

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2018

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

For the transition period from: _____ to: _____

Commission file number: 001-33522

SYNTHESIS ENERGY SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

20-2110031
(I.R.S. Employer Identification No.)

Three Riverway, Suite 300, Houston, Texas
(Address of principal executive offices)

77056
(Zip code)

Registrant's telephone number, including area code: (713) 579-0600

Former name, former address and former fiscal year, if changed since last report: N/A

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 has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

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

As of February 5, 2019, there were 11,032,120 shares of the registrant's common stock, par value \$.01 per share, outstanding.

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PART I

Item 1. Financial Statements

SYNTHESIS ENERGY SYSTEMS, INC.
Condensed Consolidated Balance Sheets
(In thousands, except per share amount)

	December 31, 2018	June 30, 2018
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,428	\$ 7,071
Accounts receivable – related party, net	15	287
Prepaid expenses	431	172
Other current assets	381	547
	<hr/>	<hr/>
Total current assets	4,255	8,077
	<hr/>	<hr/>
Property, plant and equipment, net	4	10
Intangible asset, net	1,064	1,038
Investment in joint ventures	5,023	5,036
Other long-term assets	135	153
	<hr/>	<hr/>
Total assets	<u>\$ 10,481</u>	<u>\$ 14,314</u>
LIABILITIES AND EQUITY		
Current liabilities:		
Accrued expenses and accounts payable	\$ 1,655	\$ 1,681
	<hr/>	<hr/>
Senior secured debenture principal	8,000	—
Less unamortized discount and debt issuance costs	(2,397)	—
Total senior secured debenture	5,603	—
	<hr/>	<hr/>
Total current liabilities	7,258	1,681
	<hr/>	<hr/>
Senior secured debenture principal	—	8,000
Less unamortized discount and debt issuance costs	—	(2,610)
Total senior secured debenture	—	5,390
Derivative liabilities	454	1,964
	<hr/>	<hr/>
Total long-term liabilities	454	7,354
	<hr/>	<hr/>
Total liabilities	<u>\$ 7,712</u>	<u>\$ 9,035</u>
Commitment and contingencies (Note 11)		
Stockholders' equity:		
Preferred stock, \$0.01 par value: 20,000 shares authorized – no shares issued and outstanding	—	—
Common stock, \$0.01 par value: 200,000 shares authorized: 11,022 and 10,999 shares issued and outstanding, respectively	110	110
Additional paid-in capital	265,382	265,066
Accumulated deficit	(262,894)	(260,068)
Accumulated other comprehensive income	244	244
Total stockholders' equity to SES stockholders	2,842	5,352
Noncontrolling interests in subsidiaries	(73)	(73)
	<hr/>	<hr/>
Total stockholders' equity	2,769	5,279
	<hr/>	<hr/>
Total liabilities and equity	<u>\$ 10,481</u>	<u>\$ 14,314</u>

See accompanying notes to the condensed consolidated financial statements.

SYNTHESIS ENERGY SYSTEMS, INC.
Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Revenue:				
Technology licensing-related party	\$ —	\$ 52	\$ —	\$ 320
Technology licensing and related services	—	25	—	25
Total revenue	—	77	—	345
Costs and Expenses:				
Costs of sales and operating	—	55	—	146
General and administrative expenses	1,793	1,470	3,257	2,917
Stock-based expense	102	305	316	550
Depreciation and amortization	8	9	19	18
Total costs and expenses	1,903	1,839	3,592	3,631
Operating loss	(1,903)	(1,762)	(3,592)	(3,286)
Non-operating (income)/expense:				
Equity losses of Joint Ventures	100	206	24	321
Foreign currency (gain)/ losses, net	(31)	(46)	91	(107)
Interest expense	329	233	653	233
Interest income	(7)	(8)	(24)	(10)
Gain on fair value adjustments of derivative liabilities	(702)	(439)	(1,510)	(439)
Other (gain)	—	(1,689)	—	(1,689)
Net Loss	(1,592)	(19)	(2,826)	(1,595)
Less: net loss attributable to noncontrolling interests	—	—	—	—
Net income/(loss) attributable to SES stockholders	\$ (1,592)	\$ (19)	\$ (2,826)	\$ (1,595)
Net income/(loss) per share (Basic and Diluted):				
Net income/(loss) attributable to SES stockholders	\$ (0.14)	\$ (0.00)	\$ (0.26)	\$ (0.15)
Weighted average common shares outstanding (Basic):	11,022	10,955	11,021	10,944

See accompanying notes to the condensed consolidated financial statements.

SYNTHESIS ENERGY SYSTEMS, INC.
Condensed Consolidated Statements of Comprehensive Loss
(In thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2018	2017	2018	2017
Net loss, as reported	\$ (1,592)	\$ (19)	\$ (2,826)	\$ (1,595)
Currency translation adjustment	(27)	184	—	150
Comprehensive income/(loss)	(1,619)	165	(2,826)	(1,445)
Less:				
Comprehensive income/(loss) attributable to noncontrolling interests	—	625	—	652
Comprehensive loss attributable to the Company	<u>\$ (1,619)</u>	<u>\$ (460)</u>	<u>\$ (2,826)</u>	<u>\$ (2,097)</u>

See accompanying notes to the condensed consolidated financial statements

SYNTHESIS ENERGY SYSTEMS, INC.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended December 31,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$ (2,826)	\$ (1,595)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based expense	316	550
Amortization of debenture issuance cost	213	69
Depreciation and amortization	19	18
Gain on fair value adjustment of derivative	(1,510)	(439)
Other gains	—	(1,689)
Equity in losses of joint ventures	24	321
Changes in operating assets and liabilities:		
Accounts receivable	272	(327)
Prepaid expenses and other current assets	(93)	(162)
Inventory	—	33
Other long-term assets	(21)	(40)
Accrued expenses and payables	(26)	(129)
Net cash used in operating activities	(3,632)	(3,390)
Cash flows from investing activities:		
Capital expenditures	—	—
Proceeds from TSEC share transfer	—	1,689
Equity investment in joint ventures	(11)	(321)
Net cash provided by/(used in) investing activities	(11)	1,368
Cash flows from financing activities:		
Proceeds from issuance of debenture, net	—	7,375
Payments on debenture issuance costs	—	(161)
Proceeds from exercise of stock options	—	—
Net cash provided by financing activities	—	7,214
Net increase (decrease) in cash	(3,643)	5,192
Cash and cash equivalents, beginning of period	7,071	4,988
Effect of exchange rates on cash	—	153
Cash and cash equivalents, end of period	\$ 3,428	\$ 10,333
Supplemental Disclosures:		
Cash paid for interest expense during six months ended 12/31/2018:	\$ 440	\$ —

There were no non-cash activities related to the six months ended December 31, 2018.

Non-cash activities during the six months ended December 31, 2017

- The company exchanged \$150,000 of accounts receivable for \$150,000 additional investment in AFE for the six months ended December 30, 2017.

See accompanying notes to the condensed consolidated financial statements.

SYNTHESIS ENERGY SYSTEMS, INC.
Condensed Consolidated Statement of Equity
(In thousands)
(Unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Non- controlling Interest	Total
	Shares	Common Stock					
Balance at June 30, 2017	10,930	\$ 109	\$ 263,809	\$ (250,464)	\$ 831	\$ (724)	\$ 13,561
Net loss	—	—	—	(1,575)	—	—	(1,575)
Currency translation adjustment	—	—	—	—	(60)	26	(34)
Stock-based expense	13	—	245	—	—	—	245
Balance at September 30, 2017	<u>10,943</u>	<u>\$ 109</u>	<u>\$ 264,054</u>	<u>\$ (252,039)</u>	<u>\$ 771</u>	<u>\$ (698)</u>	<u>\$ 12,197</u>
Net loss	—	—	—	(19)	—	—	(19)
Currency translation adjustment	—	—	—	—	(44)	—	(44)
Gain on disposition of investment in subsidiary	—	—	—	—	(398)	626	228
Stock-based expense	23	1	304	—	—	—	305
Balance at December 31, 2017	<u>10,966</u>	<u>\$ 110</u>	<u>\$ 264,358</u>	<u>\$ (252,058)</u>	<u>\$ 329</u>	<u>\$ (72)</u>	<u>\$ 12,667</u>
Balance at June 30, 2018	10,999	\$ 110	\$ 265,066	\$ (260,068)	\$ 244	\$ (73)	\$ 5,279
Net loss	—	—	—	(1,234)	—	—	(1,234)
Currency translation adjustment	—	—	—	—	27	—	27
Stock-based expense	23	—	214	—	—	—	214
Balance at September 30, 2018	<u>11,022</u>	<u>110</u>	<u>265,280</u>	<u>(261,302)</u>	<u>271</u>	<u>(73)</u>	<u>4,286</u>
Net loss	—	—	—	(1,592)	—	—	(1,592)
Currency translation adjustment	—	—	—	—	(27)	—	(27)
Stock-based expense	—	—	102	—	—	—	102
Balance at December 31, 2018	<u>11,022</u>	<u>\$ 110</u>	<u>\$ 265,382</u>	<u>\$ (262,894)</u>	<u>\$ 244</u>	<u>\$ (73)</u>	<u>\$ 2,769</u>

See accompanying notes to the condensed consolidated financial statements.

Note 1 — Business and Liquidity

(a) Organization and description of business

Synthesis Energy Systems, Inc. (referred to herein as “we”, “us”, and “our”), together with its wholly-owned and majority-owned controlled subsidiaries, is a global clean energy company that owns proprietary technology, SES Gasification Technology (“SGT”), for the low-cost and environmentally responsible production of synthesis gas (referred to as “syngas”). Our focus has been on commercializing our technology both in China and through the regional business platforms we have created with partners in Australia, Australia Future Energy Pty Ltd (“AFE”), and in Poland, SES EnCoal Energy sp. z o.o (“SEE”).

Over the past ten years, we have successfully deployed our technology into five industrial scale projects in China. We invested in two of those industrial projects and have licensed our technology into the remaining three. Today, four of these projects are operating and are successfully demonstrating our technology. Our first project, the smaller scale Synthesis Energy Systems (Zao Zhang) New Gas Company Ltd (“ZZ”) commercial demonstration plant, operated for several years and also successfully demonstrated our technology and was retired in 2015.

Our partnership companies, AFE and SEE, are developing energy and resource projects with what we believe to be the necessary commercial and financing structures to deliver attractive financial results. We own approximately 38% of AFE and 50% of SEE.

Through 2018, our business model has been to create value in China and through AFE and SEE via three pathways. The first pathway has been through the generation of earnings from the licensing of our proprietary technology and the sale of our proprietary equipment into syngas project developments. The second pathway is through equity income earned from equity ownership in the projects that utilize our technology and the third pathway is through achieving ownership positions in coal resources that can be linked to projects using our coal gasification technology.

We operate our business from our headquarters located in Houston, Texas and our offices in Shanghai, China. Additionally, our partnership companies, AFE and SEE have independent operations in Brisbane, Australia and Warsaw, Poland respectively.

(b) Liquidity, Management’s Plan and Going Concern

As of December 31, 2018, we had \$3.4 million in cash and cash equivalents and a negative \$3.0 million in working capital. The negative working capital is primarily due to the reclassification of the Senior Secured Debentures (the “Debentures”) from a noncurrent to a current liability in connection with the technical default, see **Note 5 – Senior Secured Debentures**. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposit, and have maturity dates greater than 90 days but less than one year.

As of February 13, 2019, we had \$2.9 million in cash and cash equivalents. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposit, and have maturity dates greater than 90 days but less than one year. Of the \$2.9 million in cash and cash equivalents, \$1.6 million resides in the United States or easily accessed foreign countries and approximately \$1.3 million resides in China.

In the quarter ended December 31, 2018, we undertook additional steps to reduce our overhead expenses through the termination of certain technology and administrative employees and other reductions associated with office rental and professional fees.

As part of our overall strategy, to the extent possible, we intend to (i) support AFE and SEE in those endeavors to develop energy, chemicals and resource projects where we would own an earned or carried equity interest in the project; (ii) monitor support and facilitate our minority ownership in BFR in order to realize the financial value through dividend income or other means; (iii) work to recover cash and monetize our Yima Joint Venture and TSEC Joint Venture operations; and (iv) taking any additional steps to utilize our existing cash reserves in the most financially productive mean possible.

We are undertaking strategies to improve our financial position and preserve our available cash to allow more time to realize the value we believe is in our assets, such as Batchfire Resources Pty Ltd (“BFR”), the Pentland coal resource and AFE. These strategies include the evaluation of a full range of financing, restructuring and strategic alternative options which may help us more fully realize the value in those assets. In addition, we are undertaking further expense reductions which we expect to be realized over the remainder of calendar year 2019 and we are undertaking the necessary steps to transfer funds currently in our Chinese bank accounts to our U.S. based bank account in order to improve our available working capital. We may also divest assets such as our Yima Joint Venture, our TSEC Joint Venture and our technology .

We believe that with the strategies above, we can continue to operate for the next nine months while we continue to work to transfer our funds currently in China to the U.S. in the most efficient manner. Based on the uncertainty of our plans to improve our financial position, our historical negative operating cash flows, our continued limited cash inflows and the potential uncertainties regarding transferring our funds from China to the U.S., there is substantial doubt about the Company’s ability to continue as a going concern, as disclosed in our prior periodic reports.

We currently plan to use our available cash for: (i) evaluation and implementing financing, divestitures and strategic restructuring options; (ii) paying the interest related to the Debentures; and (iii) working capital for general corporate and administrative expenses.

We currently have very limited financial and human resources to fully implement our plans and due to employee resource reductions, we have limited technology delivery capabilities. We can make no assurances that AFE, SEE and our other business operations including any potential return from BFR will provide us with sufficient and timely cash flows to continue our operations.

As noted above, we are seeking to improve our financial position and we may choose to raise additional capital through alternatives such as equity and debt financing, divesting certain assets such as our interests in our Yima Joint Venture, our TSEC Joint Venture, and our technology, and/or restructuring the Company. We cannot provide any assurance that any of these alternatives will be available to us in the future on acceptable terms or at all. Any such alternative could be dilutive to our existing stockholders and debtholders. If we cannot raise required funds on acceptable terms, we may further substantially reduce our expenses and we may not be able to, among other things, (i) sustain our general and administrative expenses; (ii) fund certain obligations as they become due including license fees and other vendor payments; (iii) respond to unanticipated capital requirements; or (iv) repay our indebtedness. In addition, we may be forced to seek relief to avoid or end insolvency through other proceedings including bankruptcy.

