

Sugarmade, Inc.
Form 10-Q
February 21, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: **December 31, 2018**

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

For the transition period from **N/A to N/A**

Commission file number: 000-23446

SUGARMADE, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

94-3008888

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

750 Royal Oaks Dr., Suite 108, Monrovia, CA

91016

Edgar Filing: Sugarmade, Inc. - Form 10-Q

(Address of principal executive offices)

(Zip Code)

(888) 982-1628

(Registrant's telephone number, including area code)

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the past 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See 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

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

At February 14, 2019, there were 649,252,384 shares outstanding of the issuer's common, the only class of common equity.

Transitional Small Business Disclosure Format (Check one): Yes No

SUGARMADE, INC.

FORM 10-Q

FOR THE PERIOD ENDED DECEMBER 31, 2018

TABLE OF CONTENTS

PART I: Financial Information

Item 1	<u>Financial Statements</u>	1
	<u>Condensed Consolidated Balance Sheets as of December 31, 2018 (unaudited) and June 30, 2018 (audited)</u>	1
	<u>Condensed Consolidated Statements of Operations for three and six months ended December 31, 2018 and 2017 (unaudited)</u>	2
	<u>Condensed Consolidated Statements of Cash Flows for the six months ended December 31, 2018 and 2017 (unaudited)</u>	3
	<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	4
Item 2	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	27
Item 3	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	32
Item 4	<u>Controls and Procedures</u>	32

PART II: Other Information

Item 1	<u>Risk Factors</u>	34
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
Item 3	<u>Defaults upon Senior Securities</u>	34
Item 4	<u>Mine Safety Disclosures</u>	34
Item 5	<u>Other Information</u>	34
Item 6	<u>Exhibits</u>	35
	Signatures	36

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q includes forward-looking statements. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words “believe,” “expect,” “will,” “anticipate,” “intend,” “estimate,” “project,” “plan,” “assume” or other similar expressions, or negatives of the expressions, although not all forward-looking statements contain these identifying words. All statements contained or incorporated by reference in this quarterly report regarding our future strategy, future operations, projected financial position, estimated future revenues, projected costs, future prospects, the future of our industry and results that might be obtained by pursuing management’s current plans and objectives are forward-looking statements.

You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Our forward-looking statements are based on the information currently available to us and speak only as of the date on the cover of this quarterly report, or, in the case of forward-looking statements in documents incorporated by reference, as of the date of the filing of the document that includes the statement. New risks and uncertainties arise from time to time, and it is impossible for us to predict these matters or how they may affect us. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such difference might be significant and materially adverse to our security holders. We do not undertake and specifically decline any obligation to update any forward-looking statements or to publicly announce the results of any revisions to any statements to reflect new information or future events or developments.

We have identified some of the important factors that could cause future events to differ from our current expectations and they are described in this quarterly report under the caption “Risk Factors,” below, and elsewhere in this quarterly report, which you should review carefully. Please consider our forward-looking statements in light of those risks as you read this quarterly report.

PART 1: Financial Information**Item I****Sugarmade, Inc. and Subsidiary
Condensed Consolidated Balance Sheets**

	December 31, 2018 (Unaudited)	June 30, 2018 (Audited)
Assets		
Current assets:		
Cash	\$ 159,671	\$ 42,121
Accounts receivable, net	340,444	453,623
Inventory, net	580,475	531,249
Loan receivables	171,023	157,872
Other current assets	1,986,443	756,565
Total current assets	3,238,056	1,941,432
Equipment, net	255,755	195,180
Intangible assets, net	11,900	12,600
Other assets	38,751	38,751
Total assets	\$ 3,544,462	\$ 2,187,963
Liabilities and Stockholders' Equity (Deficiency)		
Current liabilities:		
Note payable due to bank	\$ 25,982	\$ 25,982
Accounts payable and accrued liabilities	1,565,006	1,707,641
Customer deposits	210,535	329,509
Unearned revenue	20,798	110,142
Other payable	298,743	241,771
Accrued interest	567,209	493,365
Accrued compensation and personnel related payables	24,528	869,673
Note Payable	20,000	20,000
Notes payable – related parties	23,000	23,000
Loans payable	172,948	329,029
Loans payable – related parties	55,634	30,000
Convertible notes payable, net	876,386	2,399,941
Derivative liabilities	1,734,338	3,069,616
Warrants liabilities	14,480	40,400
Shares to be issued	50,000	2,691,000
Total liabilities	5,659,587	12,381,069
Stockholders' equity (deficiency):		
Preferred stock (\$0.001 par value, 10,000,000 shares authorized, 2,000,000 and 0 issued and outstanding at December 31, 2018 and June 30, 2018, respectively)	2,000	—
Common stock (\$0.001 par value, 1,990,000,000 shares authorized, 637,860,318 and 246,135,203 shares issued and outstanding at December 31, 2018 and June 30, 2018, respectively)	637,861	246,136

