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

**FORM 10-Q**

☒ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2018**

**or**

☐ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from __________ to __________**

**Commission File Number 0-29185**

**QS ENERGY, INC.**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Nevada**<br>(State or other jurisdiction of incorporation or organization) | **52-2088326**<br>(I.R.S. Employer Identification No.) |

**23902 FM 2978**
**Tomball, TX 77375**
(Address, including zip code, of principal executive offices)

**(805)-845-3561**
(Registrant's telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock, $0.001 par value.

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one)

| | |
|---|---|
| Large accelerated filer ☐ | Accelerated filer ☐ |
| Non-accelerated filer ☐ | Smaller reporting company ☒ |
| Emerging growth company ☐ | |

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

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

The number of shares of the Registrant's Common Stock outstanding as of August 13, 2018 was 251,448,515.

**QS ENERGY, INC.**
**FORM 10-Q**

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## PART I – FINANCIAL INFORMATION

### Item 1. Unaudited Condensed Consolidated Financial Statements

**QS ENERGY, INC.**
**CONDENSED CONSOLIDATED BALANCE SHEET**

| | | June 30, 2018 (unaudited) | | December 31, 2017 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current assets:** | | | | |
| Cash | $ | 493,000 | $ | 204,000 |
| Prepaid expenses and other current assets | | 32,000 | | 38,000 |
| Total current assets | | 525,000 | | 242,000 |
| Property and equipment, net of accumulated depreciation of $68,000 and $51,000 at June 30, 2018 and December 31, 2017, respectively | | 29,000 | | 46,000 |
| Other assets | | 2,000 | | 2,000 |
| **Total assets** | $ | 556,000 | $ | 290,000 |
| | | | | |
| **LIABILITIES AND STOCKHOLDERS' DEFICIT** | | | | |
| **Current liabilities:** | | | | |
| Accounts payable-license agreements | $ | 974,000 | $ | 852,000 |
| Accounts payable and accrued expenses | | 735,000 | | 748,000 |
| Accrued expenses and accounts payable-related parties | | 43,000 | | 31,000 |
| Convertible debentures, net of discounts of $47,000 and $47,000 at June 30, 2018 and December 31, 2017, respectively | | 576,000 | | 533,000 |
| Total current liabilities | | 2,328,000 | | 2,164,000 |
| | | | | |
| **Commitments and contingencies** | | | | |
| | | | | |
| **Stockholders' deficit** | | | | |
| Common stock, $.001 par value: 500,000,000 shares authorized, 251,448,515 and 234,076,907 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively | | 251,448 | | 234,077 |
| Additional paid-in capital | | 109,543,552 | | 108,000,923 |
| Accumulated deficit | | (111,567,000) | | (110,109,000) |
| Total stockholders' deficit | | (1,772,000) | | (1,874,000) |
| **Total liabilities and stockholders' deficit** | $ | 556,000 | $ | 290,000 |

See notes to condensed consolidated financial statements.

**QS ENERGY, INC.**
**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS, UNAUDITED**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |
| **Revenues** | $ – | $ – | $ – | $ 50,000 |
| **Costs and Expenses** | | | | |
| **Operating expenses** | 462,000 | 580,000 | 956,000 | 1,838,000 |
| **Research and development expenses** | 48,000 | 56,000 | 95,000 | 120,000 |
| **Loss before other expense** | (510,000) | (636,000) | (1,051,000) | (1,908,000) |
| **Other expense** | | | | |
| Interest and financing expense | (248,000) | (1,210,000) | (407,000) | (1,422,000) |
| **Net Loss** | (758,000) | (1,846,000) | (1,458,000) | (3,330,000) |
| **Net loss per common share, basic and diluted** | $ (0.00) | $ (0.01) | $ (0.01) | $ (0.02) |
| **Weighted average common shares outstanding, basic and diluted** | 242,994,163 | 207,419,243 | 238,825,606 | 203,362,641 |

See notes to condensed consolidated financial statements.

## QS ENERGY, INC.
## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT, UNAUDITED
## FOR THE SIX MONTHS ENDED JUNE 30, 2018

| | Common Stock | | Additional Paid-in | Accumulated | Total Stockholders' |
|---|---|---|---|---|---|
| | Shares | Amount | Capital | Deficit | Deficit |
| **Balance, January 1, 2018** | 234,076,907 | $ 234,077 | $ 108,000,923 | $ (110,109,000) | $ (1,874,000) |
| Common stock issued on exercise of warrants and options | 12,697,483 | 12,697 | 634,303 | | 647,000 |
| Common stock issued on conversion of notes payable | 4,624,125 | 4,624 | 332,376 | | 337,000 |
| Fair value of warrants and beneficial conversion feature of issued convertible notes | | | 319,000 | | 319,000 |
| Fair value of options and warrants issued as compensation | | | 245,000 | | 245,000 |
| Common stock issued for services | 50,000 | 50 | 11,950 | | 12,000 |
| Net loss | | | | (1,458,000) | (1,458,000) |
| **Balance, June 30, 2018** | 251,448,515 | $ 251,448 | $ 109,543,552 | $ (111,567,000) | $ (1,772,000) |

See notes to condensed consolidated financial statements.

**QS ENERGY, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, UNAUDITED**

| | Six months ended June 30 | |
|---|---|---|
| | **2018** | **2017** |
| **Cash flows from Operating Activities** | | |
| Net loss | $ (1,458,000) | $ (3,330,000) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Stock based compensation expense | 245,000 | 535,000 |
| Issuance of common stock for services | 12,000 | – |
| Amortization of debt discount and interest expense | 381,000 | 1,402,000 |
| Depreciation and amortization | 17,000 | 4,000 |
| Changes in operating assets and liabilities: | | |
| Prepaid expenses and other assets | 6,000 | (8,000) |
| Accounts payable and accrued expenses | (13,000) | 640,000 |
| Accounts payable – license agreements | 122,000 | 113,000 |
| Accounts payable and accrued expenses – related parties | 12,000 | (116,000) |
| Deposits and other current liabilities | – | (5,000) |
| Net cash used in operating activities | (676,000) | (765,000) |
| **Cash flows from investing activities** | | |
| Purchase of equipment | – | (21,000) |
| Net cash used in investing activities | – | (21,000) |
| **Cash flows from financing activities** | | |
| Net proceeds from issuance of convertible notes and warrants | 318,000 | 1,469,000 |
| Net proceeds from exercise of warrants | 647,000 | 61,000 |
| Net cash provided by financing activities | 965,000 | 1,530,000 |
| **Net increase (decrease) in cash** | 289,000 | 744,000 |
| **Cash, beginning of period** | 204,000 | 136,000 |
| **Cash, end of period** | $ 493,000 | $ 880,000 |
| | | |
| **Supplemental disclosures of cash flow information** | | |
| Cash paid during the year for: | | |
| Interest | $ – | $ – |
| Income Taxes | $ 1,600 | $ 1,600 |
| **Non-cash investing and financing activities** | | |
| Conversion of convertible debentures to common stock | $ 337,000 | $ 1,247,000 |
| Fair value of warrants and beneficial conversion feature associated with issued convertible notes | 319,000 | 1,469,000 |

See notes to condensed consolidated financial statements.

