

CYALUME TECHNOLOGIES HOLDINGS, INC.

FORM 10-Q (Quarterly Report)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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 March 31, 2017

OR

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

For the transition period from to

Commission File Number 000-52247

Cyalume Technologies Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

20-3200738

(I.R.S. Employer
Identification No.)

910 SE 17th Street, Suite 300, Fort Lauderdale, Florida
(Address of principal executive offices)

33316
(Zip Code)

(954) 315-4939

(Registrant's telephone number, including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company
(Do not check if a smaller reporting 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of May 10, 2017, there were outstanding 22,347,549 shares of the registrant's Common Stock, par value \$.001 per share.

Cyalume Technologies Holdings, Inc.
FORM 10-Q

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PART I—FINANCIAL INFORMATION

The statements contained in this quarterly report on Form 10-Q, including under the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this quarterly report, include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, without limitation, statements regarding our or our management's expectations, hopes, beliefs, intentions or strategies regarding the future. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "plan" and similar expressions may identify forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking. The forward-looking statements contained in this quarterly report are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. Unless the content otherwise requires, all references to "we", "us", the "Company" or "Cyalume" in this quarterly report on Form 10-Q refers to Cyalume Technologies Holdings, Inc.

ITEM 1. Financial Statements

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Balance Sheets
(in thousands, except shares and per share information)
(Unaudited)

	March 31, 2017	December 31, 2016
Assets		
Current assets:		
Cash	\$ 1,151	\$ 2,753
Accounts receivable, net of allowance for doubtful accounts of \$6 and \$8, respectively	5,003	3,379
Inventories, net	8,225	8,384
Income taxes refundable	169	187
Prepaid expenses and other current assets	1,444	1,078
Total current assets	15,992	15,781
Property, plant and equipment, net	7,020	7,036
Goodwill	7,992	7,992
Other intangible assets, net	4,791	4,951
Total assets	\$ 35,795	\$ 35,760
Liabilities and Stockholders' Equity		
Current liabilities:		
Line of credit	\$ 1,000	\$ 0
Current portion of notes payable	1,288	1,066
Accounts payable	1,511	1,643
Accrued expenses	2,587	4,236
Deferred revenue and deferred rent	31	37
Income taxes payable	157	82
Warrants liability	47	72
Total current liabilities	6,621	7,136
Notes payable, net of current portion	11,373	11,752
Deferred income taxes	631	626
Asset retirement obligation	228	226
Other noncurrent liabilities	90	88
Total liabilities	18,943	19,828
Commitments and contingencies (Note 12)		
Series C preferred stock, \$0.001 par value; 1,000,000 shares authorized; 1,000 shares issued and outstanding	2,744	2,665
Series D convertible preferred stock, \$0.001 par value; 1,000,000 shares authorized; 10 shares issued and outstanding	2,751	2,751
Series A convertible preferred stock, \$0.001 par value; 1,000,000 shares authorized; 123,097 shares issued and outstanding	5,956	5,784
Stockholders' equity:		
Series B convertible preferred stock, \$0.001 par value; 1,000,000 shares authorized; 1,000 shares issued and outstanding	1,401	1,401
Common stock, \$0.001 par value; 150,000,000 shares authorized; 22,347,549 and 21,400,244 shares issued and outstanding, respectively	22	21
Additional paid-in capital	101,936	102,031
Accumulated deficit	(96,903)	(97,618)
Accumulated other comprehensive loss	(1,055)	(1,103)
Total stockholders' equity	5,401	4,732
Total liabilities and stockholders' equity	\$ 35,795	\$ 35,760

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

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Statements of Comprehensive Income
(in thousands, except shares and per share information)
(Unaudited)

	For the Three Months Ended March 31, 2017	For the Three Months Ended March 31, 2016
Revenues	\$ 11,097	\$ 9,242
Cost of revenues	5,758	4,512
Gross profit	5,339	4,730
Other expenses:		
Sales and marketing	959	593
General and administrative	2,039	2,149
Research and development	483	391
Interest expense, net	642	729
Amortization of intangible assets	239	240
Change in fair value of warrant liability	38	(13)
Other expenses, net	4	26
Total other expenses, net	4,404	4,115
Income before income taxes	935	615
Provision for income taxes	220	136
Net income	715	479
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	48	118
Other comprehensive income	48	118
Comprehensive income	\$ 763	\$ 597
Net income	\$ 715	\$ 479
Series A convertible preferred stock dividends	(172)	(154)
Series C preferred stock dividends	(79)	(71)
Net income available to common stockholders – basic	\$ 464	\$ 254
Series A convertible preferred stock dividends	172	154
Change in fair value of warrant liability	0	(13)
Net income available to common stockholders –diluted	\$ 636	\$ 395
Income per common share:		
Basic	\$ 0.02	\$ 0.01
Diluted	\$ 0.01	\$ 0.00
Weighted average shares used to compute net income per common share:		
Basic	22,084,684	21,400,244
Diluted	115,442,536	104,237,394

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

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Statements of Changes in Convertible Preferred Stock and Stockholders' Equity
(in thousands, except shares)
(Unaudited)

	Series A Convertible Preferred Stock		Series C Preferred Stock		Series D Convertible Preferred Stock		Series B Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount				
Balance at December 31, 2016	123,097	\$ 5,784	1,000	\$ 2,665	10	\$ 2,751	1,000	\$ 1,401	21,400,244	\$ 21	\$ 102,031	\$ (97,618)	\$ (1,103)	\$ 4,732
Dividends accrued on Series A and Series C preferred stock	0	172	0	79	0	0	0	0	0	0	(251)	0	0	(251)
Issuance of common shares upon warrant exercise	0	0	0	0	0	0	0	0	947,305	1	63	0	0	64
Share-based compensation	0	0	0	0	0	0	0	0	0	93	0	0	0	93
Net income	0	0	0	0	0	0	0	0	0	0	0	715	0	715
Other comprehensive income	0	0	0	0	0	0	0	0	0	0	0	0	48	48
Balance at March 31, 2017	<u>123,097</u>	<u>\$ 5,956</u>	<u>1,000</u>	<u>\$ 2,744</u>	<u>10</u>	<u>\$ 2,751</u>	<u>1,000</u>	<u>\$ 1,401</u>	<u>22,347,549</u>	<u>\$ 22</u>	<u>\$ 101,936</u>	<u>\$ (96,903)</u>	<u>\$ (1,055)</u>	<u>\$ 5,401</u>

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

Cyalume Technologies Holdings, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	For the Three Months Ended March 31, 2017	For the Three Months Ended March 31, 2016
Cash flows from operating activities:		
Net income	\$ 715	\$ 479
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	233	220
Amortization of intangible assets, debt issuance costs and debt discount	486	468
Share-based compensation expense	93	85
Change in fair value of warrant liability	38	(13)
Loss on disposal of property, plant and equipment	4	29
Other non-cash expenses	(1)	9
Changes in operating assets and liabilities:		
Accounts receivable	(1,613)	577
Inventories	174	(31)
Prepaid expenses and other current assets	(280)	(251)
Restricted cash	(120)	153
Accounts payable and accrued liabilities	(1,784)	(1,549)
Deferred revenue and deferred rent	(6)	(52)
Income taxes payable	94	42
Net cash (used in) provided by operating activities	(1,967)	166
Cash flows from investing activities:		
Purchases of long-lived assets	(207)	(127)
Payments for intangibles	(72)	(7)
Net cash used in investing activities	(279)	(134)
Cash flows from financing activities:		
Repayment of long term notes payable	0	(378)
Borrowings on Monroe line of credit, net	1,000	0
Repayment on Monroe Term A Loan	(225)	0
Repayment on Monroe Delayed Draw Loan	(37)	0
Repayment of legal settlement promissory note	(107)	(107)
Net cash provided by (used in) financing activities	631	(485)
Effect of exchange rate changes on cash	13	9
Net decrease in cash	(1,602)	(444)
Cash, beginning of period	2,753	1,526
Cash, end of period	<u>\$ 1,151</u>	<u>\$ 1,082</u>

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

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

1. ORGANIZATION

Cyalume Technologies Holdings, Inc. (the “Company”) was organized as a blank check company under the laws of the State of Delaware on July 19, 2005. At that time, the Company was named Vector Security Intersect Acquisition Corp. On December 19, 2008, the Company acquired Cyalume Technologies, Inc. (“CTI”) and changed the corporate name to the current name. CTI is a Delaware corporation formed on March 27, 1997 with headquarters located in Fort Lauderdale, Florida.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information. Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to those rules and regulations. The Company believes that the disclosures made are adequate to make the information presented not misleading. All the adjustments which, in the opinion of management, are considered necessary for a fair presentation of the results of operations for the periods shown are of a normal recurring nature and have been reflected in the unaudited condensed consolidated financial statements. Results from operations for the three months ended March 31, 2017 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 2017. The consolidated balance sheet at December 31, 2016 has been derived from the audited consolidated financial statements at that date. The information included in these unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto in our Annual Report on Form 10-K for the year ended December 31, 2016 filed on March 28, 2017.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. While the Company believes that such estimates are fair when considered in conjunction with the condensed consolidated financial position and results of operations taken as a whole, the actual amount of such estimates, when known, may vary from these estimates.

