CLEAN DIESEL TECHNOLOGIES INC
Form 10-Q
August 14, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

or

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

For the transition period from to

Commission File Number: 001-33710

CLEAN DIESEL TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	06-1393453
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1621 Fiske Place
Oxnard, CA 93033
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (805) 639-9458

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definition of "large accelerated filer," "accelerated

filer”, “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company þ
Emerging growth company o

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

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

As of August 7, 2017, the outstanding number of shares of the registrant’s common stock, par value $0.01 per share, was 15,727,537.

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CLEAN DIESEL TECHNOLOGIES, INC.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

CLEAN DIESEL TECHNOLOGIES, INC.

Condensed Consolidated Balance Sheets
(in thousands, except share and per share amounts)
(unaudited)

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash	$1,611	$7,839
Accounts receivable, net	4,623	5,398
Inventories	5,833	7,125
Prepaid expenses and other current assets	978	968
Total current assets	13,045	21,330
Property and equipment, net	1,031	1,158
Intangible assets, net	1,267	1,483
Deferred tax asset	561	554
Other assets	347	305
Total assets	$16,251	$24,830
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit	$672	$1,458
Shareholder notes payable	—	1,803
Accounts payable	4,145	5,979
Accrued expenses and other current liabilities	5,143	6,345
Income taxes payable	693	642
Total current liabilities	10,653	16,227
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, par value $0.01 per share: authorized 100,000; no shares issued and outstanding	—	—
Common stock, par value $0.01 per share: authorized 50,000,000 shares; issued and outstanding 15,722,537 and 15,703,301 shares at June 30, 2017 and December 31, 2016, respectively	157	157
Additional paid-in capital	238,093	237,838
Accumulated other comprehensive loss	(6,108)	(6,329)
Accumulated deficit	(226,544)	(223,063)
Total stockholders' equity	5,598	8,603
Total liabilities and stockholders' equity	$16,251	$24,830

See accompanying notes to condensed consolidated financial statements.

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CLEAN DIESEL TECHNOLOGIES, INC.

Condensed Consolidated Statements of Comprehensive Loss
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016 As Restated	2017	2016 As Restated
Revenues	$8,399	$8,406	$16,613	$18,152
Cost of revenues	6,455	6,719	13,235	13,728
Gross profit	1,944	1,687	3,378	4,424
Operating expenses:				
Research and development	987	1,431	2,056	3,193
Selling, general and administrative	1,916	2,827	4,642	6,227
Severance and other charges	(619)	581	(619)	1,373
Total operating expenses	2,284	4,839	6,079	10,793
Loss from operations	(340)	(3,152)	(2,701)	(6,369)
Other income (expense):				
Interest expense, net	(64)	(691)	(167)	(1,083)
Gain on bifurcated derivative liability	—	2,754	—	2,754
Loss on extinguishment of debt	—	(1,630)	(194)	(1,630)
Gain (loss) on change in fair value of liability-classified warrants	4	792	(334)	1,588
Other income, net	184	1,008	83	628
Total other income (expense)	124	2,233	(612)	2,257
Loss from operations before income taxes	(216)	(919)	(3,313)	(4,112)
Income tax expense (benefit)	169	(697)	168	(1,119)
Net loss	(385)	(222)	(3,481)	(2,993)
Foreign currency translation adjustments	211	(533)	221	(270)
Comprehensive loss	$(174)	$(755)	$(3,260)	$(3,263)
Basic and diluted net loss per common share:				
Net loss	$(0.02)	$(0.06)	$(0.22)	$(0.80)
Weighted average shares outstanding – basic and diluted	15,708	3,848	15,706	3,747

See accompanying notes to the condensed consolidated financial statements.

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CLEAN DIESEL TECHNOLOGIES, INC.

Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2017	2016 As Restated
Cash flows from operating activities:		
Net loss	$(3,481)	$(2,993)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	330	418
Stock-based compensation expense	224	639
Loss (gain) on change in fair value of liability-classified warrants	334	(1,588)
Loss on extinguishment of debt	194	1,630
Gain on change in fair value of bifurcated derivative liability	—	(2,754)
Loss (gain) on foreign currency transactions	92	(796)
Amortization of debt discount	—	226
Other	4	59
Changes in operating assets and liabilities:		
Accounts receivable	823	(22)
Inventories	1,356	26
Prepaid expenses and other assets	(20)	(3,199)
Accounts payable, accrued expenses and other current liabilities	(3,449)	2,932
Income taxes payable	40	58
Net cash used in operating activities	(3,553)	(5,364)
Cash flows from investing activities:		
Purchases of property and equipment	—	(95)
Proceeds from sale of property and equipment	—	93
Net cash used in investing activities	—	(2)
Cash flows from financing activities:		
Net payments under demand line of credit	(786)	(521)
Payments of shareholder notes payable	(2,000)	—
Proceeds from exercise of stock options	30	—
Proceeds from issuance of debt	—	3,750
Proceeds from exercise of warrants	—	20
Net cash (used in) provided by financing activities	(2,756)	3,249
Effect of exchange rates on cash	81	20
Net change in cash	(6,228)	(2,097)
Cash at beginning of period	7,839	2,958
Cash at end of period	$1,611	$861

See accompanying notes to the condensed consolidated financial statements.

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CLEAN DIESEL TECHNOLOGIES, INC.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Organization

Clean Diesel Technologies, Inc. is a leading provider of technology and solutions to the automotive emissions control markets. We possess market leading expertise in emissions catalyst design and engineering for automotive and off-road applications. In particular, we have a proven ability to develop proprietary materials incorporating various base metals that replace costly platinum group metals ("PGM") and rare earth metals in coatings on vehicle catalytic converters. Our business is driven by increasingly stringent global emission standards for internal combustion engines, which are major sources of a variety of harmful pollutants.
We deliver our catalyst technology through the supply of materials and technology used in the catalyst coating process as well as finished products such as coated substrates and emission control systems. We supply our proprietary catalyst technologies to major automakers, heavy duty truck manufacturers, catalyst manufacturers, distributors, integrators and retrofitters.
We produce coated substrates at our ISO Technical Specifications certified manufacturing facility in Oxnard, California. In some instances, the coated substrates we produce are integrated into exhaust systems by third-party manufacturers before being shipped to our end customer. We also supply coated substrates directly to exhaust systems manufacturers for incorporation in their own products.
Over the past decade, we have developed several generations of high performance catalysts, including our low-PGM mixed phase catalysts, or MPC® that are used on certain new Honda vehicles. During the same period we have developed the ability to deliver our catalyst technology to other catalyst manufacturers in the form of functional powders or material systems. Recently, we have expanded our offering of material systems beyond MPC® to include new synergized-PGM diesel oxidation catalysts, or SPGM™ DOCs, base-metal activated rhodium support, or BMARS™, and Spinel™ technologies. Most catalytic systems require significant amounts of costly PGMs to operate effectively. Our family of unique high-performance material systems, featuring inexpensive base-metals with low PGM content will enable further advances in catalyst performance. We are marketing these new catalyst technologies to other catalyst manufacturers in a proprietary powder form, which will allow them to capture the benefits of our advanced catalyst technology in their own manufacturing operations and will provide a new source of revenue for the Company.

