

ANDREA ELECTRONICS CORP
Form 10-Q
May 12, 2017

**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 1-4324

ANDREA ELECTRONICS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

New York

11-0482020

State or other jurisdiction of
incorporation or organization

I.R.S. Employer Identification No.

620 Johnson Avenue Suite 1-B, Bohemia, NY
Address of Principal Executive Offices)

11716
Zip Code

631-719-1800

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, or a smaller reporting company or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company)

Smaller Reporting Company

Emerging growth company

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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 equity, as of the latest practicable date: As of May 10, 2017, there were 64,914,935 common shares outstanding.

PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

| | March 31, 2017 (unaudited) | December 31, 2016 |
|--|----------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 2,343,326 | \$ 2,955,129 |
| Accounts receivable, net of allowance for doubtful accounts of \$5,100 and \$5,092, respectively | 71,064 | 69,982 |
| Inventories, net | 81,453 | 86,512 |
| Prepaid expenses and other current assets | 48,267 | 52,215 |
| Current portion of note receivable | - | 103,709 |
| Assets from discontinued operations | 15,000 | 63,299 |
| Total current assets | 2,559,110 | 3,330,846 |
| Property and equipment, net | 57,909 | 63,611 |
| Intangible assets, net | 303,295 | 309,894 |
| Other assets, net | 5,250 | 5,250 |
| Total assets | \$ 2,925,564 | \$ 3,709,601 |
| LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY | | |
| Current liabilities: | | |
| Trade accounts payable and other current liabilities | \$ 2,095,447 | \$ 857,085 |
| Accrued Series C Preferred Stock Dividends | 55,697 | 55,697 |
| Liabilities from discontinued operations | 7,200 | 14,700 |
| Total current liabilities | 2,158,344 | 927,482 |
| Long-term debt | 1,420,729 | 1,410,153 |
| Total liabilities | 3,579,073 | 2,337,635 |
| Series B Redeemable Convertible Preferred Stock, \$.01 par value; authorized: 1,000 shares; issued and outstanding: 0 shares | - | - |
| Commitments and contingencies | | |
| Shareholders (deficit) equity: | | |
| Preferred stock, \$.01 par value; authorized: 2,497,500 shares; none issued and outstanding | - | - |
| Series C Convertible Preferred Stock, net, \$.01 par value; authorized: 1,500 shares; issued and outstanding: 33.3 shares; liquidation value: \$333,269 | 1 | 1 |
| Series D Convertible Preferred Stock, net, \$.01 par value; authorized: 2,500,000 shares; issued and outstanding: 907,144 shares; liquidation value: \$907,144 | 9,072 | 9,072 |
| Common stock, \$.01 par value; authorized: 200,000,000 shares; issued and outstanding: 64,914,935 shares | 649,149 | 649,149 |
| Additional paid-in capital | 77,840,883 | 77,806,356 |
| Accumulated deficit | (79,152,614) | (77,092,612) |
| Total shareholders (deficit) equity | (653,509) | 1,371,966 |
| Total liabilities and shareholders (deficit) equity | \$ 2,925,564 | \$ 3,709,601 |

See Notes to Condensed Consolidated Financial Statements.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | For the Three Months Ended | |
|--|----------------------------|-------------------|
| | March 31, 2017 | March 31, 2016 |
| Revenues | | |
| Net product revenues | \$ 113,702 | \$ 95,392 |
| License revenues | 20,077 | 3,047,317 |
| Total revenues | 133,779 | 3,142,709 |
| Cost of product revenues | 36,718 | 28,936 |
| Gross margin | 97,061 | 3,113,773 |
| Patent Monetization expenses | 1,565,438 | 1,650,271 |
| Research and development expenses | 225,230 | 195,521 |
| General, administrative and selling expenses | 355,500 | 369,365 |
| Operating (loss) income | (2,049,107) | 898,616 |
| Interest expense, net | (7,195) | (2,532) |
| (Loss) income from operations before provision for income taxes | (2,056,302) | 896,084 |
| Provision for income taxes | 3,700 | 39,143 |
| Net (loss) income | \$ (2,060,002) | \$ 856,941 |
| Basic weighted average shares | 64,914,935 | 64,416,035 |
| Basic net (loss) income per share | \$ (.03) | \$.01 |
| Diluted weighted average shares | 64,914,935 | 71,855,138 |
| Diluted net (loss) income per share | \$ (.03) | \$.01 |

See Notes to Condensed Consolidated Financial Statements.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS
DEFICIT FOR THE THREE MONTHS ENDED MARCH 31, 2017
(UNAUDITED)**

| | Series C Convertible Preferred Stock Outstanding | Series C Convertible Preferred Stock | Series D Convertible Preferred Stock Outstanding | Series D Convertible Preferred Stock | Common Shares Outstanding | Common Stock | Additional Paid-In Capital | Accumulated Deficit | Total Shareholders Deficit |
|--|--|---|--|---|---------------------------------|-----------------|----------------------------------|------------------------|----------------------------------|
| Balance, January 1, 2017 | 33,326,899 | \$ 1 | 907,144 | \$ 9,072 | 64,914,935 | \$ 649,149 | \$ 77,806,356 | \$ (77,092,612) | \$ 1,371,966 |
| Stock-based Compensation Expense related to Stock Option Grants | - | - | - | - | - | - | 34,527 | - | 34,527 |
| Net loss | - | - | - | - | - | - | - | (2,060,002) | (2,060,002) |
| Balance, March 31, 2017 | 33,326,899 | \$ 1 | 907,144 | \$ 9,072 | 64,914,935 | \$ 649,149 | \$ 77,840,883 | \$ (79,152,614) | \$ (653,509) |

See Notes to Condensed Consolidated Financial Statements.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | For the Three Months Ended | |
|--|----------------------------|----------------|
| | March 31, 2017 | March 31, 2016 |
| Cash flows from operating activities: | | |
| Net (loss) income | \$ (2,060,002) | \$ 856,941 |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 18,148 | 18,024 |
| Stock based compensation expense | 34,527 | 17,244 |
| Reserve (credit) for inventory obsolescence | (66,760) | 2,488 |
| Provision for income tax withholding | 3,700 | 39,143 |
| PIK interest, net | 10,576 | 10,416 |
| Accrued interest on note receivable | - | (3,874) |
| Change in: | | |
| Accounts receivable | 17,213 | 450,464 |
| Inventories | 98,123 | 30,898 |
| Prepaid expenses, other current assets and other assets | 3,948 | 3,246 |
| Trade accounts payable and other current liabilities | 1,230,862 | (1,339,473) |
| Net cash (used in) provided by operating activities | (709,665) | 85,517 |
| Cash flows from investing activities: | | |
| Repayments of note receivable | 103,709 | 104,271 |
| Purchases of patents and trademarks | (5,847) | (6,801) |
| Net cash provided by investing activities | 97,862 | 97,470 |
| Cash flows from financing activities: | | |
| Proceeds from long-term notes | - | 2,200,000 |
| Net cash provided by financing activities | - | 2,200,000 |
| Net (decrease) increase in cash | (611,803) | 2,382,987 |
| Cash, beginning of year | 2,955,129 | 5,592,554 |
| Cash, end of period | \$ 2,343,326 | \$ 7,975,541 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid for: | | |
| Income Taxes | \$ 3,876 | \$ 30,252 |

See Notes to Condensed Consolidated Financial Statements.

