured at the largest amount of benefit that is more than 50% likely of being realized upon ultimate settlement. FIN 48 applies to all tax positions accounted for under SFAS No. 109, Accounting for Income Taxes. Interpretation No. 48 is effective for fiscal years beginning after December 15, 2006. Upon adoption, the financial statements will be adjusted to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any adjustment will be recorded directly to our beginning retained earnings balance in the period of adoption and reported as a change in accounting principle. We do not expect the adoption of Interpretation No. 48 will have a material effect on our consolidated financial statements.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective beginning in October 2008. We are currently evaluating the impact of adopting this standard.

In September 2006, the SEC issued Staff Accounting Bulletin no. 108 (SAB 108) to clarify consideration of the effects of prior year errors when quantifying misstatements in current year financial statements for the purpose of quantifying materiality. SAB 108 requires issuers to quantify misstatements using both the rollover and iron curtain approaches and requires an adjustment to the current year financial statements in the event that after the application of either approach and consideration of all relevant quantitative and qualitative factors, a misstatement is determined to be material. SAB 108 is effective for fiscal years beginning after November 15, 2006. We do not expect the adoption of SAB 108 will have a material effect on our consolidated financial statements.

Other recent accounting pronouncements issued by FASB (including its Emerging Issued Task Force), the American Institute of Certified Public Accountants and the SEC did not or are not believed by management to have a material impact on our present or future consolidated financial statements.

Item 3. Controls and Procedures

(a) Evaluation of disclosure controls and procedures. Our management evaluated, with the participation of Dennis Calvert, who serves as both our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-QSB. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

(b) Changes in internal control over financial reporting: There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-QSB that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II

Item 1. Legal Proceedings

We are party to various other claims, legal actions and complaints arising periodically in the ordinary course of business. In the opinion of management, no such matters will have a material adverse effect on our financial position or results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In September 2006, we commenced a private offering that terminated in April 2007 (the Fall 2006 Offering), in which we sold an aggregate \$1,000,000 principal amount of our promissory notes (the Fall 2006 Notes) due and payable September 13, 2008 to 43 investors, convertible into 1,454,546 shares of the Company's common stock. Of this amount, we sold an aggregate \$484,000 principal amount of Fall 2006 Notes as of December 31, 2006; an aggregate \$324,000 principal amount of Fall 2006 Notes during the three-month period ended March 31, 2007; and an aggregate \$192,000 principal amount of Fall 2006 Notes during the three-month period ended June 30, 2007. Each Fall 2006 Offering Note bears interest at a rate of 10% per annum, such interest to be paid, at our option, in cash or stock at an initial conversion rate of \$0.6875 per share. Purchasers of the Fall 2006 Notes received, for no additional consideration, a stock purchase warrant (the Fall 2006 Warrant) entitling the holder to purchase a number of shares of our common stock into which the principal amount of the investor's Fall 2006 Note is convertible. The Fall 2006 Warrant is exercisable at an initial price of \$1.25 per share, and will expire on September 13, 2009.

On March 15, 2007, the board of directors and Mr. Calvert agreed to convert unpaid accrued compensation due Mr. Calvert for periods prior to January 1, 2007, in the amount of \$337,796, into 900,790 shares of our common stock at a price of \$0.375 per share, which was the last bid price on the date of conversion.

On March 21, 2007 we converted an aggregate principal amount of \$1,953,120 and aggregate accrued but unpaid interest in the amount of \$282,156, in respect of convertible notes held by 92 investors. These notes had various maturity dates and provided for various conversion prices ranging from \$0.10 to \$0.625 per share and were converted into an aggregate 6,985,441 shares of our common stock. We also converted an aggregate \$608,759 of accrued payables to five current or former officers and directors into an aggregate 1,623,359 shares of our common stock. These conversions were effected at \$0.375 per share, the closing price of a share of our common stock on the March 15, 2007 conversion date.

On March 29, 2007, we converted a note held by a former consultant in the outstanding principal amount of \$35,000, plus accrued and unpaid interest in the amount of \$6,588, into 332,704 shares of our common stock.

We also converted an aggregate \$740,296 of accrued payables to 18 of our current or former consultants into an aggregate 1,803,615 shares of our common stock. These conversions were effected at various prices ranging from \$0.20 to \$0.625 per share.

Pursuant to a private offering that commenced on May 31, 2007 (the Spring 2007 Offering) and which is continuing as of the date of the filing of this Report, we are offering up to \$1,000,000 of our convertible notes (the Spring 2007 Notes), which are due and payable on June 30, 2009. Interest accrues at 10% compounding annually and is payable at our option, in cash or stock at an initial conversion rate of \$0.70 per share. Purchasers of the Spring 2007 Notes receive, for no additional consideration, stock purchase warrants (the Spring 2007 Warrants) entitling the holder to purchase a number of shares of Company's Common Stock equal to the number of shares of Common Stock into which the principal amount of the investor's Spring 2007 Note is convertible. The Spring 2007 Warrants are exercisable at \$1.30 per share and will expire on June 30, 2010.

The Spring 2007 Notes are convertible into shares of the Company's common stock at an initial conversion price of \$0.70 per share, and can be converted voluntarily by the noteholders at any time. We can elect to convert the Spring 2007 Notes (i) on or after September 30, 2007, if we have received one or more written firm commitments, or have closed on one or more transactions, or a combination of the foregoing, of at least \$3 million gross proceeds of equity or debt; or (ii) on the Maturity Date. Accordingly, on the maturity date, we may repay the Spring 2007 Notes in cash or choose to convert the notes, at our sole option, into shares of our common stock.