3. DESCRIPTION OF BUSINESS

These consolidated financial statements and footnotes include the financial position and operations of Cyalume Technologies Holdings, Inc. (“Cyalume” or the “Company”), the parent company that is the sole shareholder of Cyalume Technologies, Inc. (“CTI”), of Cyalume Specialty Products, Inc. (“CSP”) and of CT SAS Holdings, Inc. (“CT SAS Holdings”). CTI is the sole shareholder of Cyalume Realty, Inc. (“CRI”). CT SAS Holdings is the sole shareholder of Cyalume Technologies, SAS (“CTSAS”). All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company’s primary focus is producing specialty chemicals and related products and sub-contract manufacturing of components for use in the pharmaceutical and medical products markets. The Company sells to the U.S. military and other militaries, and to major pharmaceutical and medical device companies throughout the world.

CTI and CTSAS manufacture and sell chemiluminescent products and reflective and photoluminescent materials to military, ammunition, commercial and public safety markets. CTSAS is located in France and represents CTI in certain international markets, primarily Europe and the Middle East. CTI sells to customers in all other geographic markets. CTI’s and CTSAS’s business operations constitute the majority, based on revenues and assets, of the Company’s consolidated business operations.

CSP manufactures on a subcontractor basis and sells specialty chemical products to the pharmaceutical, medical products, defense and other markets. CSP’s operations are located in Bound Brook, New Jersey.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

The Company's business is managed and financial results are reported as one segment. The Company's CEO, who is the Company's chief operating decision maker, focuses on consolidated results to make strategic and tactical decisions. The Company's one operating segment consists of three reporting units: Chemical Light (the operations of CTI, CTS and CTSAS), Specialty Products (the operations of CSP) and Other (the parent company Cyalume Technologies Holdings, Inc.).

4. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following (all amounts in thousands):

	March 31, 2017	December 31, 2016
Prepaid expenses	\$ 897	\$ 617
Debt issuance costs	422	456
Restricted cash ⁽¹⁾	120	0
Other current assets	5	5
	<u>\$ 1,444</u>	<u>\$ 1,078</u>

- (1) As of March 31, 2017, the Company had cash collateralizing a letter of credit for approximately \$120,000 which was used to facilitate purchases of raw materials from overseas vendors. This letter of credit will mature on June 15, 2017 and was included in "Prepaid expenses and other current assets" in the Company's Condensed Consolidated Balance Sheet as of March 31, 2017.

5. INVENTORIES

Inventories consist of the following (all amounts in thousands):

	March 31, 2017	December 31, 2016
Raw materials	\$ 4,668	\$ 4,568
Work-in-process	1,945	2,267
Finished goods	1,612	1,549
	<u>\$ 8,225</u>	<u>\$ 8,384</u>

6. CREDIT LINE AND NOTES PAYABLE

Monroe Refinancing

On May 18, 2015, the Company entered into a credit agreement with Monroe Capital Management Advisors, LLC (the "Monroe Credit Agreement"), refinancing its existing senior and subordinated debt (see below). The Monroe Credit Agreement provides for a \$25.0 million credit facility consisting of up to: (i) a \$5.0 million revolving credit facility (the "Monroe Line of Credit"); (ii) an \$18.0 million senior secured term loan (the "Term A Loan") and (iii) a \$2.0 million delayed draw term loan (the "Delayed Draw Loan"). The Delayed Draw Loan was used to satisfy a legal settlement agreement amount.

The Monroe Credit Agreement has a term of five years and bears interest at a rate of the one-month LIBOR plus 9%. The Term A Loan requires quarterly repayments of approximately \$113,000 beginning on June 30, 2015 through March 31, 2016; quarterly repayments of approximately \$225,000 beginning on June 30, 2016 through March 31, 2017; quarterly repayments of approximately \$450,000 beginning on June 30, 2017 through March 31, 2020; and a payment of approximately \$11.3 million on the Term A Loan maturity date of May 18, 2020. Accrued interest shall be payable monthly in arrears on the last business day of each calendar month.

Pursuant to the terms of the Monroe Credit Agreement, the Company must maintain: (i) a fixed charge coverage ratio of 1.25 to 1.00; (ii) a senior debt to EBITDA ratio initially of 4.50 to 1.00, decreasing to 1.50 to 1.00 over the term of the loans; and (iii) a twelve month trailing EBITDA, measured quarterly, with the amounts ranging from \$4,750,000, increasing up to \$7.0 million over the term of the loans. The Company was in compliance with the financial covenants related to these loans as of March 31, 2017.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

On August 3, 2015, the Company entered into a First Amendment (the “First Amendment”) to the Monroe Credit Agreement. Pursuant to the First Amendment, the Monroe Credit Agreement was amended to, among other things, reduce the aggregate amount of the Delayed Draw Loan under the Monroe Credit Agreement, which loan commitment was for purposes of funding a final payment due under the a legal settlement agreement, from \$2.0 million to \$1.5 million. On August 3, 2015, the full amount of the Delayed Draw Loan was funded to the Company, \$1.4 million of which was used to make a final legal settlement payment, and the remaining \$100,000 of which was paid to Monroe as a deferred closing fee. The First Amendment also modified, for certain periods during the term of the Credit Agreement, (i) the maximum senior debt to EBITDA ratio that the Company is required to maintain and (ii) the applicable limits on the Company’s aggregate permitted capital expenditures pursuant to the terms of the Credit Agreement.

The Delayed Draw Loan, which was drawn on August 3, 2015, provides for quarterly amortization payments on the last day of each calendar quarter in an aggregate principal amount equal to 0.625% of the original principal amount of the Delayed Draw Loan, increasing to 1.25% on March 31, 2016, and increasing to 2.5% on March 31, 2017, with the balance payable on the maturity date of May 18, 2020.

In connection with the execution of the Monroe Credit Agreement, the Company issued 10 shares of Series D convertible preferred stock (the “Series D Convertible Preferred Stock”). Each share of Series D Convertible Preferred Stock may be converted at any time at the option of the holder into a number of shares of common stock initially equal to 752,807.8 shares of common stock (see Note 7). The relative fair value of the Series D Convertible Preferred Stock was approximately \$2.8 million which was recorded as debt issuance costs of approximately \$0.4 million and debt discount on the Company’s Term A Loan and Delayed Draw Loan of approximately \$2.4 million.

The proceeds from the Monroe Credit Agreement were allocated to the various instruments issued based on their relative fair value.

Line of Credit

The Monroe Line of Credit has a maximum borrowing capacity of \$5.0 million, bears interest at a rate of the one-month LIBOR plus 9% and expires on May 18, 2020. The amount which may be borrowed under the Monroe Line of Credit is dependent mainly on accounts receivable and inventory balances. Under the terms of the Monroe Credit Agreement, the Company is able to borrow under the Monroe Line of Credit in an amount not to exceed the lesser of: (i) \$5.0 million and (ii) the sum of 85% of all eligible accounts receivable plus 60% of all eligible inventory. Interest is payable monthly and the Monroe Line of Credit’s interest rate at March 31, 2017 was 10%. This line of credit is subject to various restrictive covenants and collateral guarantees. At March 31, 2017, \$1.0 million was outstanding on the Monroe Line of Credit and availability under the Monroe Line of Credit was approximately \$4.0 million.