Edgar Filing: Sugarmade, Inc. - Form 10-Q

Additional paid-in capital	58,747,248	21,952,560
Shares issued advance for Investment	(18,000,000)	—
Shares to be issued, preferred shares	—	2,000,000
Shares to be issued, common shares	—	467,996
Accumulated deficiency	(43,502,231)	(34,859,799)
Total stockholders' equity (deficiency)	(2,115,125)	(10,193,106)
Total liabilities and stockholders' equity (deficiency)	\$3,544,462	\$2,187,963

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

Table of Contents**Sugarmade, Inc. and Subsidiary****Condensed Consolidated Statements of Operations****For the three and six months ended December 31, 2018 and 2017**

	For the Three Months Ended December 31, 2018	For the Three Months Ended December 31, 2017	For the Six Months Ended December 31, 2018	For the Six Months Ended December 31, 2017
Revenues, net	\$1,445,269	\$938,754	\$2,886,885	\$2,115,968
Cost of goods sold:	1,071,033	657,249	2,130,452	1,510,199
Gross Profit	374,236	281,505	756,433	605,769
Operating expenses:				
Selling, general and administrative expense	\$3,823,085	\$1,033,316	\$4,736,957	\$2,052,304
Operating loss	(3,448,849)	(751,811)	(3,980,524)	(1,446,535)
Non-operating income (expense):				
Other income (expense)	1,451	(229,457)	5,101	(351,830)
Interest Expense	(460,102)	(74,744)	(741,480)	(206,329)
Change in fair value of derivative liabilities	(2,019,927)	(4,924,302)	(3,661,383)	(5,064,955)
Warrant Expense	3,195	—	25,920	—
Loss on debt conversion	—	—	8,763	—
Loss on debt settlement	(94,207)	—	(255,882)	—
Amortization of debt discount	(31,591)	—	(59,597)	—
Loss on debt forgiveness	16,649	—	16,649	—
Total non-operating expenses, net	(2,584,531)	(5,223,504)	(4,661,909)	(5,618,114)
Net loss	\$(6,033,380)	\$(5,975,315)	\$(8,642,432)	\$(7,064,649)
Weighted average shares basic and diluted	393,670,334	244,474,615	330,029,294	237,925,753
Weighted average basic and diluted loss per common share	\$(0.02)	\$(0.02)	\$(0.03)	\$(0.03)

*** Shares issuable upon conversion of convertible debts and exercising of warrants were excluded in calculating diluted**

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

Table of Contents**Sugarmade, Inc. and Subsidiary****Condensed Consolidated Statements of Cash Flows For****the six months ended December 31, 2018 and 2017****(Unaudited)**