2. Liquidity and Going Concern

The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. Therefore, the condensed consolidated financial statements contemplate the realization of assets and liquidation of liabilities in the ordinary course of business. The Company has suffered recurring losses and negative cash flows from operations since inception, resulting in an accumulated deficit of $226.5 million at June 30, 2017. The Company has funded its operations through asset sales, credit facilities and other borrowings and equity sales. At June 30, 2017, the Company had $1.6 million in cash.
The Company’s continuation as a going concern is dependent upon its ability to obtain adequate financing, which the Company has successfully secured since inception, including financing from equity sales and asset divestitures. However, there is no assurance that the Company will be able to achieve projected levels of revenue and maintain access to sufficient working capital, and accordingly, there is substantial doubt as to whether the Company’s existing cash resources and working capital are sufficient to enable it to continue its operations within one year from the financial statement issuance date. The Company is currently working towards obtaining a new credit facility that would provide the Company the flexibility it needs as it implements its new business strategy. If the Company is unable to obtain the necessary capital, it will be forced to license or liquidate its assets, significantly curtail or cease its operations and/or seek reorganization under the U.S. Bankruptcy Code.

The Company has a $7.5 million secured demand facility backed by its receivables and inventory with Faunus Group International, Inc. ("FGI"). At June 30, 2017, the Company had $0.7 million in borrowings outstanding under this facility with $6.8 million available, subject to the availability of eligible accounts receivable and inventory balances for collateral. There is no guarantee that the Company will be able to borrow to the full limit of $7.5 million if FGI chooses not to finance a portion of its receivables or inventory. Additionally, FGI can cancel the facility at any time. For additional information, refer to Note 9, "Debt".

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On May 19, 2015, the Company filed a shelf registration statement on Form S-3 with the SEC, which was declared effective on November 17, 2015. The Form S-3 permits the Company to sell in one or more registered transactions up to an aggregate of $50.0 million of various securities not to exceed one-third of the Company's public float in any 12-month period. As of June 30, 2017, the Company had sold an aggregate of $3.1 million using the Form S-3.

3. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC for interim financial reporting. In the opinion of management, all normal recurring accruals and adjustments that are necessary for a fair presentation have been reflected. Intercompany transactions and balances have been eliminated in consolidation. The results reported in these unaudited condensed consolidated financial statements should not necessarily be taken as indicative of results that may be expected for the entire year. Certain financial information that is normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), but is not required for interim reporting purposes, has been condensed or omitted. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on April 7, 2017.

On July 22, 2016, the Company effected a one-for-five reverse stock split. All share and per share information presented in these unaudited condensed consolidated financial statements for periods prior to July 22, 2016 has been retroactively adjusted to reflect the reverse stock split.

Use of Estimates

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

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-9, "Revenue from Contracts with Customers (Topic 606)". ASU 2014-9 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)". ASU 2014-9 requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In July 2015, the FASB finalized the delay of the effective date by one year, making the new standard effective for interim periods and annual periods beginning after December 15, 2017. Early adoption is permitted, but it is not permitted earlier than the original effective date. ASU 2014-9 provides for either full retrospective adoption or a modified retrospective adoption by which it is applied only to the most current period presented. While the Company has not finalized the impact of the adoption of ASU 2014-9

on its consolidated financial statements, the Company does not expect the adoption to have a material impact.
In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory". ASU 2015-11 changes the measurement principle for inventory from the "lower of cost or market" to "lower of cost and net realizable value." Net realizable value is defined as the "estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation." ASU 2015-11 eliminates the guidance that entities consider replacement cost or net realizable value less an approximately normal profit margin in the subsequent measurement of inventory when cost is determined on a first-in, first-out or average cost basis. It is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those fiscal years. The Company implemented ASU

2015-11 in the first quarter 2017. The adoption of this provision did not have a material impact on the Company's consolidated financial statements.
In January 2016, the FASB issued ASU 2016-1, "Recognition and Measurement of Financial Assets and Financial Liabilities". ASU 2016-1 requires equity investments to be measured at fair value with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements and clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU 2016-1 is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is evaluating the impact of adoption of ASU 2016-1 on its consolidated financial statements.
In February 2016, the FASB issued ASU 2016-2, "Leases (Topic 842)". ASU 2016-2 requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous U.S. generally accepted accounting principles. It is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Entities are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Company is evaluating the impact of adoption of ASU 2016-2 on its consolidated financial statements.
In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting”. ASU 2016-09 will change how companies account for certain aspects of share-based payments to employees. Entities will be required to recognize the income tax effects of awards in the statement of income when the awards vest or are settled, the guidance on employers’ accounting for an employee’s use of shares to satisfy the employer’s statutory income tax withholding obligation and for forfeitures is changing and the update requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity. ASU 2016-09 is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted. The Company adopted ASU 2016-09 in the first quarter of 2017. The Company elected to account for the forfeitures when they occur. The adoption of this provision did not have a material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, “Classification of Certain Cash Receipts and Cash Payments: a consensus of the Emerging Task Force”. ASU 2016-15 provides guidance on how certain cash receipts and payments are presented and classified in the statement of cash flows, including debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination, and separately identifiable cash flows and application of the predominance principle. The standard is intended to reduce current diversity in practice. The standard will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this accounting standard on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, “Intra-Entity Transfers of Assets of Other Than Inventory.” Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. ASU 2016-16 updates the current guidance by requiring that entities recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this ASU do not change GAAP for the pre-tax effects of an intra-entity asset transfer under Topic 810,

Consolidation, or for the income tax effects of an intra-entity transfer of inventory. The standard will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this accounting standard on its consolidated financial statements.

On May 10, 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718) - Scope of Modification Accounting. The guidance clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. The standard is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those

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fiscal years. Early adoption is permitted. The Company believes the adoption of ASU 2017-09 will not have a significant impact on its consolidated financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815). The amendments in Part I of this Update change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. The amendments in Part II of this Update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect. For public business entities, the amendments in Part I of this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company is currently evaluating the impact that ASU 2017-11 will have on its consolidated financial statements.

4. Inventories

Inventories consists of the following (in thousands):

	June 30, 2017	December 31, 2016
Raw materials	$2,541	$ 3,291
Work in process	576	790
Finished goods	2,716	3,044
Total inventories	$5,833	$ 7,125

5. Goodwill and Intangible Assets

Goodwill

The Company recognized an impairment charge of $4.7 million for the year ended December 31, 2016. As such, the Company has no goodwill at June 30, 2017 and December 31, 2016, respectively.

