CLEAN DIESEL TECHNOLOGIES INC
Form 10-Q
August 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

rk 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, 2015

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, or a smaller reporting company. See the definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

(Do not check if a smaller reporting company)

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 July 31, 2015, the outstanding number of shares of the registrant s common stock, par value $0.01 per share, was 16,753,178.

CLEAN DIESEL TECHNOLOGIES, INC.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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, would, s 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 the discussion under the caption Risk Factors contained in our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission (the SEC) on March 18, 2015 and important factors discussed in this report and our other filings with the SEC, including without limitation the following:

· We have incurred losses and have not experienced positive cash flows from operations in the past, and our independent registered public accounting firm expressed substantial doubt about our ability to continue as a going concern in their reports on our financial statements for the years ended December 31, 2014 and 2013. Our ability to achieve profitability and positive cash flows from operations, or finance negative cash flows from operations, could depend on reductions in our operating costs, which may not be achievable, or from increased sales, which may not occur;

· We could require additional working capital to maintain our operations in the form of funding from outside sources which may be limited, difficult to obtain, or unavailable on acceptable terms or not available at all, or in the case of an offering of common stock or securities convertible into or exercisable for common stock, may result in dilution to our existing stockholders;

· *Future growth of our business depends, in part, on the general availability of* funding for emissions control programs, enforcement of existing emissions-related environmental regulations, further tightening of emission standards worldwide, market acceptance of our catalyst products, and successful product verifications;

· Historically, we have been dependent on a few major customers, particularly Honda, for a significant portion of our revenue and our revenue would decline if we are unable to maintain those relationships, if customers reduce their orders for our products, or if we are unable to secure new customers. In addition, we have an expired agreement with Honda that may limit our rights to commercialize certain technology within the scope of that agreement and adversely affect our technology licensing strategy;

· We cannot assure you that we will be successful in our transition into an advanced materials supplier or that those efforts will have the intended effect of increasing profitability;

· We may not be able to successfully market new products that are developed or obtain verification or approval of our new products;

· We depend on intellectual property and the failure to protect our intellectual property could adversely affect our future growth and success;

· We are subject to restrictions and must pay a royalty on certain sales of our products and technology in specified countries in Asia;

· If we are unable to attract and retain qualified personnel, it will harm the ability of our business to grow;

· We have entered into contractual agreements in connection with the sale of certain of our assets, which may expose us to liability for claims for indemnification under such agreements;

· Our results may fluctuate due to certain regulatory, marketing and competitive factors over which we have little or no control; and

· We face constant changes in governmental standards by which our products are evaluated as well as competition and technological advances by competitors.

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.

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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, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash	$ 6,784	$ 7,220
Accounts receivable, net	3,867	2,875
Inventories	6,403	6,298
Prepaid expenses and other current assets	1,268	2,130
Total current assets	18,322	18,523
Property and equipment, net	1,400	1,357
Intangible assets, net	2,291	2,662
Goodwill	4,967	5,177
Other assets	554	620
Total assets	$ 27,534	$ 28,339
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Line of credit	$ 3,583	$ 2,841
Accounts payable	3,831	3,022

Accrued expenses and other current liabilities		6,894		6,189
Income taxes payable		637		1,459
Total current liabilities		14,945		13,511
Shareholder notes payable		7,525		7,476
Deferred tax liability		339		359
Total liabilities		22,809		21,346
Commitments and contingencies (Note 12)				
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 24,000,000; issued and outstanding 16,753,178 and 14,152,772 shares at June 30, 2015 and December 31, 2014, respectively		168		142
Additional paid-in capital		204,793		200,771
Accumulated other comprehensive loss		(3,736)		(2,865)
Accumulated deficit		(196,500)		(191,055)
Total stockholders equity		4,725		6,993
Total liabilities and stockholders equity	$	27,534	$	28,339

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,	
	2015	**2014**	**2015**	**2014**
Revenues	$ 9,938	$ 11,673	$ 20,279	$ 23,252
Cost of revenues	7,171	7,848	14,694	15,687
Gross profit	2,767	3,825	5,585	7,565
Operating expenses:				
Selling, general and administrative	3,026	2,931	6,433	6,508
Research and development	1,854	1,472	3,973	2,768
Severance and other charges	(5)	34	1	377
Total operating expenses	4,875	4,437	10,407	9,653
Loss from continuing operations	(2,108)	(612)	(4,822)	(2,088)
Other expense:				
Interest expense	(301)	(288)	(577)	(592)
Other expense, net	(224)	(299)	(106)	(2,113)
Total other expense	(525)	(587)	(683)	(2,705)
Loss from continuing operations before income taxes	(2,633)	(1,199)	(5,505)	(4,793)
Income tax expense (benefit) from continuing operations	(217)	30	(60)	267
Net loss from continuing operations	(2,416)	(1,229)	(5,445)	(5,060)
Net income from discontinued operations	-	40	-	35
Net loss	(2,416)	(1,189)	(5,445)	(5,025)
Foreign currency translation adjustments	602	582	(871)	145
Comprehensive loss	$ (1,814)	$ (607)	$ (6,316)	$ (4,880)
Basic and diluted net income (loss) per common share:				
Net loss from continuing operations	$ (0.16)	$ (0.10)	$ (0.38)	$ (0.46)
Net income from discontinued operations	-	-	-	-
Net loss	$ (0.16)	$ (0.10)	$ (0.38)	$ (0.46)
Basic and diluted weighted average shares outstanding	14,846	12,304	14,503	11,038

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,	
	2015	**2014**
Cash flows from operating activities:		
Net loss	$ (5,445)	$ (5,025)
Net income from discontinued operations	-	(35)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	444	505
Stock-based compensation expense	316	284
Loss on change in fair value of liability-classified warrants	272	1,682
Gain on foreign currency transactions	(124)	153
Loss related to litigation	-	123
Gain on disposal of property and equipment	(4)	(296)
Offering costs allocated to warrants issued	88	165
Other	3	65
Changes in operating assets and liabilities:		
Accounts receivable	(1,068)	(210)
Inventories	(329)	(701)
Prepaid expenses and other assets	437	20
Accounts payable, accrued expenses and other current liabilities	296	18
Income taxes	(68)	(828)
Cash used in operating activities of continuing operations	(5,182)	(4,080)
Cash used in operating activities of discontinued operations	(100)	(45)
Net cash used in operating activities	(5,282)	(4,125)
Cash flows from investing activities:		
Purchases of property and equipment	(249)	(191)

Proceeds from sale of property and equipment	8	322
Distribution from unconsolidated affiliate	-	91
Net cash used in investing activities	(241)	222
Cash flows from financing activities:		
Net borrowings under demand line of credit	741	1,174
Proceeds from issuance of common stock and warrants, net of offering costs	4,490	6,114
Proceeds from exercise of warrants	-	1,000
Proceeds from exercise of stock options	-	275
Other	-	(18)
Net cash provided by financing activities	5,231	8,545
Effect of exchange rates on cash	(144)	7
Net change in cash	(436)	4,649
Cash at beginning of period	7,220	3,909
Cash at end of period	$ 6,784	$ 8,558
Significant noncash financing activity:		
Issuance of warrants classified as derivative liability	$ 845	$ 1,531

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. Description of Business

Clean Diesel Technologies, Inc. (CDTi or the Company) currently commercializes its material technology by manufacturing and distributing light duty vehicle catalysts and heavy duty diesel emissions control systems and products to major automakers, distributors, integrators and retrofitters. Further, CDTi is evolving from being a niche manufacturer of emissions control solutions for the automotive and heavy duty diesel OEM, retrofit and aftermarket markets to becoming an advanced materials technology provider for these markets. CDTi s business is driven by increasingly stringent global emission standards for internal combustion engines, which are major sources of a variety of harmful pollutants. It has operations in the United States (U.S.), Canada, the United Kingdom, France, Japan and Sweden as well as an Asian investment.

2. Liquidity and Going Concern

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. Therefore, the 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 $196.5 million at June 30, 2015. The Company has funded its operations through asset sales, credit facilities and other borrowings and equity sales.