	For the six months ended December 31,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$(8,642,432)	\$(7,064,649)
Adjustments to reconcile net loss to cash flows from operating activities:		
Initial valuation of debt discount	149,143	125,642
Loss on settlement	255,882	—
Gain on debt forgiveness	(16,649)	—
Derivative Expense and amortization of debt discount	565,978	249,322
Stock based compensation	5,097,206	728,729
Change in fair value of derivative liability	3,661,418	5,064,954
Amortization of Intangible Assets	700	—
Change in exercise of warrant	(25,920)	—
Depreciation and amortization	26,578	26,954
Changes in assets and liabilities:		
Accounts receivable	113,179	(121,244)
Inventory	(49,226)	50,626
Prepayment, deposits and other receivables	(54,876)	—
Other assets	—	(61,157)
Bank overdraft	—	51,554
Accounts payable and accrued liabilities	(40,876)	(166,510)
Customer deposits	(118,974)	(47,150)
Unearned revenue	(89,344)	(14,263)
Interest Payable	172,221	—
Accrued interest and Other payables	56,972	65,830
Net cash used in operating activities	1,060,981	(1,111,362)
Cash flows from investing activities:		
Acquisition of intangible assets	—	(11,775)
Acquisition of property and equipment	(87,154)	(133,131)
Net cash used in investing activities	(87,154)	(144,906)
Cash flows from financing activities:		
Proceeds from shares to be issued	—	361,478
Proceeds from shares issuance	235,000	—

Edgar Filing: Sugarmade, Inc. - Form 10-Q

Proceeds from convertible notes	1,022,500	702,653
Payment to Note payable-related parties	—	(16,666)
Proceeds (Repayment) from(to) loans	(5,261)	63,587
Proceeds from loan payable-related parties	25,634	(27,941)
Proceeds from advance share issuance	(2,121,000)	104,690
Loan receivable	(13,151)	—
Net cash provided by financing activities	(856,278)	1,187,801
Net increase (decrease) in cash	117,550	(68,467)
Cash paid during the period for:		
Cash, beginning of period	42,121	101,880
Cash, end of period	\$ 159,671	\$ 33,413
Supplemental disclosure of non-cash financing activities		
Shares issued for conversion of convertible debt	516,391	—
Reduction in derivative liability due to conversion	6,289,241	—
Debt discount related to convertible debt	1,888,248	—
Debts settled through shares issuance	1,292,544	564,415

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

Table of Contents

Sugarmade, Inc. and Subsidiary

Notes to Unaudited Condensed Consolidated Financial Statements

1. Nature of Business

Sugarmade, Inc. (hereinafter referred to as "we", "us" or "the/our Company") is a publicly traded company incorporated in the state of Delaware. Our previous legal name was Diversified Opportunities, Inc. Our Company, Sugarmade, Inc. operates much of its business activities through our subsidiary, Sugarmade, Inc., a California corporation ("SWC Group, Inc., - CA").

Sugarmade, Inc. was founded in 2010. In 2014, CarryOutSupplies.com was acquired by Sugarmade, Inc., creating the Company as it is today. As of the end of the reporting period, December 31, 2018, we were involved in several businesses including, the supply of products to the quick service restaurant sub-sector of the restaurant industry and as an importer, distributor and marketer of hydroponic supplies to various agricultural sectors. We had previously been a marketer of culinary seasoning products Seasoning Stix and Sriracha Seasoning Stix and a marketer of tree-free paper products. These products were discontinued during 2018 in order to focus the majority of our corporate resources on the marketing of hydroponic supplies.

The marketplace in which we plan to be mainly engaged is generally referred to as hydroponic agricultural supplies. While some of our customers are engaged in the legal cultivation, processing and/or distribution of cannabis or cannabis containing products, our Company neither sells any products containing cannabis nor do we handle, process, or distribute any products containing cannabis.

Our Board of Directors believes the legal cannabis-related agricultural supply sector could be highly lucrative for the Company, and thus we plan to pursue a strategy of expanding operations. According to a January 2019 report issued by Arcview Market Research, the worldwide consumer market for cannabis during 2018 was valued at approximately \$12.8 billion, up significantly from the 2017 estimated value of \$9.5 billion. The market is expected to grow at approximately 27% compounded annually through the year 2022.

While our business is rapidly expanding across most of the United States and across the west coast, California remains an important marketplace due both the sheer size of the State's economy and due to the rapid embrace of legalization. As of the end of the reporting period, there still remains a significant bottleneck in licensing of California cultivation operations. We are expecting increased business activity as California regulators begin to issue cultivation licenses in mass, although there can be no assurances that any such increased business activity from the state will actually occur.

Edgar Filing: Sugarmade, Inc. - Form 10-Q

We also believe the Company has strong revenue expansion opportunities within several sub sectors of the hydroponic agricultural sector, where we are not currently engaged. Many of these businesses would be complementary to our current business operations. We are currently in process of analyzing several acquisitions for expansion in this area.