Intangible Assets

Intangible assets consist of the following (in thousands):

	Useful Life in Years	June 30, 2017	December 31, 2016
Trade name	15 - 20	$1,209	$ 1,204
Patents and know-how	5 - 12	4,113	4,090
Customer relationships	4 - 8	743	721
		6,065	6,015
Less accumulated amortization		(4,798)	(4,532)
		$1,267	$ 1,483

The Company recorded amortization expense related to amortizable intangible assets of $0.1 million and $0.1 million during the three months ended June 30, 2017 and 2016, respectively and $0.2 million and $0.2 million for the six months ended June 30, 2017 and 2016, respectively.

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

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Years ending December 31:	
Remainder of 2017	$214
2018	161
2019	161
2020	161
2021	161
Thereafter	409
	$1,267

6. Accrued Expenses and Other Current Liabilities

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

	June 30, 2017	December 31, 2016
Accrued salaries and benefits	$ 790	$ 759
Accrued severance and other charges (1)	400	1,738
Accrued warranty (2)	312	338
Warrant liability (3)	1,560	1,226
Liability for consigned precious metals	1,615	1,282
Other	466	1,002
	$ 5,143	$ 6,345

(1) For additional information, refer to Note 7, “Severance and Other Charges”.
(2) For additional information, refer to Note 8, “Accrued Warranty”.
(3) For additional information, refer to Note 10, “Warrants” and Note 11, “Fair Value Measurements”.

7. Severance and Other Charges

Severance and other charges consist of employee severance expense and lease exit costs, and the following summarizes the activity (in thousands):

	Severance	Lease Exit Costs	Total
December 31, 2015	$ 1,092	$ —	$1,092
Provision	1,068	305	1,373
Payments	(818)	—	(818)
June 30, 2016	$ 1,342	$ 305	$1,647

	Severance	Lease Exit Costs	Total
December 31, 2016	$ 718	$ 1,020	$1,738

Provision - reversals	—	(619)	(619)
Payments	(482)	(237)	(719)
June 30, 2017	$ 236	$ 164	$400

At June 30, 2017 and December 31, 2016, the balance of severance and other charges were recorded in accrued expenses and other liabilities in the condensed consolidated balance sheet. In the second quarter of 2017, the Company reached an agreement with the property owner of its former Canadian facility to exit our lease prior to its December 2018 termination. Severance and other charges reflect the reduction of the liability for the remaining estimated costs relative to the closed facility.

8. Accrued Warranty

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

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

	Six Months Ended June 30,	
	2017	2016
Balance at beginning of period	$338	$228
Accrued warranty expense	117	142
Warranty claims paid	(147)	(90)
Translation Adjustment	4	(36)
Balance at end of period	$312	$244

At June 30, 2017 and December 31, 2016, the balance of accrued warranty was recorded in accrued expenses and other liabilities in the condensed consolidated balance sheet.

9. Debt

Notes payable consists of the following (in thousands):

	June 30, 2017	December 31, 2016
Line of credit with FGI	$672	$ 1,458
$2.0 million, 8% shareholder note due 2017 (Kanis S.A.) (1)	—	1,803
	672	3,261
Less current portion	(672)	(3,261)
	$—	$ —

(1) Debt discount related to extinguishment and amendment of previous outstanding debt. The aggregate amount of unamortized debt discount was $0.2 million at December 31, 2016. For additional information, refer to the respective discussions below.

Line of credit with FGI

The Company maintains a $7.5 million secured demand facility with FGI backed by its receivables and inventory. The Company also granted FGI a first lien collateral interest in substantially all of its assets. The current termination date is August 15, 2017, however it may be extended at the Company's option for additional one-year terms. FGI can cancel the facility at any time and demand payment.

The interest rate on advances or borrowings under the FGI facility is the greater of (i) 6.50% per annum and (ii) 2.50% per annum above the prime rate, as defined in the FGI facility and was 6.50% at June 30, 2017 and December 31, 2016. Any advances or borrowings under the FGI facility are due on demand.

At June 30, 2017, the Company had $0.4 million gross accounts receivable pledged to FGI as collateral for short-term debt as well as $0.3 million in borrowings outstanding against eligible inventory. The Company was in compliance

with the terms of the FGI Facility at June 30, 2017 and December 31, 2016. However, there is no guarantee that the Company will be able to borrow to the full limit of $7.5 million if FGI chooses not to finance a portion of the Company's receivables or inventory.

Kanis S. A. Indebtedness

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On April 1, 2016, the Company borrowed $2.0 million from Kanis S.A. pursuant to a promissory note with an interest rate of 8% per annum and a maturity date of September 30, 2017 (see Note 17).

In January 2017, the Company repaid the entire $2.0 million balance and recorded a loss on extinguishment of $0.2 million.

10. Warrants

Warrants outstanding and exercisable are summarized as follows:

	Shares(1)	Weighted Average Exercise Price	Range of Exercise Prices
Outstanding at December 31, 2016	979,869	$ 6.36	$6.25-$21.00
Exercised	—	$ —	$—
Expired	—	$ —	$—
Outstanding at June 30, 2017	979,869	$ 6.36	$6.25 - $21.00
Exercisable at June 30, 2017	979,869	$ 6.36	$6.25 - $21.00

(1) Outstanding and exercisable information includes 21,920 equity-classified warrants.

Warrant Liability
The Company's warrant liability is carried at fair value and is classified as Level 3 in the fair value hierarchy because the warrants are valued based on unobservable inputs.
The Company determines the fair value of its warrant liability using the Black-Scholes option-pricing model unless the awards are subject to market conditions, in which case it uses a Monte Carlo simulation model, which utilizes multiple input variables to estimate the probability that market conditions will be achieved. These models are dependent on several variables such as the instrument's expected term, expected strike price, expected risk-free interest rate over the expected term of the instrument, expected dividend yield rate over the expected term and the expected volatility. The expected strike price for warrants with full-ratchet down-round price protection is based on a weighted average probability analysis of the strike price changes expected during the term as a result of the full-ratchet down-round price protection.
The assumptions used in the Black-Scholes option-pricing model to estimate the fair value of the warrant liability as of June 30, 2017 were as follows:

Expected volatility	92.4% - 101.5%
Risk-free interest rate	1.33% - 1.80%
Dividend yield	—
Expected life in years	2.3 - 4.5

The assumptions used in the Monte Carlo simulation model to estimate the fair value of the warrant liability as of June 30, 2017 were as follows:

Expected volatility	91.3% - 106.2%

Risk-free interest rate	1.24% - 1.44%
Dividend yield	—
Expected life in years	1.1 - 2.4

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The warrant liability, included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets, is re-measured at the end of each reporting period with changes in fair value recognized in other income (expense), net in the consolidated statements of comprehensive loss. Upon the exercise of a warrant that is classified as a liability, the fair value of the warrant exercised is re-measured on the exercise date and reclassified from warrant liability to additional paid-in capital.