CTSAS has lines of credit, for borrowing against receivables, with a combined maximum borrowing capacity of €750,000 (or approximately \$801,120 as of March 31, 2017). There were no outstanding borrowings at March 31, 2017 or December 31, 2016. The lines’ interest rates are variable, based on the 3-month Euro Interbank Offered Rate. The lines are collateralized by primarily CTSAS accounts receivable. The lines have indefinite termination dates but can be renegotiated periodically.

Notes Payable

Outstanding notes payable consist of (all amounts in thousands):

	March 31, 2017	December 31, 2016
Monroe Term A Loan	\$ 13,817	\$ 14,042
Delayed Draw Loan	1,229	1,266
Promissory Note Payable	323	430
Total	15,369	15,738
Less: Unamortized debt discount and unamortized debt issuance costs	(2,708)	(2,920)
Less: Current portion of notes payable, including current portion of unamortized debt discount and current portion of unamortized debt issuance costs	(1,288)	(1,066)
Notes payable, net of current portion	<u>\$ 11,373</u>	<u>\$ 11,752</u>

Debt issuance costs are amortized to interest expense using the effective interest method over the life of the loan. The effective interest rate on the Term A Loan is approximately 19% and the effective interest rate on the Delayed Draw Loan is approximately 22%.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

Promissory Note Payable

On November 19, 2013, the Company entered into a legal settlement agreement. The executed settlement agreement provided for the Company to make a series of payments to Antonio Colon in the amount of \$215,000 annually, for a total of \$1,075,000 pursuant to the Promissory Note executed on November 19, 2013 (the "Promissory Note"). This Promissory Note bears interest at a rate of 2% annually and requires principal and interest payments each March and September. The Promissory Note has a maturity date of October 15, 2018.

7. PREFERRED STOCK

Series A Convertible Preferred Stock

The Company is authorized to issue 1,000,000 shares of preferred stock in one or more series with such designations, voting and other rights and preferences as may be determined from time to time by our Board of Directors.

On November 19, 2013, the Company entered into a Securities Purchase Agreement (the "Series A Purchase Agreement") with US VC Partners, L.P. (the "Series A Investor") for the purchase by the Investor of 123,077 units of securities of the Company for an aggregate purchase price of \$4.0 million (or \$32.50 per unit). Each security issued is composed of: 1) one share of Series A Convertible Preferred Stock of the Company, at a par value of \$0.001 per share (the "Series A Preferred Stock"); 2) one common stock warrant (the "Common Warrant"); and 3) one preferred stock warrant (the "Preferred Warrant").

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

Each share of Series A Preferred Stock may be converted at any time at the option of the holder into a number of shares of common stock initially equal to 50 shares of common stock, determined by dividing the Liquidation Value per share of Series A Preferred Stock by the applicable conversion price per share of Series A Preferred Stock. The initial conversion price was equal to \$0.65, subject to customary adjustments, including for any accrued but unpaid dividends and pursuant to certain anti-dilution provisions. Pursuant to the Series A Certificate of Designation amended on July 30, 2014 (the "Amended Series A Certificate of Designation"), the conversion price per share of Series A Preferred Stock is now equal to \$0.13664587. The Series A Preferred Stock is not subject to mandatory conversion at any time.

Upon voluntary or involuntary liquidation, dissolution or winding up of the Company, each holder of Series A Preferred Stock is entitled to a liquidation preference of \$32.50 per share, plus any accrued but unpaid dividends, subject to customary adjustments as set forth in the Certificate of Designation (the "Series A Liquidation Value").

Dividends on the Series A Preferred Stock accrue (payable in cash or in kind), whether or not declared by the Board and whether or not funds are available for the payment of dividends, at a rate of 12% per annum on the sum of the liquidation preference plus all accrued and accumulated dividends and will be payable quarterly in arrears in a) cash or b) newly issued shares of Series A Preferred Stock having an aggregate liquidation preference equal to the amount of such accrued dividends ("PIK Dividends") at the option of the Company. All accrued and accumulated dividends on the convertible preferred stock shall be paid prior to and in preference to any other class of securities of the Company.

Each share of Series A Preferred Stock will be entitled to a number of votes equal to the number of shares of common stock into which such share is convertible and shall be entitled to vote with holders of outstanding shares of common stock, voting together as a single class, with respect to any and all matters presented to the stockholders of the Company for their action or consideration.

The requisite holders of the Series A Preferred Stock will have the right to cause the Company to redeem, out of funds legally available, all but not less than all of the then outstanding shares of Series A Preferred Stock, for a price per share equal to the Series A Liquidation Value of such shares, from and after the fifth anniversary of the closing date of the Series A Purchase Agreement. Additionally, the Company will have the right to redeem all of the outstanding shares of Series A Preferred Stock from and after the eighth anniversary of the closing date of the Series A Purchase Agreement at a redemption price equal to the Series A Liquidation Value. As a result of the redemption provisions, the Series A Preferred Stock has been classified outside of permanent equity.

Series B Convertible Preferred Stock

On July 30, 2014, the Company entered into a Securities Purchase Agreement (the "Series B and C Purchase Agreement") with Cova Small Cap Holdings, LLC ("Cova"), Bayonet Capital Fund I, LLC (see Note 10), and another investor (each, an "Investor") for the purchase by the Investors of an aggregate of 1,000 units of securities of the Company (the "Units") for an aggregate purchase price of \$2.0 million (or \$2,000.00 per Unit), with each Unit comprising (1) one share of Series B Convertible Preferred Stock of the Company, par value \$0.001 per share (the "Series B Preferred Stock"), and (2) one share of Series C Preferred Stock of the Company, par value \$0.001 per share (the "Series C Preferred Stock"). Approximately \$1.3 million of the net proceeds from the sale of the Units was used to pay a contingent legal obligation.

The shares of Series B Preferred Stock have the rights and preferences set forth in the Certificate of Designation of Series B Convertible Preferred Stock, which was amended on May 15, 2015 (the "Amended Series B Certificate of Designation"). Pursuant to the Amended Series B Certificate of Designation, each share of Series B Preferred Stock ranks senior to the Company's common stock (the "Common Stock") and the Company's Series A Preferred Stock with respect to payment of dividends and distribution of assets upon liquidation, dissolution or winding up of the Company. Upon the Company's liquidation, sale to or merger with another corporation or other "Change of Control" (as such term is defined in the Amended Series B Certificate of Designation), each share of Series B Preferred Stock would be entitled to a liquidation preference in an amount equal to the amount per share that would have been payable had all shares of Series B Preferred Stock been converted into Common Stock immediately prior to such event in accordance with the terms of the Amended Series B Certificate of Designation, excluding for purposes of such calculation the liquidation preference payable to the holders of Series A Preferred Stock. Holders of the Series B Preferred Stock are entitled to convert at any time all or any portion of the shares of Series B

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

Preferred Stock into a number of shares of Common Stock initially equal to 35,713.147 shares of Common Stock per share of Series B Preferred Stock (the “Conversion Number”). The Conversion Number is subject to customary adjustments, including for dividends, stock splits and other reorganizations affecting the Common Stock. In addition, the Conversion Number is subject to anti-dilution protections, subject to certain exceptions, if the Company issues or sells shares of Common Stock or other equity securities for no consideration or for consideration that is based on an equity valuation of the Company of less than \$2.0 million in the aggregate (a “Trigger Issuance”). In the event of a Trigger Issuance, the Conversion Number shall be increased as of the close of business on the effective date of the Trigger Issuance to a number calculated as follows: (i) two-thirds of the Common Stock deemed Outstanding (as defined in the Amended Series A Certificate of Designation) immediately following such Trigger Issuance (excluding any Common Stock Deemed Outstanding as a result of the conversion of the Series B Preferred Stock) (ii) divided by 1,000. Each share of Series B Preferred Stock will automatically convert into shares of Common Stock on the tenth anniversary of its original issuance date, at the then-current Conversion Number. Each share of Series B Preferred Stock is entitled to a number of votes equal to the number of shares of Common Stock into which such share is convertible and will be entitled to vote with holders of outstanding shares of Common Stock, voting together as a single class, with respect to any and all matters presented to the stockholders of the Company for their action or consideration. The Series B Preferred Stock has been classified within permanent equity.