Note 2 — Summary of Significant Accounting Policies

(a) Reverse Stock Split

On December 4, 2017, we enacted a 1 to 8 reverse stock split as approved by a special stockholder meeting in November 2017. All share and per share amounts in the condensed consolidated financial statements have been retroactively restated to reflect the reverse stock split.

(b) Basis of presentation and principles of consolidation

The condensed consolidated financial statements for the periods presented are unaudited. Operating results for the three and six month period ending December 31, 2018 are not necessarily indicative of results to be expected for the fiscal year ending June 30, 2019.

The condensed consolidated financial statements are in U.S. dollars. Non-controlling interests in consolidated subsidiaries in the consolidated balance sheets represents minority stockholders’ proportionate share of the equity, including any contractual relationships in such subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto reported in the Company’s Annual Report on Form 10-K for the year ended June 30, 2018. Significant accounting policies that are new or updated from those presented in the Company’s Annual Report on Form 10-K for the year ended June 30, 2018 are included below. The condensed consolidated financial statements have been prepared in accordance with the rules of the United States Securities and Exchange Commission (“SEC”) for interim financial statements and do not include all annual disclosures required by generally accepted accounting principles in the United States.

The accompanying condensed consolidated interim financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business. As such, conditions exist that may raise substantial doubt regarding the Company's ability to continue as a going concern. These condensed consolidated interim financial statements do not give effect to any adjustment that would be necessary should the Company be unable to continue as a going concern and therefore need to realize its assets and liquidate its liabilities and commitments in other than the normal course of business and at amounts different from those in the accompanying condensed consolidated interim financial statements. In the opinion of management, all adjustments which are necessary for fair statements of results for interim periods have been included.

Immaterial prior period corrections. During the preparation of the condensed consolidated financial statements as of and for the three and six month period ended December 31, 2018, we have corrected certain amounts related to our historical financial statements for comparative purposes.

- The allocation of losses to the noncontrolling interests in our subsidiary Synthesis Energy Systems Investments, Inc. ("SESI"), should have excluded certain charges contractually agreed to with the noncontrolling interest shareholder. Accordingly, we made adjustments to increase the net loss attributable to SES stockholders by approximately \$374,000 and \$418,000 for the three and six-month periods ending December 31, 2017 with corresponding adjustments to increase accumulated deficit and decrease noncontrolling interests as of December 31, 2017.
- We also adjusted the balances as of June 30, 2017 on the condensed consolidated statement of equity to increase the noncontrolling interest by approximately \$477,000, to decrease the accumulated other comprehensive income for approximately \$3.2 million which resulted in a decrease in the accumulated deficit for approximately \$2.7 million related to the conversion of our Yima Joint Venture investment from the equity method to the cost method in 2013.
- We also adjusted the balances on the condensed consolidated balance sheets, statement of operations, comprehensive loss, cash flow and statement of equity related to reversing approximately \$67,000 of revenue prematurely recognized in the quarter ending September 30, 2018, related to our Yima Joint Venture billings as the collection of the consideration was not considered probable and the billings have not yet been collected.

(c) Accounting for Variable Interest Entities ("VIEs") and Financial Statement Consolidation Criteria

We have equity investments in various privately held entities. We account for these investments either under the equity method or cost method of accounting depending on our ownership interest and the level of our influence in each joint venture. Investments accounted for under the equity method are recorded based upon the amount of our investment and adjusted each period for our share of the investee's income or loss. Cost method investments are recorded at cost less any impairments. All investments are reviewed for changes in circumstance or the occurrence of events that suggest an other-than-temporary event where our investment may not be recoverable.

The joint ventures which we have entered into may be considered a variable interest entity, ("VIE"). We consolidate all VIEs where we are the primary beneficiary. This determination is made at the inception of our involvement with the VIE and is continuously re-assessed. We consider qualitative factors and form a conclusion that we, or another interest holder, has a controlling financial interest in the VIE and, if so, whether it is the primary beneficiary. To determine the primary beneficiary, we consider who has the power to direct activities of the VIE that most significantly impacts the VIE's performance and has the obligation to absorb losses from or the right to receive benefits of the VIE that could be significant to the VIE. We do not consolidate VIEs where we are not the primary beneficiary. As noted above, we account for these unconsolidated VIEs using either the equity method if we have significant influence but not control, or the cost method and include our net investment on our consolidated balance sheet. Under the equity method, our equity interest in the net income or loss from our investments are recorded in non-operating income/expense on a net basis on our consolidated statements of operations. In the event of a change in ownership, any gain or loss resulting from an investee share issuance is recorded in earnings. Controlling interest is determined by majority ownership interest and the ability to unilaterally direct or cause the direction of management and policies of an entity after considering any third-party participatory rights.

(d) Revenue Recognition

We may receive upfront licensing fee payments when a license agreement is entered into. Typically, the majority of a license fee is due once project financing and equipment installation occur. We recognize license fees for the use of its gasification systems as revenue when the license fees become due and payable under the license agreement, subject to the deferral of the amount of the performance guarantee. Fees earned for engineering services, such as services that relate to integrating our technology to a customer's project, are recognized using the percentage-of-completion method or as services are provided.

We adopted Accounting Standards Codification No. 606, *Revenue from Contracts with Customers* (ASC 606) beginning July 1, 2018. We have elected to adopt ASC 606 under the modified retrospective method, under the modified retrospective method, we applied the guidance retrospectively only to the most current period presented in the Company's consolidated financial statements. To do so, we have to recognize the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings at the date of initial application with the prior period presented without change. Since an entity may elect to apply the modified retrospective method to either all contracts as of the date of initial application or only to contracts that are not completed as of this date, we have elected to apply the modified retrospective method only to those contracts not completed before the dated of initial application. Due to the limited number of contracts and revenue related to these contracts, we had no cumulative adjustment.

(e) Use of estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Management considers many factors in selecting appropriate operational and financial accounting policies and controls, and in developing the assumptions that are used in the preparation of these consolidated financial statements. Management must apply significant judgment in this process. Among the factors, but not fully inclusive of all factors that may be considered by management in these processes are: the range of accounting policies permitted by accounting principles generally accepted in the United States of America; management's understanding of the Company's business for both historical results and expected future results; the extent to which operational controls exist that provide high degrees of assurance that all desired information to assist in the estimation is available and reliable or whether there is greater uncertainty in the information that is available upon which to base the estimate; expectations of the future performance of the economy, both domestically, and globally, within various areas that serve the Company's principal customers and suppliers of goods and services; expected rates of exchange, sensitivity and volatility associated with the assumptions used in developing estimates; and whether historical trends are expected to be representative of future trends. The estimation process often times may yield a range of potentially reasonable estimates of the ultimate future outcomes and management must select an amount that lies within that range of reasonable estimates based upon the risks associated with the variability that might be expected from the future outcome and the factors considered in developing the estimate. Management attempts to use its business and financial accounting judgment in selecting the most appropriate estimate, however, actual amounts could and will differ from those estimates.

(f) Fair value measurements

Accounting standards require that fair value measurements be classified and disclosed in one of the following categories:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The Company's financial assets and liabilities are classified based on the lowest level of input that is significant for the fair value measurement. The Company measures equity investments without readily determinable fair value on a non-recurring basis. The fair value of the Yima Joint Venture was determined as of June 30, 2018 through an impairment valuation. Since there were no triggering events during the six-months ended December 31, 2018, the value of the investment in the Yima Joint Venture remains the same. The following table summarizes the assets of the Company measured at fair value as of December 31, 2018 and June 30, 2018 (in thousands):

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Certificates of Deposit	\$ —	\$ 50 ⁽¹⁾	\$ —	\$ 50
Money Market Funds	1,452 ⁽²⁾	—	—	1,452
Liabilities:				
Derivative Liabilities	\$ —	\$ —	\$ 454	\$ 454
	June 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Certificates of Deposit	\$ —	\$ 50 ⁽¹⁾	\$ —	\$ 50
Money Market Funds	4,345 ⁽²⁾	—	—	4,345
Non-recurring Investment in Yima Joint Venture	—	—	5,000	5,000
Liabilities:				
Derivative Liabilities	\$ —	\$ —	\$ 1,964	\$ 1,964

(1) Amount included in current assets on the Company's consolidated balance sheets.

(2) Amount included in cash and cash equivalents on the Company's consolidated balance sheets.

The following table sets forth the changes in the estimated fair value for our Level 3 classified derivative liabilities (in thousands):

Derivative liabilities balance - June 30, 2018	\$ 1,964
Change in fair value	(1,510)
Derivative liabilities balance - December 31, 2018	\$ 454

The carrying values of the certificates of deposit and money market funds approximate fair value, which was estimated using quoted market prices for those or similar investments. The carrying value of other financial instruments, including accounts receivable and accounts payable, approximate their fair values due to the short maturities on those instruments. Our Debentures are recorded at face value of \$8.0 million and fair value is unable to be determined. The derivative liabilities are measured at fair value using a Monte Carlo simulation valuation methodology. See also **Note 6 – Derivative Liabilities** for more details related to the valuation and assumptions of the Company's derivative liabilities.

Note 3 – Recently Issued Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, which creates ASC Topic 842, "Leases." This update increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2018. We are evaluating what impact, if any, the adoption of this guidance will have on our financial condition, results of operations, cash flows or financial disclosures.

In June 2018, the FASB issued ASU No. 2018-07, which expands the scope of Topic 718, "Compensation – Stock Compensation", to include share-based payment transactions for acquiring goods and services from non-employees. An entity should apply the requirements of Topic 718 to non-employee awards except for specific guidance on inputs to an option pricing model and the attribution of cost. This amendment specifies that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. This amendment also clarifies that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, Revenue from Contracts with Customers. The standard is effective for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. We have elected to early adopt the ASU No. 2018-07 for the quarter ending December 31, 2018 and there was no material effect on our financial condition, results of operations, cash flows or financial disclosures.

Note 4 – Current Projects

Australian Future Energy Pty Ltd

In 2014, we established AFE together with an Australian company, Ambre Investments PTY Limited (“Ambre”). AFE is an independently managed Australian business platform established for the purpose of building a large-scale, vertically integrated business in Australia based on developing, building and owning equity interests in financially attractive and environmentally responsible projects that produce low-cost syngas as a competitive alternative to expensive local natural gas and LNG.

On May 10, 2017, we entered into a project technology license agreement with AFE in connection with a project being developed by AFE in Queensland, Australia. AFE intends to form a subsidiary project company and assign the project technology license agreement to that company which will assume all of the obligations of AFE thereunder. Pursuant to the project technology license agreement, we granted a non-exclusive license to use our technology at the project to manufacture syngas and to use our technology in the design of the facility. In consideration, the project technology license agreement calls for a license fee to be finalized based on the designed plant capacity and a separate fee of \$2.0 million for the delivery of a process design package. The license agreement calls for license fees to be paid as project milestones are reached throughout the planning, construction and first five years of plant operations. The success and timing of the project being developed by AFE will affect if and/or when we will be able to receive all the payments related to this technology license agreement. However, there can be no assurance that AFE will be successful in developing this or any other project or that we will be able to deliver the technology for the project.

In August 2017, AFE completed the acquisition of a mine development lease related to the 266-million ton coal resource near Pentland, Queensland through AFE’s wholly owned subsidiary, Great Northern Energy Pty Ltd. (“GNE”).

In July 2018, we entered into a loan agreement (the “Loan Agreement”) with AFE to provide short-term funding in order to enable AFE to continue to progress its project related initiatives for the betterment of AFE shareholders and the successful promotion of their projects in the amount of 350,000 Australian Dollars, approximately \$260,000. The Loan Agreement had a term of three months, subject to certain events, and an interest rate of 6%. AFE repaid the outstanding principal amount under the Loan Agreement plus interest in August 2018.

For our ownership interest in AFE, we have been contributing cash and engineering support for AFE’s business development while Ambre contributed cash and services. Additional ownership in AFE has been granted to the AFE management team and staff individuals providing services to AFE. In August 2017 and March 2018, we elected to make additional contributions of \$0.47 million and \$0.16 million respectively to assist AFE with developing its business in Australia.

We account for our investment in AFE under the equity method. Our ownership interest of approximately 38% makes us the second largest shareholder. We also maintain a seat on the board of directors which allows us to have significant influence on the operations and financial decisions, but not control, of the company. Our carrying value of our AFE investment as of December 31, 2018 and June 30, 2018 were both zero.

The following summarizes condensed financial information of AFE for the three and six months ended December 31, 2018 and 2017 and as of December 31, 2018 and June 30, 2018 (in thousands):

<u>Income Statement data:</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>December 31,</u>		<u>December 31,</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Net income/(loss)	\$ (289)	\$ (522)	\$ 9	\$ (1,013)

<u>Balance sheet data:</u>	<u>December 31, 2018</u>	<u>June 30, 2018</u>
Total assets	\$ 918	\$ 725
Total Equity	563	549

Batchfire Resources Pty Ltd

As a result of AFE's early stage business development efforts associated with the Callide coal mine in Central Queensland, Australia, AFE created BFR. BFR was a spin-off company for which ownership interest was distributed to the existing shareholders of AFE and to the new BFR management team in December 2015. BFR is registered in Australia and was formed for the purpose of purchasing the Callide thermal coal mine from Anglo-American plc ("Anglo-American"). The Callide mine is one of the largest thermal coal mines in Australia and has been in operation for more than 20 years.

In October 2016, BFR stated that it had received investment support for the acquisition from Singapore-based Lindenfels Pte, Ltd, a subsidiary of commodity traders Avra Commodities, and as a result the acquisition of the Callide thermal coal mine from Anglo-American was completed in October 2016.

We account for our investment in BFR under the cost method. Our limited ownership interest in BFR was approximately 11% and we do not have significant influence over the operation or financial decisions made by the company. At the time of the spin-off, the carrying amount of our investment in AFE was reduced to zero through equity losses. As such, the value of the investment in BFR post spin-off was also zero. As of December 31, 2018, our ownership interest in BFR was approximately 11% and the carrying value of our investment in BFR as of both December 31, 2018 and June 30, 2018 was zero.