**QS ENERGY, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, UNAUDITED**
**SIX MONTHS ENDED JUNE 30, 2018 AND 2017**

## 1. Description of Business

QS Energy, Inc. ("QS Energy", "Company") was incorporated on February 18, 1998, as a Nevada Corporation under the name Mandalay Capital Corporation. The Company changed its name to Save the World Air, Inc. on February 11, 1999. Effective August 11, 2015, the Company changed its name to QS Energy, Inc. The Company's common stock is quoted under the symbol "QSEP" on the Over-the-Counter Bulletin Board. More information including the Company's fact sheet, logos and media articles are available at our corporate website, www.qsenergy.com.

QS Energy develops and commercializes energy efficiency technologies that assist in meeting increasing global energy demands, improving the economics of oil extraction and transport, and reducing greenhouse gas emissions. The Company's intellectual properties include a portfolio of domestic and international patents and patents pending, a substantial portion of which have been developed in conjunction with and exclusively licensed from Temple University of Philadelphia, PA ("Temple"). QS Energy's primary technology is called Applied Oil Technology (AOT), a commercial-grade crude oil pipeline transportation flow-assurance product. Engineered specifically to reduce pipeline pressure loss, increase pipeline flow rate and capacity, and reduce shippers' reliance on diluents and drag reducing agents to meet pipeline maximum viscosity requirements, AOT is a 100% solid-state system that reduces crude oil viscosity by applying a high intensity electrical field to crude oil feedstock while in transit. The AOT product has transitioned from the research and development stage to initial production for continued testing in advance of our goal of seeking acceptance and adoption by the midstream pipeline marketplace.

The Company commenced, but has suspended for now, commercial development of a suite of products based on the direct application of an electrical current crude oil; a process known as Joule Heat. The Company built and tested its first Joule Heat unit in 2015. Though the test unit was functional, changes to the prototype configuration will be required to determine commercial effectiveness of this technology. In December 2015, we suspended Joule Heat development activities to focus Company resources on finalizing commercial development of the AOT. We plan to resume Joule Heat development in the future depending on the availability of sufficient capital and other resources.

### Basis of Presentation

The accompanying condensed consolidated financial statements are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC. The condensed consolidated balance sheet as of December 31, 2017 included herein was derived from the audited consolidated financial statements as of that date, but does not include all disclosures, including notes, required by GAAP.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to fairly present the Company's financial position and results of operations for the interim periods reflected. Except as noted, all adjustments contained herein are of a normal recurring nature. Results of operations for the fiscal periods presented herein are not necessarily indicative of fiscal year-end results.

## 2. Summary of Significant Accounting Policies

### Consolidation Policy

The accompanying consolidated financial statements of QS Energy Inc. include the accounts of QS Energy Inc. (the Parent) and its wholly owned subsidiaries, QS Energy Pool, Inc. and STWA Asia Pte. Limited. Intercompany transactions and balances have been eliminated in consolidation.

### Going Concern

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. As reflected in the accompanying consolidated financial statements, during the six-months ended June 30, 2018, the Company incurred a net loss of $1,458,000, used cash in operations of $676,000 and had a stockholders' deficit of $1,772,000 as of that date. These factors raise substantial doubt about the Company's ability to continue as a going concern. The ability of the Company to continue as a going concern is dependent upon the Company's ability to raise additional funds and implement its business plan. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

In addition, the Company's independent registered public accounting firm, in its report on the Company's December 31, 2017 financial statements, has raised substantial doubt about the Company's ability to continue as a going concern.

At June 30, 2018, the Company had cash on hand in the amount of $493,000. Management estimates that the current funds on hand will be sufficient to continue operations through November 2018. Management is currently seeking additional funds, primarily through the issuance of debt and equity securities for cash to operate our business, including without limitation the expenses it will incur in connection with the license agreements with Temple; costs associated with product development and commercialization of the AOT technologies; costs to manufacture and ship the products; costs to design and implement an effective system of internal controls and disclosure controls and procedures; costs of maintaining our status as a public company by filing periodic reports with the SEC and costs required to protect our intellectual property. In addition, as discussed below, the Company has substantial contractual commitments, including without limitation salaries to our executive officers pursuant to employment agreements, certain payments to a former officer and consulting fees, during the remainder of 2018 and beyond.

No assurance can be given that any future financing will be available or, if available, that it will be on terms that are satisfactory to the Company. Even if the Company is able to obtain additional financing, it may contain undue restrictions on our operations, in the case of debt financing or cause substantial dilution for our stockholders in case of equity financing.

### Basic and Diluted Income (loss) per share

Our computation of earnings per share ("EPS") includes basic and diluted EPS. Basic EPS is measured as the income (loss) available to common stockholders divided by the weighted average common shares outstanding for the period. Diluted income (loss) per share reflects the potential dilution, using the treasury stock method, that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income (loss) of the Company as if they had been converted at the beginning of the periods presented, or issuance date, if later. In computing diluted income (loss) per share, the treasury stock method assumes that outstanding options and warrants are exercised and the proceeds are used to purchase common stock at the average market price during the period. Options and warrants may have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options and warrants. Potential common shares that have an antidilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted EPS.

Income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the respective periods. Basic and diluted (loss) per common share is the same for periods in which the Company reported an operating loss because all warrants and stock options outstanding are anti-dilutive. At June 30, 2018 and 2017, we excluded the outstanding securities summarized below, which entitle the holders thereof to acquire shares of common stock as their effect would have been anti-dilutive.

| | June 30, 2018 | June 30, 2017 |
|---|---|---|
| Options | 37,301,300 | 35,313,541 |
| Warrants | 5,006,355 | 21,507,270 |
| Common stock issuable upon conversion of notes payable | 5,287,502 | 9,968,933 |
| Total | 47,595,157 | 66,789,744 |

**Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include those related to accruals for potential liabilities, assumptions used in valuing equity instruments issued for financing and services and realization of deferred tax assets, among others. Actual results could differ from those estimates.

**Revenue Recognition Policy**

In September 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-09 (ASU No. 2014-09) regarding revenue recognition. The new standard provides authoritative guidance clarifying the principles for recognizing revenue and developing a common revenue standard for U.S. generally accepted accounting principles. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in the exchange for those goods or services. The ASU became effective January 1, 2018.

The Company's commercialization of our energy efficiency technologies that would assist in meeting increasing global energy demands, improving the economics of oil extraction and transport, and reducing greenhouse gas emission have not yet reached the market and therefore; have not generated considerable revenue. Due to the nature of the products leased by the Company and the stage of development in which the products reside the adoption of the new standard has had no quantitative effect on the financial statements.

Under the new guidance, revenue is recognized when control of promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those leased products and ancillary services. The Company will review its lease transactions to identify contractual rights, performance obligations, and transaction prices, including the allocation of prices to separate performance obligations, if applicable. Revenue and costs of sales are recognized once products/services are delivered to the customer's control and performance obligations are satisfied.

**Research and Development Costs**

Costs incurred for research and development are expensed as incurred. Purchased materials that do not have an alternative future use are also expensed. Furthermore, costs incurred in the construction of prototypes with no certainty of any alternative future use and established commercial uses are also expensed.

For the six-month periods ended June 30, 2018 and 2017 research and development costs were $95,000 and $120,000, respectively.

**Patent Costs**

Patent costs consist of patent-related legal and filing fees. Due to the uncertainty associated with the successful development of our AOT and Joule Heat products, all patent costs are expensed as incurred. During the six-month periods ended June 30, 2018 and 2017, patent costs were $12,000 and $24,000, respectively, and were included as part of operating expenses in the accompanying consolidated statements of operations. During the three-month periods ended June 30, 2018 and 2017, patent costs were $6,000 and $7,000, respectively, and were included as part of operating expenses in the accompanying consolidated statements of operations.