At June 30, 2015, the Company had $6.8 million in cash, and based upon current cash levels, including proceeds from the June 2015 offering, and expected cash flows from operations, management believes that the Company will have access to sufficient working capital to fund operations through the end of this year and into next year. However, there can be no assurances that the Company will be able to achieve projected levels of revenue and maintain access to sufficient working capital. If cash from operations is not sufficient for the working capital needs of the Company, the Company may be forced to seek additional financing in the form of funding from outside sources. However, there is no assurance that the Company will be able to raise additional funds on terms acceptable to the Company or reduce its discretionary spending to a level sufficient for its working capital needs, 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 for the next twelve months.

The Company has a $7.5 million secured demand financing facility backed by its receivables and inventory with Faunus Group International, Inc. (FGI) that terminates on August 15, 2015 and may be extended at the Company s option for additional one-year terms. However, FGI can cancel the facility at any time. At June 30, 2015, the Company had $3.6 million in borrowings outstanding under this facility with $3.9 million available, subject to the availability of eligible accounts receivable and inventory balances for collateral. 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 its receivables or inventory.

On May 15, 2012, the Company filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission (SEC) (the Shelf Registration), which was declared effective by the SEC on May 21, 2012. The Shelf Registration permits the Company to sell, from time to time, up to an aggregate of $50.0 million of various securities, provided that the Company may not sell its securities in a primary offering pursuant to the Shelf Registration or any other registration statement on Form S-3 with a value exceeding one-third of its public float in any 12-month period (unless the Company s public float rises to $75.0 million or more). On May 19, 2015, the Company filed a shelf registration statement on Form S-3 with the SEC to replace the existing Shelf Registration (the Replacement Shelf), which the Company anticipates will be declared effective later this year. Once declared effective, the Replacement Shelf will permit the Company to sell, from time to time, up to an aggregate of $50.0 million of various securities, provided that the Company may not sell its securities in a primary offering pursuant to the Replacement Shelf or any other registration statement on Form S-3 with a value exceeding one-third of its public float in any 12-month period (unless the Company s public float rises to $75.0 million or more).

On April 4, 2014, the Company sold 2,030,000 units pursuant to the Shelf Registration for $3.40 per unit, with each unit consisting of one share of common stock and 0.4 of one warrant to purchase one share of common stock with an exercise price of $4.20 per share. The Company received net proceeds of $6.1 million after deducting placement agent fees and other offering expenses.

On October 20, 2014, the Company completed the sale of its Reno, Nevada-based custom fabricated exhaust parts and accessories business (the Reno Business) for $1.3 million in cash.

On November 4, 2014, the Company entered into subscription agreements to sell 1,385,000 shares of common stock and warrants to purchase up to an aggregate of 388,393 shares of common stock with an exercise price of $3.25 per share (the Series A Warrants), for a combined purchase price of $2.80 per share and 0.28 of one Series A Warrant, and other warrants to purchase up to an aggregate of 168,571 shares of common stock with an exercise price of $0.01 per share (the Series B Warrants) for a purchase price of $2.79 per Series B Warrant, pursuant to the Shelf Registration. The Company received net proceeds of $3.8 million after deducting placement agent fees and other offering expenses.

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CLEAN DIESEL TECHNOLOGIES, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

On November 11, 2014, the Company and Kanis S.A. entered into a letter agreement whereby Kanis S.A. agreed to amend the terms of the outstanding loans, in the aggregate principal amount of $7.5 million, made to the Company, such that (i) the maturity dates of all outstanding loans were extended to October 1, 2016; and (ii) the early redemption feature applicable to one of the outstanding loans was removed.

On June 2, 2015, the Company entered into an underwriting agreement to sell 2,500,000 units pursuant to the Shelf Registration for $2.05 per unit, with each unit consisting of one share of common stock and 0.2 of one warrant to purchase one share of common stock with an exercise price of $2.65 per share. The Company received net proceeds of $4.5 million after deducting the underwriting discounts and other offering expenses. For additional information, refer to Note 10, Stockholders Equity .

3. Summary of Significant Accounting Policies

a. 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 adjustments (consisting of normal recurring adjustments) 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 (U.S. 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 consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

The preparation of financial statements in conformity with U.S. GAAP 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 assets and liabilities. Actual results could differ materially from those estimates.

Discontinued Operations

In October 2014, the Company completed the sale of substantially all of the assets of its Reno Business, and the operations of this business were classified as discontinued operations for all periods presented in this report. Discontinued operations also includes accruals and related costs for the Company s estimated liability to settle its ongoing indemnification matters with Johnson Matthey (JM) associated with the sale of Applied Utility Systems, Inc. (AUS), a former subsidiary of the Company, in 2009. In the statements of cash flows, the cash flows of discontinued operations are separately classified and aggregated.

For additional information, refer to Note 14, Discontinued Operations .

All discussions and amounts in the consolidated financial statements and related notes for all periods presented relate to continuing operations only, unless otherwise noted.

b. Concentration of Risk

For the three months ended June 30, 2015 and 2014, one automotive OEM customer within the Catalyst segment accounted for 60% and 47%, respectively, of the Company s revenues. For the six months ended June 30, 2015 and 2014, one automotive OEM customer within the Catalyst segment accounted for 59% and 45%, respectively, of the Company s revenues. This customer accounted for 50% of the Company s accounts receivable at June 30, 2015 and December 31, 2014. No other customers accounted for 10% or more of the Company s revenues or accounts receivable for these periods.

For the periods presented below, certain vendors accounted for 10% or more of the Company s raw material purchases as follows:

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CLEAN DIESEL TECHNOLOGIES, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

		Three Months Ended June 30,		Six Months Ended June 30,	
Vendor	**Supplies**	**2015**	**2014**	**2015**	**2014**
A	Substrates	34%	17%	37%	19%
B	Substrates	13%	*	12%	*
C	Substrates	*	11%	*	11%
D	Catalysts	*	*	*	13%

* less than 10%

c. Net 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 and dilutive potential common shares. Dilutive potential common shares include employee stock options and restricted share units and warrants and debt that are convertible into the Company s common stock. Because the Company incurred net losses in the three and six months ended June 30, 2015 and 2014, the effect of potentially dilutive securities has been excluded in the computation of net loss per share as their impact would be anti-dilutive. Potentially dilutive common stock equivalents excluded were 2.8 million and 2.3 million shares during the three months ended June 30, 2015 and 2014, respectively. Potentially dilutive common stock equivalents excluded were 2.7 million and 2.1 million shares during the six months ended June 30, 2015 and 2014, respectively.

d. 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.

The Company records its liability-classified warrants at fair value in accordance with the fair value measurement framework. For additional information, refer to Note 11, Warrants . The valuation inputs hierarchy classification for the warrant liability measured at fair value on a recurring basis is summarized as follows (in thousands):

Warrant liability	**Level 1**	**Level 2**		**Level 3**
June 30, 2015	-	-	$	2,591
December 31, 2014	-	-	$	1,474

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):

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CLEAN DIESEL TECHNOLOGIES, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	Six Months Ended June 30, 2015			2014
Balance at beginning of period	$	1,474	$	939
Issuance of common stock warrants		845		1,531
Exercise of common stock warrants		-		(2,505)
Remeasurement of common stock warrants		272		1,682
Balance at end of period	$	2,591	$	1,647

e. Fair Value of Financial Instruments

Accounting Standards Codification (ASC) Topic 825, Financial Instruments , requires disclosure of the fair value of financial instruments for which the determination of fair value is practicable. The fair values of the Company s cash, trade 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 fair value of shareholder notes payable calculated using level 3 inputs, using a Black-Scholes option-pricing model to value the debt s conversion factor and a net present value model was $7.8 million and $7.7 million at June 30, 2015 and December 31, 2014, respectively.

f. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". ASU No. 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)". ASU No. 2014-09 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 No. 2014-09 provides for either full retrospective adoption or a modified retrospective adoption by which it is applied only to the most current period presented. The Company is currently in the process of evaluating the impact of the adoption of ASU No. 2014-09 on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern . ASU No. 2014-15 defines management's responsibility to assess an entity's ability to continue as a going concern, and to provide related footnote disclosures in certain circumstances. It is effective for annual reporting periods ending after