Townsville Metals Infrastructure Pty Ltd

In August 2018, AFE formed a separate unrelated company, Townsville Metals Infrastructure Pty Ltd ("TMI") for the purpose of completing the development of the required infrastructure such as rail and port modifications related to the transport of mined products including coal from the Pentland resource to the Townsville port. Ownership in TMI was distributed proportionately to the shareholders of AFE. Our ownership in TMI is approximately 38% upon the formation of TMI through our ownership interest in AFE.

We account for our investment in TMI under the equity method. Our ownership interest of approximately 38% makes us the second largest shareholder. We may appoint one board director for each 15% ownership interest we hold in TMI which allows us to have significant influence on the operations and financial decisions, but not control, of the company. Our carrying value of our TMI investment as of December 31, 2018 was zero.

Cape River Resources Pty Ltd

In October 2018, AFE formed a separate unrelated company, Cape River Resources Pty Ltd ("CRR") for the purpose of developing the Pentland resource into an operating thermal coal mine. Ownership in CRR was distributed proportionately to the shareholders of AFE with additional shares issued to the management team. Our ownership in CRR is approximately 38% upon the formation of CRR through our ownership interest in AFE. GNE sold its 100% ownership interest in the Pentland Coal Mine to CRR. CRR is currently finalizing the preparation of its Initial Advice Statement of the Pentland Coal Mine project to the Queensland Government for the development of the project for an initial 6.0 million metric tons per annum ("mtpa") run of mine ("ROM") coal operation, with allowance for expansion of the project for up to 9.0 million mtpa ROM coal operation. In its first phase of operation, 4.5 million mtpa of coal is planned for export to Asian markets with the balance of 1.5 million mtpa for feedstock to a future proposed coal gasification project. It is anticipated by CRR, based on current planning, for the project to be operational in 2022. CRR has indicated that a drilling program is planned to commence in late 2018 to expand the size and overall quality and understanding of the Pentland resource.

We account for our investment in CRR under the equity method. Our ownership interest of approximately 38% makes us the second largest shareholder. We may appoint one board director for each 15% ownership interest we hold in CRR which allows us to have significant influence on the operations and financial decisions, but not control, of the company. Our carrying value of our CRR investment as of December 31, 2018 was zero.

In October 2017, we entered into agreements with Warsaw-based EnInvestments sp. z o.o. Under the terms of the agreements, we and EnInvestments are equal shareholders of SEE and SEE will exclusively market, develop, and commercialize projects in Poland which utilize our technology, services and proprietary equipment and we share with SEE a portion of the technology license payments, net of fees, we receive from Poland. The goal of SEE is to establish efficient clean energy projects that provide Polish industries superior economic benefits as compared to the use of expensive, imported natural gas and LNG, while providing energy independence through our technological capabilities to convert the wide range of Poland's indigenous coals, coal waste, biomass and municipal waste to valuable syngas products. SEE has developed a pipeline of projects and together we are actively working with Polish customers and partners to complete necessary project feasibility, permitting, and SGT technology agreement steps required prior to starting construction on the projects.

For our ownership interest in SEE, we have been contributing cash and assisting in the development of SEE. SEE was funded in January 2018 with a cash contribution of approximately \$6,000 and additional funding in March 2018 of approximately \$76,000. In August 2018 we made an additional cash contribution of approximately \$11,000.

We account for our investment in SEE under the equity method. Our ownership interest of 50% makes us an equal shareholder and we also maintain two of the four seats on the management board which allows us to have significant influence on the operations and financial decisions, but not control, of the company. On December 31, 2018, as an equal shareholder, our ownership interest was 50% of SEE and the carrying value of our investment in SEE as of December 31, 2018 and June 30, 2018 was approximately \$23,000 and \$36,000, respectively.

Yima Joint Venture

In August 2009, we entered into joint venture contracts and related agreements with Yima Coal Industry Group Company ("Yima"). We continue to own a 25% interest in the Yima Joint Venture and Yima owns a 75% interest.

In December 2017 and January 2018, on-going development cooperation and discussions with the Yima Joint Venture management resulted in the joint venture agreeing to pay various costs incurred by us during the construction and commissioning period of the facility in the amount of approximately 16 million Chinese Renminbi yuan, ("RMB"), (approximately \$2.3 million). As of June 30, 2018, we have received 6.15 million RMB (approximately \$0.9 million) of payments from the Yima Joint Venture related to these costs. Additional payments may be forthcoming. Due to uncertainty, revenues will be recorded upon receipt of payment. Despite our continuous collection efforts, we have not received any additional payments during the six-months ending December 31, 2018.

Since 2014, we have accounted for this joint venture under the cost method of accounting. Our conclusion to account for this joint venture under this methodology is based upon our historical lack of significant influence in the Yima Joint Venture. The lack of significant influence was determined based upon our interactions with the Yima Joint Venture related to our limited participation in operating and financial policymaking processes coupled with our limited ability to influence decisions which contribute to the financial success of the Yima Joint Venture. We continue to evaluate our level of influence over the Yima Joint Venture.

We evaluated the conditions of the Yima Joint Venture to determine whether an other-than-temporary decrease in value had occurred as of June 30, 2018 and 2017. At June 30, 2018, management determined there was a triggering event related to the value of its investment in the Yima Joint Venture. Lower production levels in the fourth quarter reduced the annual production below expectations, which resulted in a net increase in the working capital deficit and the debt level of the joint venture. At June 30, 2017, management determined that there were triggering events related to the value of its investment and these were the lower than expected production levels and the increased debt levels as compared to the previous year, which indicated a continued cash flow concern for the joint venture. Management determined these events in both years were other-than-temporary in nature and therefore conducted an impairment analysis utilizing a discounted cash flow fair market valuation and a Black-Sholes Model-Fair Value of Optionality used in valuing companies with substantial amounts of debt where a discounted cash flow valuation may be inadequate for estimating fair value with the assistance of a third-party valuation expert. In these valuations, significant unobservable inputs were used to calculate the fair value of the investment (see Note 2 – (e) *Use of Estimates*). These inputs included forecasted methanol and coal prices, calculated discount rates and discount for lack of marketability as the majority owner is a state-owned entity in China, volatility analysis and information received from the joint venture. The valuation led to the conclusion that the investment in the Yima Joint Venture was impaired as of June 30, 2018, and accordingly, we recorded a \$3.5 million impairment for the year ended June 30, 2018. The previous valuation concluded there was an impairment, which resulted in us recording a \$17.7 million impairment for the year ended June 30, 2017.

As of December 31, 2018, the Yima Joint Venture's third-party loans balance was approximately 59.8 million Chinese Renminbi yuan ("RMB"), approximately \$8.7 million, with \$4.9 million due in April 2019 and \$3.8 million with maturities greater than one year.

Management determined that there was not an other-than-temporary triggering event during the quarter ended December 31, 2018. The carrying value of our Yima Joint Venture investment was approximately \$5.0 million as of both December 31, 2018 and June 30, 2018. We continue to monitor the Yima Joint Venture and could record an additional impairment in the future if operating conditions deteriorate or if the cash flow situation worsens.

Tianwo-SES Clean Energy Technologies Limited

Joint Venture Contract

In February 2014, SES Asia Technologies Limited, one of our wholly owned subsidiaries, entered into a Joint Venture Contract (the "JV Contract") with Zhangjiagang Chemical Machinery Co., Ltd., which subsequently changed its legal name to Suzhou Thvow Technology Co. Ltd. ("STT"), to form Tianwo-SES Clean Energy Technologies Limited (the "TSEC Joint Venture"). The purpose of the TSEC Joint Venture is to establish our gasification technology as the leading gasification technology in the TSEC Joint Venture territory (which is China, Indonesia, the Philippines, Vietnam, Mongolia and Malaysia) by becoming a leading provider of proprietary equipment and engineering services for the technology. The scope of the TSEC Joint Venture is to market and license our gasification technology via project sublicenses; procurement and sale of proprietary equipment and services; coal testing; and engineering, procurement and research and development related to the technology.

In August 2017, we entered into a restructuring agreement of the TSEC Joint Venture ("Restructuring Agreement"). The agreed change in share ownership, reduction in the registered capital of the joint venture, and the final transfer of shares with local government authorities was completed in December 2017. In this restructuring, an additional party was added to the JV Contract, upon receipt of final government approvals, The Innovative Coal Chemical Design Institute ("ICCDI") has become a 25% owner of the TSEC Joint Venture, we have decreased our ownership to 25% and STT has decreased its ownership to 50%. ICCDI previously served as general contractor and engineered and constructed all three projects for the Aluminum Corporation of China. We received 11.15 million RMB (approximately \$1.7 million) from ICCDI as a result of the restructuring. In conjunction with the joint venture restructuring, we also received 1.2 million RMB (approximately \$180,000) related to outstanding invoices for services we had provided to the TSEC Joint Venture.

TSEC Joint Venture financial data

The following summarizes condensed financial information of TSEC Joint Venture for the three and six months ended December 31, 2018 and 2017 and as of December 31, 2018 and June 30, 2018 (in thousands):

<u>Income Statement data:</u>	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2018	2017	2018	2017
Revenue	\$ —	\$ 109	\$ —	\$ 109
Operating loss	(259)	(643)	(466)	(1,241)
Net loss	(259)	(643)	(466)	(1,241)

<u>Balance sheet data:</u>	<u>December 31, 2018</u>	<u>June 30, 2018</u>
Current assets	\$ 4,322	\$ 5,918
Noncurrent assets	1,314	5,464
Current liabilities	3,677	3,938
Noncurrent liabilities	—	—
Equity	1,959	7,444

The TSEC Joint Venture is accounted for under the equity method. Our initial capital contribution in the formation of the venture was the Technology Usage and Contribution Agreement (“TUCA”), which is an intangible asset. As such, we did not record a carrying value at the inception of the venture. The carrying value of our investment in the TSEC Joint Venture as of both December 31, 2018 and June 30, 2018 was zero.

Under the equity method of accounting, losses in the venture are not recorded if the losses cause the carrying value to be negative and there is no requirement to contribute additional capital. As we are not required to contribute additional capital, we have not recognized losses in the venture, as this would cause the carrying value to be negative. Had we recognized our share of the losses related to the venture, we would have recognized losses of approximately \$0.1 million and \$0.3 million for the six months ended December 31, 2018 and 2017 respectively, and approximately \$3.6 million from inception to date.

TUCA

Pursuant to the TUCA, we have contributed to the TSEC Joint Venture certain exclusive rights to our gasification technology in the TSEC Joint Venture territory, including the right to: (i) grant site specific project sub-licenses to third parties; (ii) use our marks for proprietary equipment and services; (iii) engineer and/or design processes that utilize our technology or our other intellectual property; (iv) provide engineering and design services for joint venture projects and (v) take over the development of projects in the TSEC Joint Venture territory that have previously been developed by us and our affiliates. As a result of the Restructuring Agreement, ICCDI was added as a party to the TUCA, but all other material terms remained the same.

Note 5 — Senior Secured Debentures

On October 24, 2017, we entered into a securities purchase agreement (the “Purchase Agreement”) with certain accredited investors (the “Purchasers”) for the purchase of \$8.0 million in principal amount of Debentures. The Debentures have a term of 5 years with an interest rate of 11% that adjusts to 18% in the event the Company defaults on an interest payment. The Debentures require that dividends received from BFR are used to pay down the principal amounts of outstanding Debentures. Additionally, we issued warrants to purchase 1,000,000 shares of common stock at \$4.00 per common share. The Purchase Agreement and the Debentures contain certain customary representations, warranties and covenants. There are no financial metric covenants related to the Debentures. The transaction was approved by a special committee of our board of directors due to the fact that certain board members were Purchasers. Interest on the outstanding balance of Debentures is payable quarterly and commenced on January 2, 2018. All unpaid principal and interests on the Debentures will be due on October 23, 2022.

The net offering proceeds to us from the sale of the Debentures and warrants, after deducting the placement agent’s fee and associated costs and expenses, was approximately \$7.4 million, not including the proceeds, if any, from the exercise of the warrants issued in this offering. As compensation for their services, we paid T.R. Winston & Company, LLC (the “Placement Agent”): (i) a cash fee of \$0.56 million (representing an aggregate fee equal to 7% of the face amount of the Debentures); and (ii) a warrant to purchase 70,000 shares of common stock, 7% of the warrants issued to the Purchasers (the “Placement Agent Warrants”). We also reimbursed certain expenses of the Placement Agent. The fair market value of the warrants was approximately \$137,000 at the time of issuance and recorded as debt issuance cost. A total of approximately \$1.0 million debt issuance cost was recorded as a result and is being amortized to interest expense over the term of the Debentures by using effective interest method beginning in October 2017.

The warrants and Placement Agent Warrants contain provisions providing for the adjustment of the purchase price and number of shares into which the securities are exercisable in certain events. Also, under certain events, we shall, at the holder’s option, purchase the warrants from the holder by paying the holder an amount in cash based on a Black Scholes Option Pricing Model for remaining unexercised warrants. Under U.S. GAAP, this potential cash transaction requires us to record the fair market value of the warrants as a liability as opposed to equity. Management used a Monte Carlo Simulation method to value the warrants with Anti-Dilution Protection with the assistance of a third-party valuation expert. To execute the model and value the warrants, certain assumptions were needed as noted below:

Valuation Date:	October 24, 2017
Warrant Expiration Date:	October 31, 2022
Total Number of Warrants Issued:	1,000,000
Contracted Conversion Ratio:	1:1
Warrant Exercise Price (USD)	4.00
Next Capital Raise Date:	October 31, 2018
Threshold exercise price post Capital raise:	2.51
Spot Price (USD):	3.28
Expected Life (Years):	5.0
Volatility:	66.0%
Volatility (Per-period Equivalent):	19.1%
Risk Free Interest Rate:	2.04%
Risk Free Rate (Per-period Equivalent):	0.17%
Nominal Value (USD Mn):	4.0
No of Shares on conversion (Mn):	8.0

The results of the valuation exercise valued the warrants issued at \$1.9528 per share, or \$2.0 million in total.