**Recent Accounting Pronouncements**

In February 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-02, *Leases*. ASU 2016-02 requires a lessee to record a right of use asset and a corresponding lease liability on the balance sheet for all leases with terms longer than 12 months. ASU 2016-02 is effective for all interim and annual reporting periods beginning after December 15, 2018. Early adoption is permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is in the process of evaluating the impact of ASU 2016-02 on the Company's financial statements and disclosures.

In July 2017, the FASB issued Accounting Standards Update No. 2017-11, Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features; (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception ("ASU 2017-11"). ASU 2017-11 allows companies to exclude a down round feature when determining whether a financial instrument (or embedded conversion feature) is considered indexed to the entity's own stock. As a result, financial instruments (or embedded conversion features) with down round features may no longer be required to be accounted for as derivative liabilities. A company will recognize the value of a down round feature only when it is triggered, and the strike price has been adjusted downward. For equity-classified freestanding financial instruments, an entity will treat the value of the effect of the down round as a dividend and a reduction of income available to common shareholders in computing basic earnings per share. For convertible instruments with embedded conversion features containing down round provisions, entities will recognize the value of the down round as a beneficial conversion discount to be amortized to earnings. ASU 2017-11 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The guidance in ASU 2017-11 is to be applied using a full or modified retrospective approach. The adoption of ASU 2017-11 is not currently expected to have any impact on the Company's financial statement presentation or disclosures.

Other recent accounting pronouncements issued by the FASB, including its Emerging Issues Task Force, the American Institute of Certified Public Accountants, and the Securities and Exchange Commission did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statement presentation or disclosures.

## 3. Accrued Expenses and Accounts Payables

**Accrued Expenses**

On April 1, 2017, the Company executed a Separation Agreement and release effective with the Company's former Chief Executive Officer (CEO). As part of the agreement, the Company agreed to pay the former CEO $580,000 in severance, payable in equal installment over 24 months. In addition, the Company also agreed to continue paying certain expenses for the CEO for 24 months with an estimated cost of $44,000. As a result, the Company accrued the entire $624,000 as of March 31, 2017 which was also reported as part of operating expenses in the accompanying 2017 consolidated statements of operations. As of June 30, 2018 and December 31, 2017, $377,000 and $390,000, respectively, was due to our former CEO which was reported as part of accrued expenses and accounts payable in the accompanying consolidated balance sheet. The Company began deferring payments under the Separation Agreement in January 2018 and is currently in arrears. The former CEO has made demands for all deferred payments and has proposed an amendment to the Separation Agreement that contained terms and conditions that are unacceptable to the Company, and has threatened litigation to recover the deferred payments, future payments due under the Separation Agreement, and damages. The Company has attempted to settle this matter with the former CEO. This matter has not yet been resolved.

**Accrued Expenses and Accounts Payable – Related Parties**

Accrued expense – related parties consists of accrued salaries due to officers and fees due to members of the Board of Directors. As of June 30, 2018, and December 31, 2017, accrued expenses and accounts payable to related parties amounted to $43,000 and $31,000, respectively.

**4. Property and Equipment**

At June 30, 2018 and December 31, 2017, property and equipment consists of the following:

| | June 30, 2018 (unaudited) | December 31, 2017 |
|---|---|---|
| Office equipment | $ 30,000 | $ 30,000 |
| Furniture and fixtures | 5,000 | 5,000 |
| Testing Equipment | 37,000 | 37,000 |
| Leasehold Improvements | 25,000 | 25,000 |
| Subtotal | 97,000 | 97,000 |
| Less accumulated depreciation | (68,000) | (51,000) |
| Total | $ 29,000 | $ 46,000 |

Depreciation expense for the six-month periods ended June 30, 2018 and 2017 was $17,000 and $4,000, respectively. Depreciation expense for the three-month periods ended June 30, 2018 and 2017 was $9,000 and $2,000, respectively.

**5. Convertible Notes**

| | June 30, 2018 (unaudited) | December 31 2017 |
|---|---|---|
| Balance due on convertible notes | $ 524,000 | $ 509,000 |
| Accrued interest | 99,000 | 71,000 |
| Subtotal | 623,000 | 580,000 |
| Convertible note discount | (47,000) | (47,000) |
| Balance on convertible notes, net of note discounts | $ 576,000 | $ 533,000 |

As in the prior years, the Company continues to issue convertible notes in exchange for cash. The notes typically do not bear any interest, however, there is an implied interest rate of 10% since the notes are typically issued at a 10% discount. The notes are unsecured, and usually mature twelve months from issuance. The notes are convertible at the option of the note holder into the Company's common stock at a conversion price stipulated in the conversion agreement. In addition, the note holders received warrants to purchase shares of common stock that are fully vested and will expire in one year from the date of issuance.

As a result, the Company records a note discount to account for the relative fair value of the warrants, the notes' beneficial conversion feature or BCF, and original issue discount of 10% (OID). The note discounts are amortized over the term of the notes or amortized in full upon its conversion to common stock.

At December 31, 2017, total outstanding notes payable amounted to $509,000, accrued penalty interest of $71,000 and unamortized note discount of $47,000, or a net balance of $533,000. During the six-month period ending June 30, 2018, the Company issued similar convertible promissory notes in the aggregate of $350,000 for cash of $318,000 or a discount of $32,000. The notes do not bear any interest, however, the implied interest rate used was 10% since the notes were issued at a price 10% less than its face value. The notes are unsecured, mature in twelve months from issuance and convertible at $0.08 per share. In addition, the Company also granted these note holders warrants to purchase 2,189,688 shares of the Company' common stock. The warrants are fully vested, exercisable at $0.08 per share and will expire in one year. Upon issuance, the Company recorded a note discount of $350,000 to account for the relative fair value of the warrants, the notes' BCF, and OID. The note discounts are being amortized over the term of the note or amortized in full upon the conversion to common stock.

During the period ended June 30, 2018, a total of $336,000 notes payable was converted into 4,624,125 shares of common stock. In addition, note discount of $381,000 was amortized to interest expense, and interest of $28,000 was accrued.

As of June 30, 2018, total outstanding notes payable amounted to $524,000, accrued interest of $99,000 and unamortized note discount of $47,000 for a net balance of $576,000. In addition, a total of eight notes amounting to $454,000 reached maturity and are past due. The Company is currently in negotiations with the noteholders to settle the matured notes payable.

**6. Research and Development**

The Company constructs, develops and tests the AOT technologies with internal resources and through the assistance of various third-party entities. Costs incurred and expensed include fees such as license fees, purchase of test equipment, pipeline pumping equipment, crude oil tank batteries, viscometers, SCADA systems, computer equipment, payroll and other related equipment and various logistical expenses for the purposes of evaluating and testing the Company's AOT prototypes.

Costs incurred for research and development are expensed as incurred. Purchased materials that do not have an alternative future use are also expensed. Furthermore, costs incurred in the construction of prototypes with no certainty of any alternative future use and established commercial uses are also expensed.

For the six-month periods ended June 30, 2018 and 2017, our research and development expenses were $95,000 and $120,000 respectively. For the three-month periods ended June 30, 2018 and 2017, our research and development expenses were $48,000 and $56,000, respectively.