December 15, 2016, and for annual and interim reporting periods thereafter. Early adoption is permitted. The Company has not elected to early adopt, and it is currently in the process of evaluating the impact of the adoption of ASU No. 2014-15 on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs". ASU No. 2015-03 requires that debt issuance costs related to a recognized debt liability be reported on the consolidated statements of financial condition as a direct deduction from the carrying amount of that debt liability. It is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period with early application permitted for financial statements that have not been previously issued. The Company has not elected to early adopt, and it does not expect the impact of the adoption of ASU No. 2015-03 to be material to its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer s Accounting for Fees Paid in a Cloud Computing Arrangement". ASU No. 2015-05 provides clarification on whether a cloud computing arrangement includes a software license. If a software license is included, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a software license is not included, the arrangement should be accounted for as a service contract. It is effective for reporting periods beginning after December 15, 2015, with early adoption permitted. Entities can elect to adopt the standard update prospectively or retrospectively to arrangements entered into, or materially modified, after the effective date. The Company does not expect to early adopt ASU 2015-05, and it is currently in the process of evaluating the impact of the adoption of ASU No. 2015-05 on its consolidated financial statements.

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CLEAN DIESEL TECHNOLOGIES, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory . ASU No. 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 ending after December 15, 2016, including periods within those fiscal years. Early adoption is permitted. The Company has not yet determined whether it will elect to early adopt ASU 2015-11, and it is currently in the process of evaluating the impact of the adoption of ASU No. 2015-11 on its consolidated financial statements.

4. Inventories

Inventories consist of the following (in thousands):

	June 30, 2015	December 31, 2014
Raw materials	$ 2,864	$ 2,744
Work in process	961	902
Finished goods	2,578	2,652
	$ 6,403	$ 6,298

5. Goodwill and Intangible Assets

Goodwill

The change in the carrying amount of goodwill during the six months ended June 30, 2015 was due to the effect of foreign currency translation.

Intangible Assets

Intangible assets consist of the following (in thousands):

	Useful Life	June 30,	December 31,

	in Years		2015		2014
Trade name	15 - 20	$	1,254	$	1,293
Patents and know-how	5 - 12		4,337		4,529
Customer relationships	4 - 8		787		837
			6,378		6,659
Less accumulated amortization			(4,087)		(3,997)
		$	2,291	$	2,662

The Company recorded amortization expense related to amortizable intangible assets of $0.2 million and $0.1 million during the three months ended June 30, 2015 and 2014, respectively. The Company recorded amortization expense related to amortizable intangible assets of $0.3 million during the six months ended June 30, 2015 and 2014.

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

Years ending December 31		
Remainder of 2015	$	283
2016	$	471
2017	$	461
2018	$	164
2019	$	164
2020	$	164

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CLEAN DIESEL TECHNOLOGIES, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

6. Accrued Expenses and Other Current Liabilities

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

	June 30, 2015	December 31, 2014
Accrued salaries and benefits	$ 1,409	$ 1,115
Accrued severance and other charges (1)	108	372
Accrued warranty (2)	342	373
Warrant liability (3)	2,591	1,474
Accrued indemnification settlement (4)	550	650
Liability for consigned precious metals	494	565
Other	1,400	1,640
	$ 6,894	$ 6,189

(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 11, "Warrants".
(4) For additional information, refer to Note 14, "Discontinued Operations".

7. Severance and Other Charges

Severance and other charges consist of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Employee severance expense	$ (5)	$ 34	$ 1	$ 69
Lease exit costs	-	-	-	43
Legal settlements	-	-	-	265
Total severance and other charges	$ (5)	$ 34	$ 1	$ 377

The following summarizes the activity in the Company s accrual for severance and other charges (in thousands):

	Severance	Lease Exit Costs	Total
December 31, 2014	$ 293	$ 79	$ 372
Provision	1	-	1
Payments	(231)	(34)	(265)
June 30, 2015	$ 63	$ 45	$ 108

The Company expects to pay substantially all of the accrued amounts by the third quarter of 2015.

8. Accrued Warranty

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

	Six Months Ended June 30,	
	2015	2014
Balance at beginning of period	$ 373	$ 453
Accrued warranty expense	219	363
Warranty claims paid	(225)	(338)
Translation adjustment	(25)	7
Balance at end of period	$ 342	$ 485

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(Unaudited)

9. Debt

Debt consists of the following (in thousands):

	June 30, 2015	December 31, 2014
Line of credit with FGI	$ 3,583	$ 2,841
$1.5 million, 8% shareholder note due 2016 (1)	1,612	1,598
$3.0 million, 8% subordinated convertible shareholder notes due 2016 (1)	2,962	2,947
$3.0 million, 8% shareholder note due 2016 (1)	2,951	2,931
	11,108	10,317
Less current portion	(3,583)	(2,841)
	$ 7,525	$ 7,476

(1) The aggregate amount of unamortized debt discount was $0.1 million and $0.2 million at June 30, 2015 and December 31, 2014, respectively.

Line of Credit with FGI

At June 30, 2015, the Company had $2.9 million of gross accounts receivable pledged to FGI as collateral for short-term debt in the amount of $2.3 million. At June 30, 2015, the Company also had $1.3 million in borrowings outstanding against eligible inventory. The Company was in compliance with the terms of the FGI Facility at June 30, 2015. 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 its receivables or inventory.

10. Stockholders Equity

June 2015 Offering

On June 2, 2015, the Company entered into an underwriting agreement with Cowen and Company, LLC, as the representative of the several underwriters identified therein, pursuant to which the Company agreed to offer and sell up to 2,500,000 units at a price to the public of $2.05 per unit (the Offering). Each unit consisted of one share of common stock and 0.2 of a warrant (the Offering Warrants) to purchase one share of common stock. The Offering Warrants have an exercise price of $2.65 per share and can be exercised during the period commencing after six months and ending five and a half years from the date of issuance.

The Company received gross proceeds of $5.1 million and net proceeds of $4.5 million after deducting the underwriting discounts and other offering expenses. The Offering Warrants are within the scope of ASC 815-40 and are required to be recorded as liabilities. For additional information, refer to Note 11, Warrants . Accordingly, of the $4.5 million in net proceeds, $3.7 million was allocated to the common stock and included in additional paid-in capital and $0.8 million was allocated to the warrant liability based on the fair value of the warrants on the issuance date. Additionally, $0.1 million of the underwriter discounts and other offering costs were allocated to the Offering Warrants, based on the relative fair value of the Offering Warrants and the common stock on the issuance date, and was included in other expense, net in the accompanying statements of comprehensive loss for the three and six months ended June 30, 2015. The Company intends to use the net proceeds for general corporate purposes, which may include working capital, general and administrative expenses, capital expenditures and implementation of its strategic priorities. The Company may also use a portion of the net proceeds to acquire or invest in businesses, products and technologies that are complementary to its current business, although there are no present commitments or agreements for any such transactions.

11. Warrants

Warrants outstanding and exercisable are summarized as follows:

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	Shares	Weighted Average Exercise Price	Range of Exercise Prices
Outstanding at December 31, 2014	1,610,069	$ 3.54	$1.25 - $10.40
Issued	500,000	$ 2.65	$2.65
Outstanding at June 30, 2015	2,110,069	$ 3.33	$ 1.25 - $10.40
Exercisable at June 30, 2015	1,610,069	$ 3.54	$1.25 - $10.40

Warrant Classification

The Company evaluates warrants on issuance and at each reporting date to determine proper classification as equity or as a liability. The Offering Warrants require physical settlement by delivering registered shares, and the provisions of the warrant agreement include potential cash payments for failure to timely deliver shares and fractional share settlement. Accordingly, the Offering Warrants require liability classification.

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 warrants 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 warrant 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.