The total proceeds received are first allocated to the fair value of all the derivative instruments, and the remaining proceeds are then allocated to the Debentures, resulting in the Debentures being recorded at a discount from the face value.

The Company recorded \$8.0 million as the face value of the Debentures and a total of \$2.0 million as discount of Debentures and \$0.1 million as debt issuance cost for warrants issued to investors and placement agent, which is amortized to interest expense over the term of the Debenture which resulted in a charge to interest expense of \$0.3 million and \$0.2 million for the three months ended December 31, 2018 and 2017 respectively, and \$0.7 million and \$0.2 million for the six months period ended December 31, 2018 and 2017 respectively.

The effective annual interest rate of the debentures is approximately 18% after considering this \$2.0 million discount related to the Debentures.

The Debentures are guaranteed by the U.S. subsidiaries of the Company, as well as the Company's British Virgin Islands subsidiary, pursuant to a Subsidiary Guarantee, in favor of the holders of the Debentures by the subsidiary guarantors, party thereto, as well as any future subsidiaries which the Company forms or acquires. The Debentures are secured by a lien on substantially all of the assets of the Company and the subsidiary guarantors, other than their equity ownership interest in the Company's foreign subsidiaries, pursuant to the terms of the Purchase Agreement among the Company, the subsidiary guarantors and the holders of the Debentures.

On November 5, 2018, a default occurred related to the Purchase Agreement and the Debentures due to the Company failing to timely file its Annual Report on Form 10-K. If the default is not waived by the holders of the Debentures, the holders may have the option to accelerate the principal and interest outstanding and other mandatory charges on the Debentures. The default has not been waived at the time of filing this Quarterly Report on Form 10-Q and accordingly, we have reclassified the Debenture liabilities from noncurrent liabilities to current liabilities.

Note 6 — Derivative Liabilities

The warrants issued to the Debenture investors and the Placement Agent contain provisions providing for the adjustment of the purchase price and number of shares into which the securities are exercisable under certain events. Under certain events, the Company shall, at the holder's option, purchase the warrants from the holder by paying the holder an amount in cash based on a Black Scholes Option Pricing Model for remaining unexercised warrants. ASC 815, which establishes accounting and reporting standards for derivative instruments including certain derivative instruments embedded in other financial instruments or contracts and requires recognition of all derivatives on the balance sheet at fair value. Management used a Monte Carlo Simulation method to value the warrants with Anti-Dilution Protection with the assistance of a third-party valuation expert to initially record the fair value of these derivatives. The third-party valuation expert also assisted management in valuing the derivatives as of the year ended June 30, 2018 and the quarters ended September 30, 2018 and December 31, 2018 with the changes in the fair value reported as non-operating income or expense.

To execute the model and value the derivatives, certain assumptions were needed as noted below:

Assumptions	Year Ended June 30, 2018	Quarter Ended December 31, 2018
Warrant Issue Date:	October 24, 2017	October 24, 2017
Valuation Date:	June 30, 2018	December 31, 2018
Warrant Expiration Date:	October 31, 2022	October 31, 2022
Total Number of Warrants Issued:	1,070,000	1,070,000
Warrant Exercise Price (USD):	4.00	4.00
Next Capital Raise Date: ⁽¹⁾	June 30, 2019	September 30, 2019
Threshold Exercise Price Post Capital Raise: ⁽²⁾	2.15	0.70
Spot Price (USD):	3.28	0.79
Expected Life (Years):	4.3	3.8
Volatility:	65.0%	79.0%
Volatility (Per-period Equivalent):	18.8%	22.8%
Risk Free Interest Rate:	2.71%	2.49%
Risk Free Rate (Per-period Equivalent):	0.22%	0.20%
Nominal Value (USD Mn):	4.3	4.3
No. of Shares on Conversion (Mn):	1.1	1.1
Contracted Conversion Ratio:	1:1	1:1
Fair Values (in thousands)		
Fair Value without Anti-Dilution Protection:	\$1,704	\$199
Fair Value of Embedded Derivative:	260	255
Fair Value of the Warrants Issued:	\$1,964	\$454
Gain/(Loss) on Fair Value Adjustments to Derivative Liabilities	\$126	\$1,510

- (1) Next Capital Raise Date was assumed to be within a year of the debt offering and each valuation date. This was assumed as the Company has registered some type of capital raise in each year for the past 3 years. The Company may not have executed the capital raise but did register.
- (2) Threshold Exercise Price Post Capital Raise is assumed to be the 52-week low closing price, not to be confused with the 52-week low of the stock price.

The change in the derivative liability was mostly due to the Company's stock price movements. Other changes in assumptions are listed above, some change with the passage time, interest rate fluctuations and stock market volatility.

Note 7 — Risks and Uncertainties

As of December 31, 2018, we had \$3.4 million in cash and cash equivalents and a negative \$3.0 million of working capital. The negative working capital is primarily due to the reclassification of the Debentures from noncurrent liabilities to current liabilities in connection with the technical default discussed above in **Note 5 – Senior Secured Debentures**.

As of February 13, 2019, we had \$2.9 million in cash and cash equivalents. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposit, and have maturity dates greater than 90 days but less than one year. Of the \$2.9 million in cash and cash equivalents, \$1.6 million resides in the United States or easily accessed foreign countries and approximately \$1.3 million resides in China.

In the quarter ended December 31, 2018, we undertook additional steps to reduce our overhead expenses through the termination of certain technology and administrative employees and other reductions associated with office rental and professional fees.

We are undertaking strategies to improve our financial position and preserve our available cash to allow more time to realize the value we believe is in our assets, such as BFR, the Pentland coal resource and AFE. These strategies include the evaluation of a full range of financing, restructuring and strategic alternative options which may help us more fully realize the value in those assets. In addition, we are undertaking further expense reductions which we expect to be realized over the remainder of calendar year 2019 and we are undertaking the necessary steps to transfer funds currently in our Chinese bank accounts to our U.S. based bank account in order to improve our available working capital. We may also divest assets such as our Yima Joint Venture, our TSEC Joint Venture and our technology.

We believe that with the strategies above, we can continue to operate for the next nine months, assuming we can successfully transfer our funds currently in China to the U.S. Based on the uncertainty of our plans to improve our financial position, our historical negative operating cash flows, our continued limited cash inflows and the potential uncertainties regarding transferring our funds from China to the U.S., there is substantial doubt about the Company's ability to continue as a going concern.

We currently plan to use our available cash for: (i) evaluation and implementing financing, divestitures and strategic restructuring options; (ii) paying the interest related to the Senior Secured Debentures; and (iii) working capital for general corporate and administrative expenses.

We currently have very limited financial and human resources to fully implement our plans and due to employee resource reductions, we have limited technology delivery capabilities. We can make no assurances that AFE, SEE and our other business operations including any potential return from BFR will provide us with sufficient and timely cash flows to continue our operations.

As noted in **Note 1, Business and Liquidity**, we have limited resources and are pursuing various cost cutting measures to preserve our liquidity. Additionally, we are seeking to improve our financial position and we may choose to raise additional capital through alternatives such as equity and debt financing, divesting certain assets such as our interests in our Yima Joint Venture, our TSEC Joint Venture and our technology, and/or restructuring the Company. We cannot provide any assurance that any of these alternatives will be available to us in the future on acceptable terms or at all. Any such alternative could be dilutive to our existing stockholders. If we cannot raise required funds on acceptable terms, we may further substantially reduce our expenses and we may not be able to, among other things, (i) sustain our general and administrative expenses; (ii) fund certain obligations as they become due including license fees and other vendor payments; (iii) respond to unanticipated capital requirements; or (iv) repay our indebtedness. In addition, we may be forced to seek relief to avoid or end insolvency through other proceedings.

On November 5, 2018, a default occurred related to the Purchase Agreement and the Debentures due to the Company failing to timely file its Annual Report on Form 10-K. If the default is not waived by the holders of the Debentures, the holders may have the option to accelerate the principal and interest outstanding and other mandatory charges on the Debentures.

Our ability to make payments on and to refinance our indebtedness, including our Debentures, and to fund planned capital expenditures will depend on our ability to generate sufficient cash flow from operations in the future. To a certain extent, this is subject to general economic, financial, competitive, legislative and regulatory conditions and other factors that are beyond our control.

We cannot assure you that our business will generate sufficient cash flow from operations in an amount sufficient to enable us to pay principal and interest on our indebtedness, including our Debentures, or to fund our other liquidity needs. If our cash flow and capital resources are insufficient to fund our debt obligations, we may be forced to sell assets, seek additional equity or debt capital or restructure our debt. We cannot assure you that any of these remedies could, if necessary, be affected on commercially reasonable terms, or at all. Our cash flow and capital resources may be insufficient for payment of interest on and principal of our debt in the future, including payments on our recently issued Debentures, and any such alternative measures may be unsuccessful or may not permit us to meet scheduled debt service obligations, which could cause us to default on our obligations and could impair our liquidity or could force us to seek relief to avoid or end insolvency through other proceedings.

Pursuant to our joint venture contracts, we are committed to providing technology and related support to our partners. If we do not to perform or deliver on these obligations, our partners could pursue legal action against us and our business and operating results could be seriously harmed. We cannot assure you that we will satisfy the conditions required to maintain these relationships under existing agreements or that we can prevent the termination of these agreements. In addition, our efforts to monetize our gasification technology are dependent on our ability to successfully maintain and transfer our intellectual property. Should we be unable to satisfactorily do so, we may lose all or part of the value of our technology. Any claimed defaults on our obligations could impair our liquidity or could force us to seek relief to avoid or end insolvency through other proceedings.

We may be subject to future impairment losses due to potential declines in the fair value of our assets. As noted in **Note 4 – Current Projects – Yima Joint Venture**, management determined that there was not an other-than-temporary triggering event during the quarter ended December 31, 2018. The carrying value of our Yima Joint Venture investment was approximately \$5.0 million as of both December 31, 2018 and June 30, 2018. We continue to monitor the Yima Joint Venture and could record an additional impairment in the future if operating conditions deteriorate or if the cash flow situation worsens.

Should general economic, market or business conditions decline further, and continue to have a negative impact on our revenues or other aspects of our business, we may be required to record impairment charges in the future, which could materially and adversely affect financial condition and results of operation.

Note 8 — GTI License Agreement

In November 2009, we entered into an Amended and Restated License Agreement, or the GTI Agreement, with GTI, replacing the Amended and Restated License Agreement between us and GTI dated August 31, 2006, as amended. Under the GTI Agreement, we maintain our exclusive worldwide right to license the U-GAS[®] technology for all types of coals and coal/biomass mixtures with coal content exceeding 60%, as well as the non-exclusive right to license the U-GAS[®] technology for 100% biomass and coal/biomass blends exceeding 40% biomass.

In order to sublicense any U-GAS[®] system, we are required to comply with certain requirements set forth in the GTI Agreement. In the preliminary stage of developing a potential sublicense, we are required to provide notice and certain information regarding the potential sublicense to GTI and GTI is required to provide notice of approval or non-approval within ten business days of the date of the notice from us, provided that GTI is required to not unreasonably withhold their approval. If GTI does not respond within the ten-business day period, they are deemed to have approved of the sublicense. We are required to provide updates on any potential sublicenses once every three months during the term of the GTI Agreement. We are also restricted from offering a competing gasification technology during the term of the GTI Agreement.

For each U-GAS[®] unit which we license, design, build or operate for ourselves or for a party other than a sub-licensee and which uses coal or a coal and biomass mixture or biomass as the feedstock, we must pay a royalty based upon a calculation using the MMBtu per hour of dry syngas production of a rated design capacity, payable in installments at the beginning and at the completion of the construction of a project, or the Standard Royalty. If we invest, or have the option to invest, in a specified percentage of the equity of a third party, and the royalty payable by such third party for their sublicense exceeds the Standard Royalty, we are required to pay to GTI an agreed percentage split of third party licensing fees, or the Agreed Percentage, of such royalty payable by such third party. However, if the royalty payable by such third party for their sublicense is less than the Standard Royalty, we are required to pay to GTI, in addition to the Agreed Percentage of such royalty payable by such third party, the Agreed Percentage of our dividends and liquidation proceeds from our equity investment in the third party. In addition, if we receive a carried interest in a third party, and the carried interest is less than a specified percentage of the equity of such third party, we are required to pay to GTI, in our sole discretion, either (i) the Standard Royalty or (ii) the Agreed Percentage of the royalty payable to such third party for their sublicense, as well as the Agreed Percentage of the carried interest. We will be required to pay the Standard Royalty to GTI if the percentage of the equity of a third party that we (a) invest in, (b) have an option to invest in, or (c) receive a carried interest in, exceeds the percentage of the third party specified in the preceding sentence.

We are required to make an annual payment to GTI for each year of the term, with such annual payment due by the last day of January of the following year; provided, however, that we are entitled to deduct all royalties paid to GTI in a given year under the GTI Agreement from this amount, and if such royalties exceed the annual payment amount in a given year, we are not required to make the annual payment. We must also provide GTI with a copy of each contract that we enter into relating to a U-GAS[®] system and report to GTI with our progress on development of the technology every six months. We are currently in negotiations with GTI regarding the annual payment due on January 31, 2019.

For a period of ten years, beginning in May 2016, we and GTI are restricted from disclosing any confidential information (as defined in the GTI Agreement) to any person other than employees of affiliates or contractors who are required to deal with such information, and such persons will be bound by the confidentiality provisions of the GTI Agreement. We have further indemnified GTI and its affiliates from any liability or loss resulting from unauthorized disclosure or use of any confidential information that we receive.

While the core of our technology is the U-GAS[®] system, we have continued to innovate and modify the process to a point where we maintain certain intellectual property rights over SGT. Since the original licensing in 2004, we have maintained a strong relationship with GTI and continue to benefit from the resources and collaborative work environment that GTI provides us. It is in part for that reason, in May 2016, we exercised the first of our 10-year extensions and now maintain the exclusive license described above through 2026.