From the inception of the offering through June 30, 2007, the Company received gross and net proceeds of \$97,000 from six investors and issued Spring 2007 Notes the principle amount of which would allow conversion into an aggregate of 138,574 shares of our common stock, and Spring 2007 Warrants exercisable into an aggregate of 138,574 shares of our common stock.

Table of Contents

All of these offerings and sales were made in reliance on the exemption from registration contained in Section 4(2) of the Securities Exchange Act and/or Regulation D promulgated thereunder as not involving a public offering of securities.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

As we have previously reported in our filings with the SEC, on April 30, 2007, we completed the acquisition of the BioLargo technology. Pursuant to the terms of the Asset Purchase Agreement dated as of April 30, 2007 (the "Asset Purchase Agreement"), Mr. Code and IOWC sold, transferred and assigned to us all of their rights, title and interests to:

United States Patent Number 6,146,725, relating to an absorbent composition to be used in the transport of specimens of bodily fluids; and United States Patent Number 6,328,929, relating to method of delivering disinfectant in an absorbent substrate; and related patent applications and national filings;

all proprietary knowledge, trade secrets, confidential information, computer software and licenses, formulae, designs and drawings, quality control data, processes (whether secret or not), methods, inventions and other similar know-how or rights relating to or arising out of the patents;

all license and distribution agreements to which either Mr. Code or IOWC is presently a party; and

certain records,

in exchange for 22,139,012 shares of our common stock (the "IOWC Shares"). Mr. Code and certain other co-inventors of intellectual property had previously assigned all of their right title and interest to six patent applications filed with the United States Patent and Trademark Office and two additional patent applications filed under the International Patent Cooperation Treaty. The IOWC Shares were issued to IOWC at the Closing. Such shares constitute full payment for our obligations owed to Mr. Code and IOWC for the license rights, assigned agreements, patents and related intellectual property.

As part of the completion of the acquisition of the BioLargo technology, we entered into an employment agreement dated as of April 30, 2007 with Mr. Code (the "Code Employment Agreement"). The Code Employment Agreement provides that Mr. Code will serve as our Chief Technology Officer, and receive (i) base compensation of \$184,000 annually (with an automatic 10% annual increase); and (ii) a bonus in such amount as the compensation committee of our board of directors (the "Compensation Committee") may determine from time to time. In addition, Mr. Code will be eligible to participate in incentive plans, stock option plans, and similar arrangements as determined by our board of directors. When such benefits are made available to our senior employees, Mr. Code is also eligible to receive health insurance premium payments for himself and his immediate family, a car allowance of \$800 per month, paid vacation of four weeks per year plus an additional two weeks per year for each full year of service during the term of the agreement up to a maximum of ten weeks per year, life insurance equal to three times his base salary and disability insurance.

The Code Employment Agreement has a term of five years, unless earlier terminated in accordance with its terms. In connection with the closing of the acquisition of the BioLargo technology and the execution of the Code Employment Agreement, Mr. Code was also elected to the board of

Edgar Filing: BIOLARGO, INC. - Form 10QSB/A

both BioLargo and BLTI.

In connection with the acquisition of the BioLargo technology, we also entered into a new employment agreement dated as of April 30, 2007 with Dennis Calvert, our President and Chief Executive Officer (the Calvert Employment Agreement). The previous employment agreement with Mr. Calvert, dated December 11, 2002, was terminated.

The Calvert Employment Agreement provides that Mr. Calvert will serve as our President and Chief Executive Officer, and receive (i) base compensation of \$184,000 annually (with an automatic 10% annual increase); and (ii) a bonus in such amount as the Compensation Committee may determine from time to time. In addition, Mr. Calvert will be eligible to participate in incentive plans, stock option plans, and similar arrangements as determined by our Board of Directors. When such benefits are made available to our senior employees, Mr. Calvert is also eligible to receive health insurance premium payments for himself and his immediate family, a car allowance of \$800 per month, paid vacation of four weeks per year plus an additional two weeks per year for each full year of service during the term of the agreement up to a maximum of ten weeks per year, life insurance equal to three times his base salary and disability insurance.

Table of Contents

The Calvert Employment Agreement provides that Mr. Calvert will be granted an option (the Option) to purchase 7,733,259 shares of our common stock. The Option shall be a non-qualified stock option, shall be exercisable at \$0.18 per share, shall be exercisable for ten years from the date of grant and shall vest over time as follows:

| | |
|--|-----------|
| First anniversary of the date of this Agreement | 2,577,753 |
| Second anniversary of the date of this Agreement | 2,577,753 |
| Third anniversary of the date of this Agreement | 2,577,753 |

Notwithstanding the foregoing, any portion of the Option which has not yet vested shall be immediately vested in the event of, and prior to, a change of control, as defined in the Calvert Employment Agreement. Consistent with the foregoing, the precise terms and conditions of the agreement evidencing the Option to be entered with Mr. Calvert shall be as determined by the board of directors and/or the Compensation Committee.

The Calvert Employment Agreement has a term of five years, unless earlier terminated in accordance with its terms.

Item 6. Exhibits

The exhibits listed below are attached hereto and filed herewith:

| Exhibit No. | Description |
|--------------------|--|
| 31.1 | Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e). |
| 31.2 | Certification of Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e). |

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant has caused Amendment No. 2 to this report to be signed on its behalf by the undersigned, hereunto duly authorized.

BIOLARGO, INC.

Date: March 7, 2008

By: /s/ Dennis Calvert
Dennis Calvert

Chief Executive Officer

Table of Contents

EXHIBIT INDEX

| Exhibit No. | Description |
|--------------------|--|
| 31.1 | Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e). |
| 31.2 | Certification of Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e). |