**AOT Product Development and Testing**

The Company constructs, develops and tests the AOT technologies with internal resources and through the assistance of various third-party entities. Costs incurred and expensed include fees such as testing fees, purchase of test equipment, pipeline pumping equipment, crude oil tank batteries, viscometers, SCADA systems, computer equipment, payroll and other related equipment and various logistical expenses for the purposes of evaluating and testing the Company's AOT prototypes.

During the six-month periods ended June 30, 2018 and 2017, the Company incurred total expenses of $1,000 and $26,000, respectively, in the manufacture, delivery and testing of the AOT prototype equipment. During the three-month periods ended June 30, 2018 and 2017, the Company incurred total expenses of $1,000 and $9,000, respectively. These expenses have been reflected as part of Research and Development expenses on the accompanying consolidated statements of operations.

**Temple University Licensing Agreement**

On August 1, 2011, the Company and Temple University ("Temple") entered into two (2) Exclusive License Agreements (collectively, the "License Agreements") relating to Temple's patent applications, patents and technical information pertaining to technology associated with an electric and/or magnetic field assisted fuel injector system (the "First Temple License"), and to technology to reduce crude oil viscosity (the "Second Temple License"). The License Agreements are exclusive and the territory licensed to the Company is worldwide and replace previously issued License Agreements.

Pursuant to the two licensing agreements, the Company agreed to pay Temple the following: (i) non-refundable license maintenance fee of $300,000; (ii) annual maintenance fees of $187,500; (iii) royalty fee ranging from 4% up to 7% from revenues generated from the licensing agreements; and (iv) 25% of all revenues generated from sub-licensees to secure or maintain the sub-license or option thereon. Temple also agreed to defer $37,500 of the amount due if the Company agreed to fund at least $250,000 in research or development of Temple's patent rights licensed to the Company. The term of the licenses commenced in August 2011 and will expire upon the expiration of the patents. The agreement can also be terminated by either party upon notification under terms of the licensing agreements or if the Company ceases the development of the patent or failure to commercialize the patent rights.

Total expenses recognized during each six-month period ended June 30, 2018 and 2017 pursuant to these two agreements amounted to $94,000 and $96,000, respectively. Total expenses recognized during each three-month period ended June 30, 2018 and 2017 pursuant to these two agreements amounted to $47,000 in each year. These expenses have been reflected in Research and Development expenses on the accompanying consolidated statements of operations.

As of December 31, 2016, total unpaid fees due to Temple pursuant to these agreements amounted to $726,000. In July 2017, the Company and Temple amended the Second Temple License agreement. Pursuant to the amendment, the Company paid Temple $62,000 and Temple agreed to defer payment of the remaining $135,000 in unpaid licensing fee until such time the Company generates revenues totaling $835,000 from the license. In addition, the unpaid balance of $135,000 will accrue interest of 9% per annum.

As of June 30, 2018, and December 31, 2017, total unpaid fees due to Temple pursuant to these agreements amounted to $964,000 and $842,000, respectively, which are included as part of Accounts payable – licensing agreements in the accompanying consolidated balance sheets. With regards to the unpaid fees to Temple, a total of $68,000 are current, $405,000 are deferred until such time the Company achieves a revenue milestone of $835,000 or upon termination of the licensing agreements and the remaining $491,000 are deemed past due. The past due amount of $491,000 is owed pursuant to the First Temple License. The Company is currently in negotiations with Temple to settle or cure the past due balance.

The Company generated $50,000 in revenue from the viscosity reduction license during the three-month period ended March 31, 2017. This amount is not sufficient to be subject to additional license fees under the license agreement. No revenues were earned from the two license agreements during the six-month period ended June 30, 2018.

**Temple University Sponsored Research Agreement**

From March 2012 through August 2015, the Temple University ("Temple") provided research services at a fixed annual cost under a Sponsored Research Agreement ("Research Agreement"). The Research Agreement expired in August 2015. Temple University continues to perform laboratory tests on an as-needed basis; expenses are incurred on a per-test basis.

As of June 30, 2018, and December 31, 2017, total unpaid fees due to Temple pursuant to the Research Agreement were $10,000, which are included as part of Accounts payable – licensing agreements in the accompanying consolidated balance sheets. As of June 30, 2018, the entire $10,000 is deemed past due.

### 7. Common Stock

During the six months ended June 30, 2018, the Company issued 17,371,608 shares of its common stock as follows:

- The Company issued 4,624,125 shares of its common stock upon the conversion of $337,000 in convertible notes pursuant to the convertible notes conversion prices of $0.05 to $0.08 per share.

- The Company issued 12,517,773 shares of its common stock upon the exercise of warrants for proceeds of $634,000 at exercise prices of $0.05 to $0.08 per share.

- The Company issued 179,710 shares of its common stock upon the exercise of options for proceeds of $13,000 at exercise prices of $0.07 per share.

- The Company issued 50,000 shares of common stock in exchange for services in aggregate value of $12,000.

### 8. Stock Options and Warrants

The Company periodically issues stock options and warrants to directors, employees, and non-employees in capital raising transactions, for services and for financing costs. Options vest and expire according to terms established at the grant date.

**Options**

Options vest according to the terms of the specific grant and expire from 2 to 10 years from date of grant. The weighted-average, remaining contractual life of employee and non-employee options outstanding at June 30, 2018 was 5.4 years. Stock option activity for the period January 1, 2018 up to June 30, 2018, was as follows:

| | Options | Weighted Avg. Exercise Price |
|---|---|---|
| January 1, 2018 | 35,397,675 | $ 0.23 |
| Granted | 2,083,335 | 0.18 |
| Exercised | (179,710) | – |
| Forfeited | – | – |
| June 30, 2018 | 37,301,300 | $ 0.22 |

The weighted average exercise prices, remaining contractual lives for options granted, exercisable, and expected to vest as of June 30, 2018 were as follows:

| | Outstanding Options | | | Exercisable Options | |
|---|---|---|---|---|---|
| Option Exercise Price Per Share | Shares | Life (Years) | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| $ 0.05 - $ 0.99 | 37,150,854 | 5.4 | $ 0.22 | 33,809,187 | $ 0.21 |
| $ 1.00 - $ 1.99 | 150,446 | 5.1 | $ 1.18 | 150,446 | $ 1.18 |
| | 37,301,300 | 5.4 | $ 0.22 | 33,959,633 | $ 0.22 |

During the six-month period ending June 30, 2018, and pursuant to the Company's Board Compensation policy approved by the Board June 19, 2015, the Company granted options to purchase 2,083,335 shares of common stock to members of the Company's Board of Directors. The options are exercisable at $0.18 per share, vest monthly over a twelve-month period, and expire ten years from the date granted. Total fair value of these options at grant date was $313,000 using the Black-Scholes Option Pricing model with the following assumptions: life of 5 years; risk free interest rate of 1.7%; volatility of 118% and dividend yield of 0%.

During the six-month periods ended June 30, 2018 and 2017, the Company recognized compensation costs based on the fair value of options that vested of $245,000 and $535,000 respectively, which is included in Operating expenses in the Company's statement of operations. During the three-month periods ended June 30, 2018 and 2017, the Company recognized compensation costs based on the fair value of options that vested of $102,000 and $300,000 respectively, which is included in Operating expenses in the Company's statement of operations.