11. Fair Value Measurements

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

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

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

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

Assets and liabilities measured at fair value on the Company's balance sheet on a recurring basis include the following at June 30, 2017 and December 31, 2016 (in thousands):

Warrant Liability	Level 1	Level 2	Level 3
June 30, 2017	—	—	$ 1,560
December 31, 2016	—	—	$ 1,226

There were no transfers in or out of Level 1, Level 2 or Level 3 fair value measurements during the three and six months ended June 30, 2017.

The following is a reconciliation of the warrant liability, included in accrued expenses and other current liabilities in the accompanying unaudited condensed consolidated balance sheets, measured at fair value using Level 3 inputs (in thousands):

	Six Months Ended June 30,	
	2017	2016
Balance at beginning of period	$ 1,226	$ 3,072
Exercise of common stock warrants	—	(1,124)
Remeasurement of common stock warrants	334	(1,588)
Balance at end of period	$ 1,560	$ 360

The fair values of the Company's cash, accounts receivable, prepaid expenses and other current assets, accounts payable and accrued expenses and other current liabilities approximate carrying values due to the short maturity of these instruments. The fair value of the line of credit approximates its carrying value due to the variable interest rates.

The Company’s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy.

12. Loss per Share

Basic net loss per share is computed using the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed using the weighted average number of common shares plus potentially dilutive common shares. Potentially dilutive common shares include employee stock options and restricted share units and warrants and debt that are convertible into the Company’s common stock.

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Because the Company incurred net losses in the three and six months ended June 30, 2017 and 2016, the effect of potentially dilutive securities has been excluded in the computation of diluted loss per share as their impact would be anti-dilutive. Potentially dilutive common stock equivalents excluded were 2.1 million and 1.0 million shares during the three and six months ended June 30, 2017 and 2016, respectively.

13. Commitments and Contingencies

The Company leases facilities under non-cancellable operating leases. The leases expire at various dates through fiscal 2018 and frequently include renewal provisions for varying periods of time, provisions which require us to pay taxes, insurance and maintenance costs, and provisions for minimum rent increases. Minimum lease payments, including scheduled rent increases are recognized as rent expense on a straight-line basis over the term of the lease.

Litigation

The Company is involved in legal proceedings from time to time in the ordinary course of its business. Management does not believe that any of these claims and proceedings against it is likely to have, individually or in the aggregate, a material adverse effect on the Company’s condensed consolidated financial condition, results of operations or cash flows. Accordingly, the Company cannot determine the final amount, if any, of its liability beyond the amount accrued in the unaudited condensed consolidated financial statements as of June 30, 2017, nor is it possible to estimate what litigation-related costs will be in the future.

For information related to commitments and contingencies related to Applied Utility Systems, a former subsidiary of the Company that was sold in 2009, refer to Note 16, “Discontinued Operations”.

14. Geographic Information

Net sales by geographic region based on the location of the Company’s point of sale is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
United States	$5,387	$6,513	$10,060	$12,390
Canada	2,215	1,243	4,904	4,421
Europe	797	650	1,649	1,341
Total international	3,012	1,893	6,553	5,762
Total revenues	$8,399	$8,406	$16,613	$18,152

15. Concentrations

For the three months ended June 30, 2017 and 2016, Honda accounted for 57% and 54%, respectively, of the Company's revenues. For the six months ended June 30, 2017 and 2016, Honda accounted for 54% and 55%, respectively, of the Company's revenues. This customer accounted for 36% and 35% of the Company's accounts receivable at June 30, 2017 and December 31, 2016, respectively.

For the three months ended June 30, 2017, the Company had four suppliers that accounted for approximately 25%, 12%, 10%, and 10% of the Company's material purchases. For the three months ended June 30, 2016, the Company had one supplier that accounted for approximately 34% of the Company's material purchases.

For the six months ended June 30, 2017, the Company had three suppliers that accounted for approximately 18%, 11% and 10% of the Company's material purchases. For the six months ended June 30, 2016, the Company had one supplier that accounted for approximately 35% of the Company's material purchases.

16. Discontinued Operations

Applied Utility Systems, Inc.

The Company is undergoing a sales and use tax audit by the State of California (the “State”) on Applied Utility Systems, Inc. “AUS” for the period of 2007 through 2009. The audit has identified a project performed by the Company during that time

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period for which sales tax was not collected and remitted and for which the State asserts that proper documentation of resale may not have been obtained and that the Company owes sales tax of $1.5 million, inclusive of interest. The Company contends and believes that it received sufficient and proper documentation from its customer to support not collecting and remitting sales tax from that customer and is actively disputing the audit report with the State. On August 12, 2013, the Company appeared at an appeals conference with the State Board of Equalization (“BOE”). On July 21, 2014, the Company received a Decision and Recommendation (“D&R”) from the BOE. The D&R’s conclusion was that the basis for the calculation of the aforementioned $1.5 million tax due should be reduced from $12.2 million to $9.0 million with a commensurate reduction in the tax owed to the State. Based on a re-audit, the BOE lowered the tax due to $0.9 million, inclusive of interest. The Company continues to disagree with these findings based on the aforementioned reasons. However, in October 2015, the Company offered to settle this case for $0.1 million, which is based on the expected cost of continuing to contest this audit. Accordingly, an accrual was charged to discontinued operations during the year ended December 31, 2015. Should the Company not prevail with the offer to settle this case, it plans to continue with the appeals process. Further, should the Company not prevail in this case, it will pursue reimbursement from the customer for all assessments from the State. As of each of June 30, 2017 and December 31, 2016, the Company had $0.1 million, respectively, in accrued expenses on the condensed consolidated balance sheet.

17. Restatement of Prior Period Financial Statements

Subsequent to the issuance of the Company's consolidated financial statement for the quarterly period ended September 30, 2016, the Company identified immaterial errors that were the result of an incorrect assessment of the April 1, 2016 debt transaction with Kanis S.A.

On April 1, 2016, the Company executed a promissory note (the “Note”) in favor of Kanis S.A., pursuant to which Kanis S.A. loaned the Company $2.0 million (the “New Loan”). In addition, on April 1, 2016, the Company entered into an amendment to the loan agreement (the “Amendment”) with Kanis S.A., pursuant to which the Company and Kanis S.A. agreed to amend certain prior loans and amendments aggregating a principal balance of $7.5 million (the “Existing Loans”). The Amendment included the addition of a conversion feature to the Existing Loans, providing for their conversion into the Company’s common stock. Certain financial instruments of the Amendment required bifurcation and were determined to be an embedded derivative comprised of a conversion feature and a call option valued at $3.9 million using the Monte Carlo simulation model. The Company recorded the bifurcated derivative as a liability with a corresponding debt discount. During the three months ended June 30, 2016, the Company recognized $0.3 million of debt discount amortization, and on June 30, 2016, the Company marked to market the derivative liability resulting in a gain on the derivative liability of $2.8 million.