Note 1. Basis of Presentation

Basis of Presentation - The accompanying unaudited condensed consolidated interim financial statements include the accounts of Andrea Electronics Corporation and its subsidiaries (Andrea or the Company). All intercompany balances and transactions have been eliminated in consolidation.

These unaudited condensed consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In addition, the December 31, 2016 balance sheet data was derived from the audited consolidated financial statements, but does not include all disclosures required by GAAP. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for any other interim period or for the fiscal year.

These unaudited condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2016 included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the Securities and Exchange Commission (the SEC) on March 24, 2017. The accounting policies used in preparing these unaudited condensed consolidated interim financial statements are consistent with those described in the December 31, 2016 audited consolidated financial statements.

Note 2. Summary of Significant Accounting Policies

(Loss) income Per Share - Basic (loss) income earnings per share is computed by dividing the net (loss) income by the weighted average number of common shares outstanding during the period. Diluted (loss) earnings per share adjusts basic (loss) earnings per share for the effects of convertible securities, stock options and other potentially dilutive financial instruments, only in the periods in which such effect is dilutive. Diluted earnings per share are based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method for the outstanding options, and the if-converted method for the outstanding convertible instruments. Under the treasury stock method, options are assumed to be exercised at the beginning of the period (or at the time of issuance, if later) and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Under the if-converted method, outstanding convertible instruments are assumed to be converted into common stock at the beginning of the period (or at the time of issuance, if later). Securities that could potentially dilute basic earnings per share (EPS) in the future that were not included in the computation of the diluted EPS because to do so would have been anti-dilutive for the periods presented, consist of the following:

| | For the Three Months Ended | |
|---|----------------------------|-------------------|
| | March 31, 2017 | March 31, 2016 |
| Total potentially dilutive common shares as of: | | |
| Stock options to purchase common stock (Note 7) | 17,329,820 | 11,499,821 |
| Series C Convertible Preferred Stock and related accrued dividends (Note 4) | 1,524,758 | - |
| Series D Convertible Preferred Stock (Note 5) | 3,628,576 | - |
| Total potentially dilutive common shares | 22,483,154 | 11,499,821 |
| Numerator: | | |
| Net (loss) income | \$ (2,060,002) | \$ 856,941 |
| Denominator: | | |
| Basic Weighted average shares | 64,914,935 | 64,416,035 |
| Effect of dilutive securities: | | |
| Stock options | - | 1,786,869 |
| Series C Convertible Preferred Stock and related accrued dividends (Note 4) | - | 2,023,658 |
| Series D Convertible Preferred Stock (Note 5) | - | 3,628,576 |
| Denominator for diluted (loss) income per share-adjusted weighted average shares after assumed conversions | 64,914,935 | 71,855,138 |

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Cash - Cash includes cash and highly liquid investments with original maturities of three months or less. At various times during the periods ended March 31, 2017 and December 31, 2016, the Company had cash deposits in excess of the maximum amounts insured by the Federal Deposit Insurance Corporation insurance limits. At March 31, 2017 and December 31, 2016, the Company's cash was held at four financial institutions.

Concentration of Credit Risk - The following customers accounted for 10% or more of Andrea's consolidated total revenues during at least one of the periods presented below:

| | For the Three Months Ended | |
|------------|----------------------------|----------------|
| | March 31, 2017 | March 31, 2016 |
| Customer A | 38% | * |
| Customer B | 31% | * |
| Customer C | 11% | * |
| Customer D | * | 16% |
| Customer E | * | 27% |
| Customer F | * | 41% |

* Amounts are less than 10%

As of March 31, 2017, Customers A, B and C accounted for approximately 25%, 56% and 16%, respectively, of accounts receivable. As of December 31, 2016, Customers A and C accounted for approximately 54% and 22% of accounts receivable, respectively.

Allowance for Doubtful Accounts - The Company performs on-going credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by the review of their current credit information. Collections and payments from customers are continuously monitored. The Company maintains an allowance for doubtful accounts, which is based upon historical experience as well as specific customer collection issues that have been identified. While such bad debt expenses have historically been within expectations and allowances established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories - Inventories are stated at the lower of cost (on a first-in, first-out) or market basis. The cost of inventory is based on the respective cost of materials. Andrea reviews its inventory reserve for obsolescence on a quarterly basis and establishes reserves on inventories based on the specific identification method as well as a general reserve. Andrea records changes in inventory reserves as part of cost of revenues.

| | March 31, 2017 | December 31, 2016 |
|--------------------------------|-------------------|----------------------|
| Raw materials | \$ 17,798 | \$ 17,533 |
| Finished goods | 176,075 | 188,304 |
| | 193,873 | 205,837 |
| Less: reserve for obsolescence | (112,420) | (119,325) |
| | \$ 81,453 | \$ 86,512 |

Long-Lived Assets - Andrea accounts for its long-lived assets in accordance with Accounting Standards Codification (ASC) 360 Property, Plant and Equipment for purposes of determining and measuring impairment of its long-lived assets (primarily intangible assets) other than goodwill. Andrea's policy is to periodically review the value assigned to its long-lived assets to determine if they have been permanently impaired by adverse conditions which may affect Andrea whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If Andrea identifies a permanent impairment such that the carrying amount of Andrea's long-lived assets is not recoverable using the sum of an undiscounted cash flow projection (gross margin dollars from product revenues), the impaired asset is adjusted to its estimated fair value, based on an estimate of future discounted cash flows which becomes the new cost basis for the impaired asset. Considerable management judgment is necessary to estimate undiscounted future operating cash flows and fair values and, accordingly, actual results could vary significantly from such estimates. At March 31, 2017 and December 31, 2016, Andrea concluded that Intangibles and long-lived assets were not required to be tested for recoverability.

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Trade accounts payable and other current liabilities - Trade accounts payable and other current liabilities consists of the following:

| | March 31, 2017 | December 31, 2016 |
|--|-------------------|-------------------------|
| Trade accounts payable | \$ 36,809 | \$ 31,887 |
| Payroll and related expenses | 49,813 | 25,630 |
| Patent monetization expenses | 1,880,244 | 705,964 |
| Short-term deferred revenue | 2,030 | - |
| Professional and other service fees | 126,551 | 93,604 |
| Total trade accounts payable and other current liabilities | \$ 2,095,447 | \$ 857,085 |

Subsequent to March 31, 2017, Andrea received \$2,300,000 in Additional Notes to pay current patent monetization expenses.

Revenue Recognition - Non software-related revenue, which is generally comprised of microphones and microphone connectivity product revenues, is recognized when title and risk of loss pass to the customer, which is generally upon shipment. With respect to licensing revenues, Andrea recognizes revenue in accordance with ASC 985, Software and ASC 605 Revenue Recognition. License revenue is recognized based on the terms and conditions of individual contracts. In addition, fee based services, which are short-term in nature, are generally performed on a time-and-material basis under separate service arrangements and the corresponding revenue is generally recognized as the services are performed.