At June 30, 2018, the Company's closing stock price was $0.12 per share. The aggregate intrinsic value of the options outstanding at June 30, 2018 was $520,000. Future unamortized compensation expense on the unvested outstanding options at June 30, 2018 is $209,000 to be recognized through May 2019.

**Warrants**

The following table summarizes certain information about the Company's stock purchase warrants activity for the period starting January 1, 2018 up to June 30, 2018.

| | Warrants | Weighted Avg. Exercise Price |
|---|---|---|
| January 1, 2018 | 17,622,437 | $ 0.09 |
| Granted | 2,189,688 | 0.08 |
| Exercised | (12,517,773) | 0.05 |
| Cancelled | (2,287,997) | 0.05 |
| June 30, 2018 | 5,006,355 | $ 0.21 |

The weighted average exercise prices, remaining contractual lives for warrants granted, exercisable, and expected to vest as of June 30, 2018 were as follows:

| | Outstanding Warrants | | | Exercisable Warrants | |
|---|---|---|---|---|---|
| Warrant Exercise Price Per Share | Shares | Life (Years) | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| $ 0.05 - $ 0.99 | 5,006,355 | 2.1 | $ 0.21 | 4,956,355 | $ 0.21 |
| $ 1.00 - $ 1.99 | – | – | – | – | – |
| | 5,006,355 | 2.1 | $ 0.21 | 4,956,355 | $ 0.21 |

In the six-month period ending June 30, 2018, pursuant to terms of convertible notes issued, the Company granted warrants to purchase 2,189,688 shares of common stock with an exercise price of $0.08 per share, vesting immediately upon grant and expiring one year from the date of grant (see Note 5).

During the six-month period ended March 31, 2018, warrants to acquire 12,217,773 shares of common stock were exercised resulting in net proceeds to the Company of $634,000.

At June 30, 2018, the aggregate intrinsic value of the warrants outstanding was $77,000.

**9. Commitments and Contingencies**

There is no current or pending litigation of any significance with the exception of the matters that have arisen under, and are being handled in, the normal course of business.

**10. Subsequent Events**

**Issuance of Convertible Notes**

From July 1 up to July 31, 2018, the Company issued convertible notes in aggregate of $228,000 in exchange for cash of $208,000. The notes are unsecured, convertible into 4,565,000 shares of common stock of the Company at a conversion price of $0.05 per share and mature in one year. In connection with these notes, the Company also issued warrants to purchase 2,282,500 shares of common stock of the Company at an exercise price of $0.05 per share and expiring one year from the date of issuance. As a result, the Company will record a note discount of $228,000 to account for the relative fair value of the warrants, the notes' beneficial conversion feature and original issue discount which will be amortized as interest expense over the life of the notes.

**Annual Meeting of Shareholders**

The Board, at its meeting on August 13, 2018, set the date for the Annual Meeting of Shareholders for November 9, 2018, and set September 10, 2018, as the Record Date for the meeting.

### 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 the Consolidated Financial Statements and supplementary data referred to in this Form 10-Q.

This discussion contains forward-looking statements that involve risks and uncertainties. Such statements, which include statements concerning future revenue sources and concentration, selling, general and administrative expenses, research and development expenses, capital resources, additional financings and additional losses, are subject to risks and uncertainties, including, but not limited to, those discussed elsewhere in this Form 10-Q, and in the "Risk Factors" section filed with the SEC on April 2, 2018, that could cause actual results to differ materially from those projected. Unless otherwise expressly indicated, the information set forth in this Form 10-Q is as of June 30, 2018, and we undertake no duty to update this information.

**Overview**

QS Energy, Inc. ("QS Energy" or "Company" or "we" or "us" or "our") develops and commercializes energy efficiency technologies that assist in meeting increasing global energy demands, improving the economics of oil transport, and reducing greenhouse gas emissions. The Company's intellectual properties include a portfolio of domestic and international patents and patents pending, a substantial portion of which have been developed in conjunction with and exclusively licensed from Temple University of Philadelphia, PA ("Temple"). QS Energy's primary technology is called Applied Oil Technology (AOT), a commercial-grade crude oil pipeline transportation flow-assurance product. Engineered specifically to reduce pipeline pressure loss, increase pipeline flow rate and capacity, and reduce shippers' reliance on diluents and drag reducing agents to meet pipeline maximum viscosity requirements, AOT is a 100% solid-state system that reduces crude oil viscosity by applying a high intensity electrical field to crude oil while in transit. AOT technology delivers reductions in crude oil viscosity and pipeline pressure loss as demonstrated in independent third-party tests performed by the U.S. Department of Energy, the PetroChina Pipeline R&D Center, and ATS RheoSystems, a division of CANNON™, at full-scale test facilities in the U.S. and China, and under commercial operating conditions on one of North America's largest high-volume crude oil pipelines. Prior testing on a commercial crude oil condensate pipeline demonstrated high correlation between laboratory analysis and full-scale AOT operations under commercial operating conditions with onsite measurements and data collected by the pipeline operator on its supervisory control and data acquisition ("SCADA") system. The AOT product has transitioned from laboratory testing and ongoing research and development to initial production and continued testing in advance of our goal of seeking acceptance and adoption by the upstream and midstream pipeline marketplace. We continue to devote the bulk of our efforts to the promotion, design, testing and the commercial manufacturing and operations of our crude oil pipeline products in the upstream and midstream energy sector. We anticipate that these efforts will continue during 2018.

Our Company was incorporated on February 18, 1998, as a Nevada Corporation under the name Mandalay Capital Corporation. The Company changed its name to Save the World Air, Inc. on February 11, 1999. Effective August 11, 2015, the Company changed its name to QS Energy, Inc. The name change was affected through a short-form merger pursuant to Section 92A.180 of the Nevada Revised Statutes. Additionally, QS Energy Pool, Inc., a California corporation, was formed as a wholly-owned subsidiary of the Company on July 6, 2015 to serve as a vehicle for the Company to explore, review and consider acquisition opportunities. To date, QS Energy Pool has not entered into any acquisition transaction. The Company's common stock is quoted under the symbol "QSEP" on the Over-the-Counter Bulletin Board. More information including the Company's fact sheet, logos and media articles are available at our corporate website, www.qsenergy.com.

Between 2011 and 2012, the Company transitioned from prototype testing of its AOT technology at the U.S. Department of Energy Rocky Mountain Oilfield Testing Center, Midwest, Wyoming ("RMOTC"), to the design and production of full-scale commercial prototype units. The Company worked in a collaborative engineering environment with multiple energy industry companies to refine the AOT commercial design to comply with the stringent standards and qualification processes as dictated by independent engineering audit groups and North American industry regulatory bodies. In May 2013, the Company's first commercial prototype was completed.