Series C Preferred Stock

The shares of Series C Preferred Stock have the rights and preferences set forth in the Certificate of Designation of Series C Preferred Stock, which was amended on May 15, 2015 (the “Amended Series C Certificate of Designation”). Pursuant to the Amended Series C Certificate of Designation, each share of Series C Preferred Stock ranks senior to the Common Stock, the Series A Preferred Stock, the Series B Preferred Stock and the Series D Preferred Stock with respect to payment of dividends and distribution of assets upon liquidation, dissolution or winding up of the Company. Upon the Company’s liquidation, sale to or merger with another corporation or other “Change of Control” (as such term is defined in the Amended Series C Certificate of Designation), each share of Series C Preferred Stock would be entitled to a liquidation preference equal to the sum of: (1) \$3,000 per share (the “Base Liquidation Value”) and the (2) the amount, if any, by which the Base Value exceeds 150% of the purchase price (the “Excess Liquidation Value), plus any accrued but unpaid dividends, in each case subject to customary adjustments as set forth in the Amended Series C Certificate of Designation. Holders of the Series C Preferred Stock are entitled to cumulative quarterly dividends at a rate of 12% per annum, calculated based on an assumed price of \$2,000 per share, payable in cash or in kind; provided that to the extent not paid in cash or by issuance of additional shares of Series C Preferred Stock on the last day of each calendar quarter (a “Dividend Payment Date”), all accrued dividends on any outstanding shares of Series C Preferred Stock shall accumulate and compound. In the event the Company has not paid in cash or by the issuance of additional shares of Series C Preferred Stock all accrued dividends on a Dividend Payment Date, at the election of holders of at least 75% of the outstanding shares of Series C Preferred Stock (the “Requisite Holders”), all such dividends accruing on the shares of Series C Preferred Stock will be paid in shares of Series C Preferred Stock. From and after the fifth anniversary of the issuance of the shares of Series C Preferred Stock, the Requisite Holders will have the right to elect to cause the Company to redeem, out of funds legally available therefore, all but not less than all of the then outstanding shares of Series C Preferred Stock, for a price per share equal to the Series C Liquidation Value for such shares. In addition, the Company has the right to redeem at any time, out of funds legally available therefore, all or any portion of the then outstanding shares of Series C Preferred Stock, for a price per share equal to the Series C Liquidation Value for such shares. The Series C Preferred Stock is not convertible into Common Stock or other securities of the Company, and does not have any voting rights. As a result of the redemption provisions, the Series C Preferred Stock has been classified outside of permanent equity.

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Notes to Condensed Consolidated Financial Statements

Series D Convertible Preferred Stock

In connection with the execution of the Monroe Credit Agreement, the Company entered into a Subscription Agreement (the "Subscription Agreement") with Monroe Capital Corporation, Monroe Capital Senior Secured Direct Loan Fund LP, Monroe Capital Senior Secured Direct Loan Fund (Unleveraged) LP and Monroe Capital Partners Fund II, LP. Pursuant to the Subscription Agreement, the Company issued 10 shares of \$0.001 par value per share Series D convertible preferred stock (the "Series D Convertible Preferred Stock"). Each share of Series D Convertible Preferred Stock may be converted at any time at the option of the holder into a number of shares of common stock initially equal to 752,807.8 shares of common stock. The Series D Convertible Preferred Stock has a mandatory conversion date on the tenth anniversary of the issuance date. The Series D Convertible Preferred Stock will automatically, without any action on the part of the holder thereof, be converted into that number of fully paid and nonassessable shares of the Company's common stock equal to the conversion number at the time in effect. The Series D Convertible Preferred Stock ranks senior to the Company's Series A Preferred Stock and the Company's Series B Preferred Stock. The Company's Series C Preferred Stock ranks senior to the Series D Convertible Preferred Stock. The shares of Series D Preferred Stock have the rights and preferences set forth in the Certificate of Designation of Series D Convertible Preferred Stock (the "Series D Certificate of Designation").

In the event of any voluntary or involuntary liquidation, the holders of the Series D Convertible Preferred Stock shall be entitled to be paid out of the assets of the Corporation available for distribution to its stockholders before any payment shall be made to the holders of junior securities. The Series C Preferred Stockholders would receive the Base Liquidation Value first, and not be entitled to the Excess Liquidation Value (as defined in the Amended Certificate of Designation of the Series C Preferred Stock) until the holders of the Series D Convertible Preferred Stock receive a pro rata Liquidation Value amount in cash. If at any time the Company redeems the outstanding shares of Series A Preferred Stock or Series C Preferred Stock, the holders of the Series D Preferred Stock would have the right to elect to cause the Company to redeem, out of funds legally available therefore, all but not less than all of the then outstanding shares of Series D Preferred Stock, for a price per share equal to the Liquidation Value for such shares; provided that, prior to the Company paying the full redemption price for all outstanding shares of Series D Preferred Stock, the Company would not be permitted to pay (i) any amounts in excess of the Series C Base Liquidation Value upon the redemption of shares of Series C Preferred Stock or (ii) any amounts upon the redemption of shares of Series A Preferred Stock. In the event of a voluntary or involuntary liquidation, each share of Series D Preferred Stock would be entitled to a liquidation preference in an amount equal to the amount per share that would have been payable had all shares of Series D Preferred Stock been converted into Common Stock immediately prior to such event in accordance with the terms of the Series D Certificate of Designation, excluding for purposes of such calculation the liquidation preference payable to the holders of Series A Preferred Stock and the holders of Series B Preferred Stock. The Series D Preferred Stock does not have any voting rights, except that the written consent of the holders of a majority of the then-outstanding Series D Preferred Stock shall be required for the Company to take certain actions, including the amendment of its certificate of incorporation or bylaws in a manner that adversely affects the relative rights, preferences, privileges or powers of holders of Series D Preferred Stock. As a result of the redemption provisions, the Series D Convertible Preferred Stock has been classified outside of permanent equity.

8. STOCKHOLDERS' EQUITY

Common Stock

The Company is authorized to issue 150,000,000 shares of common stock. Common stockholders are entitled to one vote for each share held of record on all matters to be voted on by stockholders. Common stockholders have no conversion, preemptive or other subscription rights and there are no sinking fund or redemption provisions applicable to the common stock.

Common Stock Purchase Warrants

Common stock purchase warrants accounted for within equity are recorded at their initial fair value and reported in stockholders' equity as increases to additional paid-in capital. Warrants reported as equity, rather than liabilities (i) may not be net-cash settled, (ii) have contractual limits on the number of shares to be delivered in a net-share settlement and (iii) are supported by sufficient unissued common shares available to settle the outstanding warrants. Subsequent changes in fair value from the warrants' initial fair value are not recognized as long as the warrants continue to merit classification as equity.

As of March 31, 2017 and December 31, 2016, respectively, warrants to purchase 187,564 and 455,514 shares of the Company's common stock were outstanding (see Note 13). These warrants are not indexed to the Company's stock, are considered a derivative and therefore, are being accounted for as a liability.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

Pursuant to the terms of a letter agreement previously entered into between the Company and Dragonfly Capital Partners, LLC (“Dragonfly”) under which Dragonfly provided advisory services to the Company in connection with the Company’s debt financing, the Company paid \$820,000 cash to Dragonfly and issued to Dragonfly a warrant on May 18, 2015 to purchase from the Company up to an aggregate of 1,003,744 shares of Common Stock (subject to customary adjustments) at an exercise price of \$0.05 per share (the “Dragonfly Warrant”). The Dragonfly warrant is was accounted for within equity at its initial fair value. The Dragonfly Warrant was reflected at its relative fair value of approximately \$43,000 in connection with the Monroe refinancing transaction. The Dragonfly warrant was exercised during January 2017.