Income Taxes - Andrea accounts for income taxes in accordance with ASC 740, Income Taxes. ASC 740 requires an asset and liability approach for financial accounting and reporting for income taxes and establishes for all entities a minimum threshold for financial statement recognition of the benefit of tax positions, and requires certain expanded disclosures. The provision for income taxes is based upon income or loss after adjustment for those permanent items that are not considered in the determination of taxable income. Deferred income taxes represent the tax effects of differences between the financial reporting and tax bases of the Company's assets and liabilities at the enacted tax rates in effect for the years in which the differences are expected to reverse. The Company evaluates the recoverability of deferred tax assets and establishes a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of March 31, 2017 and December 31, 2016 the Company had recorded a full valuation allowance. Andrea expects it will reduce its valuation allowance in future periods to the extent that it can demonstrate its ability to utilize the assets. Management makes judgments as to the interpretation of the tax laws that might be challenged upon an audit and cause changes to previous estimates of tax liability. In management's opinion, adequate provisions for income taxes have been made for all years. If actual taxable income by tax jurisdiction varies from estimates, additional allowances or reversals of reserves may be necessary. Income tax expense consists of taxes payable for the period, withholding of income tax as mandated by the foreign jurisdiction in which the revenues are earned withholding of income tax as mandated by the foreign jurisdiction in which the revenues are earned and the change during the period in deferred tax assets and liabilities. The Company has identified its federal tax return and its state tax return in New York as "major" tax jurisdictions. Based on the Company's evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company's condensed consolidated interim financial statements. The Company's evaluation was performed for tax years ended 2013 through 2016. The Company believes that its income tax positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position.

Stock-Based Compensation - At March 31, 2017, Andrea had one stock-based employee compensation plan, which is described more fully in Note 7. Andrea accounts for stock-based compensation in accordance with ASC 718, Compensation - Stock Compensation. ASC 718 establishes accounting for stock-based awards exchanged for employee services. Under the provisions of ASC 718, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the employee's requisite service period (generally the vesting period of the equity grant). The fair value of the Company's common stock options are estimated using the Black Scholes option-pricing model with the following assumptions: expected volatility, dividend rate, risk free interest rate and the expected life. The Company expenses stock-based compensation by using the straight-line method. In accordance with ASC 718, excess tax benefits realized from the exercise of stock-based awards are classified in cash flows from financing activities. The future realization of the reserved deferred tax assets related to these tax benefits associated with the exercise of stock options will result in a credit to additional paid in capital if the related tax deduction reduces taxes payable. The Company has elected the with and without approach regarding ordering of windfall tax benefits to determine whether the windfall tax benefit did reduce taxes payable in the current year. Under this approach, the windfall tax benefit would be recognized in additional paid-in-capital only if an incremental tax benefit is realized after considering all other benefits presently available.

Use of Estimates - The preparation of condensed consolidated interim financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated interim financial statements and the reported amounts of revenues and expenses during the reporting period.

Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. The most significant estimates, among other things, are used in accounting for allowances for bad debts, inventory valuation and obsolescence, product warranty, depreciation, deferred income taxes, expected realizable values for assets (primarily intangible assets), contingencies, revenue recognition as well as the recording and presentation of the Company's convertible preferred stock. Estimates and assumptions are periodically reviewed and the effects of any material revisions are reflected in the condensed consolidated interim financial statements in the period that they are determined to be necessary. Actual results could differ from those estimates and assumptions.

Recent Accounting Pronouncements - In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers" (Topic 606), which supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition," and most industry-specific guidance. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. The amendments in the ASU must be applied using one of two retrospective methods and are effective for annual and interim periods beginning after December 15, 2016. On July 9, 2015, the FASB modified ASU 2014-09 to be effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. As modified, the FASB permits the adoption of the new revenue standard early, but not before the annual periods beginning after December 15, 2017. A public organization would apply the new revenue standard to all interim reporting periods within the year of adoption. The Company will evaluate the effects, if any, that adoption of this guidance will have on its financial statements.

In August 2014, FASB issued ASU No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This standard is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under U.S. GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. Financial reporting under this presumption is commonly referred to as the going concern basis of accounting.

The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, U.S. GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This ASU provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. The Company adopted ASU 2014-15 and management has made the appropriate evaluations and disclosures. The adoption of this standard did not have a material impact on the Company's financial position and results of operations.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes (ASU 2015-17). The standard requires that deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial position. ASU 2015-17 is effective for fiscal years and interim periods within those years, beginning after December 15, 2016. Early adoption is permitted. ASU 2015-17 may be applied either prospectively, for all deferred tax assets and liabilities, or retrospectively. The Company has adopted ASU 2015-17 and the adoption of this standard did not have a material impact on the Company's financial position and results of operations.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01). The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company is currently evaluating the impact the adoption of this new standard will have on its financial statements.

In January 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This standard requires that a lessee recognize the assets and liabilities that arise from operating leases. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company is currently evaluating the impact the adoption of this new standard will have on its financial statements.

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In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606) Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (ASU 2016-08). ASU No. 2016-08 maintains the core principles of Topic 606 on revenue recognition, but clarifies whether an entity is a principal or an agent in a contract and the appropriate revenue recognition principles under each of these circumstances. The amendments in ASU 2016-08 affect the guidance of ASU 2014-09 which is not yet effective. The Company will evaluate the effects, if any, that adoption of this guidance will have on its financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting. ASU No. 2016-09 includes provisions to simplify certain aspects related to the accounting for share-based awards and the related financial statement presentation. This ASU includes a requirement that the tax effect related to the settlement of share-based awards be recorded in income tax benefit or expense in the statements of earnings. This change is required to be adopted prospectively in the period of adoption. In addition, the ASU modifies the classification of certain share-based payment activities within the statements of cash flows and these changes are required to be applied retrospectively to all periods presented, or in certain cases prospectively, beginning in the period of adoption. The Company has adopted ASU 2016-09. The adoption of this standard did not have a material impact on the Company's financial position and results of operations.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing. ASU No. 2016-10 maintains the core principles of Topic 606 on revenue recognition, but clarifies identification of performance obligations and licensing implementation guidance. The amendments in ASU 2016-10 affect the guidance of ASU 2014-09 which is not yet effective. The Company will evaluate the effects, if any, that adoption of this guidance will have on its financial statements.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606) - Narrow- Scope Improvements and Practical Expedients. ASU No. 2016-12 maintains the core principles of Topic 606 on revenue recognition, but addresses collectability, sales tax presentation, noncash consideration, contract modifications at transition and completed contracts at transition. The amendments in ASU 2016-12 affect the guidance of ASU 2014-09 which is not yet effective. The Company will evaluate the effects, if any, that adoption of this guidance will have on its financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments. ASU No. 2016-13 provides financial statement readers more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The Company will evaluate the effects, if any, that adoption of this guidance will have on its financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments. ASU No. 2016-15 addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. It is effective for annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact, if any, this guidance will have on its financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (230) Restricted Cash. ASU No. 2016-18 requires an entity to include amounts described as restricted cash and restricted cash equivalents with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. It is effective for annual reporting periods beginning after December 15, 2018. The adoption of this standard is not expected to have a material impact on the Company's financial position and results of operations.

In December 2016, the FASB issued ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. ASU No. 2016-20 amends certain aspects of ASU No. 2014-09 and clarifies, rather than changes, the core revenue recognition principles in ASU No. 2014-09. It is effective for annual reporting periods beginning after December 15, 2018. The adoption of this standard is not expected to have a material impact on the Company's financial position and results of operations.

Reclassifications - Certain prior year amounts have been reclassified to conform to the current year presentation. The reclassifications did not have any effect on reported consolidated net (loss) income for the periods presented.

Subsequent Events - The Company evaluates events that occurred after the balance sheet date but before the condensed consolidated interim financial statements are issued. Based upon the evaluation the Company did not identify any recognized or non-recognized subsequent events that would have required adjustment or disclosure in the condensed consolidated interim financial statements.