In 2013, the Company entered into an Equipment Lease/Option to Purchase Agreement (“TransCanada Lease”) with TransCanada Keystone Pipeline, L.P. by its agent TC Oil Pipeline Operations, Inc. ("TransCanada") which agreed to lease and test the effectiveness of the Company’s AOT technology and equipment on one of TransCanada’s operating pipelines. As previously reported in our 10-K report filed with the SEC on March 16, 2015, in June 2014, the equipment was accepted by TransCanada and the lease commenced and the first full test of the AOT equipment on the Keystone pipeline was performed in July 2014 by Dr. Rongjia Tao of Temple University, with subsequent testing performed by an independent laboratory, ATS RheoSystems, a division of CANNON™ (“ATS”) in September 2014. Upon review of the July 2014 test results and preliminary report by Dr. Tao, QS Energy and TransCanada mutually agreed that this initial test was flawed due to, among other factors, the short-term nature of the test, the inability to isolate certain independent pipeline operating factors such as fluctuations in upstream pump station pressures, and limitations of the AOT device to produce a sufficient electric field to optimize viscosity reduction. Subsequent testing by ATS in September 2014 demonstrated viscosity reductions of 8% to 23% depending on flow rates and crude oil types in transit. In its summary report, ATS concluded that i) data indicated a decrease in viscosity of crude oil flowing through the TransCanada pipeline due to AOT treatment of the crude oil; and ii) the power supply installed on our equipment would need to be increased to maximize reduction in viscosity and take full advantage of the AOT technology. While more testing is required to establish the commercial efficacy of our AOT technology, we are encouraged by the findings of these field tests performed under commercial operating conditions. The TransCanada Lease was terminated by TransCanada, effective October 15, 2014. Upon termination of the TransCanada Lease, all equipment was uninstalled, returned, inspected and configured for re-deployment.

On July 15, 2014, the Company entered into an Equipment Lease/Option to Purchase Agreement (“Kinder Morgan Lease”) with Kinder Morgan Crude & Condensate, LLC (“Kinder Morgan”) under which Kinder Morgan agreed to lease and test the effectiveness of the Company’s AOT technology and equipment on one of Kinder Morgan’s operating pipelines. Equipment provided under the Lease includes a single AOT pressure vessel with a maximum flow capacity of 5,000 gallons per minute. The equipment was delivered to Kinder Morgan in December 2014 and installed in March 2015. In April 2015, during pre-start testing, low electrical impedance was measured in the unit, indicating an electrical short. A replacement unit was installed May 2015. The second unit also presented with low impedance when flooded with crude condensate from Kinder Morgan’s pipeline. Subsequent to design modifications, a remanufactured AOT unit was installed and tested at Kinder Morgan’s pipeline facility in August 2015. Initial results were promising, with the unit operating generally as expected. However, voltage dropped as preliminary tests continued, indicating decreased impedance within the AOT pressure vessel. QS Energy personnel and outside consultants performed a series of troubleshooting assessments and determined that, despite modifications made to the AOT, conductive materials present in the crude oil condensate continued to be the root cause of the decreased impedance. Based on these results, QS Energy and Kinder Morgan personnel mutually agreed to put a hold on final acceptance of equipment under the lease and temporarily suspend in-field testing to provide time to re-test crude oil condensate in a laboratory setting, and thoroughly review and test selected AOT component design and fabrication. Subsequent analysis and testing led to changes in electrical insulation, inlet flow improvements and other component modifications. These design changes were implemented and tested by Industrial Screen and Maintenance (ISM), one of QS Energy's supply chain partners in Casper, Wyoming. Tests performed by ISM at its Wyoming facility indicated significant improvements to system impedance and efficiency of electric field generation.

In February 2016, the modified AOT equipment was installed at Kinder Morgan’s facility. Pre-acceptance testing was performed in April 2016, culminating in more than 24 hours of continuous operations. In-field viscosity measurements and pipeline data collected during this test indicated the AOT equipment operated as expected, resulting in viscosity reductions equivalent to those measured under laboratory conditions. Supervisory Control And Data Acquisition (“SCADA”) pipeline operating data collected by Kinder Morgan during this test indicated a pipeline pressure drop reduction consistent with expectations. Kinder Morgan provided the Company with a number of additional crude oil samples which were tested in the laboratory for future test correlation and operational planning purposes. Based on final analysis of in-field test results, SCADA operating data and subsequent analysis of crude oil samples at Temple University, Kinder Morgan and QS Energy are considering moving the AOT test facility to a different, higher-volume pipeline location. The Kinder Morgan Lease is currently in suspension and lease payments have not yet commenced.

Southern Research Institute (SRI) was engaged by QS Energy in 2015 to investigate the root cause of the crude oil condensate impedance issue by replicating conditions experienced in the field utilizing a laboratory-scaled version of the AOT and crude oil condensate samples provided by Kinder Morgan. In addition, QS Energy retained an industry expert petroleum pipeline engineer to review the AOT design and suggest design modifications to resolve the crude oil condensate impedance issue. This engineer has studied design details, staff reports and forensic photographs of each relevant AOT installation and test. Based on these investigations, specific modifications were proposed to resolve the impedance issue, and improve the overall efficiency of the AOT device, resulting in a new value-engineered design of certain AOT internal components.

During the third quarter 2016, the Company developed a new onsite testing program to demonstrate AOT viscosity reduction at prospective customer sites. This program utilized a fully functional laboratory-scale AOT device designed and developed by the Company and tested at the Southern Research Institute. Under this program, Company engineers set up a temporary lab at the customer's site to test a full range of crude oils. Fees charged for providing this service were dependent on scope of services, crude oil sample to be tested, and onsite time requirements. In the fourth quarter 2016, the Company entered a contract to provide these onsite testing services to a North American oil producer and pipeline operator over a one-week period in early 2017 at a fixed price of $50,000. This test was performed in January 2017; data analysis and final report was completed in March 2017. Test results demonstrated viscosity reduction under limited laboratory conditions. The test equipment was not capable of controlling temperature as required to simulate operating conditions. The oil producer has requested access to a full-scale pilot facility and operating data when available. The Company is in the process of upgrading the laboratory-scale AOT device for planned deployment in 2018 to include temperature control and is actively pursuing a pilot site to demonstrate AOT operations.

In 2014, the Company began development of a new suite of products based around the new electrical heat system which reduces oil viscosity through a process known as joule heat ("Joule Heat"). The Company built and tested its first Joule Heat prototype in June 2015. The system was operational; however, changes to the prototype configuration will be required to determine commercial effectiveness of this unit. In December 2015, we suspended Joule Heat development activities to focus Company resources on finalizing commercial development of the AOT.

In July 2017, the Company filed for trademark protection for the word "eDiluent" in advance of rolling out a new marketing and revenue strategy based on the concept of using AOT to reduce pipeline dependence upon diluent to reduce viscosity of crude oils. A primary function of AOT is to reduce viscosity by means of its solid-state electronics technology; in essence providing an electronic form of diluent, or "eDiluent". The Company plans to market and sell a value-added service under the name eDiluent, designed to be upsold by the Company's midstream pipeline customers in an effort to provide the Company with long-term recurring revenues.

During the third quarter 2017, the Company built a dedicated laboratory space at its Tomball Texas facility, and now has the capability to perform onsite testing utilizing our laboratory-scale AOT device, among other equipment. Development of an AOT unit for use in crude oil upstream and gathering operations was restarted in September 2017 utilizing resources at the Tomball facility, and the Company plans to resume Joule Heat development in the future depending on the availability of sufficient capital and other resources. Also, during the third quarter 2017, the Company built an outdoor facility at its Tomball Texas facility for onsite storage of AOT inventory and other large equipment. The Tomball facility is owned by the Company's CEO as described in our Form 10-K filed with the SEC on April 2, 2018.