-4-

Table of Contents

Our legacy business operation, CarryOutSupplies.com, is a producer and wholesaler of custom printed and generic supplies servicing more than 2,000 quick service restaurants. Our products include double poly paper cups for cold beverage; disposable, clear, plastic cold cups, paper coffee cups, yogurt cups, ice cream cups, cup lids, cup sleeves, food containers, soup containers, plastic spoons and many other similar products for this market sector. CarryOutSupplies.com was founded in 2009 when the founders gained first-hand experience within the restaurant industry of the difficulty for restaurant owners to acquire custom printed supplies at a reasonable cost. Many quick service restaurants wish to acquire custom printed products, such as those embossed with logos, but the minimum order size for such customization had been cost prohibitive. With that in mind, carry out supplies was founded to provide products to this underserved section of the market. Since that time, the company has become a key supplier to many popular U.S. franchises, particularly in the frozen dessert segments. The company estimates it holds at least a 20% market share of generic and printed products within the take-out frozen yogurt and ice cream industries.

In December of 2017, we announced a Master Marketing Agreement with BizRight, LLC where the Company would market BizRight's products. The Company also gained an option to acquire all of BizRight's operations. We began recognizing revenues under this marketing agreement during late calendar 2018 and expect to begin recognizing an increasing amount of revenue under the Master Marketing Agreement as we move further into calendar 2019.

Also during 2017, Sugarmade announced the signing of an exclusive distribution agreement for California, Oregon and Washington with privately held Plantation Corp. for its BudLife preservation technology based on integration of specialized gases and natural agents that dramatically extends the useful life of medical marijuana up to six (6) months by actively monitoring the internal containers environment and automatically adjusting its atmosphere as needed. Sugarmade has conducted initial product prototype testing of the BudLife product, realizing positive results. Sugarmade plans to move forward as Plantation's distribution partner upon availability of the BudLife product line. As of the end of the reporting period, the Company is awaiting final product availability in order to begin marketing the products under the Agreement.

During October 2018, the Company signed a Letter of Intent to acquire Sky Unlimited, LLC doing business as Athena United, a Southern California-based, supplier of hydroponic cultivation supplies to the wholesale sector and to large commercial cultivators. Athena United operates its ecommerce website at www.AthenaUnited.com. Under the terms of the Agreement, which contains both binding and non-binding elements, Sugarmade will acquire all of the outstanding capital stock and the business operations for a combination of cash and common shares of Sugarmade. Athena United, and its associated operations, is believed to be one of the larger operators in this market sector and is producing revenues of approximately \$40 million per year, is profitable, and cash flow positive. Should the Company be successful in its acquisition efforts, the operation would be integrated under the Sugarmade corporate umbrella with Sugarmade assuming all operations and recognizing all revenues and profits.

During January of 2019, the Company announced its intention to acquire a retail location of Washington State-based Hydro4Less. The operation is expected to produce approximately \$5 million in revenues and to be profitable during calendar 2019. Additionally, via the pending transaction, Sugarmade will gain an option to purchase two additional Hydro4Less retail operations, which are currently producing in excess of \$20 million annually. Should all three Hydro4Less acquisitions close, Sugarmade will increase its annual revenues by approximately \$25 million per year.

Via the marketing agreement with BizRight, LLC and the acquisitions of Athena United and Hydro4Less, the Company believes it could become one of the largest and fast growing market participants in the cannabis and other agricultural supply/hydroponic industries. As has been also outlined and disclosed in other corporate filings, there can be no assurances these acquisitions will close and that such revenues will be realized by the Company.

-5-

Table of Contents

2. Summary of Significant Accounting

Policies Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the United States Securities and Exchange Commission for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes necessary for a comprehensive presentation of financial position, results of operations, or cash flows. It is management's opinion however, that all material adjustments (consisting of normal recurring adjustments) have been made which are necessary for a fair financial statement presentation.