Note 3. Revenue Sharing, Note Purchase Agreement and Long-Term Debt

On December 24, 2014, the Company entered into an Amended and Restated Revenue Sharing and Note Purchase Agreement (the Revenue Sharing Agreement), with AND34 Funding LLC (AND34) (acting as the Revenue Participants, the Note Purchasers, and the Collateral Agent) which was retroactively effective as of February 14, 2014. Under the Revenue Sharing Agreement, the Company granted AND34 a perpetual predetermined share in the rights of the Company's specified future revenues from patents (Monetization Revenues) currently owned by the Company (the Patents) in exchange for \$3,500,000, which was originally recorded as an Advance from Revenue Sharing Agreement on the accompanying consolidated balance sheet and was fully repaid as of September 30, 2016. AND34's rights to the Company's Monetization Revenues (as defined in the Revenue Sharing Agreement) from the Patents and the Notes are secured by the Patents. Under the terms of the Revenue Sharing Agreement with AND34, Andrea issued and sold to AND34 Notes of \$10,800,000 of which were repaid in 2016. On August 10, 2016, Andrea and AND34 executed a Rider to the Revenue Sharing Agreement (Rider). Under the Rider, Andrea has agreed to issue and sell to AND34 Additional Notes up to an aggregate original amount of \$7,000,000, or such greater amount as AND34 may agree to in its sole discretion, during the four year period beginning on the date of execution of the Rider. The Additional Notes will have a Maturity date of August 31, 2020. The proceeds of the Additional Notes will be used to pay certain expenses related to the Revenue Sharing Agreement, and be used for expenses of the Company incurred in pursuing patent monetization. As of March 31, 2017, there was \$1,400,000 and \$20,729 in Additional Notes outstanding and PIK interest, respectively. Subsequent to March 31, 2017, Andrea received \$2,300,000 in Additional Notes to pay current patent monetization expenses.

Any Monetization Revenues will first be applied 100% to the payment of accrued and unpaid interest on, and then to repay outstanding principal of, the Additional Notes. After the Additional Notes are paid in full, the Monetization Revenues will be allocated amongst the Revenue Participants and the Company in accordance with certain predetermined percentages (based on aggregate amounts received by the Revenue Participants) ranging from 50% to the Revenue Participants to ultimately 20% to the Revenue Participants. Monetization Revenues is defined in the Revenue Sharing Agreement to include, but is not limited to, amounts that the Company receives from third parties with respect to the Patents, which may include new license revenues, certain product revenue, payments and judgments. Monetization Revenues and associated expenses are included in the Company's Patent Monetization Segment (Note 8). For period ended March 31, 2016 there was approximately \$2,944,000 of non-recurring monetization revenues recognized for patent licensing agreements entered into during 2016 in which the Company recorded.

The Revenue Sharing Agreement contains many stipulations between the parties regarding the handling of various matters related to the monetization of the Patents. The Revenue Participants and the Company will account for the tax treatment as set forth in the Revenue Sharing Agreement. Following an Event of Default under the Revenue Sharing Agreement, the Note Purchasers and Revenue Participants may proceed to protect and enforce their rights by suit or other appropriate proceeding, either for specific performance or the exercise of any power granted under the Revenue Sharing Agreement or ancillary documents including the Notes.

Long-term debt

| | March 31, 2017 | December 31, 2016 |
|--|-------------------|----------------------|
| Note Payable | \$ 1,400,000 | \$ 1,400,000 |
| PIK interest | 20,729 | 10,153 |
| Total long-term debt | 1,420,729 | 1,410,153 |
| Less: current maturities of long-term debt | - | - |
| Long-term debt, net of current maturities | \$ 1,420,729 | \$ 1,410,153 |

The unpaid principal amount of the Notes (including any PIK Interest) have an interest rate equal to LIBOR (as defined in the Revenue Sharing Agreement) plus 2% per annum, (3% at March 31, 2017 and December 31, 2016); provided that upon and during the continuance of an Event of Default (as set forth in the Revenue Sharing Agreement), the interest rate will increase an additional 2% per annum. Interest may be paid in cash at the option of the Company and otherwise shall be paid by increasing the principal amount of the Additional Notes by the amount of such interest (PIK Interest). The outstanding principal balance of the Additional Notes and all unpaid interest thereon will be paid within the next twelve months. The Company may prepay the Additional Notes from time to time in whole or in part, without penalty or premium.

Note 4. Series C Redeemable Convertible Preferred Stock

The Series C Preferred Stock had a stated value of \$10,000 plus a \$1,671 increase in the stated value, which sum is convertible into Common Stock at a conversion price of \$0.2551. The shares of Series C Preferred Stock are subject to antidilution provisions, which are triggered in the event of certain stock splits, recapitalizations, or other dilutive transactions. In addition, issuances of common stock at a price below the

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conversion price of \$0.2551, or the issuance of warrants, options, rights, or convertible securities which have an exercise price or conversion price less than that conversion price, other than for certain previously outstanding securities and certain excluded securities (as defined in the certificate of amendment), require the adjustment of the conversion price to that lower price at which shares of common stock have been issued or may be acquired. In the event that Andrea issues securities in the future which have a conversion price or exercise price which varies with the market price and the terms of such variable price are more favorable than the conversion price in the Series C Preferred Stock, the purchasers may elect to substitute the more favorable variable price when making conversions of the Series C Preferred Stock.

As of March 31, 2017, there were 33,326,899 shares of Series C Preferred Stock outstanding, which were convertible into 1,524,758 shares of Common Stock and remaining accrued dividends of \$55,697.

Note 5. Series D Redeemable Convertible Preferred Stock

The Series D Preferred Stock is convertible into Common Stock at a conversion price of \$0.25 per share. The shares of Series D Preferred Stock are also subject to antidilution provisions, which are triggered in the event of certain stock splits, recapitalizations, or other dilutive transactions. In addition, issuances of common stock at a price below the conversion price then in effect (currently \$0.25), or the issuance of warrants, options, rights, or convertible securities which have an exercise price or conversion price less than that conversion price, other than for certain previously outstanding securities and certain excluded securities (as defined in the certificate of amendment), require the adjustment of the conversion price to that lower price at which shares of common stock have been issued or may be acquired. In the event that Andrea issues securities in the future which have a conversion price or exercise price which varies with the market price and the terms of such variable price are more favorable than the conversion price in the Series D Preferred Stock, the purchasers may elect to substitute the more favorable variable price when making conversions of the Series D Preferred Stock. In addition, the Company is required to use its best efforts to secure the inclusion for quotation on the Over the Counter Bulletin Board for the common stock issuable under the Series D Preferred Stock and to arrange for at least two market makers to register with the Financial Industry Regulatory Authority. In the event that the holder of the Series D Preferred Stock and related warrants is unable to convert these securities into Andrea Common Stock, the Company shall pay to each such holder a Registration Delay Payment. This payment is to be paid in cash and is equal to the product of (i) the stated value of such Preferred Shares multiplied by (ii) the product of (1) .0005 multiplied by (2) the number of days that sales cannot be made pursuant to the Registration Statement (excluding any days during that may be considered grace periods as defined by the Registration Rights Agreement).

As of March 31, 2017, there were 907,144 shares of Series D Preferred Stock outstanding which were convertible into 3,628,576 shares of Common Stock.