During the three months ended September 30, 2016, the Company received stockholder approval to complete the conversion of the Existing Loans into common stock, which conversion occurred on August 30, 2016. The Company accounted for the conversion of the Existing Loans as an extinguishment. The Company subsequently reviewed the accounting treatment of the Amendment and determined that the Amendment resulted in the extinguishment of the Existing Loans, and that the Company should have followed the accounting required for debt extinguishment and recorded the revalued Existing Loans on April 1, 2016.

As a result of its review, the Company determined that an extinguishment loss should have been recorded in other income (expense) with a corresponding decrease to Notes payable, net of debt discount and current portion in the second quarter of 2016 for $1.6 million as a result of the April 1, 2016 Amendment of the Existing Loans

The Company has restated the three and six months ending June 30, 2016 Condensed Consolidated Statement of Comprehensive Loss and Condensed Consolidated Statements of Cash Flows to correct for the extinguishment loss of $1.6 million and $0.1 million of amortization of discount, respectively, within other income (expense).

The impact of this error in the prior year periods was not material to the consolidated financial statements in any of the periods effected. In addition, the Company properly reflected the extinguishment loss in its consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2016.

The revisions to the Company's Condensed Consolidated Statement of Comprehensive Loss for the three and six months ended June 30, 2016 were as follows:

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	Three Months Ended June 30, 2016		Six Months Ended June 30, 2016	
	As Reported	As Restated	As Reported	As Restated
Other income (expense):				
Interest expense	(756)	(691)	(1,148)	(1,083)
Gain on bifurcated derivative liability	2,754	2,754	2,754	2,754
Loss on extinguishment of convertible debt	—	(1,630)	—	(1,630)
Gain (loss) on warrant liability	792	792	1,588	1,588
Other income, net	1,008	1,008	628	628
Total other income	3,798	2,233	3,822	2,257
Income (loss) from continuing operations before income taxes	646	(919)	(2,547)	(4,112)
Net income (loss)	1,343	(222)	(1,428)	(2,993)
Comprehensive income (loss)	$810	$(755)	$(1,698)	$(3,263)
Earnings/(loss) per common share:				
Basic	$0.35	$(0.06)	$(0.38)	$(0.80)
Diluted	$0.13	$(0.06)	$(0.38)	$(0.80)

The revisions to the Company's Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2016 were as follows:

	Six Months Ended June 30, 2016	
	As Reported	As Restated
Cash flows from operating activities:		
Net loss	$(1,428)	$(2,993)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss on extinguishment of convertible debt	—	1,630
Amortization of debt discount	291	226

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes thereto included elsewhere in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q should also be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

As used in this Quarterly Report on Form 10-Q, the terms “CDTi” or the “Company” or “we,” “our” and “us” refer to Clean Diesel Technologies, Inc. and its consolidated subsidiaries.

In addition, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, adopted pursuant to the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks and uncertainties, as well as assumptions, which could cause our results to differ materially from those expressed or implied by such forward-looking statements. Forward-looking statements generally are identified by the

words “may,” “will,” “project,” “might,” “expects,” “anticipates,” “believes,” “intends,” “estimates,” “should,” “could,” “woul
“continue,” “pursue,” or the negative of these words or other words or expressions of similar meaning. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements. These forward-looking statements are based on information available to us, are current only as of the date on which the statements are made, and are subject to numerous risks and uncertainties that could cause our actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, the forward-looking statements. For examples of such risks and uncertainties, please refer to

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the discussion under the caption “Risk Factors” contained in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission (the “SEC”) on April 7, 2017 and our other filings with the SEC.

You should not place undue reliance on any forward-looking statements. Except as otherwise required by federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to other forward-looking statements.

Overview

Clean Diesel Technologies, Inc. is a leading provider of technology and solutions to the automotive emissions control markets. We possess market leading expertise in emissions catalyst design and engineering for automotive and off-road applications. In particular, we have a proven ability to develop proprietary materials incorporating various base metals that replace costly platinum group metals ("PGM") and rare earth metals in coatings on vehicle catalytic converters. Our business is driven by increasingly stringent global emission standards for internal combustion engines, which are major sources of a variety of harmful pollutants.

We deliver our catalyst technology through the supply of materials and technology used in the catalyst coating process as well as finished products such as coated substrates and emission control systems. We supply our proprietary catalyst technologies to major automakers, heavy duty truck manufacturers, catalyst manufacturers, distributors, integrators and retrofitters.

We produce coated substrates at our ISO Technical Specifications certified manufacturing facility in Oxnard, California. In some instances, the coated substrates we produce are integrated into exhaust systems by third-party manufacturers before being shipped to our end customer. We also supply coated substrates directly to exhaust systems manufacturers for incorporation in their own products.

Over the past decade, we have developed several generations of high performance catalysts, including our low-PGM mixed phase catalysts, or MPC®, that are used on certain new Honda vehicles. During the same period we have developed the ability to deliver our catalyst technology to other catalyst manufacturers in the form of functional powders or material systems. Recently, we have expanded our offering of material systems beyond MPC® to include new synergized-PGM diesel oxidation catalysts, or SPGM™ DOCs, base-metal activated rhodium support, or BMARS™, and Spinel™ technologies. Most catalytic systems require significant amounts of costly PGMs to operate effectively. Our family of unique high-performance material systems, featuring inexpensive base-metals with low PGM content will enable further advances in catalyst performance. We are marketing these new catalyst technologies to other catalyst manufacturers in a proprietary powder form, which will allow them to capture the benefits of our advanced catalyst technology in their own manufacturing operations and will provide a new source of revenue for the Company.

Strategy

Over more than twenty years, we have developed the emissions control technology and manufacturing know-how to allow us to progress to delivering enabling technology for manufacturers serving the emissions catalyst market. The ability to deliver our advanced materials to other catalyst producers as functional powders allows us to achieve greater scale and higher return on our technology investment than would be possible as a manufacturer of emission control systems. The strategy to provide our technology to other manufacturers has significantly increased the size of our addressable market and provides access to markets that would not be achievable as a catalyst producer. In the short term, we are focusing our efforts and resources by pursuing opportunities in fast growing markets in China and India, as well as North America, where we believe that we can serve profitably with our technology provider business model.

The Chinese market offers significant opportunity as the world's single largest automotive market with over 24 million vehicles produced in 2016. There is an extensive emission control systems supply chain serving domestic and international automobile manufacturers in China. Somewhat unique to China, there are many domestic catalyst manufacturers serving the automotive market in competition with the large global catalyst producers. This segment of the market requires technology and know-how to adhere to increasingly stringent emissions standards and to deliver competitively priced catalysts. In addition, there is significant pressure for the Chinese automotive market to address increasing air pollution, an issue that has escalated to become a matter of public policy. We believe these factors provide a highly favorable environment for our products and technology.