Warrants to purchase the Company’s common stock were outstanding as follows as of March 31, 2017:

Warrant Holder	Number of Shares Exercisable Under Warrant	Exercise Price	Expiration Date
Patriot Capital II, L.P. (“Patriot”)	187,564	\$ 0.01	November 19, 2023

Warrants to purchase the Company’s common stock were outstanding as follows as of December 31, 2016:

Warrant Holder	Number of Shares Exercisable Under Warrant	Exercise Price	Expiration Date
Granite Creek Flex Cap I, L.P. (“Granite”)	267,950	\$ 0.01	November 19, 2023
Patriot Capital II, L.P. (“Patriot”)	187,564	\$ 0.01	November 19, 2023
Dragonfly Capital Partners, LLC	1,003,744	\$ 0.05	May 18, 2020

The fair value as of March 31, 2017 and December 31, 2016 of the Company’s liability warrants is estimated using the Black-Scholes pricing model with the following inputs:

	March 31, 2017 Warrants	December 31, 2016 Warrants
Stock price of underlying equity	\$ 0.25	\$ 0.16
Exercise price	\$ 0.01	\$ 0.01
Expected term (years)	6.6	6.9
Risk-free interest rate	2.08%	2.09%
Estimated dividend yield	None	None
Volatility	180.6%	178.91%

The change in the fair value of the warrants liability during the three months ended March 31, 2017 is as follows (amounts in thousands):

	Granite and Patriot Warrants (see Note 13)
Warrant liability at December 31, 2016	\$ 72
Exercise of warrant	(63)
Change in fair value of warrants	38
Warrant liability at March 31, 2017	<u>\$ 47</u>

9. INCOME TAXES

During the three months ended March 31, 2017 and 2016, the Company incurred tax expense of approximately \$95,000 and \$36,000, respectively, on foreign income generated by the Company’s CTSAS subsidiary. The remaining income tax expense reflected for the three months ended March 31, 2017 and 2016, respectively, reflects tax expense on U.S. income generated. Due to management’s assessment that it is more likely than not that a portion of certain deferred tax assets may not be realized, the Company has a valuation allowance of approximately \$11.8 million as of March 31, 2017 against its U.S. deferred tax asset, which was generated primarily as a result of foreign tax credits and net operating losses.

Cyalume Technologies Holdings, Inc.
Notes to Condensed Consolidated Financial Statements

10. RELATED PARTY TRANSACTIONS

Financing Arrangements with Related Parties

In December 2012, the Company entered into a \$2,100,000 unsecured promissory note with JFC Technologies, LLC (“JFC”), an entity controlled by James Schleck, a previous employee of CSP, who is an owner of a significant amount of the Company’s common shares and is a Board member. On November 19, 2013, the unsecured promissory note was amended (the “Amended JFC Note”). Pursuant to the Amended JFC Note, interest accrued at the rate of 12% per annum, retroactive to the date of the original note. On May 18, 2015, the Amended JFC Note of approximately \$2.1 million and approximately \$0.5 million of accrued interest on the Amended JFC Note were repaid in connection with the Company refinancing its debt. Pursuant to the Amended JFC Note, up to \$1.0 million of the principal amount was convertible, at the option of JFC, into the number of shares of Series A Preferred Stock equal to the portion of the principal amount being converted divided by the conversion price of \$32.50 per share. On May 18, 2015, \$650 was converted into 20 shares of Series A Preferred Stock issued to James Schleck.

CSP leases property in Bound Brook, New Jersey, from Brook Industrial Park, LLC. on a month-to-month basis, at a monthly amount of approximately \$30,000.

Bayonet Capital Fund I, LLC, Brook Industrial Park, LLC and JFC are controlled by James Schleck. On July 30, 2014, 100 units of securities of the Company (the “Units”) were issued to Bayonet Capital Fund I, LLC (see Note 7), with each Unit comprising (1) one share of Series B Preferred Stock and (2) one share of Series C Preferred Stock.

Other Related Party Transactions

CSP sells product to Organic Dyes and Pigments, LLC (“Organic Dyes”). Michael Barry, a Board member of the Company, owns approximately 19% of Organic Dyes. Revenue from this CSP customer was less than \$0.1 million for both the three months ended March 31, 2017 and 2016. The accounts receivable balances due from Organic Dyes were less than \$0.1 million as of March 31, 2017 and December 31, 2016.

11. NET INCOME PER COMMON SHARE

Basic income per common share is computed by dividing net income available to common stockholders by the basic weighted average number of common shares outstanding. Diluted income per common share is computed by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common share equivalents then outstanding. Potential common share equivalents consist of (i) shares issuable upon the exercise of warrants and options (using the “treasury stock” method), (ii) unvested restricted stock awards (using the “treasury stock” method) and (iii) shares issuable upon conversion of convertible notes and convertible preferred stock using the “if-converted” method.

(in thousands, except shares and per share information)

	Three Months Ended March 31,	
	2017	2016
Numerator (in thousands):		
Net income	\$ 715	\$ 479
Less: Series A convertible preferred stock dividends	(172)	(154)
Less: Series C preferred stock dividends	(79)	(71)
Net income available to common stockholders – basic	\$ 464	\$ 254
Effect of dilutive securities:		
Add: Series A convertible preferred stock dividends	172	154
Add: Change in fair value of warrant liability for dilutive warrants expense	0	(13)
Income available to common stockholders – diluted	<u>\$ 636</u>	<u>\$ 395</u>

(in thousands, except shares and per share information)

	Three Months Ended March 31,	
	2017	2016
Denominator:		
Weighted average common shares outstanding – basic	22,084,684	21,400,244
Weighted average effect of dilutive common equivalent shares:		
Assumed conversion of Series A convertible preferred stock	43,583,989	38,723,815
Assumed conversion of Series B convertible preferred stock	35,713,147	35,713,147
Assumed conversion of Series D convertible preferred stock	7,528,078	7,528,078
Warrants	152,211	862,958
Options	6,380,427	9,152
Weighted average common shares outstanding – diluted	<u>115,442,536</u>	<u>104,237,394</u>

Income per common share:

Basic	\$	0.02	\$	0.01
Diluted	\$	0.01	\$	0.00

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Notes to Condensed Consolidated Financial Statements

The following potentially dilutive common share equivalents were excluded from the calculation of diluted earnings per common share because their effect was antidilutive for each of the periods presented:

	Three Months Ended March 31,	
	2017	2016
Options	1,023,333	1,258,082
Warrants	187,564	0

12. COMMITMENTS AND CONTINGENCIES

Legal

From time to time and in the ordinary course of business, the company may be subject to various claims, charges, and litigation. At March 31, 2017, the company did not have any pending claims, charges or litigation that it expects would have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

13. FAIR VALUES OF ASSETS AND LIABILITIES

Under U.S. GAAP, the Company is required to record certain financial assets and liabilities at fair value and may choose to record other financial assets and financial liabilities at fair value as well. Also under U.S. GAAP, the Company is required to record nonfinancial assets and liabilities at fair value due to events that may or may not recur in the future, such as an impairment event. When required to record such assets and liabilities at fair value, that fair value is estimated using an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. That fair value is determined based on significant inputs contained in a fair value hierarchy as follows:

- Level 1** Quoted prices for identical assets or liabilities in active markets to which the Company has access at the measurement date.
- Level 2** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3** Unobservable inputs for the asset or liability.

The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

There are three general valuation techniques that may be used to measure fair value, as described below:

- Market Approach** Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. Prices may be indicated by pricing guides, sale transactions, market trades, or other sources.
- Cost Approach** Based on the amount that currently would be required to replace the service capacity of an asset (replacement cost).
- Income Approach** Uses valuation techniques to convert future amounts to a single present amount based on current market expectations about the future amounts (includes present value techniques and option-pricing models).
 Net present value is an income approach where a stream of expected cash flows is discounted at an appropriate market interest rate.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities itemized below were measured at fair value on a recurring basis at March 31, 2017 (all amounts in thousands):

	Level 1 Quoted Prices in Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs	Assets/ (Liabilities) At Fair Value
Warrants (see Note 8) ⁽¹⁾	0	0	(47)	(47)
	\$ 0	\$ 0	\$ (47)	\$ (47)

(1) The Company has classified its warrant liability which could be potentially settled in cash within Level 3 because the fair values are determined using significant unobservable inputs into the Black-Scholes pricing model.