Note 6. Commitments And Contingencies

Leases

In May 2015, Andrea entered into a lease for its current corporate headquarters located in Bohemia, New York, where Andrea leases space for research and development, sales and executive offices from an unrelated party. The lease is for approximately 3,000 square feet and expires in October 2020. Rent expense under this operating lease was \$8,187 and \$7,909 for the three months ended March 31, 2017 and March 31, 2016, respectively. The monthly rent under this lease is \$2,725 with annual escalations of 3.5%.

As of March 31, 2017, the minimum future lease payments under this lease and all other noncancellable operating leases are as follows:

| | |
|------------------------------|-------------------|
| 2017 (April 1 - December 31) | \$ 40,823 |
| 2018 | 50,319 |
| 2019 | 45,729 |
| 2020 | 30,870 |
| Total | \$ 167,741 |

Employment Agreements

In August 2014, the Company entered into an employment agreement with Mr. Andrea. The effective date of the employment agreement was August 1, 2014 and it currently expires on July 31, 2017, subject to renewal as approved by the Compensation Committee of the Board of Directors. Pursuant to his employment agreement, Mr. Andrea will receive an annual base salary of \$300,000. The employment agreement provides for quarterly bonuses equal to 5% of the Company's pre-bonus net after tax quarterly earnings for a total quarterly bonus amount not to exceed \$12,500; and annual bonuses equal to 9% of the Company's annual pre-bonus net after tax earnings in excess of \$300,000 up to \$3,000,000, and 3% of the Company's annual pre-bonus adjusted net after tax earnings in excess of \$3,000,000. Adjustments to net after tax earnings shall be made to remove the impact of change in recognition of accumulated deferred tax asset value. All bonuses shall be payable as soon as the Company's cash flow permits. All bonus determinations or any additional bonus in excess of the above will be made in the sole discretion of the Compensation Committee. Mr. Andrea is also entitled to a change in control payment equal to three times the three year average of the cash incentive compensation paid or accrued as of the date of termination, continuation of health and medical benefits for three years and immediate vesting of all stock options in the event of a change in control during the term of his agreement and subsequent termination of his employment within two years following the change of control. In the event of his termination without cause or resignation with the Company's consent, Mr. Andrea is entitled to a severance payment equal to nine months of his base salary, plus the nine months prorated portion

of his most recent annual and quarterly bonuses, and a continuation of health insurance coverage for Mr. Andrea, his spouse and his dependents for 12 months. At March 31, 2017, the future minimum cash commitments under this agreement aggregate \$104,080.

In November 1999, as amended August 2008, the Company entered into a change in control agreement with the Chief Financial Officer, Corisa L. Guiffre. This agreement provides for a change in control payment equal to three times her average annual compensation for the five preceding taxable years, with continuation of health and medical benefits for three years in the event of a change in control of the Company, as defined in the agreement, and subsequent termination of employment other than for cause.

Legal Proceedings

In December 2010, Audrey Edwards, Executrix of the Estate of Leon Leroy Edwards, filed a law suit in the Superior Court of Providence County, Rhode Island, against 3M Company and over 90 other defendants, including the Company, alleging that the Company processed, manufactured, designed, tested, packaged, distributed, marketed or sold asbestos containing products that contributed to the death of Leon Leroy Edwards. The Company received service of process in April 2011. The Company has retained legal counsel and has filed a response to the complaint. The Company believes the lawsuit is without merit and has filed a Motion for Summary Judgment to that affect. Accordingly, the Company does not believe the lawsuit will have a material adverse effect on the Company's financial position or results of operations.

In September 2016, the Company filed a Complaint with the United States International Trade Commission (ITC), alleging patent infringement against Apple Inc. (Apple) and Samsung Electronics Co., Ltd. and Samsung Electronics America, Inc. (together, Samsung), and requesting injunctive relief. An ITC investigation was instituted on October 19, 2016. Apple and Samsung answered the Company's Complaint on November 21, 2016. The Company intends to vigorously prosecute its claims at the ITC.

Also in September 2016, the Company filed complaints with the United States District Court for the Eastern District of New York, alleging patent infringement against Apple and Samsung, and requesting monetary and injunctive relief. These cases against Apple and Samsung are stayed pending the outcome of the Company's litigation at the ITC against Apple and Samsung.

In January 2017, Apple filed four (4) petitions for inter partes review of the Andrea patents asserted in the ITC and District Court litigation proceedings with the United States Patent and Trademark Office (PTO). Andrea intends to vigorously defend its patents in these PTO proceedings.

Note 7. Stock Plans and Stock Based Compensation

In October 2006, the Board adopted the Andrea Electronics Corporation 2006 Equity Compensation Plan (2006 Plan), which was subsequently approved by the shareholders. The 2006 Plan, as amended, authorizes the granting of awards, the exercise of which would allow up to an aggregate of 18,000,000 shares of Andrea's Common Stock to be acquired by the holders of those awards. The awards can take the form of stock options, stock appreciation rights, restricted stock or other stock-based awards. Awards may be granted to key employees, officers, directors and consultants. No further awards will be granted under the 2006 Plan.

The stock option awards granted under these plans have been granted with an exercise price equal to the market price of the Company's stock at the date of grant; with vesting periods of up to four years and 10-year contractual terms. The fair values of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model that uses the weighted-average assumptions noted in the following table. Expected volatilities are based on implied volatilities from historical volatility of the Company's stock. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

There were no options granted during the three months ended March 31, 2017 or March 31, 2016.

Option activity during the three months ended March 31, 2017 is summarized as follows:

| | Options Outstanding | Options Outstanding | | | Weighted Average Remaining Contractual Life | Options Exercisable | Options Exercisable | | |
|--------------------|---------------------|---------------------------------|-----------------------------|---|---|---------------------|---------------------------------|-----------------------------|---|
| | | Weighted Average Exercise Price | Weighted Average Fair Value | Weighted Average Remaining Contractual Life | | | Weighted Average Exercise Price | Weighted Average Fair Value | Weighted Average Remaining Contractual Life |
| At January 1, 2017 | 17,369,820 | \$ 0.07 | \$ 0.07 | 4.59 years | 12,672,230 | \$ 0.08 | \$ 0.08 | 2.79 years | |
| Forfeited | (3,840) | \$ 0.08 | \$ 0.08 | | | | | | |
| Canceled | (36,160) | \$ 0.08 | \$ 0.07 | | | | | | |
| At March 31, 2017 | 17,329,820 | \$ 0.07 | \$ 0.07 | 4.35 years | 12,636,070 | \$ 0.08 | \$ 0.08 | 2.56 years | |

Based on the March 31, 2017, fair market value of the Company's common stock of \$0.05 per share, the aggregate intrinsic value for the 17,329,820 options outstanding and 12,636,070 shares exercisable is \$47,850.

Total compensation expense recognized related to stock option awards was \$34,527 and \$17,244 for the three months ended March 31, 2017 and 2016, respectively. In the accompanying condensed consolidated statement of operations for the three months ended March 31, 2017, \$29,346 of compensation expense is included in general, administrative and selling expenses and \$5,181 of compensation expense is included in research and development expenses. In the accompanying condensed consolidated statement of operations and for the three months ended March 31, 2016, \$14,427 of compensation expense is included in general, administrative and selling expenses and \$2,817 of compensation expense is included in research and development expenses.