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Air quality is also an important market driver in India where annual vehicle production was over 4 million in 2016. India has a number of domestic vehicle manufacturers that are served by both global and local catalyst manufacturers. There is significant opportunity to provide enabling technology to domestic catalyst producers with the appropriate manufacturing expertise.

North America continues to be a leading global automotive market with over 18 million vehicles produced in 2016. We have focused our resources in North America on developing the growing original equipment manufacturer ("OEM") diesel particulate filter ("DPF") and diesel oxidation catalysts ("DOC") replacement market. We currently serve that market directly with our DuraFit™ product line and through the supply of technology and products to other manufacturers and distributors for sale under their own brand. We believe that our technology has the potential to become the market standard in the OEM DPF and DOC replacement market.

In support of this strategy, we have filed approximately 215 patents that underpin next-generation technology for our advanced zero-PGM or ZPGM and low-PGM catalysts, and during 2015 and 2016, we completed an initial series of vehicle tests to validate our next-generation technologies. Based on the success of these tests, we are beginning to make our new catalyst technologies available to OEMs, catalyst coaters and other participants in the emission reduction supply chain for use in proprietary powder form, and we foresee multiple paths to market our new technologies.

Financial Overview

For the three months ended June 30, 2017 revenues were $8.4 million, consistent with the prior year, loss from operations was $0.3 million, a decrease of approximately $2.8 million from the prior year, primarily due to benefits from our 2016 cost reduction initiatives as well as a decrease in severance and other charges for our remaining liability related to our closed Canadian manufacturing facility.

For the six months ended June 30, 2017 revenues were $16.6 million, a decrease of approximately $1.5 million from the prior year, and loss from operations was $2.7 million, a decrease of approximately $3.7 million from the prior year primarily due to benefits from our 2016 cost reduction initiatives as well as a decrease in severance and other charges for our remaining liability related to our closed Canadian manufacturing facility. The decrease in revenues is largely attributable to the decrease in coated catalyst shipments to Honda in the first quarter.

Net cash used in operations was $3.6 million for the six months ended June 30, 2017.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures in the financial statements. Critical accounting policies are those accounting policies that may be material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and that have a material impact on financial condition or operating performance. While we base our estimates and judgments on our experience and on various other factors that we believe to be reasonable under the circumstances, actual results may differ from these estimates under different assumptions or conditions.

We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, allowance for doubtful accounts, inventory valuation, product warranty reserves, accounting for income taxes, goodwill, impairment of long-lived assets other than goodwill, stock-based compensation and liability-classified warrants have the greatest potential impact on our unaudited condensed consolidated financial statements. Please refer to Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2016 for a more complete discussion of our critical accounting policies and estimates.

Impact of Recent Accounting Pronouncements

For information with respect to recent accounting pronouncements and the impact of these pronouncements see Note 3, “Summary of Significant Accounting Policies – Recent Accounting Pronouncements” in the accompanying notes to the unaudited condensed consolidated financial statements.

Customer Dependency and Relationship with Honda

Historically, we have derived a significant portion of our revenue from a limited number of customers. Sales to Honda represented 54% and 55% of our revenues for the six months ended June 30, 2017 and 2016, respectively. However, based on

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discussions with Honda, and acceleration of our powder-to-coat strategy, we anticipate that our supply of coated catalysts to Honda will begin to significantly decline in the second half of 2017, as certain current vehicle models are phased out. Accordingly, it will be critical that our advanced materials business strategy produces revenue with new customers, which may include Honda, directly or indirectly, to replace revenues from our current core catalyst business.

Results of Operations

In the past, the Company operated with two reportable business division segments based on the products it delivered. Beginning in late 2015, the Company began its transition from a niche manufacturer of emissions control solutions for the automotive and heavy duty diesel markets to becoming an advanced materials technology provider of proprietary powders for these markets. During the second quarter of 2016, the transition of the operating strategy was completed and the Company now views its operations and measures business as one reportable segment.

Comparison of Three and Six Months Ended June 30, 2017 and 2016
(Amounts in tables in thousands, except percentages)

Revenues

	Three Months Ended June 30,					
	2017		2016			
	$	% of Revenues	$	% of Revenues	Change	% Change
Coated catalysts	$4,821	57 %	$4,830	58 %	$ (9)	— %
Emission control systems	3,011	36 %	2,946	35 %	65	2 %
Technology and advanced materials	567	7 %	630	7 %	(63)	(10)%
Total revenues	$8,399	100 %	$8,406	100 %	$ (7)	— %

	Six Months Ended June 30,					
	2017		2016			
	$	% of Revenues	$	% of Revenues	Change	% Change
Coated catalysts	$16,613 →					

Coated catalyst revenues are generated from the sale of our high performance catalysts which reduce emissions from gasoline, diesel and natural gas combustion engines. Emission control systems revenues are generated from the sale of products in our extensive line of heavy duty applications including DuraFit TM, branded OEM replacement diesel particulate filters, or DPFs, and diesel oxidation catalysts, or DOCs, sold through our distribution/dealer network and direct sales. We have begun offering a "private label" opportunity that will allow customers to place their proprietary branding on our line of heavy duty applications. Technology and advanced materials revenues included licenses and royalties, as well as sales of our advanced materials platform. The timing and amounts of revenue generated from licensing agreements will fluctuate.

For the three months ended June 30, 2017 revenue was consistent with the prior year.

For the six months ended June 30, 2017 our lower coated catalysts revenues are largely attributable to a decline in sales to Honda. The decrease in revenues from our emission control systems is due primarily to the timing of DuraFit TM shipments.

Cost of revenues

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	Three Months Ended June 30,					
	2017		2016			
	$	% of Revenues	$	% of Revenues	Change	% Change
Cost of revenues	$6,455	77 %	$6,719	80 %	$(264)	(4)%

	Six Months Ended June 30,					
	2017		2016			
	$	% of Revenues	$	% of Revenues	Change	% Change
Cost of revenues	$13,235	80 %	$13,728	76 %	$(493)	(4)%

Cost of revenues includes the costs of materials and assembly labor, as well as assembly services, and labor and overhead costs associated with manufacturing and product procurement, planning and quality assurance. Our cost of revenues is affected by various factors, including product mix, volume, and provisions for excess and obsolete inventories, materials, labor and overhead costs, as well as manufacturing efficiencies. Our cost of revenues as a percentage of revenues is affected by these factors, as well as customer mix, volume, pricing and competitive pricing programs.

The decrease in cost of revenues as a percentage of revenue for the three months ended June 30, 2017 is driven by a more favorable revenue mix as compared to the same period in the prior year partially offset by the ongoing realignment of our business strategy for our heavy duty applications in North America including introductory pricing to new customers, the launch of additional private label programs.