Due to the significant change in the Company following its business combination with Catalytic Solutions, Inc. (the Merger), CDTi s pre-Merger historical price volatility was not considered representative of expected volatility going forward. Therefore, for warrants with an expected term that required a volatility look-back that pre-dated the Merger, the Company used an estimate based upon a weighted average of implied and historical volatility of a portfolio of peer companies and CDTi s post-Merger historical volatility for the valuation of these warrants prior to 2015. For warrants with an expected term that did not require a volatility look-back that pre-dated the Merger, CDTi s post-Merger historical price volatility was considered representative of expected volatility, and accordingly, only CDTi s historical volatility was used for the valuation of these warrants prior to 2015. During 2015, the Company determined that its post-Merger historical volatility was considered representative of expected volatility for the valuation of its warrants. The expected life is equal to the remaining contractual life of the warrants.

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The assumptions used in the Black-Scholes option-pricing model to estimate the fair value of the warrant liability for these warrants outstanding are as follows:

	June 30, 2015	June 8, 2015	December 31, 2014
Issued April 2014			
Number of warrants	812,000		812,000
CDTi stock price	$ 1.84		$ 1.81
Strike price	$ 4.20		$ 4.20
Expected volatility (1)	121.4%		86.6%
Risk-free interest rate	1.4%		1.6%
Dividend yield	-		-
Expected life in years	4.3		4.8
Issued November 2014			
Number of warrants	388,393		388,393
CDTi stock price	$ 1.84		$ 1.81
Strike price	$ 3.25		$ 3.25
Expected volatility (1)	122.5%		86.5%
Risk-free interest rate	1.4%		1.6%
Dividend yield	-		-
Expected life in years	4.4		4.9
Issued June 2015			
Number of warrants	500,000	500,000	
CDTi stock price	$ 1.84	$ 2.09	
Strike price	$ 2.65	$ 2.65	
Expected volatility	106.4%	114.6%	
Risk-free interest rate	1.7%	1.8%	
Dividend yield	-	-	
Expected life in years	5.4	5.5	

(1) During 2015, the Company's post-Merger historical volatility began to be considered representive of expected volatility for these warrants.

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The assumptions used in the Monte Carlo simulation model to estimate the fair value of the warrant liability for warrants outstanding with full-ratchet down-round protection are as follows:

		June 30, 2015		**December 31, 2014**
Issued July 2013				
Number of warrants		159,000		159,000
CDTi stock price	$	1.84	$	1.81
Strike price	$	1.25	$	1.25
Expected volatility		98.9%		103.6%
Risk-free interest rate		1.0%		1.2%
Dividend yield		-		-
Expected life in years		3.0		3.5
Issued November 2014				
Number of warrants		80,000		80,000
CDTi stock price	$	1.84	$	1.81
Strike price	$	1.75	$	1.75
Expected volatility (1)		106.6%		77.0%
Risk-free interest rate		1.4%		1.6%
Dividend yield		-		-
Expected life in years		4.4		4.9

(1) During 2015, the Company's post-Merger historical volatility began to be considered representive of expected volatility for these warrants.

The warrant liability, included in accrued expenses and other current liabilities in the accompanying unaudited condensed consolidated balance sheets, is re-measured at the end of each reporting period with changes in fair value recognized in other expense, net in the accompanying unaudited condensed 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. For additional information regarding the fair value of the warrant liability, amounts recognized in other income (expense) and amounts reclassified to additional paid-in capital upon exercise, refer to the warrant liability reconciliation in Note 3(d), Summary of Significant Accounting Policies Fair Value Measurements .

12. Commitments and Contingencies

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 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 consolidated financial statements as of June 30, 2015, nor is it possible to estimate what litigation-related costs will be in the future.

For information related to commitments and contingencies related to AUS, a former subsidiary of the Company that was sold in 2009, refer to Note 14, Discontinued Operations .

13. Segment Reporting and Geographic Information

The Company has two business division segments based on the products it delivers:

Catalyst division The Catalyst division develops and produces catalysts to reduce emissions from gasoline, diesel and natural gas combustion engines that are offered for multiple markets and a wide range of applications. The Catalyst Division developed a family of unique high-performance catalysts, featuring inexpensive base-metals with low or even no platinum group metals to provide increased catalytic function and value for technology-driven automotive industry customers. The Catalyst division s technical and manufacturing competence in the light duty vehicle market is aimed at meeting auto makers most stringent requirements, and it has supplied over eleven million parts to light duty vehicle customers since 2001. The Catalyst division also provides catalyst formulations for the Company s Heavy Duty Diesel Systems division. Intersegment revenues are based on market prices.

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Heavy Duty Diesel Systems division The Heavy Duty Diesel Systems division designs and manufactures exhaust emissions control solutions. This division offers a full range of DuraFit OEM replacement diesel particulate filters and products for the verified retrofit and non-retrofit OEM markets through its distributor/dealer network and direct sales. These products are used to reduce exhaust emissions created by on-road, off-road and stationary diesel and alternative fuel engines including propane and natural gas. The retrofit market in the U.S. is driven in particular by state and municipal environmental regulations and incentive funding for voluntary early compliance. The Heavy Duty Diesel Systems division derives significant revenues from retrofit with a portfolio of solutions verified by the California Air Resources Board and the United States Environmental Protection Agency.

Corporate Corporate includes cost for personnel, insurance and public company expenses such as legal, audit and taxes that are not allocated down to the operating divisions.

Summarized financial information for the Company s reportable segments is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues				
Catalyst	$ 6,882	$ 6,289	$ 13,693	$ 12,100
Heavy Duty Diesel Systems	3,826	6,101	7,978	12,376
Eliminations (1)	(770)	(717)	(1,392)	(1,224)
Total	$ 9,938	$ 11,673	$ 20,279	$ 23,252
Income (loss) from operations				
Catalyst	$ (157)	$ 361	$ (715)	$ 583
Heavy Duty Diesel Systems	(484)	642	(862)	938
Corporate	(1,419)	(1,625)	(3,129)	(3,599)
Eliminations (1)	(48)	10	(116)	(10)
Total	$ (2,108)	$ (612)	$ (4,822)	$ (2,088)

(1) Elimination of Catalyst revenue and profit in ending inventory related to sales to Heavy Duty Diesel Systems.

Net sales by geographic region based on the location of sales organization is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
United States	$ 6,296	$ 5,683	$ 12,643	$ 11,097
Canada	2,835	4,689	5,957	9,716
Europe	807	1,301	1,679	2,439
Total international	3,642	5,990	7,636	12,155
Total revenues	$ 9,938	$ 11,673	$ 20,279	$ 23,252

14. Discontinued Operations

The Reno Business

On October 20, 2014, the Company completed the sale of its Reno Business for $1.3 million in cash. The net assets held for sale of the Reno Business were eliminated from the Company s balance sheet as of the sale date, and the Company recognized a gain of $0.2 million. Historically, the Reno Business was a component of the Company s Heavy Duty Diesel Systems division.

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Applied Utility Systems, Inc.

The Company is undergoing a sales and use tax audit by the State of California (the State) on AUS for the period of 2007 through 2009. The audit has identified a project performed by the Company during that time 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. Regardless of this finding, the Company continues to believe that it will prevail in this matter, as it believes that the State did not adequately address the legal arguments related to the Company s acceptance of the valid resale certificate from its customer. The Company has not agreed to these findings, and therefore, it will be appealing at a higher level at the BOE. Based on a re-audit, the BOE lowered the tax due to $0.9 million, inclusive of interest. However, the Company continues to not agree with these findings based on the aforementioned reasons, and it will continue with the appeals process. Accordingly, no accrual has been recorded for this matter as the Company does not assess a loss as being probable. Should the Company not prevail in this matter, it will pursue reimbursement from the customer for all assessments from the State.

On November 15, 2013, BP Products North America (BP) instituted claims against Johnson Matthey (JM) as the parent company of and purchaser of Applied Utility Systems, Inc. (AUS), a former subsidiary of the Company. On May 12, 2010, JM tendered to the Company a claim for indemnification under the Asset Purchase Agreement dated October 1, 2009 (the Asset Purchase Agreement) among JM, the Company and AUS. On June 11, 2013, BP, JM and the Company entered into a settlement agreement and mutual release pursuant to which they settled all claims. This settlement agreement had no material impact on the Company. Under the indemnification clauses of the Asset Purchase Agreement, the Company may be liable for legal expenses incurred by JM. These legal costs may be offset against funds withheld by JM from the acquisition of AUS.