Note 9 – Equity

Common Stock issued to Consultants for Services Rendered

On July 12, 2018, the Company issued 22,890 shares of common stock to ILL-Sino Development Inc. (“ILL-Sino”), the Company’s business development advisor, pursuant to the term of the consulting agreement, as amended on July 1, 2018, between the Company and ILL-Sino. The shares are fully vested and non-forfeitable at the time of issuance. The fair value of the common stock was \$3.08 per share on the date of issuance, and the Company recorded approximately \$71,000 of expense for the quarter ended September 30, 2018 relating to the issuance of these shares.

Stock-Based Compensation

As of December 31, 2018, the Company has outstanding stock option and restricted stock awards granted under the Company’s 2015 Long Term Incentive Plan (the “2015 Incentive Plan”) and Amended and Restated 2005 Incentive Plan (the “2005 Incentive Plan”), under which the Company’s stockholders have authorized a total of 2,625,000 shares of common stock for awards under the 2015 and 2005 Incentive Plan. The 2005 Incentive Plan expired as of November 7, 2015 and no future awards will be made thereunder. As of December 31, 2018, there were 359,787 shares authorized for future issuance pursuant to the 2015 Incentive Plan. Under the 2015 Incentive Plan, the Company may grant incentive and non-qualified stock options, stock appreciation rights, restricted stock units and other stock-based awards to officers, directors, employees and non-employees. Stock option awards generally vest ratably over a one to four year period and expire ten years after the date of grant.

Restricted stock activity during the six months ended December 31, 2018 was as follows:

	Restricted stock outstanding December 31, 2018
Unvested shares outstanding at June 30, 2018	9,837
Granted	—
Vested	—
Forfeited	—
Unvested shares outstanding at December 31, 2018	<u>9,837</u>

Stock option activity during the six months ended December 31, 2018 was as follows:

	Number of Underlying Stock Options
Outstanding at June 30, 2018	1,720,732
Granted	—
Exercised	—
Forfeited	(16,979)
Outstanding at December 31, 2018	<u>1,703,753</u>
Exercisable at December 31, 2018	<u>1,687,052</u>

On October 31, 2018, the Company issued warrants to Market Development Consulting Group, Inc. (“MDC”), the Company’s investor relations advisor, to acquire 100,000 shares of the Company’s common stock at an exercise price of \$1.30 per share according to the term of the consulting agreement, as amended on October 31, 2018, between the Company and MDC. The fair value of the warrants was estimated to be approximately \$0.1 million.

Stock warrants activity during the six months ended December 31, 2018 were as follows:

	Number of Underlying Warrants
Outstanding at June 30, 2018	1,676,021
Granted	100,000
Exercised	—
Forfeited	—
Outstanding at December 31, 2018	<u>1,776,021</u>
Exercisable at December 31, 2018	<u>1,701,021</u>

The fair value of the warrants issued during the six months ended December 31, 2018 to MDC was estimated at the date of grant using Black-Scholes-Morton model with the following weighted-average assumptions:

Risk-free rate of return	3.15%
Expected life of award (years)	10
Expected dividend yield	0.00%
Expected volatility of stock	94%
Weighted-average grant date fair value	\$1.12

The Company recognizes the stock-based expense related to the Incentive Plan awards and warrants over the requisite service period. The following table presents stock based compensation expense attributable to stock option awards issued under the Incentive Plan and attributable to warrants and common stock issued to consulting firms as compensation (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
2005 and 2015 Incentive Plans	\$ 75	\$ 92	\$ 218	\$ 337
Warrants and common stock	27	213	98	213
Total stock-based compensation expense	<u>\$ 102</u>	<u>\$ 305</u>	<u>\$ 316</u>	<u>\$ 550</u>

Note 10 – Net Loss Per Share

All share amounts and number of shares used in the calculation of earnings per share have been adjusted for the 1 for 8 reverse stock split which became effective on December 4, 2017.

Historical net loss per share of common stock is computed using the weighted average number of shares of common stock outstanding. Basic loss per share excludes dilution and is computed by dividing net loss available to common stockholders by the weighted average number of shares of common stock outstanding for the period. Stock options, warrants and unvested restricted stock are the only potential dilutive share equivalents the Company had outstanding for the periods presented. For the six months ended December 31, 2018 and 2017, options, restricted shares and warrants to purchase common stock were excluded from the computation of diluted earnings per share as their effect would have been anti-dilutive as the Company incurred net losses during those periods, amounted to 3.5 million and 3.3 million, respectively.

Note 11 — Commitments and Contingencies

Litigation

The Company is currently not a party to any legal proceedings.

Contractual Obligations

In October 2017, the Company extended its corporate office lease term for an additional 13 months ending January 31, 2019 with rental related payments of approximately \$18,000 per month (monthly rent changes depending on actual utility usage each month).

In November 2018, the Company entered into a new office lease agreement for 12 months ending December 31, 2019 with rental related payments of approximately \$3,300 per month (monthly rent can change depending on additional services usage each month).

The Debentures have a term of 5 years and will mature in October 2022.

Governmental and Environmental Regulation

The Company's operations are subject to stringent federal, state and local laws and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. Numerous governmental agencies, such as the U.S. Environmental Protection Agency, and various Chinese authorities, issue regulations to implement and enforce such laws, which often require difficult and costly compliance measures that carry substantial administrative, civil and criminal penalties or may result in injunctive relief for failure to comply. These laws and regulations may require the acquisition of a permit before operations at a facility commence, restrict the types, quantities and concentrations of various substances that can be released into the environment in connection with such activities, limit or prohibit construction activities on certain lands lying within wilderness, wetlands, ecologically sensitive and other protected areas, and impose substantial liabilities for pollution resulting from our operations. The Company believes that it is in substantial compliance with current applicable environmental laws and regulations and it has not experienced any material adverse effect from non-compliance with these environmental requirements.

Note 12 – Segment Information

The Company's reportable operating segments have been determined in accordance with internal management reporting structure and include SES Foreign Operating, Technology Licensing and Related Services, and Corporate. The SES Foreign Operating reporting segment includes all of the assets, operations and related administrative costs for China and our equity positions and earnings related to our joint ventures including AFE, BFR, the Yima Joint Venture and the TSEC Joint Venture. The Technology Licensing and Related Services reporting segment includes all operating activities related to our technology group. The Corporate reporting segment includes the executive and administrative expenses of the corporate office in Houston. The Company evaluates performance based upon several factors, of which a primary financial measure is segment operating income or loss.

We actively monitor the price of our common stock and will consider all available options to regain compliance with the continued listing standards of the NASDAQ.

Management Changes

On February 8, 2019, DeLome Fair, President and Chief Executive Officer, and principal financial officer of the Company, notified the Company of her intention to resign as President and Chief Executive Officer, and as a director on the Board effective March 1, 2019. The Company also announced that Robert Rigdon, Vice Chairman of the Board and the former Chief Executive Officer of the Company will succeed Ms. Fair as President and Chief Executive Officer and principal financial officer. Ms. Fair's employment agreement with the Company as of February 2016 will also be terminated effective as such date.

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

You should read the following discussion and analysis of our financial condition and results of operations together with our consolidated financial statements and the related notes and other financial information included elsewhere in this quarterly report. Some of the information contained in this discussion and analysis or set forth elsewhere in this quarterly report, including information with respect to our plans and strategy for our business and related financing, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" section of our Annual Report on Form 10-K for the fiscal year ended June 30, 2018 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. All statements other than statements of historical fact are forward-looking statements and are subject to certain risks, trends and uncertainties that could cause actual results to differ materially from those projected. Among those risks, trends and uncertainties are the ability of Batchfire Resources Pty Ltd ("BFR"), Australian Future Energy Pty Ltd ("AFE"), and Cape River Resources Pty Ltd ("CRR") management to successfully grow and develop their Australian assets and operations, including Callide, Pentland and the Gladstone Energy and Ammonia Project; the ability of BFR to produce earnings and pay dividends; the ability of SES EnCoal Energy sp. z o. o. ("SEE") management to successfully grow and develop projects, assets and operations in Poland; our ability to raise additional capital; our indebtedness and the amount of cash required to service our indebtedness; our ability to find a partner for our technology business; our ability to develop and expand business of the TSEC Joint Venture in the joint venture territory; our ability to develop our business verticals, including DRI steel, through our marketing arrangement with Midrex Technologies; our ability to successfully develop our licensing business; our ability to continue as a going concern; the ability of our project with Yima to produce earnings and pay dividends; the economic conditions of countries where we are operating; events or circumstances which result in an impairment of our assets; our ability to reduce operating costs; our ability to make distributions and repatriate earnings from our Chinese operations; our ability to maintain our listing on the NASDAQ Stock Market; our ability to successfully commercialize our technology at a larger scale and higher pressures; commodity prices, including in particular natural gas, crude oil, methanol and power; the availability and terms of financing; our customers' and/or our ability to obtain the necessary approvals and permits for future projects; our ability to estimate the sufficiency of existing capital resources; the sufficiency of internal controls and procedures; and our results of operations in countries outside of the U.S., where we are continuing to pursue and develop projects. Although we believe that in making such forward-looking statements our expectations are based upon reasonable assumptions, such statements may be influenced by factors that could cause actual outcomes and results to be materially different from those projected by us. We cannot assure you that the assumptions upon which these statements are based will prove to be correct.

When used in this Form 10-Q, the words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Because these forward-looking statements involve risks and uncertainties, actual results could differ materially from those expressed or implied by these forward-looking statements for a number of important reasons, including those discussed under "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and elsewhere in this Form 10-Q.

You should read these statements carefully because they discuss our expectations about our future performance, contain projections of our future operating results or our future financial condition, or state other "forward-looking" information. You should be aware that the occurrence of certain of the events described in this Form 10-Q could substantially harm our business, results of operations and financial condition and that upon the occurrence of any of these events, the trading price of our common stock could decline, and you could lose all or part of your investment.

We cannot guarantee any future results, levels of activity, performance or achievements. Except as required by law, we undertake no obligation to update any of the forward-looking statements in this Form 10-Q after the date hereof.

Business Overview

Synthesis Energy Systems, Inc. (referred to herein as “we”, “us”, and “our”), together with its wholly-owned and majority-owned controlled subsidiaries is a global clean energy company that owns proprietary technology, SES Gasification Technology (“SGT”), for the low-cost and environmentally responsible production of synthesis gas (referred to as “syngas”). Our focus has been on commercializing our technology both in China and through the regional business platforms we have created with partners in Australia, Australian Future Energy Pty Ltd (“AFE”), and in Poland, SES EnCoal Energy sp. z o.o (“SEE”).

Over the past ten years, we have successfully deployed our technology into five industrial scale projects in China. We invested in two of those industrial projects and have licensed our technology into the remaining three. Today, four of these projects are operating and are successfully demonstrating our technology. Our first project, the smaller scale Synthesis Energy Systems (Zao Zhang) New Gas Company Ltd (“ZZ”) commercial demonstration plant, operated for several years and also successfully demonstrated our technology and was retired in 2015.

Our partnership companies, AFE and SEE, are developing energy and resource projects with what we believe to be the necessary commercial and financing structures to deliver attractive financial results. We own approximately 38% of AFE and 50% of SEE.

Through 2018, our business model has been to create value in China and through AFE and SEE via three pathways. The first pathway has been through the generation of earnings from the licensing of our proprietary technology and the sale of our proprietary equipment into syngas project developments. The second pathway is through equity income earned from equity ownership in the projects that utilize our technology and the third pathway is through achieving ownership positions in coal resources that can be linked to projects using our coal gasification technology.

On February 8, 2019, DeLome Fair, President and Chief Executive Officer, and principal financial officer of the Company, notified the Company of her intention to resign as President and Chief Executive Officer, and as a director on the Board effective March 1, 2019. The Company also announced that Robert Rigdon, Vice Chairman of the Board and the former Chief Executive Officer of the Company will succeed Ms. Fair as President and Chief Executive Officer and principal financial officer. Ms. Fair’s employment agreement with the Company as of February 2016 will also be terminated effective as such date.

We operate our business from our headquarters located in Houston, Texas and our offices in Shanghai, China. Additionally, our partnership companies, AFE and SEE have independent operations in Brisbane, Australia and Warsaw, Poland respectively.

Outlook

As of December 31, 2018, we had \$3.4 million in cash and cash equivalents and a negative \$3.0 million of working capital. The negative working capital is primarily due to the reclassification of the Senior Secured Debentures (the “Debentures”) from a noncurrent to a current liability in connection with the technical default. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposit, and have maturity dates greater than 90 days but less than one year.

As of February 13, 2019, we had \$2.9 million in cash and cash equivalents. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposit, and have maturity dates greater than 90 days but less than one year. Of the \$2.9 million in cash and cash equivalents, \$1.6 million resides in the United States or easily accessed foreign countries and approximately \$1.3 million resides in China.

In the quarter ended December 31, 2018, we undertook additional steps to reduce our overhead expenses through the termination of certain technology and administrative employees and other reductions associated with office rental and professional fees.

As part of our overall strategy, to the extent possible, we intend to (i) support AFE and SEE partnership companies in those endeavors to develop energy, chemicals and resource projects where we would own an earned or carried equity interest in the project; (ii) monitor support and facilitate our minority ownership in BFR in order to realize the financial value through dividend income or other means; (iii) work to recover cash and monetize our Yima Joint Venture and TSEC Joint Venture operations; and (iv) taking any additional steps to utilize our existing cash reserves in the most financially productive mean possible.

We are undertaking strategies to improve our financial position and preserve our available cash to allow more time to realize the value we believe is in our assets, such as Batchfire Resources Pty Ltd (“BFR”), the Pentland coal resource and AFE. These strategies include the evaluation of a full range of financing, restructuring and strategic alternative options which may help us more fully realize the value in those assets. In addition, we are undertaking further expense reductions which we expect to be realized over the remainder of calendar year 2019 and we are undertaking necessary steps to transfer funds currently in our Chinese bank accounts to our U.S. based bank accounts in order to improve our available working capital. We may also divest assets such as our Yima Joint Venture, our TSEC Joint Venture and our technology.

We believe that with the strategies above, we can continue to operate for the next nine months while we continue to work to transfer our funds currently in China to the U.S. in the most efficient manner. Based on the uncertainty of our plans to improve our financial position, our historical negative operating cash flows, our continued limited cash inflows and the potential uncertainties regarding transferring our funds from China to the U.S., there is substantial doubt about the Company's ability to continue as a going concern as disclosed in our prior periodic reports.