Cyalume Technologies Holdings, Inc.
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The tables below presents reconciliations for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (all amounts in thousands):

	March 31, 2017	December 31, 2016
Warrants liability:		
Balance at the beginning of period	\$ 72	\$ 54
Exercise of Granite warrant	(63)	0
Change in fair value of warrants	38	18
Balance at the end of period	<u>\$ 47</u>	<u>\$ 72</u>

The Company has other financial instruments, such as cash, accounts receivable, due from related party, accounts payable, notes payable and a line of credit. The Company believes the carrying amounts of those assets and liabilities approximate their fair value since those carrying amounts have been estimated to approximate the exit price which would be received to sell these assets or pay to transfer these liabilities to a market participant.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

During the three months ended March 31, 2017, none of the Company's assets or liabilities were remeasured at fair value on a nonrecurring basis and no assets were identified as impaired as of March 31, 2017.

14. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash Paid for Interest and Income Taxes (all amounts in thousands) :

	Three Months Ended March 31	
	2017	2016
Interest	\$ 406	\$ 505
Income taxes	125	98

Non-Cash Investing and Financing Activities (all amounts in thousands) :

	Three Months Ended March 31	
	2017	2016
Series A Convertible Preferred stock accrued dividend	\$ 172	\$ 154
Series C Preferred stock accrued dividend	79	71

15. SUBSEQUENT EVENTS

Pursuant to the terms of the Monroe Credit Agreement, the Company expects to make an excess cash payment of approximately \$0.6 million on or before May 17, 2017, which will reduce the principal of the Company's Term A Loan and the Delayed Draw Loan. The excess cash payment is calculated based on the definition of excess cash flow under the Monroe Credit Agreement.

16. NEW ACCOUNTING PRONOUNCEMENTS

The following are recent accounting pronouncements that have affected the Company's consolidated financial statements or may affect the Company's consolidated financial statements in the future.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers*, as a new Topic, Accounting Standards Codification ("ASC") Topic 606. The new revenue recognition standard relates to revenue from contracts with customers, which, along with amendments issued in 2015 and 2016, will supersede nearly all current U.S. GAAP guidance on this topic and eliminate industry-specific guidance. The underlying principle is to use a five-step analysis of transactions to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The Company is in the initial stages of evaluating the effect of adopting ASU 2014-09 on its consolidated financial statements. The planned approach includes performing a detailed review of key contracts representative of the different businesses and comparing historical accounting policies and practices to the new accounting guidance. The Company will continue its evaluation of the standards update through the date of adoption. The Company plans to adopt this standard utilizing the modified retrospective approach.

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In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10)* (“ASU 2016-01”), which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for the Company beginning in its first quarter of 2019 and early adoption is not permitted. The Company does not expect the adoption of ASU 2016-01 will have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (“ASU 2016-02”), which requires companies that are lessees to recognize a right-of-use asset and lease liability for most leases that do not meet the definition of a short-term lease. For income statement purposes, leases will continue to be classified as either operating or financing. Classification will be based on criteria that are largely similar to those applied in current lease accounting. This standard will result in extensive qualitative and quantitative disclosure changes. This standard will be effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. While the Company is currently assessing the impact ASU No. 2016-02 will have on its consolidated financial statements, the Company expects the primary impact upon adoption will be the recognition, on a discounted basis, of its minimum commitments under noncancellable operating leases on its consolidated balance sheets resulting in the recording of right of use assets and lease obligations.

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, *Compensation- Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”). The purpose of the update is to simplify several areas of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual reporting periods after December 15, 2016, including interim periods within those fiscal periods. Early adoption is permitted. The adoption of ASU No. 2016-09 did not have a material impact on the Company’s financial position and results of operations.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments* (“ASU 2016-15”), which clarifies how certain cash receipts and payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted. The amendments in ASU 2016-15 should be applied using a retrospective transition method to each period presented. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its statement of cash flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230) – Restricted Cash* (“ASU 2016-18”), which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. With this standard, amounts generally described as restricted cash or restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted. The Company does not expect the adoption of ASU 2016-18 to have a material impact on its statement of cash flows and related disclosures.

In January 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment* (“ASU 2017-04”) which removes the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. ASU 2017-04 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. Early adoption is permitted and applied prospectively. The Company does not expect ASU 2017-04 to have a material impact on its financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in conjunction with our interim condensed consolidated financial statements and the accompanying notes to those financial statements included elsewhere in this Quarterly Report on Form 10-Q and in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. This discussion contains forward-looking statements that involve risks and uncertainties. Unless the content otherwise requires, all references to "we", "us", the "Company" or "Cyalume" in this Quarterly Report on Form 10-Q refers to Cyalume Technologies Holdings, Inc.

Company Overview

Our primary focus is producing specialty chemicals and related products and sub-contract manufacturing of components for use in the pharmaceutical and medical products markets. We manufacture chemical light, reflective and battlefield effects simulator products.

We sell our products into the law enforcement, commercial public safety and other markets. We provide specialty chemical products to the pharmaceutical, medical products, defense and other markets. We primarily sell to the U.S. military and other militaries, and to major pharmaceutical and medical device companies throughout the world.

We maintain principal executive offices at 910 SE 17th Street, Suite 300, Fort Lauderdale, Florida 33316. We have three direct U.S.-based subsidiaries: Cyalume Technologies, Inc. ("CTI"), CT SAS Holdings, Inc. ("CT SAS Holdings") and Cyalume Specialty Products, Inc. ("CSP"). CTI is located in West Springfield, Massachusetts and CSP is located in Bound Brook, New Jersey. CT SAS Holdings is a U.S. holding company with one non-U.S.-based subsidiary, Cyalume Technologies, SAS ("CTSAS"), located in Aix-en-Provence, France. CTI has one U.S.-based subsidiary, Cyalume Realty, Inc. ("CRI"). We manufacture products in the West Springfield, Bound Brook, and Aix-en-Provence locations.

Material Changes in Results of Operations – Three Months Ended March 31, 2017 versus the Three Months Ended March 31, 2016

Revenue (\$ in millions)	2017	2016	Change
Chemical Light	\$ 5.4	\$ 5.5	\$ (0.1)
Ammunition	1.0	1.1	(0.1)
Specialty Products	4.7	2.6	2.1
Total	<u>\$ 11.1</u>	<u>\$ 9.2</u>	<u>\$ 1.9</u>

During the first quarter of 2017, Chemical Light and Ammunition revenues were both approximately \$0.1 million less than the first quarter of 2016. Specialty Products revenue during the first quarter of 2017 increased \$2.1 million over the first quarter of 2016 as a result of an increase in product sales, as well as a price increase to Specialty Products customers.

Cost of goods sold for the first quarter of 2017 increased to approximately \$5.8 million from the prior year amount of approximately \$4.5 million as a result of the higher revenue levels during 2017. The gross profit margin for the first quarter of 2017 decreased to approximately 48.1% compared to a gross profit margin of approximately 51.2% for the first quarter of 2016. This decrease was largely attributable to a higher mix of lower-margin Specialty Product sales as well as manufacturing variances carried over from 2016 which were expensed during the first quarter of 2017.

Sales and marketing expenses for the first quarter of 2017 were approximately \$1.0 million, which was an increase of approximately \$0.4 million compared to first quarter of 2016. This increase is the result of higher commissions on the increased Specialty Products sales levels, in addition to an increase in online marketing spend during 2017 compared to 2016.

General and administrative expenses for the first quarter of 2017 were approximately \$2.0 million, versus approximately \$2.1 million for the corresponding prior year period. The \$0.1 million decrease was due to lower consulting fees, lower legal fees and a small decrease in various other corporate-related expenses and fees.