In connection with the Asset Purchase Agreement, on October 1, 2009, JM presented the Company with an indemnification claim seeking recovery of the net amount of $0.9 million after offsetting the funds withheld by JM from the acquisition of AUS. These claims are for matters relating to various customer contracts that JM purchased, including the BP contract discussed above. The Company and JM entered into discussions relating to the application of offsets and the validity of the claims presented. The Company initially offered a settlement amount of $0.2 million during the fourth quarter of 2013, and during the third and fourth quarters of 2014, it offered increases to the settlement amount that have now increased its total settlement offer to $0.7 million. The expense for the value of these settlement offers was recorded in discontinued operations at the time that each offer was made, and the associated liability was included in accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheets. On June 3, 2015, JM and the Company entered into a settlement and release agreement pursuant to which they settled all claims for the aforementioned offer of $0.7 million. This settlement was paid with an initial $0.1 million installment upon execution of the settlement and release agreement, and the remaining balance was paid in July 2015.

In presenting discontinued operations, general corporate overhead expenses that have been historically allocated to the Reno Business for segment presentation purposes are not included in discontinued operations. The following table presents revenue and expense information for discontinued operations.

	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Revenue	$ 918	$ 1,801
Expenses	(878)	(1,766)
Net income from discontinued operations	$ 40	$ 35

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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 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, 2014. This discussion contains forward-looking statements, the accuracy of which involves risks and uncertainties. Refer to the Cautionary Note Concerning Forward-Looking Statements at the beginning of this Quarterly Report on Form 10-Q. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, as a result of many important factors, including those set forth in Part I Item 1A Risk Factors of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

References to Notes are notes included in the unaudited condensed consolidated financial statements included elsewhere in the Quarterly Report on Form 10-Q.

Overview

Our business is evolving from being a niche manufacturer of emissions control solutions for the automotive and heavy duty diesel OEM, retrofit and replacement markets to becoming an advanced materials technology provider for these markets. We have a proven ability to develop proprietary materials incorporating various base metals that replace costly platinum group metals, or PGM, and rare earth metals in coatings on vehicle catalytic converters. Over the past decade, we have developed several generations of high performance catalysts, including our low-PGM MPC® catalysts that are used on certain new Honda vehicles. Recently, we have expanded our materials platform to include new SPGM™ diesel oxidation catalysts, Base-Metal Activated Rhodium Support, or BMARS™, and Spinel technologies. Initial vehicle tests using these new technologies have demonstrated dramatic PGM savings compared to current OEM catalysts. We are now in the process of introducing these new catalyst technologies to OEMs and other vehicle 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. We believe that this powder-to-coat business model will allow us to achieve greater scale and higher return on our technology investment than in the past, while continuing to manufacture catalysts for select customers in our existing facilities.

We currently commercialize our materials technology by manufacturing and distributing light duty vehicle catalysts and heavy duty diesel emissions control systems and products to major automakers, distributors, integrators and retrofitters. We have more than 14 years history of supplying catalysts to light duty vehicle OEMs and 35 years of experience in the heavy duty diesel systems market. We have a proven technical and manufacturing competence in the light duty vehicle catalyst market meeting auto makers stringent requirements for performance, quality and delivery. Our business is driven by increasingly stringent global emission standards for internal combustion engines, which are major sources of a variety of harmful pollutants. Since inception, we have developed a substantial portfolio of patents and related proprietary rights and extensive technological know-how.

We organize our operations in two business divisions: Catalyst and Heavy Duty Diesel Systems.

Catalyst: Utilizing our advanced materials technology platform, we develop and produce catalysts to reduce emissions from gasoline, diesel and natural gas combustion engines. Most catalytic systems require significant amounts of costly PGMs to operate efficiently. Using our proprietary mixed-phase catalyst, or MPC®, technology, we have developed a family of unique high-performance catalysts, featuring inexpensive base-metals with low or even no PGM content. We have recently developed a new generation of catalyst technologies, which we believe will enable further advances in catalyst performance and further reductions in PGM usage. Our technical and manufacturing capabilities have been established to meet automakers most stringent requirements. Since 2001, we have supplied over eleven million parts to light duty vehicle OEM customers. Our Catalyst division is also a supplier of products for our Heavy Duty Diesel Systems division. Revenues from our Catalyst division accounted for 61% and 47% of the total consolidated revenues for the six months ended June 30, 2015 and 2014, respectively.

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Heavy Duty Diesel Systems: We specialize in the design and manufacture of exhaust emissions control solutions for a wide range of heavy duty diesel applications. We offer a full range of DuraFit OEM replacement diesel particulate filters and products for the verified retrofit and non-retrofit OEM markets through our distribution/dealer network and direct sales. We believe we offer one of the industry s most comprehensive portfolios of emissions control systems for use in engine retrofit programs that have been evaluated and verified as compliant with applicable regulations by the United States, or U.S., Environmental Protection Agency, or EPA, and the California Air Resources Board, or CARB, as well as by regulators in several European countries. We recently announced that we received certification from the Verification of Emission Reduction Technologies Association (VERT) for our Purifilter® exhaust gas recirculation (EGR) diesel particulate filter system, which expands our retrofit market opportunities into South America and other international locations. Sales of emissions control systems by our Heavy Duty Diesel Systems division are driven by the regulation of diesel emissions, particularly in the State of California. Revenues from our Heavy Duty Diesel Systems division accounted for 39% and 53% of the total consolidated revenues for the six months ended June 30, 2015 and 2014, respectively.

Strategy

Our strategy is to transition from being a niche manufacturer of emissions control solutions for the automotive and heavy duty diesel OEM, retrofit and replacement markets to becoming an advanced materials technology provider for these markets. In support of this strategy, we have filed a significant number of patents that underpin next-generation technology for our advanced low-PGM catalysts. Late last year, we were awarded two significant patents for our new Spinel technology, a proprietary clean emissions exhaust platform aimed at improved catalytic performance, which we believe will dramatically reduce the cost of compliance with more stringent clean-air requirements. This is becoming increasingly relevant as new standards, such as the EPA s Tier 3, become effective and are expected to require increased loadings of PGMs to achieve compliance with conventional formulation technology.

We have recently completed an initial series of vehicle tests to validate our next-generation technologies for specific introductory products for global OEMs, with a goal of accelerating broad commercialization of these technologies. Based on the success of these tests, we are beginning to make our new catalyst technologies available to OEMs and other catalytic coaters for use in proprietary powder form, and we foresee multiple paths to market our new technologies to complement our existing business model.

We plan to continue to maintain our current world-class manufacturing capability, and deploy it selectively where it adds value for our customers; to explore new joint ventures and partnerships; and to pursue new verticals. We intend to continue to evaluate and refine our strategic plan in order to seize opportunities as they arise.

Since 2013, we have filed over 100 patents pertaining to our advanced low-PGM and ZPGM catalysts. The development of our advanced low-PGM and ZPGM catalysts utilizing our new technologies and their commercialization is a strategic priority and will require investment in research, development, marketing and sales.

Recent Developments

Initial Vehicle and Engine Test Results

· **SPGM™ diesel oxidation catalyst technology**. Preliminary engine and vehicle test results indicate the achievement of emission control and system performance comparable to a leading OEM catalyst product while reducing PGM usage by over 80%.

· **BMARS™ technology.** Initial test results also demonstrate that BMARS™, with one catalyst and 50% less PGM, outperformed the OEM s typical two-catalyst system on a popular passenger car. These results provide OEMs the prospect of eliminating one of the catalyst units altogether, while achieving a greater than 50% PGM cost reduction on the remaining catalyst unit.

· **Spinel technology.** Initial vehicle test results demonstrated that a Spinel underfloor catalyst with 97% less PGM usage achieved emissions control performance equivalent to the OEM catalyst. Testing of the Spinel close coupled catalyst is currently underway with results expected during the 2nd half of 2015.