The increase in cost of revenues as a percentage of revenue for the six months ended June 30, 2017 is driven by the ongoing realignment of our business strategy for our heavy duty applications in North America including introductory pricing to new customers, the launch of additional private label programs and the elimination of certain product offerings outside that strategy. As it relates to our coated catalyst products, the decrease in sales impacted the absorption of overhead. We also saw a significant increase in the price of palladium in the first quarter of 2017, which impacted our PGM liability.

Operating expenses

	Three Months Ended June 30,					
	2017		2016			
	$	% of Revenues	$	% of Revenues	Change	% Change
Research and development	$987	12 %	$1,431	17 %	$(444)	(31)%
Selling, general and administrative	1,916	23 %	2,827	34 %	(911)	(32)%
Severance and other charges	(619)	(7)%	581	7 %	(1,200)	*
Total operating expenses	$2,284	28 %	$4,839	58 %	$(2,555)	(53)%

* Percentage not meaningful

	Six Months Ended June 30,					
	2017		2016			
	$	% of Revenues	$	% of Revenues	Change	% Change

Research and development	$2,056	12 %	$3,193	18 %	$(1,137)	(36)%
Selling, general and administrative	4,642	28 %	6,227	34 %	(1,585)	(25)%
Severance and other charges	(619)	(4)%	1,373	8 %	(1,992)	*
Total operating expenses	$6,079	36 %	$10,793	60 %	$(4,714)	(44)%

* Percentage not meaningful

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Research and development expenses consist primarily of compensation expense for employees and contractors engaged in research, design and development activities, as well costs paid to outside parties for testing, validation and certification of our products. Selling, general and administrative expenses consist primarily of compensation expense, legal and professional fees, facilities expenses, and communication expenses. Severance and other charges related primarily to the closure of our Canadian facility and the transfer of operations to our California facility and include severance costs, equipment disposal, moving costs, and building exit costs.

Research and development expenses

The decrease is primarily a result of headcount reduction, decreased legal fees relative to the timing of new patent registrations, as well as reduced outside testing of our advanced materials, as the fundamental research of our new key materials, such as SPGM-DOC™, BMARS™ and Spinel™, have largely transitioned out of fundamental research into applications development for specific market opportunities.

Selling, general and administrative expenses

We decreased general and administrative costs including consulting, payroll and benefits expenses, as a result of the closure of our Canadian facility and changes made at our California location. In the first quarter, these decreases were partially offset by increases in seasonal expenses related to our 2016 audit.

Severance and other charges

In the second quarter of 2017, we reached an agreement with the property owner of our former Canadian facility to exit our lease prior to its December 2018 termination. Severance and other charges reflect the reduction of the liability for the remaining estimated costs relative to the closed facility.

Other Income

	Three Months Ended June 30,					
	2017		2016 As Restated			
	$	% of Revenues	$	% of Revenues	Change	% Change
Interest expense, net	$(64)	(1)%	$(691)	(8)%	$627	(91)%
Gain on bifurcated derivative liability	—	— %	2,754	33 %	(2,754)	(100)%
Loss on extinguishment of debt	—	— %	(1,630)	(19)%	1,630	(100)%
(Loss)/gain on change in fair value of liability-classified warrants	4	— %	792	9 %	(788)	(99)%
Other income, net	184	2 %	1,008	12 %	(824)	(82)%
Total other income	$124	1 %	$2,233	27 %	$(2,109)	*

* Percentage not meaningful

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	Six Months Ended June 30,					
	2017		2016 As Restated			
	$	% of Revenues	$	% of Revenues	Change	% Change
Interest expense, net	$(167)	(1)%	$(1,083)	(6)%	$916	(85)%
Gain on bifurcated derivative liability	—	— %	2,754	15 %	(2,754)	(100)%
Loss on extinguishment of debt	(194)	(1)%	(1,630)	(9)%	1,436	(88)%
(Loss)/gain on change in fair value of liability-classified warrants	(334)	(2)%	1,588	9 %	(1,922)	(121)%
Other income, net	83	— %	628	3 %	(545)	(87)%
Total other (expense)/income	$(612)	(4)%	$2,257	12 %	$(2,869)	*

For the three and six months ended June 30, 2017, the decrease in other income was primarily due to the gain on bifurcated derivative liability partially offset by a loss on extinguishment of debt related to the Kanis Note and the amendment of the Kanis Agreement during the second quarter of 2016. We also incurred a loss in three and six months ended June 30, 2017, due to the remeasurement of liability-classified warrants partially offset by the lower interest expense due to the decrease in debt outstanding during the respective periods.

Income Tax Expense (Benefit)

We incurred income tax expense of approximately $0.2 million in the three and six months ended June 30, 2017. For the three and six months ended months ended June 30, 2016, we recognized an income tax benefit of approximately $0.7 million and $1.1 million respectively. The effective income tax rates were (78.2)% and 75.8% for the three months ended June 30, 2017 and 2016, respectively. The effective income tax rates were (5.1)% and 27.2% for the six months ended June 30, 2017 and 2016, respectively. For interim income tax reporting, we estimate our annual effective tax rate and apply it to our year-to-date pre-tax loss. Tax jurisdictions with a projected or year-to-date loss for which a tax benefit cannot be realized are excluded from the annualized effective tax rate. The difference between our effective tax rate and the U.S. statutory tax rate is primarily related to the valuation allowance offsetting the deferred tax assets in both the U.S. and United Kingdom jurisdictions as well as to a foreign tax rate differential related to Sweden and Canada.

Liquidity and Capital Resources

Historically, the revenue that we have generated has not been sufficient to fund our operating requirements and debt servicing needs. Notably, we have suffered recurring losses since inception. As of June 30, 2017, we had an accumulated deficit of $226.5 million compared to $223.1 million at December 31, 2016. We have also had negative cash flows from operations from inception. Our primary sources of liquidity in recent years have been asset sales, credit facilities and other borrowings and equity sales.

We had $1.6 million in cash at June 30, 2017 compared to $7.8 million at December 31, 2016. At June 30, 2017, $0.6 million of our cash was held by foreign subsidiaries in Canada, Sweden and the United Kingdom. If we decide to repatriate unremitted foreign earnings in the future, it could have negative tax implications.

We have a $7.5 million secured demand financing facility backed by our receivables and inventory with FGI that terminates on August 15, 2017 and may be extended at our option for additional one-year terms. However, FGI can cancel the facility at any time. For details regarding the FGI facility, refer to the "Description of Indebtedness" discussion below. At June 30, 2017, we had $0.7 million in borrowings outstanding under this facility with $6.8 million available, subject to the availability of eligible accounts receivable and inventory balances for collateral.

However, there is no guarantee that we will be able to borrow to the full limit of $7.5 million if FGI chooses not to finance a portion of our receivables or inventory. We are currently in negotiation with FGI to amend the facility.