The Company is actively seeking deployments of its AOT technology intended to demonstrate and document AOT efficacy, operational benefits, and financial impact. Primary activities are focused on AOT demonstration and joint development projects in the United States, South America and Asia. These projects are designed to provide operating data and physical access to prospective customers to aid product commercialization and future sales. We are currently working with a U.S.-based pipeline operator on a potential development agreement under which we would operate an AOT midstream unit on a pipeline located in the southern United States delivering South American heavy crudes to inland-land refineries. We are working towards finalizing a development agreement subject to the pipeline company's engineering review, targeting installation and operations in the fourth quarter 2018. We are also in discussions with an exploration and production company regarding AOT operations on a West Coast heavy crude gathering line that relies heavily on diluent to achieve required viscosity. This project is designed to demonstrate AOT for upstream and trucking applications, targeting operations in late 2018.

The Company is currently pursuing AOT testing in several countries in South America related to upstream, midstream, barge, and tanker truck applications. Oil samples from multiple clients for testing at Temple University have been delivered to a shipping facility in South America, awaiting customs and shipping clearance. There is a vast amount of heavy oil in these countries and we believe the Ministers of Hydrocarbons have standing orders to increase production and transportation capacity. We continue to work with an existing client in Asia for an AOT installation; however, progress on this project has slowed from our original targets. A Company representative is scheduled to meet with our Asian client in August 2018 to assess the project.

Our expenses to date have been funded primarily through the sale of shares of common stock and convertible debt, as well as proceeds from the exercise of stock purchase warrants and options. We will need to raise substantial additional capital through 2018, and beyond, to fund our sales and marketing efforts, continuing research and development, and certain other expenses, until our revenue base grows sufficiently.

There are significant risks associated with our business, our Company and our stock. See "Risk Factors," below.

**Results of Operation for Six and Three-month periods ended June 30, 2018 and 2017**

I. Six months ended June 30, 2018 and 2017

| | Six months ended June 30 2018 | 2017 | Change |
|---|---|---|---|
| **Revenues** | $ – | $ 50,000 | $ (50,000) |
| **Costs and expenses** | | | |
| **Operating expenses** | 956,000 | 1,838,000 | (882,000) |
| **Research and development expenses** | 95,000 | 120,000 | (25,000) |
| **Loss before other income (expense)** | (1,015,000) | (1,908,000) | 857,000 |
| **Other income (expense)** | | | |
| Interest and financing expense | (407,000) | (1,422,000) | 1,015,000 |
| **Net Loss** | $ (1,458,000) | $ (3,330,000) | $ 1,872,000 |

During the six-month period ended June 30, 2017, the Company recognized revenues of $50,000 pursuant to the completion of lease and testing agreement of the Company's AOT equipment. There were no such revenues in the comparable period in 2018.

Operating expenses were $956,000 for the six-month period ended June 30, 2018, compared to $1,838,000 for the six-month period ended June 30, 2017, a decrease of $882,000. This is due to decreases in non-cash expenses of $266,000 and in other expenses of $616,000. Specifically, the decrease in non-cash expenses is attributable to a decrease in the fair value of options granted to directors and employees of $290,000, offset by an increase in stock compensation expenses attributable to the fair value warrants and common stock granted to consultants of $11,000. The decrease in other expense is attributable mostly to a severance package expense of $624,000 with a former Chief Executive Officer in 2017.

Research and development expenses were $95,000 for the six-month period ended June 30, 2018, compared to $120,000 for the six-month period ended June 30, 2017, a decrease of $25,000. This decrease is attributable to decreases in prototype product development costs of $22,000, and in product testing, research, patents and other costs of $3,000.

Other income and expense were $407,000 expense for the six-month period ended June 30, 2018, compared to $1,422,000 expense for the six-month period ended June 30, 2017, a net decrease in other expenses of $1,015,000. This decrease is attributable to a decrease in non-cash other expenses of $1,015,000. The decrease in non-cash other expense is due to decreases in expense attributable to interest, beneficial conversion factors and warrants associated with convertible notes issued in the amount of $1,023,000, offset by an increase in other non-cash interest of $8,000.

The Company had a net loss of $1,458,000, or $0.01 per share, for the six-month period ended June 30, 2018, compared to a net loss of $3,330,000, or $0.02 per share, for the six-month period ended June 30, 2017.

II. Three months ended June 30, 2018 and 2017

| | Three months ended June 30 2018 | 2017 | Change |
|---|---|---|---|
| Revenues | $ – | $ – | $ – |
| Costs and expenses | | | |
| Operating expenses | 462,000 | 580,000 | (118,000) |
| Research and development expenses | 48,000 | 56,000 | (8,000) |
| Loss before other income (expense) | (510,000) | (636,000) | (126,000) |
| Other income (expense) | | | |
| Interest and financing expense | (248,000) | (1,210,000) | 962,000 |
| **Net Loss** | $ (758,000) | $ (1,846,000) | $ 836,000 |

The Company had no revenues in the three month-periods ended June 30, 2018 and 2017.

Operating expenses were $462,000 for the three-month period ended June 30, 2018, compared to $580,000 for the three-month period ended June 30, 2017, a decrease of $118,000. This is due to a decrease in non-cash expenses of $191,000, and an increase in cash expenses of $73,000. Specifically, the decrease in non-cash expenses are attributable to an increase in depreciation of $7,000, offset by a decrease in stock compensation expenses attributable to the fair value of options granted to directors and employees of $198,000. The increase in cash expense is attributable to decreases in office expenses of $9,000, and legal and accounting expenses of $33,000, offset by increases in consulting fees of $3,000, corporate expenses of $37,000, insurance expenses of $8,000, salaries and benefits of $60,000, and other expenses of $7,000.

Research and development expenses were $48,000 for the three-month period ended June 30, 2018, compared to $56,000 for the three-month period ended June 30, 2017, a decrease of $8,000. This decrease is attributable to decreases in prototype product development costs of $8,000.

Other income and expense were $248,000 expense for the three-month period ended June 30, 2018, compared to $1,210,000 expense for the three-month period ended June 30, 2017, a net decrease in other expenses of $962,000. This decrease is attributable to a crease in non-cash other expenses of $962,000. The decrease in non-cash other expense is due to decreases in expense attributable to interest, beneficial conversion factors and warrants associated with convertible notes issued in the amount of $1,114,000, offset by an increase in other non-cash interest of $12,000.

The Company had a net loss of $758,000, or $0.00 per share, for the three-month period ended June 30, 2018, compared to a net loss of $1,846,000, or $0.01 per share, for the three-month period ended June 30, 2017.

**Liquidity and Capital Resources**

**General**

As reflected in the accompanying condensed consolidated financial statements, the Company has not yet generated significant revenues and has incurred recurring net losses. We have incurred negative cash flow from operations since our inception in 1998 and a stockholders' deficit of $1,772,000 as of June 30, 2018. Our negative operating cash flow for the periods ended June 30, 2018 was funded primarily through issuance of convertible notes and the exercise of options and warrants.

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. As reflected in the accompanying condensed consolidated financial statements, the Company had a net loss of $1,458,000 and a negative cash flow from operations of $676,000 for the six-month period ended June 30, 2018. These factors raise substantial doubt about our ability to continue as a going concern.

In addition, the Company's independent registered public accounting firm, in its report on the Company's December 31, 2017 financial statements, has raised substantial doubt about the Company's ability to continue as a going concern. Our ability to continue as a going concern is dependent upon our ability to raise additional funds and implement our business plan. The consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

**Summary**

During the period ended June 30, 2018, we received cash totaling $965,000 from issuance of our convertible notes payable and exercise of warrants, and used cash in operations of $676,000. At June 30, 2018, we had cash on hand in the amount of $493,000. We will need additional funds to operate our business, including without limitation the expenses we will incur in connection with the license and research and development agreements with Temple University, as amended; costs associated with product development and commercialization of the AOT and related technologies; costs to manufacture and ship our products; costs to design and implement an effective system of internal controls and disclosure controls and procedures; costs of maintaining our status as a public company by filing periodic reports with the SEC and costs required to protect our intellectual property. In addition, as discussed above, we have substantial contractual commitments, including without limitation salaries to our executive officers pursuant to employment agreements, certain severance payments to a former officer and consulting fees, during the remainder of 2018 and beyond.