These interim condensed consolidated financial statements should be read in conjunction with our Company's Annual Report on Form 10-K for the year ended June 30, 2018, which contains our audited consolidated financial statements and notes thereto, together with the Management's Discussion and Analysis of Financial Condition and Results of Operation, for the year ended June 30, 2018. The interim results for the period ended December 31, 2018 are not necessarily indicative of the results for the full fiscal year.

Principles of consolidation

The condensed consolidated unaudited financial statements include the accounts of our Company and its wholly-owned subsidiaries, Sugarmade-CA and SWC. All significant intercompany transactions and balances have been eliminated in consolidation.

Going concern

The Company sustained continued losses from operations during the six months ended December 31, 2018 and for the fiscal year ended June 30, 2018. The Company's continuation as a going concern is dependent on its ability to generate sufficient cash flows from operations to meet its obligations, in which it has not been successful, and/or obtaining additional financing from its shareholders or other sources, as may be required.

Our condensed consolidated financial statements have been prepared assuming that we will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. These condensed consolidated financial statements do not include any adjustments to reflect the possible

future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result should the Company be unable to continue as a going concern.

Management is endeavoring to increase revenue-generating operations. While priority is on generating cash from operations through the sale of the Company's products, management is also seeking to raise additional working capital through various financing sources, including the sale of the Company's equity and/or debt securities, which may not be available on commercially reasonable terms to our Company, or which may not be available at all. If such financing is not available on satisfactory terms, we may be unable to continue our business as desired and our operating results will be adversely affected. In addition, any financing arrangement may have potentially adverse effects on us and/or our stockholders. Debt financing (if available and undertaken) will increase expenses, must be repaid regardless of operating results and may involve restrictions limiting our operating flexibility. If we issue equity securities to raise additional funds, the percentage ownership of our existing stockholders will be reduced and the new equity securities may have rights, preferences or privileges senior to those of the current holders of our common stock.

Table of Contents

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates.

Revenue recognition

Sugarmade applies a five-step approach in determining the amount and timing of revenue to be recognized: (1) identifying the contract with a customer, (2) identifying the performance obligations in the contract, (3) determining the transaction price, (4) allocating the transaction price to the performance obligations in the contract and (5) recognizing revenue when the performance obligation is satisfied.

Substantially all of Sugarmade's revenue is recognized at the time control of the products transfers to the customer.

Cash

Cash and cash equivalents consist of amounts held as bank deposits and highly liquid debt instruments purchased with an original maturity of three months or less.

From time to time, we may maintain bank balances in interest bearing accounts in excess of the \$250,000 currently insured by the Federal Deposit Insurance Corporation for interest bearing accounts (there is currently no insurance limit for deposits in noninterest bearing accounts). We have not experienced any losses with respect to cash. Management believes our Company is not exposed to any significant credit risk with respect to its cash.

Accounts receivable

Accounts receivable are carried at their estimated collectible amounts, net of any estimated allowances for doubtful accounts. We grant unsecured credit to our customer's deemed credit worthy. Ongoing credit evaluations are

performed and potential credit losses estimated by management are charged to operations on a regular basis. At the time any particular account receivable is deemed uncollectible, the balance is charged to the allowance for doubtful accounts. The Company had accounts receivable net of allowances of \$126,262 as of December 31, 2018 and of \$453,623 as of June 30, 2018.

Inventory

Inventory consists of finished goods paper and paper-based products such as paper cups and food containers ready for sale and is stated at the lower of cost or market. We value our inventory using the weighted average costing method. Our Company's policy is to include as a part of inventory any freight incurred to ship the product from our contract manufacturers to our warehouses. Outbound freights costs related to shipping costs to our customers are considered period costs and reflected in selling, general and administrative expenses. We regularly review inventory and consider forecasts of future demand, market conditions and product obsolescence.

If the estimated realizable value of our inventory is less than cost, we make provisions in order to reduce its carrying value to its estimated market value. On a consolidated basis, as of December 31, 2018 and June 30, 2018, the balance for the inventory totaled \$580,475 and \$531,249, respectively. Obsolescence reserve at December 31, 2018 and June 30, 2018 were \$16,177 and \$120,486, respectively.

Table of Contents

Impairment of Long-Lived Assets

Long-lived assets, which include property, plant and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable.