On May 19, 2015, we filed a shelf registration statement on Form S-3 with the SEC, which was declared effective on November 17, 2015. Shelf registration statements are intended to provide us with additional flexibility to access capital markets for general corporate purposes, subject to market conditions and our capital needs. The Form S-3 permits us to sell in one or more registered transactions up to an aggregate of $50.0 million of various securities not to exceed one-third of our public float in any 12-month period. At June 30, 2017, we had sold an aggregate of $3.1 million using the Form S-3.

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We believe the equity raise and the debt conversions completed in 2016 improved our overall net cash positions; however, there is no assurance that we will be able to achieve projected levels of revenue and maintain access to sufficient working capital. As a result there is substantial doubt as to whether our existing cash resources and working capital are sufficient to enable us to continue operations within one year from the financial statement issuance date. If necessary, we will seek to raise additional capital from the sale of equity securities or the increase of indebtedness. There can be no assurance that additional financing will be available to us on acceptable terms, or at all. Additionally, if we issue additional equity securities to raise funds, whether to potential customers or other investors, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. Additionally, we may be limited as to the amount of funds we can raise pursuant to SEC rules and the continued listing requirements of NASDAQ. If we cannot raise needed funds, we might be forced to make substantial reductions in our operating expenses, which could adversely affect our ability to implement our business plan and ultimately our viability as a company. These consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might result from this uncertainty.

The following table summarizes our cash flows for the periods indicated.

	Six Months Ended June 30,			
			Change	
	2017	2016	$	%
	(unaudited)			
	(in thousands, except percentages)			
Cash (used in) provided by :				
Operating activities	$(3,553)	$(5,364)	$1,811	34 %
Investing activities	$—	$(2)	$2	*
Financing activities	$(2,756)	$3,249	$(6,005)	(185)%

* Percentage not meaningful

Cash used in operating activities

Our largest source of operating cash flows is cash collections from our customers following the sale of our products and services. Our primary uses of cash for operating activities are for purchasing inventory in support of the products that we sell, personnel related expenditures, facilities costs and payments for general operating matters. During the six months ended June 30, 2017, cash used in operations was $3.6 million. Cash flows were largely impacted by the loss from operations, adjusted for non-cash items, including depreciation and amortization, stock-based compensation, change in the fair value of the liability-classified warrant as well as the net effect of changes in net working capital and other balance sheet accounts. These changes include decreases in operating cash flows associated with lower accounts payable and accrued expenses. This decrease was partially offset by decreases in our accounts receivable and inventory balances.

Cash used in investing activities

We had no cash provided by or used in investing activities for the six months ended June 30, 2017.

Cash (used in) / provided by financing activities

Cash used in financing activities was due to a $2.0 million repayment of outstanding debt as well as net payments under our demand line of credit during the six months ended June 30, 2017.

Cash provided by financing activities during the six months ended June 30, 2016 was due to $2.0 million generated from the promissory note entered into with Kanis S.A. on April 1, 2016, $0.5 million generated from the promissory note entered into with Lon E. Bell, Ph.D., one of CDTi's directors, on April 11, 2016 and $1.3 million generated from the convertible notes entered into with Haldor Topsøe on June 30, 2016. These were partially offset by net payments under our demand line of credit of approximately $0.5 million.

Description of Indebtedness

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	June 30, 2017	December 31, 2016
	(unaudited)	
	(in thousands)	
Line of credit with FGI	$672	$ 1,458
$2.0 million, 8% shareholder note due 2017 (Kanis S.A.)	—	1,803
	$672	$ 3,261

We have a $7.5 million secured demand facility with FGI backed by our receivables and inventory. FGI can cancel the facility at any time.

Under the FGI facility, FGI can elect to purchase eligible accounts receivables from us and certain of our subsidiaries at up to 80% of the value of such receivables (retaining a 20% reserve). At FGI's election, FGI may advance us up to 80% of the value of any purchased accounts receivable, subject to the $7.5 million limit. Reserves retained by FGI on any purchased receivable are expected to be refunded to us net of interest and fees on advances once the receivables are collected from customers. We may also borrow against eligible inventory up to the inventory sublimit as determined by FGI subject to the aggregate $7.5 million limit under the FGI facility and certain other conditions. At June 30, 2017, the inventory sublimit was the lesser of $1.5 million or 50% of the aggregate purchase price paid for accounts receivable purchased under the FGI facility.

The interest rate on advances or borrowings under the FGI facility is the greater of (i) 6.50% per annum and (ii) 2.50% per annum above the prime rate, as defined in the FGI facility, and was 6.50% at June 30, 2017 and December 31, 2016.
We were in compliance with the terms of the FGI facility at June 30, 2017. However, there is no guarantee that we will be able to borrow the full limit of $7.5 million if FGI chooses not to finance a portion of our receivables or inventory.

For additional information on our indebtedness, refer to Note 9, "Debt".

Capital Expenditures

As of June 30, 2017, we had no material commitments for capital expenditures and no material commitments are anticipated in the near future.

Off-Balance Sheet Arrangements

As of June 30, 2017 and December 31, 2016, we had no off-balance sheet arrangements.

Commitments and Contingencies

As of June 30, 2017, other than office leases, we had no material commitments other than the liabilities reflected in our unaudited condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q. For additional information, refer to Note 13, "Commitments and Contingencies".

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that the information required to be disclosed in our filings under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is (1) recorded, processed, summarized and reported within the time periods specified in SEC's rules and forms, and (2) accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our procedures or our internal controls will prevent or detect all errors and all fraud. Any internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the

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inherent limitations in all control systems, no evaluation of our controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) of the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 13, “Commitments and Contingencies” to the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

Item 1A. Risk Factors

This Quarterly Report on Form 10-Q contains forward-looking statements, which are subject to a variety of risks and uncertainties. Other actual results could differ materially from those anticipated in those forward-looking statements as a result of various factors, including those set forth in the risk factors relating to our business and common stock contained in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016. There are no material changes to such risk factors as of the date of this report.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information.

None.

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Item 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File Number	Exhibit	Filing Date	Filed Herewith
3.1.1	Composite Certificate of Incorporation of the Registrant.	10-K	001-33710	3.1	3/30/2016	
3.1.2	Certificate of Amendment to the Restated Certificate of Incorporation of the Registrant.	8-K	001-33710	3.1	7/26/2016	
3.2	By-Laws of the Registrant, as amended through November 6, 2008	10-Q	001-33710	3.1	11/10/2008	
31.1	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.2	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.1#	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X

- The information in this exhibit is furnished and deemed not filed with the Securities and Exchange Commission for purposes of section 18 of the Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of Registrant under the Securities Act of 1933, as amended, or the Exchange Act of 1934, as amended, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

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SIGNATURES

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

CLEAN DIESEL TECHNOLOGIES, INC.

Date: August 14, 2017 By: /s/ Matthew Beale
Matthew Beale
Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2017 By: /s/ Tracy Kern
Tracy Kern
Chief Financial Officer
(Principal Financial and Accounting Officer)