No assurance can be given that any future financing will be available or, if available, that it will be on terms that are satisfactory to the Company.

**Licensing Fees to Temple University**

For details of the licensing agreements with Temple University, see Financial Statements included in this report, Note 6 (Research and Development).

## Critical Accounting Policies and Estimates

Our discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements and related disclosures requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, expenses, and related disclosure of contingent assets and liabilities. We evaluate, on an on-going basis, our estimates and judgments, including those related to the useful life of the assets. We base our estimates on historical experience and assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results that we report in our consolidated financial statements. The SEC considers an entity's most critical accounting policies to be those policies that are both most important to the portrayal of a company's financial condition and results of operations and those that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain at the time of estimation. For a more detailed discussion of the accounting policies of the Company, see Note 1 of the Notes to the Condensed Consolidated Financial Statements, "Summary of Significant Accounting Policies".

We believe the following critical accounting policies, among others, require significant judgments and estimates used in the preparation of our consolidated financial statements.

**Estimates**

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Certain significant estimates were made in connection with preparing our consolidated financial statements as described in Note 1 to Notes to the Condensed Consolidated Financial Statements. Actual results could differ from those estimates.

**Stock-Based Compensation**

The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board whereas the value of the award is measured on the date of grant and recognized over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the Financial Accounting Standards Board whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete. Non-employee stock-based compensation charges generally are amortized over the vesting period on a straight-line basis. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company's common stock option grants is estimated using the Black-Scholes Option Pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the common stock options, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes Option Pricing model, and based on actual experience. The assumptions used in the Black-Scholes Option Pricing model could materially affect compensation expense recorded in future periods.

**Going Concern**

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. As reflected in the accompanying consolidated financial statements, during the six-months ended June 30, 2018, the Company incurred a net loss of $1,458,000, used cash in operations of $676,000 and had a stockholders' deficit of $1,772,000 as of that date. These factors raise substantial doubt about the Company's ability to continue as a going concern. The ability of the Company to continue as a going concern is dependent upon the Company's ability to raise additional funds and implement its business plan. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

At June 30, 2018, the Company had cash on hand in the amount of $493,000. Management estimates that the current funds on hand will be sufficient to continue operations through November 2018. Management is currently seeking additional funds, primarily through the issuance of debt and equity securities for cash to operate our business, including without limitation the expenses it will incur in connection with the license and research and development agreements with Temple; costs associated with product development and commercialization of the AOT and Joule Heat technologies; costs to manufacture and ship the products; costs to design and implement an effective system of internal controls and disclosure controls and procedures; costs of maintaining our status as a public company by filing periodic reports with the SEC and costs required to protect our intellectual property. In addition, as discussed below, the Company has substantial contractual commitments, including without limitation salaries to our executive officers pursuant to employment agreements, certain payments to a former officer and consulting fees, during the remainder of 2018 and beyond.

No assurance can be given that any future financing will be available or, if available, that it will be on terms that are satisfactory to the Company. Even if the Company is able to obtain additional financing, it may contain undue restrictions on our operations, in the case of debt financing or cause substantial dilution for our stockholders in case of equity financing.

**Recent Accounting Polices**

See Footnote 2 in the accompanying financial statements for a discussion of recent accounting policies.

**Item 3. Quantitative and Qualitative Disclosure about Market Risk**

We issue from time to time fixed rate discounted convertible notes. Our convertible notes and our equity securities are exposed to risk as set forth below, in Part II Item 1A, "Risk Factors." Please also see Item 2, above, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

**Item 4. Controls and Procedures**

**1. Disclosure Controls and Procedures**

The Company's management, with the participation of the Company's chief executive officer and chief financial officer, evaluated, as of June 30, 2018, the effectiveness of the Company's disclosure controls and procedures, which were designed to be effective at the reasonable assurance level. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of the Company's disclosure controls and procedures as of June 30, 2018, management, the chief executive officer and the chief financial officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level at that date.

**(a) Changes in Internal Control over Financial Reporting**

No change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the six-month period ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

There is no litigation of any significance with the exception of the matters that have arisen under, and are being handled in, the normal course of business.

### Item 1A. Risk Factors

There have been no material changes in the risk factors previously disclosed in Form 10-K for the period ended December 31, 2017, which we filed with the SEC on April 2, 2018.

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

**Issuances**

In private offerings exempt from registration, during the six months ended June 30, 2018, the Company issued 4,624,125 shares of its common stock upon the conversion of $647,000 in convertible notes at $0.05 to $0.08 per share, and issued 12,697,483 shares of its common stock upon the exercise of warrants and options at an exercise price of $0.05 to $0.08 per share. In connection with the issuances of the foregoing securities, the Company relied on the exemption from registration provided by Section 4(a)(2) of the Securities Act of 1933, as amended, for transactions not involving a public offering.

The proceeds received by the Company in connection with the above issuances of shares were used for general corporate purposes.

### Item 3. Defaults Upon Senior Securities

None

### Item 4. Mine Safety Disclosures

None

### Item 5. Other Information

None

**Item 6. Exhibits**

| Exhibit No. | Description |
|---|---|
| 31.1 | Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e) |
| 31.2 | Certification of Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e) |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Schema Document |
| 101.CAL | XBRL Calculation Linkbase Document |
| 101.LAB | XBRL Label Linkbase Document |
| 101.PRE | XBRL Presentation Linkbase Document |
| 101.DEF | XBRL Definition Linkbase Document |

## SIGNATURES

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

QS ENERGY, INC.

Date: August 14, 2018

By: /s/ Michael McMullen
Michael McMullen
Chief Financial Officer

## EXHIBITS

| Exhibit No. | Description |
|---|---|
| 31.1 | Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e) |
| 31.2 | Certification of Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e) |
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| 101.DEF | XBRL Definition Linkbase Document |

**EXHIBIT 31.1**

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
AND RULES 13A-14 AND 15D-14 UNDER THE SECURITIES EXCHANGE ACT OF 1934

I, Jason Lane, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of QS Energy, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) or 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(d)-15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its condensed consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2018

/s/ Jason Lane
Jason Lane
Chief Executive Officer

**EXHIBIT 31.2**

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
AND RULES 13A-14 AND 15D-14 UNDER THE SECURITIES EXCHANGE ACT OF 1934

I, Michael McMullen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of QS Energy, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) or 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(d)-15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its condensed consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2018

/s/ Michael McMullen
Michael McMullen
Chief Financial Officer

**EXHIBIT 32**

CERTIFICATION OF PERIODIC FINANCIAL REPORT BY THE CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, we, the undersigned Acting Chief Executive Officer and the Chief Financial Officer of QS Energy, Inc. (the "Company"), hereby certify, based on our knowledge, that the Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 2018 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2018

/s/ Jason Lane
Jason Lane
Chief Executive Officer

Date: August 14, 2018

/s/ Michael McMullen
Michael McMullen
Chief Financial Officer