Collaboration Agreement

We recently entered into a collaboration agreement with AP Exhaust Technologies, Inc., or AP Exhaust, to commercialize next-generation catalysts. This collaboration aims to bring to market our latest catalyst technologies, which include MPC®, BMARS and Spinel, across portions of AP Exhaust's extensive aftermarket catalytic converter product line. This collaboration agreement is also expected to involve a powder-to-coat business model whereby we would sell AP Exhaust enabling proprietary catalytic powders that AP Exhaust would precision coat onto catalytic converter substrates in its state-of-the-art coating facility. The initial drive to commercialization will target the North American aftermarket for light duty replacement catalytic converters, and it is designed to achieve large-scale, rapid commercialization of our advanced catalyst technologies.

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Equity Financing

On June 2, 2015, we entered into an underwriting agreement, pursuant to which we agreed to offer and sell up to 2,500,000 units at a price to the public of $2.05 per unit. Each unit consisted of one share of common stock and 0.2 of a warrant (the Offering Warrants) to purchase one share of common stock. The Offering Warrants have an exercise price of $2.65 per share and can be exercised during the period commencing after six months and ending five and a half years from the date of issuance. We received net proceeds of $4.5 million after deducting the underwriting discounts and other offering expenses. We intend to use the net proceeds for general corporate purposes, which may include working capital, general and administrative expenses, capital expenditures and implementation of strategic priorities. We may also use a portion of the net proceeds to acquire or invest in businesses, products and technologies that are complementary to our current business, although there are no present commitments or agreements for any such transactions.

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, 2014 for a more complete discussion of our critical accounting policies and estimates.

Recently Issued Accounting Guidance

Refer to Note 3(f), Summary of Significant Accounting Policies Recent Accounting Pronouncements .

Factors Affecting Future Results

Technology Strategy

Our strategy is to transition from being a niche manufacturer of emissions control solutions for the automotive and heavy duty diesel OEM, retrofit and replacement markets to becoming an advanced materials technology provider for these markets. In support of this strategy, we have filed a significant number of patents that underpin next-generation technology for our advanced low-PGM catalysts. It is our intention to invest in developing and commercializing these catalyst technologies. As a consequence, we anticipate that we will continue to expand our intellectual property portfolio with additional patents in 2015 and beyond. In addition, we will invest in other development and marketing activities, including hiring of personnel and incurring costs for outside testing and consulting.

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DuraFit

In the third quarter of 2014, we introduced CDTi s DuraFit OEM replacement diesel particulate filters through independent distributors to provide an alternative to OEM manufactured parts. According to market analysis firm Power System Research, manufacturers in North America have produced an average of 250,000 heavy duty on-road diesel vehicles equipped with diesel particulate filters each year since 2007 to comply with EPA requirements. The typical OEM warranty on diesel particulate filters is 5 years and has expired for many of these vehicles with more continuing to expire in the coming years. As 2007 and newer diesel particulate filters from OEMs fail and require replacement, non-OEM diesel particulate filters will be needed as replacements. According to a 2012 industry report, the market for medium and heavy duty vehicle after-treatment maintenance and repair is projected to grow from $0.3 billion in 2010 to $3.0 billion by 2017. Recently, we announced that the New York Department of Sanitation, or DSNY, became the first major fleet customer for our DuraFit OEM replacement diesel particulate filters. The DSNY operates the largest municipal-owned sanitation fleet in the world consisting of approximately 3,000 vehicles including refuse collection trucks and mechanical street sweepers. Additionally, we recently announced that we signed a National Distribution Agreement, pursuant to which DuraFit will be sold under a private label to hundreds of retailers in the North American aftermarket. As expected, sales from these products were modest in 2014, with increased sales expected in 2015 and beyond.

Customer Dependency

Historically, we have derived a significant portion of our revenue from a limited number of customers. For example, sales to Honda represented 59% of our revenues for the six months ended June 30, 2015 and 52% of our revenues for the year ended December 31, 2014. While we continually seek to broaden our customer base, it is likely that for the foreseeable future we will remain dependent on Honda to supply a substantial portion of our revenue. Manufacturers typically seek to have two or more sources of critical components. However, there can be no assurance that manufacturers for which we are a shared supplier will not sole source the products we supply. Once our product is designed into a vehicle model, we generally supply our component for the life of that model. There can be no assurance, however, that our customers will retain us for a full model term. In this regard, relationships with our customers are based on purchase orders rather than long-term formal supply agreements and customers can discontinue or materially reduce orders without warning or penalty. In addition, while new models tend to remain relatively stable for a few years, there can be no assurance that manufacturers will not change models more rapidly, or change the performance requirements of components used in those models, and use other suppliers for these new or revised models.

Our business with Honda has grown steadily in the last few years as we have expanded the sale of our catalyst solutions from four passenger vehicle models in 2012 to seven models in 2014. In conjunction with our longstanding relationship with Honda, we entered into a joint research agreement with the motorcycle division of Honda regarding the development of ZPGM catalysts for motorcycles. The agreement was signed in 2010, extended in 2012 and expired in March 2014, although confidentiality provisions continue to survive. The agreement provides that technology within the scope of the agreement developed solely by one party is owned by that party, and that technology within the scope of the agreement that is jointly developed by both parties is jointly owned. The parties are in the process of assessing what technology, if any, developed during the term of the agreement is jointly owned. While we believe that core technology within the scope of the agreement was developed solely by us, there can be no assurance that our belief will not be challenged or invalidated. To the extent that Honda is a joint owner of critical technology developed under the agreement, Honda (including its automotive division) might not be required to pay us a license or royalty fee for use of the jointly owned technology; Honda may be able to manufacture its own catalysts based on the jointly owned technology; and Honda may be able to license the jointly owned technology to others without our consent. In addition, under the terms of the agreement, we may not be able to license jointly owned technology to others without Honda s consent. Our inability to license jointly owned technology to others could adversely affect our technology licensing strategy. Further, as noted above, we do not have long-term supply agreements with Honda, and accordingly, Honda could terminate its relationship with us at any time for any reason.

Government Funding and Standards

The nature of our business is heavily influenced by government funding of emissions control projects and increased emission control regulations and mandates. Compliance with these regulatory initiatives drives demand for our products and the timing of the implementation of emission reduction projects. We believe that, due to the constant focus on the environment and clean air standards throughout the world, it can be expected that new and more stringent regulations, both domestically and abroad, will continually be adopted, requiring the ongoing development of new products that meet these standards. However, the availability of funding to incentivize the adoption of emission reduction programs is often one-off, which means that such funding does not generally result in a regular source of recurring revenues for us.

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Macroeconomic Factors Impacting the Automotive Industry

Since the customers of our Catalyst division are primarily OEM auto makers, this division is generally affected by macroeconomic factors impacting the automotive industry. Demand for our products is tied directly to the demand for vehicles. Accordingly, factors that affect the truck and automobile markets have a direct effect on our business, including factors outside of our control, such as vehicle sales slowdowns due to economic concerns, or as a result of natural disasters, including earthquakes and/or tsunamis.

In addition, our business, operations, results of operation and financial condition may be affected by other factors, including those discussed in Part I, Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2014, and our other filings with the Securities and Exchange Commission, or SEC.

Results of Operations

The tables in the discussion that follow are based upon the way we analyze our business. For additional information regarding our business divisions, refer to Note 13, Segment Reporting and Geographic Information .

Comparison of Three Months Ended June 30, 2015 to Three Months Ended June 30, 2014

Revenues

	Three Months Ended June 30,					
	2015	% of Total Revenues	2014	% of Total Revenues	Change $	Change %
	($ in thousands)					
Catalyst	$ 6,882	69%	$ 6,289	54%	$ 593	9%
Heavy Duty Diesel Systems	3826	38%	6,101	52%	(2,275)	(37)%
Intercompany revenues	(770)	(7)%	(717)	(6)%	(53)	(7)%
Total revenues	$ 9,938	100%	$ 11,673	100%	$ (1,735)	(15)%

Excluding intercompany revenues, the increase in revenues for our Catalyst division was due to an increase in demand from our Japanese OEM customer, including the new model that we announced in March of 2015, which entered production in January of 2015. Further, unit volume for this customer increased by 6% for vehicles currently in mass production.