As of March 31, 2017, there was \$157,967 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the 2006 Plan which is expected to be recognized over the weighted-average period of 1.39 years. Specifically, this unrecognized compensation cost is expected to be recognized during 2017, 2018 and 2019 in the amounts of \$90,168, \$49,453 and \$18,346, respectively.

Note 8. Segment Information

Andrea follows the provisions of ASC 280 Segment Reporting. Reportable operating segments are determined based on Andrea's management approach. The management approach, as defined by ASC 280, is based on the way that the chief operating decision-maker organizes the segments within an enterprise for making operating decisions and assessing performance. While Andrea's results of operations are primarily reviewed on a consolidated basis, the chief operating decision-maker also manages the enterprise in two segments: (i) Patent Monetization and (ii) Andrea DSP Microphone and Audio Software Products. Patent Monetization includes Monetization Revenues (as defined in our Amended and Restated Revenue Sharing Agreement). Andrea DSP Microphone and Audio Software Products primarily include products based on the use of some, or all, of the following technologies: Andrea Digital Super Directional Array microphone technology (DSDA), Andrea Direction Finding and Tracking Array microphone technology (DFTA), Andrea PureAudio noise filtering technology, and Andrea EchoStop, an advanced acoustic echo cancellation technology.

The following represents selected condensed consolidated interim financial information for Andrea's segments for the three-month periods ended March 31, 2017 and 2016.

| 2017 Three Month Segment Data | Andrea DSP Microphone and Audio Software Products | | 2017 Three Month Segment Data |
|--|---|------------|-------------------------------|
| | Patent Monetization | | |
| Net product revenues | \$ - | \$ 113,702 | \$ 113,702 |
| License revenues | 464 | 19,613 | 20,077 |
| Operating loss | (1,694,534) | (354,573) | (2,049,107) |
| Depreciation and amortization | 6,224 | 11,924 | 18,148 |
| Assets | 276,473 | 2,634,091 | 2,910,564 |
| Property and equipment and intangibles | 151,644 | 209,560 | 361,204 |
| Purchases of patents and trademarks | 2,923 | 2,924 | 5,847 |

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| 2016 Three Month Segment Data | Patent Monetization | Andrea DSP Microphone and Audio Software Products | 2016 Three Month Segment Data |
|-------------------------------|---------------------|---|-------------------------------|
| Net product revenues | \$ - | \$ 95,392 | \$ 95,392 |
| License revenues | 2,945,862 | 101,455 | 3,047,317 |
| Operating income (loss) | 1,232,042 | (333,426) | 898,616 |
| Depreciation and amortization | 6,025 | 11,999 | 18,024 |

| December 31, 2016 Year End Segment Data | Patent Monetization | Andrea DSP Microphone and Audio Software Products | 2016 Year End Segment Data |
|---|---------------------|---|----------------------------|
| Assets | \$ 673,295 | \$ 2,973,007 | \$ 3,646,302 |
| Property and equipment and intangibles | 154,945 | 218,560 | 373,505 |

Management assesses non-operating income statement data on a consolidated basis only. International revenues are based on the country in which the end-user is located. For the three-month periods ended March 31, 2017 and 2016 total revenues by geographic area were as follows:

| Geographic Data | March 31, 2017 | March 31, 2016 |
|------------------------|----------------|----------------|
| Total revenues: | | |
| United States | \$ 105,303 | \$ 1,431,152 |
| Foreign ⁽¹⁾ | 28,476 | 1,711,557 |
| | \$ 133,779 | \$ 3,142,709 |

(1) Net revenues to any one foreign country did not exceed 10% of total net revenues for the three months ended March 31, 2017. Total revenue from Israel represented 41% of total revenues for the three months ended March 31, 2016.

As of March 31, 2017 and December 31, 2016, accounts receivable by geographic area were as follows:

| Geographic Data | March 31, 2017 | December 31, 2016 |
|----------------------|----------------|-------------------|
| Accounts receivable: | | |
| United States | \$ 61,502 | \$ 35,268 |
| Foreign | 9,562 | 34,714 |
| | \$ 71,064 | \$ 69,982 |

Note 9. Sale of Andrea Anti-Noise Products Division

On April 2, 2015, Andrea Electronics Corporation consummated the transactions contemplated by the Asset Purchase Agreement, by and between Andrea Electronics Corporation and Andrea Communications LLC dated March 27, 2015. Under the Asset Purchase Agreement, the Company sold its Anti-Noise Products Division (the Division) and certain related assets for a selling price of \$900,000 which included a cash payment of \$300,000 and a note receivable of \$600,000 payable in 18 equal monthly installments of \$34,757 including interest at a rate of 3.25% per annum beginning in October 2015. The note receivable was paid in full in March 2017. In addition, under the Asset Purchase Agreement the Company is entitled to receive an additional \$100,000 in the event that the revenues derived from Andrea Communications LLC's operation of the Division exceed certain thresholds over a specified time period, as defined in the Asset Purchase Agreement. Accordingly, the results of operations, the assets and liabilities of the Division are presented as discontinued operations for both current and prior periods.

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The following table reflects the results of the discontinued operations of the Division's business segment for the three months ended March 31, 2017 and 2016 and as of March 31, 2017 and December 31, 2016, respectively:

| | For the Three Months Ended | |
|--|----------------------------|----------------------|
| | March 31, 2017 | March 31, 2016 |
| Operations | | |
| Net Revenues | \$ 16,728 | \$ 48,772 |
| Cost of Sales | 16,728 | 48,772 |
| Gross margin | - | - |
| Research and Development Expenses | - | - |
| General, administrative and selling expenses | - | - |
| Gain on sale of Anti-Noise Products Division | - | - |
| Income from Discontinued Operations | \$ - | \$ - |
| | March 31, 2017 | December 31, 2016 |
| Assets | | |
| Accounts Receivable, net | \$ 15,000 | \$ 36,995 |
| Inventories, net | - | 26,304 |
| Assets from Discontinued Operations | \$ 15,000 | \$ 63,299 |
| Liabilities | | |
| Other current liabilities | 7,200 | 14,700 |
| Liabilities from discontinued operations | \$ 7,200 | \$ 14,700 |

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

Overview

We design, develop and manufacture state-of-the-art digital microphone products and noise reduction software that facilitate natural language, human/machine interfaces. Our technologies eliminate unwanted background noise to enable the optimum performance of various speech-based and audio applications. We are incorporated under the laws of the State of New York and have been engaged in the electronic communications industry since 1934. Our patented and patent-pending digital noise canceling technologies enable a speaker to be at a distance from the microphone (we refer to this capability as far-field microphone use), and free the speaker from having to use a close talking microphone. We believe that the strength of our intellectual property rights will be important to the success of our business. We utilize patent and trade secret protection, confidentiality agreements with customers and partners, disclosure and invention assignment agreements with employees and consultants and other contractual provisions to protect our intellectual property and other proprietary information. As part of our Patent Monetization efforts we plan to license specific, custom designs to our customers, charging royalties at a fixed amount per product or a percentage of sales and we intend to vigorously defend and monetize our intellectual property through licensing arrangements and, where necessary, enforcement actions against those entities using our patented solutions in their products.