Research and development expenses of approximately \$0.5 million for the first quarter of 2017 increased slightly by approximately \$0.1 million from the prior year. The increase was the result of additional research and development initiatives during 2017 as compared to 2016.

During the three months ended March 31, 2017 and 2016, we recorded tax expense of approximately \$0.1 million and \$36,000, respectively, on foreign income generated by our CTSAS subsidiary. The remaining income tax expense reflected for both the three months ended March 31, 2017 and 2016, respectively, reflects tax expense on U.S. income generated. We have a valuation allowance against our U.S. deferred tax asset due to management's assessment that it is more likely than not that a portion of certain deferred tax assets may not be realized.

Material Changes in Financial Condition – March 31, 2017 versus December 31, 2016

Cash was approximately \$1.2 million at March 31, 2017, representing a decrease of approximately \$1.6 million from December 31, 2016. From December 31, 2016 to March 31, 2017, combined accounts payable and accrued liabilities decreased by approximately \$1.8 million; accounts receivable increased by approximately \$1.4 million; and inventories decreased by approximately \$0.2 million.

Our accounts receivable increased by approximately \$1.6 million at March 31, 2017 compared to December 31, 2016 due to strong first quarter revenues and the timing of customer payments. Our receivables are generally collected within 30 to 45 days, thus revenues recorded in the 30-day period preceding the measurement date significantly influence the reported balances.

Accounts payable and accrued expenses combined were approximately \$4.1 million at March 31, 2017 versus approximately \$5.9 million at December 31, 2016, a decrease of approximately \$1.8 million. Payments during the first quarter of 2017 on amounts accrued for at the end of 2016, such as the 2016 accrued performance bonus amounts included within accrued expenses which were paid during the first quarter of 2016, are the primary reason for this decrease. We had a decrease in accrued expenses of approximately \$1.7 million and a decrease in accounts payable of approximately \$0.1 million at March 31, 2017 compared to December 31, 2016. We had a balance of \$1.0 million outstanding on our line of credit at March 31, 2017, which we use to meet temporary working capital needs. We did not have a balance outstanding under our line of credit at December 31, 2016.

Liquidity and Capital Resources

On May 18, 2015, we entered into a credit agreement with Monroe Capital Management Advisors, LLC as administrative agent and lead arranger (the "Agent") and the various lenders party thereto (the "Monroe Credit Agreement"). The Monroe Credit Agreement provides for a total borrowing commitment of \$25.0 million (the "Monroe Credit Facility") in the form of (i) a \$5.0 million revolving credit facility (the "Monroe Line of Credit"); (ii) an \$18.0 million senior secured term loan (the "Term A Loan") and (iii) a \$2.0 million delayed draw term loan (the "Delayed Draw Loan").

On August 3, 2015, we entered into a First Amendment (the "First Amendment") to the Monroe Credit Agreement. Pursuant to the First Amendment, the Monroe Credit Agreement was amended to, among other things, reduce the aggregate amount of the Delayed Draw Loan under the Credit Agreement from \$2.0 million to \$1.5 million. On August 3, 2015, the full amount of the Delayed Draw Loan was funded to us, \$1.4 million of which was used to make a payment in connection with a legal settlement agreement and the remaining \$100,000 of which was paid to the Agent as a deferred closing fee. The First Amendment also modified, for certain periods during the term of the Credit Agreement, (i) the maximum senior debt to EBITDA ratio that the Company is required to maintain and (ii) the applicable limits on the Company's aggregate permitted capital expenditures pursuant to the terms of the Credit Agreement.

Under the terms of the Monroe Credit Agreement, the Company is able to borrow under the Monroe Line of Credit in an amount not to exceed the lesser of: (i) \$5.0 million; and (ii) the sum of 85% of all eligible accounts receivable plus 60% of all eligible inventory. Additionally, while the loans are outstanding we must maintain: (a) a fixed charge coverage ratio of 1.25 to 1.00; (b) a senior debt to EBITDA ratio initially of 4.50 to 1.00, decreasing to 1.50 to 1.00 over the term of the loans; and (c) a twelve month trailing EBITDA, measured quarterly, with the amounts ranging from \$4,750,000, increasing up to \$7.0 million over the term of the loans.

The Term A Loan provides for quarterly amortization payments on the last day of each calendar quarter, commencing on June 30, 2015, in an aggregate principal amount equal to \$112,500, increasing to \$225,000 on June 30, 2016, and increasing to \$450,000 on June 30, 2017, with the balance payable on the termination date of May 18, 2020 (the "Termination Date"). The Delayed Draw Loan provides for quarterly amortization payments on the last day of each calendar quarter, in an aggregate principal amount equal to 0.625% of the original principal amount of the Delayed Draw Loan, increasing to 1.25% on March 31, 2016, and increasing to 2.5% on March 31, 2017, with the balance payable on the Termination Date. The Monroe Line of Credit is payable on the Termination Date.

As of March 31, 2017 and December 31, 2016, we had approximately \$1.2 million and \$2.8 million, respectively, of cash on hand. The major sources and uses of cash during 2017 were all in the normal course of business. Our availability under the Monroe Line of Credit was approximately \$4.0 million at March 31, 2017 and approximately \$3.9 million at December 31, 2016.

Capital expenditures and payments for intangibles were approximately \$0.3 million for the three months ended March 31, 2017. We expect to fund capital expenditures for the remainder of 2017 from existing cash and operating cash flows.

We were in compliance with our financial covenants relating to our loans as of March 31, 2017. We expect to meet our financial covenants for 2017 and we also expect that cash provided by the business will be adequate to meet our planned needs during 2017.

Pursuant to the terms of the Monroe Credit Agreement, we plan to make an excess cash payment of approximately \$0.6 million on or before May 17, 2017, which will reduce the principal of our Term A Loan and our Delayed Draw Loan. The excess cash payment is calculated based on the definition of excess cash flow under the Monroe Credit Agreement and is related to favorable financial performance, primarily relating to cash flow generation.

We did not pay a dividend in 2017 and we do not have plans to pay a common dividend in the future. We are accruing dividends in connection with the Series A Convertible Preferred Stock issued on November 19, 2013 and the Series C Preferred Stock issued on July 30, 2014.

Critical Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Estimates are used when accounting for certain items such as reserves for inventory, accounts receivable and deferred tax assets; assessing the carrying value of intangible assets including goodwill; determining the useful lives of property, plant and equipment and intangible assets; determining asset retirement obligations; and determining the fair value of contingent consideration. Estimates are based on historical experience, where applicable, and assumptions that we believe are reasonable under the circumstances. Due to the inherent uncertainty involved with estimates, actual results may differ.

Revenue Recognition

Revenue from the sale of products or the providing of services is recognized when the earnings process is complete, the amount of recognizable revenue can be determined, the risks and rewards of ownership have transferred to the customer and collectability is reasonably assured. Depending on the terms of the individual sales arrangement with our customer, product sales are recognized at either the shipping point or upon receipt by the customer. Costs and related expenses to manufacture the products are recorded as costs of goods sold when the related revenue is recognized. Additionally, if the right of return is granted to the buyer in a product sale, revenue is deferred until enough historical customer data is available to reasonably estimate returns and related costs.

We have two significant contracts providing for the sale of indefinite quantities of products at fixed per unit prices, subject to adjustment for certain economic factors. Revenue under these contracts is recognized when products ordered under the contracts are received by the customer. Whenever costs change, we review the pricing under these contracts to determine whether they require the sale of products at a loss. To date, we have no loss contracts which would require the accrual of future losses in the current financial statements.

We also provide research and development services for customers for which we earn payments that are contingent upon achieving a specific result (“milestones”). Upon achieving such milestones, revenue is recognized provided the payment is (i) related to past performance, (ii) reasonable relative to all of the deliverables and payment terms within the arrangement with our customer, and (iii) nonrefundable.