The decrease in revenues for our Heavy Duty Diesel Systems division was due to a sharp downturn in retrofit due to a compliance deadline in California during the prior year period, partially offset by DuraFit sales, which are just beginning to ramp.

We eliminate intercompany revenues from the Catalyst division to our Heavy Duty Diesel Systems division in consolidation.

Gross profit

	Three Months Ended June 30,				
	2015	% of Revenues (1)	2014	% of Revenues (1)	Percentage point change in gross profit margin
	($ in thousands)				
Catalyst	$ 1,816	26%	$ 1,721	27%	(1)%
Heavy Duty Diesel Systems	1,001	26%	2,095	34%	(8)%
Intercompany eliminations	(50)	-	9	-	-
Total gross profit	$ 2,767	28%	$ 3,825	33%	(5)%

(1) Division calculations based on division revenues. Total based on total revenues.

The gross margin for our Catalyst division remained fairly consistent.

The decrease in gross margin for our Heavy Duty Diesel Systems division was a result of the aforementioned decrease in revenues, coupled with the impact of fixed costs. Further, gross margin was impacted by DuraFit launch costs and a supply chain that we are in the process of optimizing.

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Operating expenses

	Three Months Ended June 30,					
	2015	% of Total Revenues	2014	% of Total Revenues	Change $	Change %
	($ in thousands)					
Selling, general and administrative	$ 3,026	30%	$ 2,931	25%	$ 95	3%
Research and development	1,854	19%	1,472	13%	382	26%
Severance and other charges	(5)	0%	34	0%	(39)	(115)%
Total operating expenses	$ 4,875	49%	$ 4,437	38%	$ 438	10%

Selling, general and administrative expenses

The increase was primarily due to a $0.3 million gain on the sale of a building at one of our foreign locations in the prior period, and partially offsetting the change from this gain were employee-related cost savings in the current period.

Research and development expenses

The increase was primarily due to development work and outside testing related to new products and employee-related costs to support our technology initiatives. During 2015, we expect costs to be higher than 2014 and to remain fairly consistent sequentially, as we continue testing newer technologies and pursuing our advanced materials business strategy.

Severance and other charges

The decrease was due to higher severance costs in the prior year period.

Other expense

	Three Months Ended June 30,			
	2015	2014	Change $	Change %
	($ in thousands)			
Interest expense	$ (301)	$ (288)	$ (13)	(5)%

Other expense, net		(224)		(299)	75	25%
Total other expense	$	(525)	$	(587)	$ 62	11%

The decrease in total other expense was due to a decrease in foreign exchange losses and less offering costs attributable to the relative fair value of warrants issued, partially offset by a decrease in income for the change in the warrant liability re-measurement.

Income Tax Expense (Benefit)

We incurred income tax benefit of $0.2 million in the three months ended June 30, 2015. The effective income tax rates were 8.2% and (2.5)% for the three months ended June 30, 2015 and 2014, 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.

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Comparison of Six Months Ended June 30, 2015 to Six Months Ended June 30, 2014

Revenues

	Six Months Ended June 30,				Change	
	2015	% of Total Revenues	2014	% of Total Revenues	$	%
	($ in thousands)					
Catalyst	$ 13,693	68%	$ 12,100	52%	$ 1,593	13%
Heavy Duty Diesel Systems	7,978	39%	12,376	53%	(4,398)	(36)%
Intercompany revenues	(1,392)	(7)%	(1,224)	(5)%	(168)	(14)%
Total revenues	$ 20,279	100%	$ 23,252	100%	$ (2,973)	(13)%

Excluding intercompany revenues, the increase in revenues for our Catalyst division was due to an increase in demand from our Japanese OEM customer, including the new model that we announced in March of 2015, which entered production in January of 2015. Further, unit volume for this customer increased by 8% for vehicles currently in mass production.

The decrease in revenues for our Heavy Duty Diesel Systems division was due to a sharp downturn in retrofit due to a compliance deadline in California during the prior year period, partially offset by DuraFit sales, which are just beginning to ramp.

We eliminate intercompany revenues from the Catalyst division to our Heavy Duty Diesel Systems division in consolidation.

Gross profit

	Six Months Ended June 30,				Percentage point change in gross profit margin
	2015	% of Revenues (1)	2014	% of Revenues (1)	
	($ in thousands)				
Catalyst	$ 3,562	26%	$ 3,240	27%	(1)%
Heavy Duty Diesel Systems	2,139	27%	4,336	35%	(8)%
Intercompany eliminations	(116)	-	(11)	-	-
Total gross profit	$ 5,585	28%	$ 7,565	33%	(5)%

(1) Division calculations based on division revenues. Total based on total revenues.
The gross margin for our Catalyst division remained fairly consistent.

The decrease in gross margin for our Heavy Duty Diesel Systems division was a result of the aforementioned decrease in revenues, coupled with the impact of fixed costs. Further, gross margin was impacted by DuraFit launch costs and a supply chain that we are in the process of optimizing.

Operating expenses

	Six Months Ended June 30,				Change	
	2015	% of Total Revenues	2014	% of Total Revenues	$	%
	($ in thousands)					
Selling, general and administrative	$ 6,433	32%	$ 6,508	28%	$ (75)	(1)%
Research and development	3,973	19%	2,768	12%	1,205	44%
Severance and other charges	1	0%	377	2%	(376)	(100)%
Total operating expenses	$ 10,407	51%	$ 9,653	42%	$ 754	8%

Selling, general and administrative expenses

The dollar decrease was primarily due to employee-related cost savings, and partially offsetting the change from these cost savings was a $0.3 million gain on the sale of a building at one of our foreign locations in the prior period.

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Research and development expenses

The increase was primarily due to development work and outside testing related to new products and employee-related costs to support our technology initiatives. During 2015, we expect costs to be higher than 2014 and to remain fairly consistent sequentially, as we continue testing newer technologies and pursuing our advanced materials business strategy.

Severance and other charges

The decrease was due to litigation settlement costs, settlement of a customer dispute and higher severance costs in the prior year period.

Other expense

	Six Months Ended June 30,					
					Change	
		2015		2014	$	%
			($ in thousands)			
Interest expense	$	(577)	$	(592)	$ 15	3%
Other expense, net		(106)		(2,113)	2,007	95%
Total other expense	$	(683)	$	(2,705)	$ 2,022	75%

The decrease in total other expense was due to a $1.4 million decrease in losses for the warrant liability re-measurement driven largely by lower stock prices and foreign exchange gains in the current year period.

Income Tax Expense (Benefit)

We incurred income tax expense (benefit) of $(0.1) million and $0.3 million in the six months ended June 30, 2015 and 2014, respectively. The effective income tax rates were 1.1% and (5.6)% for the six months ended June 30, 2015 and 2014, 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, 2015, we had an accumulated deficit of $196.5 million compared to $191.1 million at December 31, 2014. 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 $6.8 million in cash at June 30, 2015 compared to $7.2 million at December 31, 2014. At June 30, 2015, $1.3 million of our cash was held by foreign subsidiaries in Canada, Sweden and the United Kingdom. We do not intend to repatriate any amount of this cash to the United States as it will be used to fund our subsidiaries operations. 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 Faunus Group International, Inc., or FGI, that terminates on August 15, 2015 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, 2015, we had $3.6 million in borrowings outstanding under this facility with $3.9 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.

On May 15, 2012, we filed a shelf registration statement on Form S-3 with the SEC, or the Shelf Registration, which permits us to sell, from time to time, up to an aggregate of $50.0 million of various securities. However, we may not sell our securities in a primary offering pursuant to the Shelf Registration or any other registration statement on Form S-3 with a value exceeding one-third of our public float in any 12-month period (unless our public float rises to $75.0 million or more). On May 19, 2015, we filed a shelf registration statement on Form S-3 with the SEC to replace the existing Shelf Registration, which we anticipate will be declared effective later this year. 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.