Our Critical Accounting Policies

Our unaudited condensed consolidated interim financial statements and the notes to our unaudited condensed consolidated interim financial statements contain information that is pertinent to management's discussion and analysis. The preparation of unaudited condensed consolidated interim financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. On a continual basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are

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adjusted accordingly. Actual results may vary from these estimates and assumptions under different and/or future circumstances. Our significant accounting policies are described in Note 2 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2016. A discussion of our critical accounting policies and estimates are included in Management's Discussion and Analysis or Plan of Operation in our Annual Report on Form 10-K for the year ended December 31, 2016. Management has discussed the development and selection of these policies with the Audit Committee of the Company's Board of Directors, and the Audit Committee of the Board of Directors has reviewed the Company's disclosures of these policies. There have been no material changes to the critical accounting policies or estimates reported in the Management's Discussion and Analysis section of the Annual Report on Form 10-K for the year ended December 31, 2016.

Cautionary Statement Regarding Forward-Looking Statements

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of the Company. These forward-looking statements are generally identified by use of the words believe, expect, intend, anticipate, estimate, project, similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in economic, competitive, governmental, technological and other factors that may affect our business and prospects. Additional factors are discussed below under Risk Factors and in Part *Item 1A Risk Factors* in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 and the Company's quarterly reports on Form 10-Q. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Results Of Continuing Operations***Three Months ended March 31, 2017 compared to Three Months ended March 31, 2016***Total Revenues

| | For the Three Months Ended | | % Change | |
|---|----------------------------|---------------------|-------------|-----|
| | 2017 | March 31, 2016 | | |
| <u>Patent Monetization revenues</u> | | | | |
| License revenues | \$ 464 | \$ 2,945,862 | (100) | (a) |
| Total Patent Monetization revenues | 464 | 2,945,862 | (100) | |
| <u>Andrea DSP Microphone and Audio Software Product revenues</u> | | | | |
| Revenue from automotive array microphone products | 13,738 | 4,361 | 215 | (b) |
| Revenue from OEM array microphone products | 45,411 | 19,969 | 127 | (c) |
| Revenue from customized digital product | 50,491 | 47,743 | 6 | (d) |
| All other Andrea DSP Microphone and Audio Software Product revenues | 4,062 | 23,319 | (83) | (e) |
| License revenues | 19,613 | 101,455 | (81) | (f) |
| Total Andrea DSP Microphone and Audio Software Products revenues | 133,315 | 196,847 | (32) | |
| Total revenues | \$ 133,779 | \$ 3,142,709 | (96) | |

- (a) The decrease of approximately \$2,945,000 in license revenues is the result of non-recurring revenue recognized for patent licensing agreements entered into during the three months ended March 31, 2016.
- (b) The approximate \$10,000 increase in sales of automotive array microphone products is the result of increased product sales to integrators of public safety and mass transit vehicle solutions for the three months ended March 31, 2017, compared to the three months ended March 31, 2016.
- (c) The approximate \$25,000 increase in OEM array microphone products for the three months ended March 31, 2017, compared to the three months ended March 31, 2016 is primarily the result of increased product revenues from integrators of commercial product audio solutions.

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- (d) The increase of approximately \$3,000 for three months ended March 31, 2017 as compared to same period in 2016 in customized digital product revenues is related to increased product revenues to an OEM customer for a customized digital product.
- (e) The approximate \$19,000 decrease in all other Andrea DSP Microphone and Audio product revenues for the three months ended March 31, 2017 as compared to same period in 2016 is related to decreased product revenues from all other Andrea DSP Microphone and Audio product revenues.
- (f) The \$82,000 decrease in license revenues is a result of a decrease of royalties for the three month period ended March 31, 2017 as compared to the three month period ended March 31, 2016.

Cost of Revenues

Cost of revenues as a percentage of total revenues, from continuing operations, for the three months ended March 31, 2017 increased to 27% from 1% for the three months ended March 31, 2016. There was no cost of revenues associated with the Patent Monetization revenues of \$464 for the three months ended March 31, 2017 compared to no cost of revenues associated with the Patent Monetization revenues of \$2,945,862, for the three months ended March 31, 2016. The cost of revenues as a percentage of total revenues for the three months ended March 31, 2017 for Andrea DSP Microphone and Audio Software Products was 28% compared to 15% for the year ended March 31, 2016. These changes are primarily the result of the decrease of licensing revenues with no associated cost of revenues as described under Total Revenues above.

Patent Monetization Expenses

Patent monetization expenses for the three months ended March 31, 2017 decreased 5% to \$1,565,438 from \$1,650,271 for the three months ended March 31, 2016. The decrease in Patent Monetization expenses for the three months ended March 31, 2017 is attributable to the timing of legal services incurred in connections with our patent monetization efforts.

Research and Development Expenses

Research and development expenses for the three months ended March 31, 2017 increased 15% to \$225,230 from \$195,521 for the three months ended March 31, 2016. The expenses primarily relate to costs associated with the development of new products. For the three months ended March 31, 2017, the decrease in research and development expenses reflects a 3% increase in our Patent Monetization efforts to \$6,224, or 3% of total research and development expenses, and a 16% increase in our Andrea DSP Microphone and Audio Software Technology efforts to \$219,006, or 97% of total research and development expenses. These increases are related to an increase in spending with respect to DSP Microphone and Audio Software technologies. Research efforts are primarily focused on the pursuit of commercializing a natural language-driven human/machine interface by developing optimal far-field microphone solutions for various voice-driven interfaces, incorporating Andrea's digital super directional array microphone technology, and certain other related technologies such as noise suppression and stereo acoustic echo cancellation. We believe that continued research and development spending should benefit Andrea in the future.

General, Administrative and Selling Expenses

General, administrative and selling expenses decreased approximately 4% to \$355,500 for the three months ended March 31, 2017 from \$369,365 for the three months ended March 31, 2016. For the three months ended March 31, 2017, general, administrative and selling expenses related to our Patent Monetization efforts were \$123,336, or 35% of the total general, administrative and selling expenses and general, administrative and selling expenses related to our Andrea DSP Microphone and Audio Software Technology were \$232,164, or 65% of total general, administrative and selling expenses.

Interest expense, net

Interest expense, net for the three months ended March 31, 2017 was \$7,195 compared to \$2,532 for the three months ended March 31, 2016. The change in this line item was attributable to a decrease of interest income related to lower cash balances as well as a lower amount of interest income on the note receivable related to the sale of the Andrea Anti-Noise Products Division.

Provision for Income Taxes

The income tax provision for the three months ended March 31, 2017 was \$3,700 compared to \$39,143 for the three months ended March 31, 2016. The provision for the three months ended March 31, 2017 and 2016 is a result of certain licensing revenues that are subject to withholding of income tax as mandated by the foreign jurisdiction in which the revenues are earned.

Net (loss) income

Net loss for the three months ended March 31, 2017 was \$2,060,002 compared to a net income of \$856,941 for the three months ended March 31, 2016. The net loss for the three months ended March 31, 2017 and net income for the three months ended March 31, 2016 principally reflects the factors described above.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Liquidity And Capital Resources

At March 31, 2017, we had cash of \$2,343,326 compared with \$2,955,129 at December 31, 2016. The decrease in our cash balance at March 31, 2017 was primarily a result of cash used in operations.

Our working capital balance at March 31, 2017 was \$400,766 compared to working capital of \$2,403,364 at December 31, 2016. The decrease in working capital reflects a decrease in total current assets of \$771,736 and an increase in total current liabilities of \$1,230,862. The decrease in total current assets of \$771,736 reflects a decrease in cash of \$611,803, an increase in accounts receivable of \$1,082, a decrease in inventories of \$5,059, a decrease in prepaid expenses and other current assets of \$3,948, a decrease in assets from discontinued operations of \$48,299 and a decrease in current note receivable of \$103,709. The increase in total current liabilities of \$1,230,862 reflects an increase in trade accounts payable and other current liabilities of \$1,238,362 partially offset by a decrease in liabilities from discontinued operations of \$7,500.

