

LUNA INNOVATIONS INC  
Form 10-Q  
August 13, 2007  
Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

---

**FORM 10-Q**

---

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

For the quarterly period ended June 30, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 000-52008

---

**LUNA INNOVATIONS INCORPORATED**

*(Exact name of registrant as specified in its charter)*

---

**Delaware**  
*(State or Other Jurisdiction of*

*Incorporation or Organization)*

1703 South Jefferson Street, SW, Suite 400

Roanoke, VA 24016

**54-1560050**  
*(I.R.S. Employer*

*Identification Number)*

Edgar Filing: LUNA INNOVATIONS INC - Form 10-Q

*(Address of Principal Executive Offices)*

**(540) 769-8400**

*(Registrant's Telephone Number, Including Area Code)*

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

---

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of August 6, 2007, there were 10,271,020 shares of the registrant's common stock outstanding.

---

**Table of Contents**

**LUNA INNOVATIONS INCORPORATED**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED JUNE 30, 2007**  
**TABLE OF CONTENTS**

**PART I. FINANCIAL INFORMATION**

ITEM 1.	<u>FINANCIAL STATEMENTS</u>	3
ITEM 2.	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	10
ITEM 3.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	16
ITEM 4.	<u>CONTROLS AND PROCEDURES</u>	17

**PART II. OTHER INFORMATION**

ITEM 1.	<u>LEGAL PROCEEDINGS</u>	17
ITEM 1A.	<u>RISK FACTORS</u>	18
ITEM 2.	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	33
ITEM 3.	<u>DEFAULTS UPON SENIOR SECURITIES</u>	33
ITEM 4.	<u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	33
ITEM 5.	<u>OTHER INFORMATION</u>	33
ITEM 6.	<u>EXHIBITS</u>	33
	<u>SIGNATURES</u>	34
	<u>EXHIBIT INDEX</u>	35

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Luna Innovations Incorporated****Consolidated Balance Sheets**

	June 30, 2007 (unaudited)	December 31, 2006
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 13,933,115	\$ 17,866,753
Accounts receivable, net	7,999,979	7,233,406
Refundable income taxes	396,062	396,062
Inventory	1,334,619	843,294
Other current assets	447,039	503,703
Total current assets	24,110,814	26,843,218
Property and equipment, net	6,271,336	5,730,094
Intangible assets, net	1,965,947	2,031,489
Deferred tax asset	600,000	600,000
Other assets	12,355	12,413
<b>Total assets</b>	<b>\$ 32,960,452</b>	<b>\$ 35,217,214</b>
<b>Liabilities and stockholders' equity</b>		
Current liabilities		
Current portion of capital lease obligation	\$ 58,708	\$ 85,378
Current portion of long-term debt obligation		214,955
Accounts payable	2,093,850	2,757,381
Accrued liabilities	4,367,025	3,627,277
Deferred credits	2,268,262	874,676
Total current liabilities	8,787,845	7,559,667
Long-term capital lease obligation	12,039	27,873
Long-term debt obligation	5,000,000	5,000,000
Deferred credits	604,418	554,418
Total liabilities	14,404,302	13,141,958
Stockholders' equity:		
Common stock, par value \$0.001, 100,000,000 shares authorized at June 30, 2007 and December 31, 2006, 10,250,208 and 9,911,546 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	10,250	9,912
Additional paid-in capital	32,926,183	31,585,762
Accumulated deficit	(14,380,283)	(9,520,418)
Total stockholders' equity	18,556,150	22,075,256

<b>Total liabilities and stockholders equity</b>	<b>\$ 32,960,452</b>	<b>\$ 35,217,214</b>
--	----------------------	----------------------

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

**Table of Contents**

**Luna Innovations Incorporated**  
**Consolidated Statements of Operations**

	Three Months Ended		Six Months Ended	
	2007	June 30, 2006 (unaudited)	2007	June 30, 2006 (unaudited)
<b>Revenues:</b>				
Technology development revenues	\$ 5,852,109	\$ 4,170,273	\$ 11,138,706	\$ 8,091,212
Product and license revenues	2,003,171	762,442	3,786,747	1,357,740
<b>Total revenues</b>	<b>7,855,280</b>	<b>4,932,715</b>	<b>14,925,453</b>	<b>9,448,952</b>
<b>Cost of revenues:</b>				
Technology development costs	4,048,424	3,105,289	7,898,039	6,013,124
Product and license costs	911,768	408,219	1,712,189	674,270
<b>Total cost of revenues</b>	<b>4,960,192</b>	<b>3,513,508</b>	<b>9,610,228</b>	<b>6,687,394</b>
<b>Gross Profit</b>	<b>2,895,088</b>	<b>1,419,207</b>	<b>5,315,225</b>	<b>2,761,558</b>
Operating expense	5,185,965	4,252,343	10,400,984	7,694,351
<b>Operating loss</b>	<b>(2,290,877)</b>	<b>(2,833,136)</b>	<b>(5,085,759)</b>	<b>(4,932,793)</b>
<b>Other income</b>				
Other income		3,110	519	9,397
Interest income, net	113,107	109,185	225,375	113,145
<b>Total other income</b>	<b>113,107</b>	<b>112,295</b>	<b>225,894</b>	<b>122,542</b>
<b>Loss before income taxes</b>	<b>(2,177,770)</b>	<b>(2,720,841)</b>	<b>(4,859,865)</b>	<b>(4,810,251)</b>
<b>Income tax expense (benefit)</b>				
<b>Net loss</b>	<b>\$ (2,177,770)</b>	<b>\$ (2,720,841)</b>	<b>\$ (4,859,865)</b>	<b>\$ (4,810,251)</b>
<b>Net loss per share:</b>				
Basic	\$ (0.21)	\$ (0.37)	\$ (0.48)	\$ (0.72)
Diluted	\$ (0.21)	\$ (0.37)	\$ (0.48)	\$ (0.72)
<b>Weighted average shares:</b>				
Basic	10,136,446	7,277,964	10,053,371	6,677,306
Diluted	10,136,446	7,277,964	10,053,371	6,677,306