Warrants Liability

We use fair values as determined by significant unobservable inputs. These estimated values are significant inputs into the Black Scholes pricing model used to calculate the estimated fair value of warrants potentially settleable in cash, which are recorded as warrants liability. The estimated fair value of the common warrants are determined at each balance sheet date and the change in the estimated fair value of the warrants is reflected within our statements of comprehensive income.

Income Taxes

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are recognized when, based upon available evidence, realization of the assets is more likely than not.

In assessing the realization of long-term deferred income tax assets, we consider whether it is more likely than not that the deferred income tax assets will be realized. The realization of deferred income tax assets depends upon future taxable income in years before net operating loss carryforwards expire. We evaluate the recoverability of deferred income tax assets on a quarterly basis. If we determine that it is more likely than not that deferred income tax assets will not be recovered, we establish a valuation allowance against some or all deferred income tax assets.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefit associated with tax positions taken that exceeds the amount measured as described above, if such a position existed, would be reflected as a liability for unrecognized tax benefits in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. There were no such positions as of March 31, 2017 or December 31, 2016.

We classify interest on tax deficiencies as interest expense and income tax penalties as other expense.

In September 2015, the IRS completed an audit of our tax return for the year 2013. There were no adjustments to our 2013 tax return. Our tax returns filed for the 2014 and 2015 years are still open for audit. The tax return for 2015 was filed on September 15, 2016 under a filing extension. The tax return for 2016 is expected to be filed under a filing extension prior to September 15, 2017.

Goodwill

Goodwill is deemed to have an indefinite life and accordingly, is not subject to amortization. Goodwill is subject to an annual impairment review, and, if conditions warrant, interim impairment reviews. Impairment charges, if any, are recorded in the period in which the impairment is determined.

Our business is managed and financial results are reported as one segment. The Company's one operating segment consists of three reporting units: Chemical Light (the operations of CTI, CTS and CTSAS), Specialty Products (the operations of CSP) and Other (the parent company Cyalume Technologies Holdings, Inc.).

We perform the traditional two-step process for assessing goodwill for impairment. The first step of the two-step process requires a comparison of our estimated fair value for each reporting unit versus our carrying (book) value. If our carrying value exceeded our fair value, further analysis (step 2 of the two-step process) is required to determine the amount, if any, that our goodwill was impaired. To determine the amount of fair value, we used a discounted cash flow analysis.

Intangible Assets

Intangible assets include developed technologies and patents, customer relationships, customer backlog, non-compete agreements and certain trade names, which are amortized over their estimated useful lives, and other trademarks and trade names, which are considered to have indefinite useful lives and therefore are not amortized. The carrying amounts of intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that those carrying amounts may not be recoverable. Additionally, the carrying amounts of non-amortizing intangible assets are reviewed for impairment annually every August 31. Costs incurred to register new patents or defend existing patents are capitalized while costs to renew or extend the term of intangible assets are expensed when incurred.

Inventories

Inventories are stated at the lower of cost (on a first-in first-out ("FIFO") method) or net realizable value. We periodically review the realizability of inventory. Provisions are recorded for potential obsolescence which requires management's judgment. Conditions impacting the realizability of inventory could cause actual write-offs to be materially different than provisions for obsolescence.

Foreign Operations and Currency

Accounts of our foreign subsidiary are recorded using their local currency (the euro) as the functional currency. For consolidation, revenues and expenses are converted to U.S. dollars using the average exchange rate for the month in which they were recorded. Assets and liabilities are converted to U.S. dollars using the exchange rate in effect as of the balance sheet date. Equity transactions are converted to U.S. dollars using the exchange rate in effect as of the date of the transaction. Translation gains and losses are reported as a component of accumulated other comprehensive income or loss. Gains and losses resulting from transactions which are denominated in other than the functional currencies are reported as other income, net in the statement of comprehensive income in the period the gain or loss occurred.

Recent Accounting Pronouncements

The following are recent accounting pronouncements that have affected our consolidated financial statements or may affect them in the future.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers*, as a new Topic, Accounting Standards Codification (“ASC”) Topic 606. The new revenue recognition standard relates to revenue from contracts with customers, which, along with amendments issued in 2015 and 2016, will supersede nearly all current U.S. GAAP guidance on this topic and eliminate industry-specific guidance. The underlying principle is to use a five-step analysis of transactions to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The Company is in the initial stages of evaluating the effect of adopting ASU 2014-09 on its consolidated financial statements. The planned approach includes performing a detailed review of key contracts representative of the different businesses and comparing historical accounting policies and practices to the new accounting guidance. The Company will continue its evaluation of the standards update through the date of adoption. The Company plans to adopt this standard utilizing the modified retrospective approach.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10)* (“ASU 2016-01”), which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for the Company beginning in its first quarter of 2019 and early adoption is not permitted. The Company does not expect the adoption of ASU 2016-01 will have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (“ASU 2016-02”), which requires companies that are lessees to recognize a right-of-use asset and lease liability for most leases that do not meet the definition of a short-term lease. For income statement purposes, leases will continue to be classified as either operating or financing. Classification will be based on criteria that are largely similar to those applied in current lease accounting. This standard will result in extensive qualitative and quantitative disclosure changes. This standard will be effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. While the Company is currently assessing the impact ASU No. 2016-02 will have on its consolidated financial statements, the Company expects the primary impact upon adoption will be the recognition, on a discounted basis, of its minimum commitments under noncancellable operating leases on its consolidated balance sheets resulting in the recording of right of use assets and lease obligations.

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, *Compensation- Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”). The purpose of the update is to simplify several areas of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual reporting periods after December 15, 2016, including interim periods within those fiscal periods. Early adoption is permitted. The adoption of ASU 2016-09 did not have a material impact on the Company’s financial position and results of operations.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments* (“ASU 2016-15”), which clarifies how certain cash receipts and payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted. The amendments in ASU 2016-15 should be applied using a retrospective transition method to each period presented. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its statement of cash flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230) – Restricted Cash* (“ASU 2016-18”), which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. With this standard, amounts generally described as restricted cash or restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted. The Company does not expect the adoption of ASU 2016-18 to have a material impact on its statement of cash flows and related disclosures.

In January 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment* (“ASU 2017-04”) which removes the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. ASU 2017-04 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. Early adoption is permitted and applied prospectively. We do not expect ASU 2017-04 to have a material impact to our financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to provide information typically disclosed under this item.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in reports filed or submitted under the Securities Exchange Act of 1934 (“Exchange Act”) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls include, without limitation, controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to management, including principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Our management carried out an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer (our principal financial officer), of the effectiveness of our disclosure controls and procedures as of March 31, 2017. Based upon that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the design and operation of our disclosure controls and procedures were effective as of March 31, 2017.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the three months ended March 31, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

As a smaller reporting company, we are not required to provide information typically disclosed under this item.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Recent Sales of Unregistered Securities and Use of Proceeds from Registered Securities

None.

Purchases of Equity Securities by the Company and Affiliated Purchasers

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description
31.1	* Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	* Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	* Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	*XBRL Instance Document
101.SCH	*XBRL Taxonomy Extension Schema
101.CAL	*XBRL Taxonomy Extension Calculation Database
101.DEF	*XBRL Taxonomy Extension Definition Linkbase
101.LAB	*XBRL Taxonomy Extension Label Linkbase
101.PRE	*XBRL Taxonomy Extension Presentation Linkbase

* Filed herewith.

SIGNATURES

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

Cyalume Technologies Holdings, Inc.

Date: May 18, 2017

By: _____ /s/ Zivi Nedivi

Zivi Nedivi, Chief Executive Officer
(Principal Executive Officer)

Date: May 18, 2017

By: _____ /s/ Andrea Settembrino

Andrea Settembrino, Chief Financial Officer
(Principal Financial Officer)

CERTIFICATION

I, Zivi Nedivi, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Cyalume Technologies Holdings, 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: May 18, 2017

/s/ Zivi Nedivi

Zivi Nedivi, Chief Executive Officer

CERTIFICATION

I, Andrea Settembrino, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Cyalume Technologies Holdings, 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: May 18, 2017

/s/ Andrea Settembrino

Andrea Settembrino, Chief Financial Officer (Principal Financial Officer)