We currently plan to use our available cash for: (i) evaluation and implementing financing, divestitures and strategic restructuring options; (ii) paying the interest related to the Debentures; and (iii) working capital for general corporate and administrative expenses.

We currently have very limited financial and human resources to fully implement our plans and due to employee resource reductions, we have limited technology delivery capabilities. We can make no assurances that AFE, SEE and our other business operations including any potential return from BFR will provide us with sufficient and timely cash flows to continue our operations.

As noted above, we are seeking to improve our financial position and we may choose to raise additional capital through alternatives such as equity and debt financing, divesting certain assets such as our interests in our Yima Joint Venture, TSEC, and our technology, and/or restructuring the Company. We cannot provide any assurance that any of these alternatives will be available to us in the future on acceptable terms or at all. Any such alternative could be dilutive to our existing stockholders and debtholders. If we cannot raise required funds on acceptable terms, we may further substantially reduce our expenses and we may not be able to, among other things, (i) sustain our general and administrative expenses; (ii) fund certain obligations as they become due including license fees and other vendor payments; (iii) respond to unanticipated capital requirements; or (iv) repay our indebtedness. In addition, we may be forced to seek relief to avoid or end insolvency through other proceedings including bankruptcy.

Results of Operations

Three Months Ended December 31, 2018 (“Current Quarter”) Compared to the Three Months Ended December 31, 2017 (“Comparable Quarter”)

Revenue. There was no revenue for the Current Quarter as compared to \$77,000 for the Comparable Quarter. The Comparable Quarter revenue was primarily due to technical consulting and engineering services provided to customers which included \$52,000 provided to the related parties.

Costs of sales expenses. Total costs of sales expenses were zero for the Current Quarter as compared to \$55,000 for the Comparable Quarter. Cost of sales of \$55,000 for the Comparable Quarter was related to the costs of technical consulting and engineering services provided to the related parties.

General and administrative expenses. General and administrative expenses was \$1.8 million in the Current Quarter as compared with \$1.5 million for the Comparable Quarter. The \$0.3 million increase was due primarily to the accrual of severance payments and the increased allowance for doubtful account receivables.

Stock-based expense. Stock-based expense was \$0.1 million for the Current Quarter as compared to \$0.3 million for the Comparable Quarter. The decrease of \$0.2 million was due primarily to a decrease in the value and number of stock warrants issued during the Current Quarter as compared with the Comparable Quarter.

Depreciation and amortization. Depreciation and amortization expense was \$8,000 for the Current Quarter as compared with \$9,000 for the Comparable Quarter, which primarily relates to the amortization of our global patents.

Equity in losses of joint ventures. The equity losses of joint ventures was \$0.1 million during the Current Quarter as compared to \$0.2 million equity losses for the Comparable Quarter, which primarily relates to our 38% share of earnings in AFE.

Gain on fair value adjustments of derivative liabilities. The net gain on fair value adjustments of derivative liabilities was approximately \$0.7 million for the Current Quarter as compared with approximately \$0.4 million for the Comparable Quarter. This resulted from the lower fair market value for our warrants issued to the debentures investors and the placement agent as of December 31, 2018 versus the fair market value as of September 30, 2018. The change in the derivative liability was primarily due to movements in the Company's stock price. Other changes in the assumptions related to the passage of time, interest rate fluctuations and stock market volatility.

Other gain. Other gain was zero for the Current Quarter as compared to \$1.7 million for the Comparable Quarter, which was primarily due to the transfer of shares related to the restructure of the TSEC Joint Venture.

Interest expense. Interest expense was \$0.3 million for the Current Quarter as compared to \$0.2 million for the Comparable Quarter, which was primarily due to the interest paid to the Debenture investors and the amortization of debt discount and issuance cost for the Debentures issued in October 2017.

Foreign currency gain. Foreign currency gain was approximately \$31,000 for the Current Quarter as compared with a gain of \$46,000 for the Comparable Quarter. The foreign currency gain of both quarters were the result of appreciation of the Chinese Renminbi yuan ("RMB") to the U.S. dollar during the Current Quarter and Comparable Quarter.

Six Months Ended December 31, 2018 ("Current Period") Compared to the Six Months Ended December 31, 2017 ("Comparable Period")

Revenue. There was no revenue for the Current Period as compared to \$0.3 million for the Comparable Period, which was primarily due to technical consulting and engineering services provided to related parties.

Costs of sales and operating expenses. Total costs of sales and plant operating expenses was zero for the Current Period as compared to \$0.1 million for the Comparable Period, which was primarily due to the costs of technical consulting and engineering services provided to related parties.

General and administrative expenses. General and administrative expenses was \$3.3 million in the Current Period compared with \$2.9 million for the Comparable Period. The \$0.4 million increase was due primarily to the accrual of severance payments and the increased allowance for doubtful account receivables.

Stock-based expense. Stock-based expense was \$0.3 million for the Current Period as compared to \$0.6 million for the Comparable Period. The decrease of \$0.3 million was due primarily to a decrease in the value and number of stock warrants issued during the Current Period as compared with the Comparable Period.

Depreciation and amortization. Depreciation and amortization expense for was \$19,000 for the Current Period compared with \$18,000 for the Comparable Period, which primarily related to the amortization of our global patents.

Equity in losses of joint ventures. The equity losses of joint ventures was \$24,000 during the Current Period as compared to \$0.3 million equity losses for the Comparable Period, which primarily relates to our 38% share of earnings in AFE.

Gain on fair value adjustments of derivative liabilities. The net gain on fair value adjustments of derivative liabilities was approximately \$1.5 million for the Current Period compared with \$0.4 million for the Comparable Period, which resulted from the lower fair market value for our warrants issued to the debentures investors and placement agent as of December 31, 2018 versus the fair market value as of June 30, 2018. The change in the derivative liability was primarily due to movements in the Company's stock price. Other changes in the assumptions related to the passage of time, interest rate fluctuations and stock market volatility.

Other gain. Other gain was zero for the Current Period as compared to \$1.7 million for the Comparable Period, which was primarily due to the transfer of shares related to the restructure of the Tianwo-SES Joint Venture.

Interest expenses. Interest expense was \$0.7 million for the Current Period as compared to \$0.2 million for the Comparable Period, which was primarily due to the interest paid to the Debenture investors and the amortization of debt discount and issuance cost for the Debentures issued in October 2017.

Foreign currency gain / loss. Foreign currency loss was \$91,000 for the Current Period as compared a foreign currency gain of \$107,000 for the Comparable Period. The \$91,000 foreign currency loss for the Current Period primarily resulted from the 3.7% depreciation of the RMB relative to the USD from June to December 2018 as compared to an appreciation of the RMB relative to the USD of 3.5% from June to December 2017.

Liquidity and Capital Resources

As of December 31, 2018, we had \$3.4 million in cash and cash equivalents and a negative \$3.0 million of working capital. The negative working capital is primarily due to the reclassification of the Debentures from a noncurrent to a current liability in connection with the technical default. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposit, and have maturity dates greater than 90 days but less than one year.

As of February 13, 2019, we had \$2.9 million in cash and cash equivalents. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposits, and have maturity dates greater than 90 days but less than one year. Of the \$2.9 million in cash and cash equivalents, \$1.6 million resides in the United States or easily accessed foreign countries and approximately \$1.3 million resides in China.

On October 24, 2017, we entered into a securities purchase agreement (the "Purchase Agreement") with certain accredited investors (the "Purchasers") for the purchase of \$8.0 in principal amount of Senior Secured Debentures (the "Debentures"). The Debentures have a term of 5 years with an interest rate of 11% that adjusts to 18% per annum in the event the Company defaults on an interest payment. The Debentures require that dividends received from BFR are used to pay down the principal amounts of outstanding Debentures. Additionally, we issued warrants to purchase 1,000,000 shares of Common Stock at \$4.00 per common share. The net offering proceeds to us from the sale of the Debentures and warrants, after deducting the placement agent's fee and associated costs and expenses, was approximately \$7.4 million, not including the proceeds, if any, from the exercise of the warrants issued in this the offering. The Purchase Agreement and the Debentures contain certain customary representations, warranties and covenants. There are no financial metric covenants related to the Debentures. The transaction was approved by a special committee of our board of directors due to the fact that certain board members were Purchasers. Interest on the outstanding balance of Debentures is payable quarterly commenced on January 2, 2018. All unpaid principal and interests on the Debentures will be due on October 23, 2022.

On November 5, 2018, a default occurred related to the Purchase Agreement and the Debentures due to the Company failing to file its Annual Report on Form 10-K. If the default is not waived by the holders of the Debentures, the holders may have the option to accelerate the principal and interest outstanding and other mandatory charges on the Debentures. The default has not been waived at the time of filing this Quarterly Report on Form 10-Q and accordingly, we have reclassified the Debenture liabilities from noncurrent liabilities to current liabilities.

The following summarizes the sources and uses of cash during the Current Period:

- **Operating Activities:** During the Current Period, we used \$3.6 million in cash for operating activities compared to \$3.4 million during the Comparable Period. This increase was primarily due to payment of interest on the Debentures.

- **Investing Activities:** During the Current Period, we used approximately \$11,000 in investing activities to invest in our SEE joint venture. During the Comparable Period, we had a net source of cash of \$1.4 million in investing activities which was primarily due to the approximately \$1.7 million advances resulted from the TSEC Joint Venture's share transfer and offset by approximately \$0.3 million cash investment into AFE.
- **Financing Activities:** There was no financing activities for the Current Period. During the Comparable Period, we had a net source of \$7.2 million, receiving net proceeds of \$7.4 million from issuance of the debentures and paid legal fees of \$0.2 million related to issuance costs of the Debentures.

Current Projects

Australian Future Energy Pty Ltd

In 2014, we established AFE together with an Australian company, Ambre Investments PTY Limited ("Ambre"). AFE is an independently managed Australian business platform established for the purpose of building a large-scale, vertically integrated business in Australia based on developing, building and owning equity interests in financially attractive and environmentally responsible projects that produce low-cost syngas as a competitive alternative to expensive local natural gas and LNG.

On May 10, 2017, we entered into a project technology license agreement with AFE in connection with a project being developed by AFE in Queensland Australia. AFE intends to form a subsidiary project company and assign the project technology license agreement to that company which will assume all of the obligations of AFE thereunder. Pursuant to the project technology license agreement, we granted a non-exclusive license to use our technology at the project to manufacture syngas and to use the technology in the design of the facility. In consideration, the project technology license agreement calls for a license fee to be finalized based on the designed plant capacity and a separate fee of \$2.0 million for the delivery of a process design package. The license agreement calls for license fees to be paid as project milestones are reached throughout the planning, construction and first five years of plant operations. The success and timing of the project being developed by AFE will affect if and/or when we will be able to receive all of the payments related to this technology license agreement. However, there can be no assurance that AFE will be successful in developing this or any other project or that we will be able to deliver the technology for the project.

In August 2017, AFE completed the acquisition of a mine development lease related to the 266-million ton coal resource near Pentland, Queensland through AFE's wholly owned subsidiary, Great Northern Energy Pty Ltd ("GNE").

In September 2018, AFE's Gladstone Energy and Ammonia Project ("GEAP") was formally announced in Queensland Parliament by Minister for State Development, Manufacturing, Innovation and Planning, Mr. Cameron Dick and was declared by the Queensland Co-Ordinator General as a Co-Ordinated Project. A coordinated project approach also means that all the potential impacts and benefits of the project are considered in an integrated and comprehensive manner and the Coordinator-General's decision to declare this project a Coordinated Project is expected to help streamline approvals and fast-track delivery of the project.

The project will be located in the State Development Area in Gladstone, Queensland and is planned to process 1.5 million mtpa of low-quality coal using SGT, to produce up to 330,000 mtpa of ammonia product, and up to 8 petajoules of pipeline quality gas for the east coast domestic gas market. In addition, the proposed project will generate approximately 90 MW of electrical power, with approximately 25 MW of this being available for export to the local domestic grid. The ammonia and gas produced is to be used by major industrial users, including those focusing on agriculture, the mining industry and advanced manufacturing. The project is estimated by AFE to commence construction by mid-2020, with the first ammonia production proposed in mid-2022.

In July 2018, we entered into a loan agreement (the "Loan Agreement") with AFE to provide short-term funding in order to enable AFE to continue to progress its project related initiatives for the betterment of AFE shareholders and the successful promotion of their projects in the amount of 350,000 Australian Dollars, approximately \$260,000. The Loan Agreement had a term of three months, subject to certain events, and an interest rate of 6%. AFE repaid the outstanding principal amount under the Loan Agreement plus interest in August 2018.

For our ownership interest in AFE, we have been contributing cash and engineering support for AFE's business development while Ambre contributed cash and services. Additional ownership in AFE has been granted to the AFE management team and staff individuals providing services to AFE. In August 2017 and March 2018, we elected to make additional contributions of \$0.47 million and \$0.16 million respectively to assist AFE with developing its business in Australia.

We account for our investment in AFE under the equity method. Our ownership interest of approximately 38% makes us the second largest shareholder. We also maintain a seat on the board of directors, which allows us to have significant influence on the operations and financial decisions, but not control, of the company. Our carrying value of our AFE investment as of December 31, 2018 and June 30, 2018 were both zero.

Batchfire Resources Pty Ltd

As a result of AFE's early stage business development efforts associated with the Callide coal mine in Central Queensland, Australia, AFE created BFR. BFR was a spin-off company for which ownership interest was distributed to the existing shareholders of AFE and to the new BFR management team in December 2015. BFR is registered in Australia and was formed for the purpose of purchasing the Callide thermal coal mine from Anglo-American plc ("Anglo-American"). The Callide mine is one of the largest thermal coal mines in Australia and has been in operation for more than 20 years. As reported by BFR at the time of the acquisition, Callide has approximately 230 million metric tons of recoverable reserves and an additional 850 million metric tons of proven resources.

In October 2016, BFR stated that it had received investment support for the acquisition from Singapore-based Lindenfels Pte, Ltd, a subsidiary of commodity traders Avra Commodities, and as a result the acquisition of the Callide thermal coal mine from Anglo-American was completed in October 2016. Since then, BFR has been implementing its plan at Callide intended to lower the per unit mining costs and deliver profitable financial results.