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On April 4, 2014, we completed a registered direct offering under the Shelf Registration in which we sold 2,030,000 shares of common stock and warrants to purchase 812,000 shares of common stock and received net proceeds of $6.1 million after deducting placement agent fees and other offering expenses.

On October 20, 2014, we completed the sale of our Reno, Nevada-based custom fabricated exhaust parts and accessories business for $1.3 million in cash.

On November 4, 2014, we entered into subscription agreements to sell 1,385,000 shares of common stock, Series A Warrants to purchase up to an aggregate of 388,393 shares of common stock, and Series B Warrants to purchase up to an aggregate of 168,571 shares of common stock. We received net proceeds of $3.8 million after deducting placement agent fees and other offering expenses.

On November 11, 2014, we and Kanis S.A. entered into a letter agreement whereby Kanis S.A. agreed to amend the terms of the outstanding loans, in the aggregate principal amount of $7.5 million, made to us, such that (i) the maturity dates of all outstanding loans were extended to October 1, 2016; and (ii) the early redemption feature applicable to one of the outstanding loans was removed.

On June 2, 2015, we entered into an underwriting agreement to sell 2,500,000 shares of common stock and warrants to purchase up to an aggregate of 500,000 shares of common stock. We received net proceeds of $4.5 million after underwriting discounts and other offering expenses.

We continue to pursue revenue generating opportunities relating to special government mandated retrofit programs in California and potentially others in various jurisdictions domestically and internationally. Opportunities such as these require cash investment in operating expenses and working capital such as inventory and receivables prior to realizing profits and cash from sales. Additionally, as previously discussed, we intend to pursue aggressive development of our materials science platform which will require cash investment.

Based on our current cash levels, including proceeds from the June 2015 offering, and expected cash flows from operations, we believe that we will have access to sufficient working capital to fund operations through the end of this year and into next year. However, there can be no assurances that we will be able to achieve projected levels of revenue and maintain access to sufficient working capital. If cash from operations is not sufficient for our working capital needs, we may be forced to seek additional financing in the form of funding from outside sources. However, there is no assurance that we will be able to raise additional funds on acceptable terms or reduce our discretionary spending to a level sufficient for our working capital needs, and accordingly, there is substantial doubt as to whether our existing cash resources and working capital are sufficient to enable us to continue our operations for the next twelve months.

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

	Six Months Ended June 30,			
			Change	
	2015	**2014**	**$**	**%**
	($ in thousands)			

Cash provided by (used in):							
Operating activities	$	(5,282)	$	(4,125)	$	(1,157)	(28)%
Investing activities	$	(241)	$	222	$	(463)	(209)%
Financing activities	$	5,231	$	8,545	$	(3,314)	(39)%

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. Cash flows were largely impacted by the loss from operations, adjusted for non-cash items, including depreciation and amortization, stock-based compensation, change in fair value of the liability-classified warrants, and foreign currency gains. The cash flows of the current year period were also impacted by the timing of sales and collections, net of other working capital changes.

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Cash provided by (used in) investing activities

The increase in cash used in investing activities was due to proceeds from the sale of a building at one of our foreign location and the return of most of our investment balance for our dissolved joint venture with Pirelli in the prior period.

Cash provided by financing activities

The decrease in cash provided by financing activities was due to higher proceeds from a common stock and warrant offering, pursuant to our Shelf Registration, and proceeds from the exercise of warrants in the prior year period.

Description of Indebtedness

		June 30, 2015		December 31, 2014
		($ in thousands)		
Line of credit with FGI	$	3,583	$	2,841
$1.5 million, 8% shareholder note due 2016		1,612		1,598
$3.0 million, 8% subordinated convertible shareholder notes due 2016		2,962		2,947
$3.0 million, 8% shareholder note due 2016		2,951		2,931
	$	11,108	$	10,317

We have a $7.5 million secured demand facility with FGI backed by our receivables and inventory. The FGI facility expires on August 15, 2015 and may be extended at our option for additional one-year terms. However, 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, 2015, 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. While the overall credit limit and inventory sublimit were not changed, borrowing against Honda inventory has been limited to $0.2 million by FGI due to their concerns about customer concentration.

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, 2015 and December 31, 2014.

We were in compliance with the terms of the FGI facility at June 30, 2015. 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, 2015, 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, 2015 and December 31, 2014, we had no off-balance sheet arrangements.

Commitments and Contingencies

As of June 30, 2015, other than office leases, employment agreements with key executive officers and the obligation to fund our portion (5%) of the losses of our Asian investment, we had no material commitments other than the liabilities reflected in our unaudited condensed consolidated financial statement included elsewhere in this Quarterly Report on Form 10-Q. For additional information, refer to Note 12, Commitments and Contingencies .

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

In evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (1) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (2) is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting during the period covered by this Quarterly Report on Form 10-Q.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 12 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

Not applicable.

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.

Item 6. Exhibits

Refer to the Exhibit Index immediately following the signature page, which is incorporated herein by reference.

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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 hereunto duly authorized.

CLEAN DIESEL TECHNOLOGIES, INC.

Date: August 6, 2015	By:	/s/ Christopher J. Harris Christopher J. Harris President and Chief Executive Officer (Principal Executive Officer)
Date: August 6, 2015	By:	/s/ David E. Shea David E. Shea Chief Financial Officer (Principal Financial Officer)

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Exhibit Index

Exhibit No.	Description of Exhibit
2.1	Asset Purchase Agreement, dated as of October 20, 2014, between Clean Diesel Technologies, Inc., ECS Holdings, Inc., Engine Control Systems Ltd., and SES USA Inc. (incorporated by reference to Exhibit 2.1 to CDTi s Current Report on Form 8-K (SEC file number 001-33710) filed on October 21, 2014).
3.1	Restated Certificate of Incorporation of Clean Diesel Technologies, Inc., as amended through May 23, 2012. (incorporated by reference to Exhibit 3.1 to CDTi s Annual Report on Form 10-K (SEC file number 001-33710) filed on March 18, 2015).
3.2	By-Laws of Clean Diesel Technologies, Inc. as amended through November 6, 2008 (incorporated by reference to Exhibit 3.1 to CDTi s Quarterly Report on Form 10-Q (SEC file number 001-33710) filed on November 10, 2008).
4.1	Specimen of Certificate for Clean Diesel Technologies, Inc. Common Stock (incorporated by reference to Exhibit 4.1 to CDTi s Post-Effective Amendment No. 1 to Form S-4 on Form S-3 (SEC file number 333-166865) filed on November 10, 2010).
4.2	Form of Investor Warrant issued on July 3, 2013 (incorporated by reference to Exhibit 4.1 to CDTi s Current Report on Form 8-K (SEC file number 001-33710) filed on July 3, 2013).
4.3	Form of Investor Warrant issued on April 4, 2014 (incorporated by reference to Exhibit 4.1 to CDTi s Current Report on Form 8-K (SEC file number 001-33710) filed on April 1, 2014).
4.4	Form of Investor Series A Warrant issued on November 7, 2014 (incorporated by reference to Exhibit 4.1 to CDTi s Current Report on Form 8-K (SEC file number 001-33710) filed on November 4, 2014).
4.5	Form of Investor Warrant issued on June 8, 2015 (incorporated by reference to Exhibit 4.1 to CDTi s Current Report on Form 8-K (SEC file number 001-33710) filed on June 3, 2015).
10.1	Stock Incentive Plan as amended through May 20, 2015 (incorporated by reference to Appendix A to CDTi s Definitive

	Proxy Statement (SEC file number 001-33710) filed on April 2, 2015).
10.2*	North American Purchase and Sale Agreement, dated June 5, 2015, between Honda North America and each of the other Honda Companies named in the Agreement and Clean Diesel Technologies, Inc.
10.3*	Employment agreement, dated July 27, 2015, between Hans Eric Bippus and Clean Diesel Technologies, Inc.
31.1*	Certification of Christopher J. Harris pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of David E. Shea pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32**	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

*	Filed herewith
**	Furnished herewith
	Indicates a management contract or compensatory plan or arrangement