Recoverability of long-lived assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the assets. Fair value is generally determined using the asset's expected future discounted cash flows or market value, if readily determinable. Based on its review, the Company, as of June 30, 2018, performed an impairment test of all of its intangible assets. Based on the company's analysis, the company had an impairment of \$65,625.

Income taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their perspective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are recorded, when necessary, to reduce deferred tax assets to the amount expected to be realized.

As a result of the implementation of certain provisions of ASC 740, Income Taxes ("ASC 740"), which clarifies the accounting and disclosure for uncertainty in tax position, as defined, ASC 740 seeks to reduce the diversity in practice associated with certain aspect of the recognition and measurement related to accounting for income taxes. We adopted the provisions of ASC 740 as of October 2, 2008, and have analyzed filing positions in each of the federal and state jurisdictions where we are required to file income tax returns, as well as open tax years in these jurisdictions. We have identified the U.S. federal and California as our "major" tax jurisdictions and generally, we remain subject to Internal Revenue Service examination of our 2013 U.S. federal income tax returns. However, we have certain tax attribute carryforwards, which will remain subject to review and adjustment by the relevant tax authorities until the statute of limitations closes with respect to the year in which such attributes are utilized.

We believe that our income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material change to our financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to ASC 740. In addition, we did not record a cumulative effect adjustment related to the adoption of ASC 740. Our policy for recording interest and penalties associated with income-based tax

audits is to record such items as a component of income taxes. We have no interest or penalties as of December 31, 2018.

-8-

Table of Contents

Stock based compensation

Stock based compensation cost to employees is measured at the date of grant, based on the calculated fair value of the stock-based award, and will be recognized as expense over the employee's requisite service period (generally the vesting period of the award). We estimate the fair value of employee stock options granted using the Binomial Option Pricing Model. Key assumptions used to estimate the fair value of stock options will include the exercise price of the award, the fair value of our common stock on the date of grant, the expected option term, the risk free interest rate at the date of grant, the expected volatility and the expected annual dividend yield on our common stock. We use our company's own data among other information to estimate the expected price volatility and the expected forfeiture rate. Share-based compensation awards issued to non-employees for services rendered are recorded at either the fair value of the services rendered or the fair value of the share-based payment, whichever is more readily determinable.

Loss per share

We calculate basic earnings per share ("EPS") by dividing our net loss by the weighted average number of common shares outstanding for the period, without considering common stock equivalents. Diluted EPS is computed by dividing net income or net loss by the weighted average number of common shares outstanding for the period and the weighted average number of dilutive common stock equivalents, such as options and warrants. Options and warrants are only included in the calculation of diluted EPS when their effect is dilutive.

Fair value of financial instruments

ASC Topic 820 defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 - observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - include other inputs that are directly or indirectly observable in the marketplace.

Level 3 - unobservable inputs which are supported by little or no market activity.

The Company used Level 2 inputs for its valuation methodology for the derivative liabilities in determining the fair value using the Binomial option-pricing model for the six months ended December 31, 2018.

	Carrying Value As of December 31, 2018	Fair Value Measurements at December 31, 2018 Using Fair Value Hierarchy Level 1 Level 2 Level 3		
Liabilities				
Derivative liabilities	\$1,734,338	\$—	\$ —	\$1,734,338
Total	\$1,734,338	\$—	\$ —	\$1,734,338

	June 30, 2018	December 31, 2018
Expected life (years)	0.5	0.5
Risk-free interest rate	2.06 %	2.56 %
Expected volatility	151 %	154 %

-9-

Table of Contents

	Carrying Value As of June 30, 2018	Fair Value Measurements at June 30, 2018 Using Fair Value Hierarchy Level 1 Level 2 Level 3		
Liabilities				
Derivative liabilities	\$3,069,616	\$—	\$ —	\$3,069,616
Total	\$3,069,616	\$—	\$ —	\$3,069,616

Derivative instruments

The fair value of derivative instruments is recorded and shown separately under current liabilities. Changes in the fair value of derivatives liability are recorded in the consolidated statement of operations under non-operating income (expense).