In January 2018, the Minister of Natural Resources, Mines and Energy approved BFR's mining lease application through to 2043 for Callide coal mine's Boundary Hill South Project. The Callide mining tenure extends across 180 square kilometers and contains an estimated coal resource of up to 1.7 billion metric tons and saleable coal production averages 10 million metric tons per year. BFR is implementing its mining plan at Callide intended to lower the per unit mining costs and deliver profitable financial results.

We account for our investment in BFR under the cost method. Our limited ownership interest in BFR was approximately 11% and we do not have significant influence over the operation or financial decisions made by the company. At the time of the spin-off, the carrying amount of our investment in AFE was reduced to zero through equity losses. As such, the value of the investment in BFR post spin-off was also zero. As of December 31, 2018, our ownership interest in BFR was approximately 11% and the carrying value of our investment in BFR as of both December 31, 2018 and June 30, 2018 was zero.

Townsville Metals Infrastructure Pty Ltd

In August 2018, AFE formed a separate unrelated company, Townsville Metals Infrastructure Pty Ltd ("TMI") for the purpose of completing the development of the required infrastructure such as rail and port modifications related to the transport of mined products including coal from the Pentland resource to the Townsville port. Ownership in TMI was distributed proportionately to the shareholders of AFE. Our ownership in TMI is approximately 38% upon the formation of TMI through our ownership interest in AFE.

We account for our investment in TMI under the equity method. Our ownership interest of approximately 38% makes us the second largest shareholder. We may appoint one board director for each 15% ownership interest we hold in TMI which allows us to have significant influence on the operations and financial decisions, but not control, of the company. Our carrying value of our TMI investment as of December 31, 2018 was zero.

Cape River Resources Pty Ltd

In October 2018, AFE formed a separate unrelated company, Cape River Resources Pty Ltd (“CRR”) for the purpose of developing the Pentland resource into an operating thermal coal mine. Ownership in CRR was distributed proportionately to the shareholders of AFE with additional shares issued to the management team. Our ownership in CRR is approximately 38% upon the formation of CRR through our ownership interest in AFE. GNE sold its 100% ownership interest in the Pentland Coal Mine to CRR. CRR is currently finalizing the preparation of its Initial Advice Statement of the Pentland Coal Mine project to the Queensland Government for the development of the project for an initial 6.0 million metric tons per annum (“mtpa”) run of mine (“ROM”) coal operation, with allowance for expansion of the project for up to 9.0 million mtpa ROM coal operation. In its first phase of operation, 4.5 million mtpa of coal is planned for export to Asian markets with the balance of 1.5 million mtpa for feedstock to a future proposed coal gasification project. It is anticipated by CRR, based on current planning, for the project to be operational in 2022. CRR has indicated that a drilling program is planned to commence in late 2018 to expand the size and overall quality and understanding of the Pentland resource.

We account for our investment in CRR under the equity method. Our ownership interest of approximately 38% makes us the second largest shareholder. We may appoint one board director for each 15% ownership interest we hold in CRR which allows us to have significant influence on the operations and financial decisions, but not control, of the company. Our carrying value of our CRR investment as of December 31, 2018 was zero.

SES EnCoal Energy sp. z o.o

In October 2017, we entered into agreements with Warsaw-based EnInvestments sp. z o.o. Under the terms of the agreements, we and EnInvestments are equal shareholders of SEE and SEE will exclusively market, develop, and commercialize projects in Poland which utilize our technology, services and proprietary equipment and we share with SEE a portion of the technology license payments, net of fees, we receive from Poland. The goal of SEE is to establish efficient clean energy projects that provide Polish industries superior economic benefits as compared to the use of expensive, imported natural gas and LNG, while providing energy independence through our technological capabilities to convert the wide range of Poland’s indigenous coals, coal waste, biomass and municipal waste to valuable syngas products. SEE has developed a pipeline of projects and together we are actively working with Polish customers and partners to complete the necessary project feasibility, permitting and SGT technology agreement steps required prior to starting construction on the projects.

Tauron Wytwarzanie S.A., (“Tauron”), has contracted Poland’s Institute of Coal Chemistry (“IChPW”) to complete a detailed preliminary design assessment and economic study for the conversion of its 200MW conventional power boilers to clean syngas which would be Poland’s first SGT facility. The project feasibility study concluded in March 2018 with positive results. The results presented by IChPW to Tauron have shown that the conversion of Tauron’s 200 MW power boiler utilizing SGT can be both economically attractive and environmentally beneficial. We believe that SGT power boiler conversions are an ideal solution capable of meeting EU and IED targets.

For our ownership interest in SEE, we have been contributing cash and assisting in the development of SEE. SEE was funded in January 2018 with a cash contribution of approximately \$6,000 and additional funding in March 2018 and August 2018 of approximately \$76,000 and \$11,000 respectively.

We account for our investment in SEE under the equity method. Our ownership interest of 50% makes us an equal shareholder and we also maintain two of the four seats on the management board which allows us to have significant influence on the operations and financial decisions, but not control, of the company. On December 31, 2018, as an equal shareholder, our ownership was 50% of SEE and the carrying value of our investment in SEE as of December 31, 2018 and June 30, 2018 was approximately \$23,000 and \$36,000, respectively.

Yima Joint Venture

In August 2009, we entered into joint venture contracts and related agreements with Yima Coal Industry Group Company (“Yima”). We continue to own a 25% interest in the Yima Joint Venture and Yima owns a 75% interest.

In December 2017 and January 2018, on-going development cooperation and discussions with the Yima Joint Venture management resulted in the joint venture agreeing to pay various costs incurred by us during the construction and commissioning period of the facility in the amount of approximately 16 million Chinese Renminbi yuan, (“RMB”), (approximately \$2.3 million). As of June 30, 2018, we have received 6.15 million RMB (approximately \$0.9 million) of payments from the Yima Joint Venture related to these costs. Additional payments may be forthcoming. Due to uncertainty, revenues will be recorded upon receipt of payment. Despite our continuous collection efforts, we have not received any additional payments during the six-months ending December 31, 2018.

Since 2014, we have accounted for this joint venture under the cost method of accounting. Our conclusion to account for this joint venture under this methodology is based upon our historical lack of significant influence in the Yima Joint Venture. The lack of significant influence was determined based upon our interactions with the Yima Joint Venture related to our limited participation in operating and financial policymaking processes coupled with our limited ability to influence decisions which contribute to the financial success of the Yima Joint Venture. We continue to evaluate our level of influence over the Yima Joint Venture.

We evaluated the conditions of the Yima Joint Venture to determine whether an other-than-temporary decrease in value had occurred as of June 30, 2018 and 2017. At June 30, 2018, management determined there was a triggering event related to the value of its investment in the Yima Joint Venture. Lower production levels in the fourth quarter reduced the annual production below expectation, which resulted in a net increase in the working capital deficit and the debt level of the joint venture. At June 30, 2017, management determined that there were triggering events related to the value of its investment and these were the lower than expected production levels and the increased debt levels as compared to the previous year, which indicated a continued cash flow concern for the joint venture. Management determined these events in both years were other-than-temporary in nature and therefore conducted an impairment analysis utilizing a discounted cash flow fair market valuation and a Black-Scholes Model-Fair Value of Optionality used in valuing companies with substantial amounts of debt where a discounted cash flow valuation may be inadequate for estimating fair value with the assistance of a third-party valuation expert. In these valuations, significant unobservable inputs were used to calculate the fair value of the investment (see Note 2 – (e) *Use of Estimates*). These inputs included forecasted methanol and coal prices, calculated discount rates and discount for lack of marketability as the majority owner is a state-owned entity in China, volatility analysis and information received from the joint venture. The valuation led to the conclusion that the investment in the Yima Joint Venture was impaired as of June 30, 2018, and accordingly, we recorded a \$3.5 million impairment for the year ended June 30, 2018. The previous valuation concluded there was an impairment which resulted in us recording a \$17.7 million impairment for the year ended June 30, 2017.

As of December 31, 2018, the Yima Joint Venture's third-party loans balance was approximately 59.8 million Chinese Renminbi yuan ("RMB"), approximately \$8.7 million, with \$4.9 million due in April 2019 and \$3.8 million with maturities greater than one year.

Management determined that there was not an other-than-temporary triggering event during the quarter ended December 31, 2018. The carrying value of our Yima Joint Venture investment was approximately \$5.0 million as of both December 31, 2018 and June 30, 2018. We continue to monitor the Yima Joint Venture and could record an additional impairment in the future if operating conditions deteriorate or if the cash flow situation worsens.

Tianwo-SES Clean Energy Technologies Limited

Joint Venture Contract

In February 2014, SES Asia Technologies Limited, one of our wholly owned subsidiaries, entered into a Joint Venture Contract (the "JV Contract") with Zhangjiagang Chemical Machinery Co., Ltd., which subsequently changed its legal name to Suzhou Thvow Technology Co. Ltd. ("STT"), to form Tianwo-SES Clean Energy Technologies Limited (the "TSEC Joint Venture"). The purpose of the TSEC Joint Venture is to establish our gasification technology as the leading gasification technology in the TSEC Joint Venture territory (which is China, Indonesia, the Philippines, Vietnam, Mongolia and Malaysia) by becoming a leading provider of proprietary equipment and engineering services for the technology. The scope of the TSEC Joint Venture is to market and license our gasification technology via project sublicenses; procurement and sale of proprietary equipment and services; coal testing; and engineering, procurement and research and development related to the technology.

In August 2017, we entered into a restructuring agreement of the TSEC Joint Venture (“Restructuring Agreement”). The agreed change in share ownership, reduction in the registered capital of the joint venture, and the final transfer of shares with local government authorities was completed in December 2017. In this restructuring, an additional party was added to the JV Contract, upon receipt of final governmental approvals, The Innovative Coal Chemical Design Institute (“ICCDI”) has become a 25% owner of TSEC Joint Venture, we have decreased our ownership to 25% and STT has decreased its ownership to 50%. ICCDI previously served as general contractor and engineered and constructed all three projects for the Aluminum Corporation of China. We received 11.15 million RMB (approximately \$1.7 million) from ICCDI as a result of the restructuring. In conjunction with the joint venture restructuring, we also received 1.2 million RMB (approximately \$180,000) related to outstanding invoices for services we had provided to the SEC Joint Venture.

The TSEC Joint Venture is accounted for under the equity method. Our initial capital contribution in the formation of the venture was the Technology Usage and Contribution Agreement (“TUCA”), which is an intangible asset. As such, we did not record a carrying value at the inception of the venture. The carrying value of our investment in the TSEC Joint Venture as of both December 31, 2018 and June 30, 2018 was zero.

TUCA

Pursuant to the TUCA, we have contributed to the TSEC Joint Venture certain exclusive rights to our gasification technology in the TSEC Joint Venture territory, including the right to: (i) grant site specific project sub-licenses to third parties; (ii) use our marks for proprietary equipment and services; (iii) engineer and/or design processes that utilize our technology or our other intellectual property; (iv) provide engineering and design services for joint venture projects and (v) take over the development of projects in the TSEC Joint Venture territory that have previously been developed by us and our affiliates. As a result of the Restructuring Agreement, ICCDI was added as a party to the TUCA, but all other material terms remained the same.

GTI Agreement

In November 2009, we entered into an Amended and Restated License Agreement, or the GTI Agreement, with GTI, replacing the Amended and Restated License Agreement between us and GTI dated August 31, 2006, as amended. Under the GTI Agreement, we maintain our exclusive worldwide right to license the U-GAS[®] technology for all types of coals and coal/biomass mixtures with coal content exceeding 60%, as well as the non-exclusive right to license the U-GAS[®] technology for 100% biomass and coal/biomass blends exceeding 40% biomass.

In order to sublicense any U-GAS[®] system, we are required to comply with certain requirements set forth in the GTI Agreement. In the preliminary stage of developing a potential sublicense, we are required to provide notice and certain information regarding the potential sublicense to GTI and GTI is required to provide notice of approval or non-approval within ten business days of the date of the notice from us, provided that GTI is required to not unreasonably withhold their approval. If GTI does not respond within the ten-business day period, they are deemed to have approved of the sublicense. We are required to provide updates on any potential sublicenses once every three months during the term of the GTI Agreement. We are also restricted from offering a competing gasification technology during the term of the GTI Agreement.

For each U-GAS[®] unit which we license, design, build or operate for ourselves or for a party other than a sub-licensee and which uses coal or a coal and biomass mixture or biomass as the feedstock, we must pay a royalty based upon a calculation using the MMBtu per hour of dry syngas production of a rated design capacity, payable in installments at the beginning and at the completion of the construction of a project, or the Standard Royalty. If we invest, or have the option to invest, in a specified percentage of the equity of a third party, and the royalty payable by such third party for their sublicense exceeds the Standard Royalty, we are required to pay to GTI an agreed percentage split of third party licensing fees, or the Agreed Percentage, of such royalty payable by such third party. However, if the royalty payable by such third party for their sublicense is less than the Standard Royalty, we are required to pay to GTI, in addition to the Agreed Percentage of such royalty payable by such third party, the Agreed Percentage of our dividends and liquidation proceeds from our equity investment in the third party. In addition, if we receive a carried interest in a third party, and the carried interest is less than a specified percentage of the equity of such third party, we are required to pay to GTI, in our sole discretion, either (i) the Standard Royalty or (ii) the Agreed Percentage of the royalty payable to such third party for their sublicense, as well as the Agreed Percentage of the carried interest. We will be required to pay the Standard Royalty to GTI if the percentage of the equity of a third party that we (a) invest in, (b) have an option to invest in, or (c) receive a carried interest in, exceeds the percentage of the third party specified in the preceding sentence.

We are required to make an annual payment to GTI for each year of the term, with such annual payment due by the last day of January of the following year; provided, however, that we are entitled to deduct all royalties paid to GTI in a given year under the GTI Agreement from this amount, and if such royalties exceed the annual payment amount in a given year, we are not required to make the annual payment. We must also provide GTI with a copy of each contract that we enter into relating to a U-GAS[®] system and report to GTI with our progress on development of the technology every six months. We are currently in negotiations with GTI regarding the annual payment due on January 31, 2019.