The decrease in cash of \$611,803 reflects \$709,665 of net cash used in operating activities and \$97,862 cash provided by investing activities.

The cash used by operating activities of \$709,665, excluding non-cash charges for the three months ended March 31, 2017, was attributable to a \$17,213 decrease in accounts receivable, a \$98,123 decrease in inventories, a \$3,948 decrease in prepaid expenses, other current assets and other assets, a \$1,230,862 increase in trade accounts payable and other current liabilities. The changes in accounts receivable, inventories, prepaid expenses, other current assets and other assets and trade accounts payable and other current liabilities primarily reflect differences in the timing related to both the payments for and the acquisition of inventory as well as for other services in connection with ongoing efforts related to Andrea's various product lines including continuing efforts to pursue patent monetization.

The cash provided by investing activities of \$97,862 reflects \$103,709 of repayments in note receivable offset in part by \$5,847 in patent and trademark related expenses. The increase in patent and trademark expenses reflects capital expenditures associated with our intellectual property.

We plan to improve our cash flows in 2017 by aggressively pursuing monetization of our patents related to our Andrea DSP Microphone Audio Software, increasing the sales of our Andrea DSP Microphone Audio Software Products through the introduction of new products as well as the increased efforts we are putting into our sales and marketing efforts. As of May 10, 2017, Andrea had approximately \$3,300,000 of cash deposits. We cannot assure that demand will continue for any of our products, including future products related to our Andrea DSP Microphone and Audio Software technologies, or, that if such demand does exist, that we will be able to obtain the necessary working capital to increase production and provide marketing resources to meet such demand on favorable terms, or at all.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Andrea's management, including its principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, Andrea's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that it files or submits under the Exchange Act with the SEC (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to Andrea's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that all control issues and instances of fraud, if any, within a company have been detected. Andrea's disclosure controls and procedures are designed to provide reasonable assurance of achieving its objectives.

There have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonable likely to materially affect the Company's internal controls over financial reporting during the period covered by this Quarterly Report.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In December 2010, Audrey Edwards, Executrix of the Estate of Leon Leroy Edwards, filed a law suit in the Superior Court of Providence County, Rhode Island, against 3M Company and over 90 other defendants, including the Company, alleging that the Company processed, manufactured, designed, tested, packaged, distributed, marketed or sold asbestos containing products that contributed to the death of Leon Leroy Edwards. The Company received service of process in April 2011. The Company has retained legal counsel and has filed a response to the complaint. The Company believes the lawsuit is without merit and has filed a Motion for Summary Judgment to that affect. Accordingly, the Company does not believe the lawsuit will have a material adverse effect on the Company's financial position or results of operations.

In September 2016, the Company filed a Complaint with the United States International Trade Commission (ITC), alleging patent infringement against Apple Inc. (Apple) and Samsung Electronics Co., Ltd. and Samsung Electronics America, Inc. (together, Samsung), and requesting injunctive relief. An ITC investigation was instituted on October 19, 2016. Apple and Samsung answered the Company's Complaint on November 21, 2016. The Company intends to vigorously prosecute its claims at the ITC.

Also in September 2016, the Company filed complaints with the United States District Court for the Eastern District of New York, alleging patent infringement against Apple and Samsung, and requesting monetary and injunctive relief. These cases against Apple and Samsung are stayed pending the outcome of the Company's litigation at the ITC against Apple and Samsung.

In January 2017, Apple filed four (4) petitions for inter partes review of the Andrea patents asserted in the ITC and District Court litigation proceedings with the United States Patent and Trademark Office (PTO). Andrea intends to vigorously defend its patents in these PTO proceedings.

ITEM 1A. RISK FACTORS

Risk Factors

Our operating results are subject to significant fluctuation, period-to-period comparisons of our operating results may not necessarily be meaningful and you should not rely on them as indications of our future performance.

Our results of operations have historically been and are subject to continued substantial annual and quarterly fluctuations. The causes of these fluctuations include, among other things:

the volume of sales of our products under our collaborative marketing arrangements;

the cost of development of our products;

the mix of products we sell;

the mix of distribution channels we use;

the timing of our new product releases and those of our competitors;

fluctuations in the computer and communications hardware and software marketplace;
and

general economic conditions.

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We cannot assure that the level of revenues and gross profit, if any, that we achieve in any particular fiscal period will not be significantly lower than in other fiscal periods. Our total revenues for the three months ended March 31, 2017 were \$133,779 compared to \$3,142,709 for the three months ended March 31, 2016. Net loss for the three months ended March 31, 2017 was \$2,060,002, or \$0.03 loss per share on a basic and diluted basis, compared to a net income of \$856,941, or \$0.01 per share on a basic and diluted basis for the three months ended March 31, 2016. We continue to explore opportunities to grow sales in other business areas and vigorously defend and monetize our intellectual property. However, we cannot predict whether such opportunities and defense of our intellectual property will be successful.

Shares Eligible For Future Sale May Have An Adverse Effect On Market Price and Andrea Shareholders May Experience Substantial Dilution.

Sales of a substantial number of shares of our common stock in the public market could have the effect of depressing the prevailing market price of our common stock. Of the 200,000,000 shares of common stock presently authorized, 64,914,935 were outstanding as of May 10, 2017. The number of shares outstanding does not include an aggregate of 22,483,154 shares of common stock that are issuable. This number of issuable common shares is equal to approximately 35% of the 64,914,935 outstanding shares. These issuable common shares are comprised of: a) 17,329,820 shares of our common stock reserved for issuance upon exercise of outstanding awards granted under our 2006 Stock Plan; b) 1,524,758 shares of common stock that are issuable upon conversion of the Series C Preferred Stock; and c) 3,628,576 shares of common stock issuable upon conversion of the Series D Preferred Stock.

In addition to the risk factors set forth above and the other information set forth in this report, you should carefully consider the factors discussed in Part I, *Item 1A Risk Factors* in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 and quarterly reports on Form 10-Q, which could materially affect our business, financial condition or future results. The risks described in this report and in our Annual Report on Form 10-K and quarterly reports on Form 10-Q are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

a) Exhibits

Exhibit 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

Exhibit 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

Exhibit 32 Section 1350 Certifications*

Exhibit 101.0 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2017, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets; (ii) Condensed Consolidated Statements of Operations; (iii) Condensed Consolidated Statement of Shareholders' Deficit; (iv) the Condensed Consolidated Statements of Cash Flows and (v) the Notes to the Condensed Consolidated Financial Statements.

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.

ANDREA ELECTRONICS CORPORATION

By: /s/ DOUGLAS J. ANDREA
Name: **Douglas J. Andrea**
Title: **Chairman of the Board, President, Chief
Executive Officer and Corporate Secretary**

Date: May 12, 2017

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| <u>/s/ DOUGLAS J. ANDREA</u> Douglas J. Andrea | Chairman of the Board, President, Chief Executive Officer and Corporate Secretary | May 12, 2017 |
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| <u>/s/ CORISA L. GUIFFRE</u> Corisa L. Guiffre | Vice President, Chief Financial Officer and Assistant Corporate Secretary | May 12, 2017 |
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