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

**Table of Contents**

**Luna Innovations Incorporated**  
**Consolidated Statements of Cash Flows**

	Six months ended	
	2007	June 30, 2006
	(unaudited)	
<b>Cash flows used in operating activities</b>		
Net loss	\$ (4,859,865)	\$ (4,810,251)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	892,838	502,401
Share-based compensation	1,096,555	761,282
Change in assets and liabilities:		
Accounts receivable	(766,573)	981,715
Refundable income taxes		118,735
Inventory	(491,325)	
Other current assets	56,721	(466,093)
Accounts payable and accrued expenses	76,216	709,875
Deferred credits	1,443,585	(489,876)
<b>Net cash used in operating activities</b>	<b>(2,551,848)</b>	<b>(2,698,212)</b>
<b>Cash flows used in investing activities</b>		
Acquisition of property and equipment	(1,171,747)	(632,587)
Intangible property costs	(196,790)	(197,300)
<b>Net cash used in investing activities</b>	<b>(1,368,537)</b>	<b>(829,887)</b>
<b>Cash flows from financing activities</b>		
Payments on capital lease obligations	(42,504)	(49,899)
Proceeds from the issuance of common stock, net		17,660,608
Proceeds from the exercise of options and warrants	244,206	79,028
Payment of debt	(214,955)	
<b>Net cash (used in) provided by financing activities</b>	<b>(13,253)</b>	<b>17,689,737</b>
<b>Net change in cash</b>	<b>(3,933,638)</b>	<b>14,161,638</b>
Cash and cash equivalents beginning of period	17,866,753	12,514,839
Cash and cash equivalents end of period	\$ 13,933,115	\$ 26,676,477

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

**Table of Contents**

**Luna Innovations Incorporated**

**Notes to Consolidated Financial Statements**

**1. Basis of Presentation and Significant Accounting Policies**

**Nature of Operations**

Luna Innovations Incorporated ( Luna Innovations ) was incorporated in the Commonwealth of Virginia in 1990 and subsequently reincorporated in the State of Delaware in April 2003. We research, develop and commercialize innovative technologies in two primary areas of focus: instrumentation and test & measurement products and healthcare products. We have a disciplined and integrated business model that is designed to accelerate the process of bringing new and innovative products to market. We identify technologies that can fulfill unmet market needs and then take these technologies from the applied research stage through commercialization.

**Unaudited Interim Financial Information**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and footnotes required by US GAAP for audited financial statements. The unaudited consolidated financial statements have been prepared on the same basis as the annual financial statements and in the opinion of management reflect all adjustments, consisting of only normal recurring accruals, considered necessary to present fairly our financial position at June 30, 2007 and results of operations and cash flows for the three and six months ended June 30, 2007 and 2006. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The consolidated financial statements, including the Company's significant accounting policies, should be read in conjunction with the audited Consolidated Financial Statements and the notes thereto included in the Company's Form 10-K as amended and filed with the Securities and Exchange Commission on March 30, 2007. As used herein, the terms Luna , Company , we , our and us mean Luna Innovations Incorporated and its consolidated subsidiaries.

**Consolidation Policy**

Our consolidated financial statements are prepared in accordance with US GAAP and include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest. We eliminate from our financial results all significant intercompany transactions. The Company does not have any investments in entities it believes are variable interest entities for which the Company is the primary beneficiary.

**Use of Estimates**

The preparation of our consolidated financial statements in accordance with US GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in our consolidated financial statements and accompanying notes. Although these estimates and assumptions are based on our knowledge of current events and actions we may undertake in the future, actual results may differ.

**Inventory**

Inventory consists of finished goods and parts valued at the lower of cost (determined on the first-in, first-out basis) or market. We provide reserves for estimated obsolescence or unmarketable inventory equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions.

**Net Loss Per Share**

We compute net loss per share in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings Per Share*. Basic per share data is computed by dividing loss available to common shareholders by the weighted average number of shares outstanding during the



## Edgar Filing: LUNA INNOVATIONS INC - Form 10-Q

period. Diluted per share data is computed by dividing loss available to common shareholders by the weighted average shares outstanding during the period increased to include, if dilutive, the number of additional common share equivalents that would have been outstanding if potential common shares had been issued using the treasury stock method. Diluted per share data would also include the potential common share equivalents relating to convertible securities by application of the if-converted method.

Per share amounts for all periods presented in this report have been adjusted to reflect the 1-for-1.7691911 reverse stock split of our common stock occurring on May 23, 2006. All applicable share and per share amounts in the financial statements give pro forma effect to such split. The following information presents the pro forma effect of such split on basic and diluted net loss per share:

**Table of Contents**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Net loss	\$ (2,177,770)	\$ (2,720,841)	\$ (4,859,865)	\$ (4,810,251)
Weighted average shares basic	10,136,446	7,277,964	10,053,371	6,677,306
Dilutive effect of common stock equivalents: Shares issued upon the exercise of stock options and warrants				