For a period of ten years, beginning in May 2016, we and GTI are restricted from disclosing any confidential information (as defined in the GTI Agreement) to any person other than employees of affiliates or contractors who are required to deal with such information, and such persons will be bound by the confidentiality provisions of the GTI Agreement. We have further indemnified GTI and its affiliates from any liability or loss resulting from unauthorized disclosure or use of any confidential information that we receive.

While the core of our technology is the U-GAS[®] system, we have continued to innovate and modify the process to a point where we maintain certain intellectual property rights over SGT. Since the original licensing in 2004, we have maintained a strong relationship with GTI and continue to benefit from the resources and collaborative work environment that GTI provides us. It is in part for that reason, in May 2016, we exercised the first of our 10-year extensions and now maintain the exclusive license described above through 2026.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not Applicable.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

In connection with the preparation of this Quarterly Report on Form 10-Q, as of December 31, 2018, an evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Corporate Controller, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on that evaluation, our Chief Executive Officer and Corporate Controller concluded that as of December 31, 2018, as a result of the material weakness in our internal control over financial reporting discussed below and in the Company's Annual Report on Form 10-K, for the year ended June 30, 2018, our disclosure controls and procedures were not effective in ensuring that the information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Corporate Controller, as appropriate to allow timely decisions regarding disclosure.

Material Weaknesses

As disclosed in our Annual Report on Form 10-K for the year ended June 30, 2018, we did not maintain effective internal controls over financial reporting. A material weakness was identified relating to the impairment evaluation of our cost basis investment and an additional material weakness relating to management's review of controls over non-routine and complex transactions. Specifically, we did not effectively operate controls over management's review of the impairment assessment, including its review of certain elements related to the valuation of our cost based investments. This material weakness resulted in errors that, if not corrected, would have resulted in a material misstatement of the amount of our impairment of our cost method investment. Additionally, we did not effectively operate review controls over non-routine and complex transactions that were caused by a lack of segregation of duties over these types of transactions.

Management is reviewing our controls related to the valuation of cost basis investment and non-routine and complex transactions and a remediation plan is being addressed.

Management is committed to improving our internal control processes with oversight from our Audit Committee and believes once the review of these controls is completed, the measures to be taken should remediate the material weakness identified. We will not be able to conclude the material weakness has been remediated until we are able to test its operational effectiveness as we must maintain such effectiveness over multiple quarters to ensure full remediation.

Notwithstanding the identified material weaknesses, management, including our principal executive officer and principal financial officer, and the principal accounting officer believe the consolidated financial statements included in this Quarterly Report on Form 10-Q fairly represent in all material respects our financial condition, results of operations and cash flows at and for the periods presented in accordance with U.S. GAAP.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the three-months ended December 31, 2018 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

There are numerous factors that affect our business and results of operations, many of which are beyond our control. In addition to information set forth in this quarterly report, you should carefully read and consider "Item 1A. Risk Factors" in Part I and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II of our annual report on Form 10-K for the year ended June 30, 2018, which contains descriptions of significant risks that might cause our actual results of operations in future periods to differ materially from those currently anticipated or expected. Except as discussed below, there have been no material changes from the risks previously disclosed in our annual report on Form 10-K for the year ended June 30, 2018.

We will require substantial additional funding, and our failure to raise additional capital necessary to support and expand our operations could reduce our ability to compete and could harm our business.

As of December 31, 2018, we had \$3.4 million in cash and cash equivalents and a negative \$3.0 million of working capital. The negative working capital is primarily due to the reclassification of the Debentures from noncurrent liabilities to current liabilities in connection with the technical default.

As of February 13, 2019, we had \$2.9 million in cash and cash equivalents. In addition to the cash and cash equivalents, we have approximately another \$0.1 million in Chinese bank acceptance notes, which are similar to certificates of deposit, and have maturity dates greater than 90 days but less than one year. Of the \$2.9 million in cash and cash equivalents, \$1.6 million resides in the United States or easily accessed foreign countries and approximately \$1.3 million resides in China.

In the quarter ended December 31, 2018, we undertook additional steps to reduce our overhead expenses through the termination of certain technology and administrative employees and other reductions associated with office rental and professional fees.

As part of our overall strategy, to the extent possible, we intend to (i) support AFE and SEE in those endeavors to develop energy, chemicals and resource projects where we would own an earned or carried equity interest in the project; (ii) monitor support and facilitate our minority ownership in BFR in order to realize the financial value through dividend income or other means; (iii) work to recover cash and monetize our Yima Joint Venture and TSEC Joint Venture operations; and (iv) taking any additional steps to utilize our existing cash reserves in the most financially productive mean possible.

We are undertaking strategies to improve our financial position and preserve our available cash to allow more time to realize the value we believe is in our assets, such as BFR, the Pentland coal resource and AFE. These strategies include the evaluation of a full range of financing, restructuring and strategic alternative options which may help us more fully realize the value in those assets. In addition, we are undertaking further expense reductions which we expect to be realized over the remainder of calendar year 2019 and we are also undertaking the necessary steps to transfer funds currently in our Chinese bank accounts to our U.S. based bank accounts in order to improve our available working capital. We may also divest assets such as our Yima Joint Venture, our TSEC Joint Venture and our technology.

We believe that with the strategies above, we can continue to operate for the next nine months while we continue to work to transfer our funds currently in China to the U.S. in the most efficient manner. Based on the uncertainty of our plans to improve our financial position, our historical negative operating cash flows, our continued limited cash inflows and the potential uncertainties regarding transferring our funds from China to the U.S., there is substantial doubt about the Company's ability to continue as a going concern, as disclosed in our prior periodic reports.

We currently plan to use our available cash for: (i) evaluation and implementing financing, divestitures and strategic restructuring options; (ii) paying the interest related to the Senior Secured Debentures; and (iii) working capital for general corporate and administrative expenses.

We currently have very limited financial and human resources to fully implement our plans and due to employee resource reductions, we have limited technology delivery capabilities. We can make no assurances that AFE, SEE and our other business operations including any potential return from BFR will provide us with sufficient and timely cash flows to continue our operations.

As noted above, we are seeking to improve our financial position and we may choose to raise additional capital through alternatives such as equity and debt financing, divesting certain assets such as our interests in our Yima Joint Venture, our TSEC Joint Venture and our technology, and/or restructuring the Company. We cannot provide any assurance that any of these alternatives will be available to us in the future on acceptable terms or at all. Any such alternative could be dilutive to our existing stockholders and debtholders. If we cannot raise required funds on acceptable terms, we may further substantially reduce our expenses and we may not be able to, among other things, (i) sustain our general and administrative expenses; (ii) fund certain obligations as they become due including license fees and other vendor payments; (iii) respond to unanticipated capital requirements; or (iv) repay our indebtedness. In addition, we may be forced to seek relief to avoid or end insolvency through other proceedings including bankruptcy.

On November 5, 2018, a default occurred related to the Purchase Agreement and the Debentures due to the Company failing to file its Annual Report on Form 10-K. If the default is not waived by the holders of the Debentures, the holders may have the option to accelerate the principal and interest outstanding and other mandatory charges on the Debentures. The default has not been waived at the time of filing this Quarterly Report on Form 10-Q and accordingly, we have reclassified the Debenture liabilities from noncurrent liabilities to current liabilities.

Our ability to generate cash to service our indebtedness depends on many factors beyond our control, and any failure to meet our debt obligations could harm our business, financial condition and results of operations.

Our ability to make payments on and to refinance our indebtedness, including our Debentures, and to fund planned capital expenditures will depend on our ability to generate sufficient cash flow from operations in the future. To a certain extent, this is subject to general economic, financial, competitive, legislative and regulatory conditions and other factors that are beyond our control.

We cannot assure you that our business will generate sufficient cash flow from operations in an amount sufficient to enable us to pay principal and interest on our indebtedness, including our Debentures, or to fund our other liquidity needs. If our cash flow and capital resources are insufficient to fund our debt obligations, we may be forced to sell assets, seek additional equity or debt capital or restructure our debt. We cannot assure you that any of these remedies could, if necessary, be affected on commercially reasonable terms, or at all. Our cash flow and capital resources may be insufficient for payment of interest on and principal of our debt in the future, including payments on our recently issued Debentures, and any such alternative measures may be unsuccessful or may not permit us to meet scheduled debt service obligations, which could cause us to default on our obligations and could impair our liquidity or could force us to seek relief to avoid or end insolvency through other proceedings.

If we fail to perform or deliver on our obligations to our joint venture partners, our business and operating results could suffer.

Pursuant to our joint venture contracts, we are committed to providing technology and related support to our partners. If we do not perform or deliver on these obligations, our partners could pursue legal action against us and our business and operating results could be seriously harmed. We cannot assure you that we will satisfy the conditions required to maintain these relationships under existing agreements or that we can prevent the termination of these agreements. In addition, our efforts to monetize our gasification technology are dependent on our ability to successfully maintain and transfer our intellectual property. Should we be unable to satisfactorily do so, we may lose all or part of the value of our technology. Any claimed defaults on our obligations could impair our liquidity or could force us to seek relief to avoid or end insolvency through other proceedings.

We may be subject to future impairment losses due to potential declines in the fair value of our assets.

We evaluated the conditions of the Yima Joint Venture to determine whether other-than-temporary decrease in value had occurred as of June 30, 2018 and 2017. As of each date, management determined that there were applicable triggering events related to its investment in the Yima Joint Venture. Management determined these events in these years were other-than-temporary in nature and therefore conducted an impairment analysis utilizing a discounted cash flow fair market valuation and a Black-Scholes Model-Fair Value of Optionality used in valuing companies with substantial amounts of debt where a discounted cash flow valuation may be inadequate for estimating fair value with the assistance of a third-party valuation expert. In the valuations, significant unobservable inputs were used to calculate the fair value of the investment. These inputs included forecasted methanol and coal prices, calculated discount rates and discount for lack of marketability as the majority owner is a state-owned entity in China, volatility analysis and information received from the joint venture. These valuations led to the conclusion that the investment in the Yima Joint Venture were impaired as of June 30, 2018 and 2017, and accordingly, we recorded a \$3.5 million impairment for the year ended June 30, 2018, and a \$17.7 million impairment for the year ended June 30, 2017. The carrying value of our Yima investment as of June 30, 2018 and 2017 was approximately \$5.0 million and \$8.5 million respectively.

Management determined that there was not an other-than-temporary triggering event during the quarter ended December 31, 2018. The carrying value of our Yima Joint Venture investment was approximately \$5.0 million as of both December 31, 2018 and June 30, 2018. We continue to monitor the Yima Joint Venture and could record an additional impairment in the future if operating conditions deteriorate or if the cash flow situation worsens.

Should general economic, market or business conditions decline further, and continue to have a negative impact on our revenues or other aspects of our business, we may be required to record impairment charges in the future, which could materially and adversely affect financial condition and results of operation.

We are at risk of being delisted from NASDAQ if we do not regain compliance with the minimum \$1 bid price per share required by NASDAQ.

On February 5, 2019, we received a notification from the NASDAQ Stock Market (the "NASDAQ") indicating that the minimum bid price of our common stock has been below \$1.00 per share for 30 consecutive business days and as a result, we are not in compliance with the minimum bid price requirement for continued listing. The NASDAQ notice has no immediate effect on the listing or trading of our common stock.

Under NASDAQ Listing Rule 5810(c)(3)(A), we have a grace period of 180 calendar days, or until August 5, 2019, in which to regain compliance with the minimum bid price rule. To regain compliance, the closing bid price of our common stock must meet or exceed \$1.00 per share for a minimum of ten consecutive business days during this grace period.

If we do not regain compliance before August 5, 2019, the NASDAQ stated that it will provide us with written notice that our securities are subject to delisting. At that time, we may appeal the NASDAQ's determination to a NASDAQ Listing Qualifications Panel, which would stay any further delisting action by the NASDAQ pending the final decision by the panel. Alternatively, we may be eligible for an additional grace period if we meet the initial listing standards, with the exception of bid price, for the NASDAQ Capital Market, and we successfully apply for a transfer of our securities to that market. Such a transfer would provide us with an additional 180 calendar day period to regain compliance with the minimum bid requirement.

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

None

Item 3. Defaults Upon Senior Securities.

On November 5, 2018, a default occurred related to the Purchase Agreement and the Debentures due to the Company failing to timely file its Annual Report on Form 10-K. If the default is not waived by the holders of the Debentures, the holders may have the option to accelerate the principal and interest outstanding and other mandatory charges on the Debentures.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information.

None.

Item 6. Exhibits

<u>Number</u>	<u>Description of Exhibits</u>
<u>10.1</u>	<u>Online Office Agreement dated November 9, 2018 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 15, 2018).</u>
<u>31.1*</u>	<u>Certification of Principal Executive Officer and Principal Financial Officer of Synthesis Energy Systems, Inc. pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.</u>
<u>32.1*</u>	<u>Certification of Principal Executive Officer and Principal Financial Officer of Synthesis Energy Systems, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code.</u>
101.INS	XBRL Instance Document.**
101.SCH	XBRL Taxonomy Extension Schema Document.**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.**

+ Management contract or compensatory plan or arrangement.

* Filed herewith.

** In accordance with Rule 406T of Regulation S-T, the XBRL information in Exhibit 101 to this quarterly report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SYNTHESIS ENERGY SYSTEMS, INC.

Date: February 13, 2019

By: /s/ DeLome Fair
DeLome Fair
President and Chief Executive Officer
(Principal Executive Officer and Principal Financial Officer)

Date: February 13, 2019

By: /s/ David Hiscocks
David Hiscocks
Corporate Controller

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER PURSUANT TO RULE 13a-14(a)/15d-14(a) PROMULGATED UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, DeLome Fair, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Synthesis Energy Systems, 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(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-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 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(s) 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: February 13, 2019

/s/ DeLome Fair

DeLome Fair

President and Chief Executive Officer

Principal Executive Officer and Principal Financial Officer

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Synthesis Energy Systems, Inc. (the "Company") on Form 10-Q for the period ended December 31, 2018 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, DeLome Fair, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ DeLome Fair

DeLome Fair

President and Chief Executive Officer

Principal Executive Officer and Principal Financial Officer

February 13, 2019