Our Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the consolidated statements of operations. For stock-based derivative financial instruments, the Company uses a weighted average Binomial option-pricing model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

Segment Reporting

FASB ASC Topic 280, “Segment Reporting”, requires use of the “management approach” model for segment reporting. The management approach model is based on the way a company’s management organizes segments within the Company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure, or any other manner in which management disaggregates a company.

FASB ASC Topic 280 has no effect on the Company's financial statements as substantially all of its operations are conducted in one industry segment – paper and paper-based products such as paper cups, cup lids, food containers, etc.

New accounting pronouncements not yet adopted

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is in the process of evaluating the impact of adoption of this ASU on the consolidated financial statements.

Table of Contents

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The standard should be applied prospectively on or after the effective date. The Company will evaluate the impact of adopting this standard prospectively upon any transactions of acquisitions or disposals of assets or businesses.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. 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. The guidance should be adopted on a prospective basis for the annual or any interim goodwill impairment tests beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting. The new standard contains several amendments that will simplify the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

ASC 606, Revenue from Contracts with Customers, was issued jointly by the FASB and IASB on May 28, 2014. It was originally effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016, for public entities. Early application was not permitted (however, early adoption was optional for entities reporting under IFRSs). On August 12, 2015, the FASB issued an ASU, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred for one year the effective date of the new revenue standard for public and nonpublic entities reporting under U.S. GAAP. The Company is currently evaluating the impact of this guidance on its financial statements and related disclosures.

3. Concentration

Customers

For the six months ended December 31, 2018 and 2017, our Company earned net revenues of \$2,886,885 and \$2,115,968 respectively. The vast majority of these revenues for the period ending December 31, 2018 were derived from a large number of customers, whereas the vast majority of these revenues for the period ending December 31,

2017 were derived from a limited number of customers. No customers accounted for over 10% of the Company's total revenues for the period ended December 31, 2018.

Suppliers

For the six months ended December 31, 2018, we purchased products for sale from several contract manufacturers located in Asia and the U.S. A substantial portion of the Company's inventory is purchased from two (2) suppliers. The two (2) suppliers accounted as follows: Two suppliers accounted for 26.19% and 25.96% of the Company's total inventory purchase for the six months ended December 31, 2018, respectively.

Table of Contents

4. Equity Transaction - Exclusive License Rights

On December 13, 2017, we entered into a Master Marketing Agreement with BizRight Hydroponic, Inc. (“BizRight”), a leading marketer and supplier hydroponic growth supplies, which offers a range of hydroponics-related products including: HPS grow lights, electronic ballasts, HPS Bulbs, nutrient mixes, environmental control products, pH measurement and calibration solutions and other cannabis-related grow and storage products. BizRight operates the ZenHydro.com website and other e-commerce properties, and sells various products to distributors and retailers.

Under the terms of the Master Marketing Agreement, all products procured, developed and imported by BizRight will be sold by the Company. The expected term of the exclusive license rights is 20 years. BizRight and its owners will be compensated via a combination of cash and common shares in Sugarmade. Effective the contract date, Bizright will be compensated Two hundred million (200,000,000) common shares. Sugarmade will compensate BizRight and its owners six million dollars (\$6,000,000) in cash. The amount due will be divided over 3 payments equally and are contingent upon the filing of the S-1 and significant funding.

As of December 31, 2018, the shares to be issued in connection with the acquisition of exclusive license rights has been issued and the transaction has not been fully completed. \$550,000 in cash has been paid and reflected as a prepaid deposit in other current assets on our balance sheet.

5. Legal Proceedings

From time to time and in the course of business, we may become involved in various legal proceedings seeking monetary damages and other relief. The amount of the ultimate liability, if any, from such claims cannot be determined. As of date of this filing, there were no legal claims currently pending or, to our knowledge, threatened against our Company that, in the opinion of our management, would be likely to have a material adverse effect on our financial position, results of operations or cash flows, except as follows:

- The Company has filed a lawsuit in Contra Costa County, California, alleging breach of fiduciary duty, conspiracy to commit breach of fiduciary duty, fraud, conspiracy to commit fraud, conversion, breach of contract, and interference with contractual relations against, Diversified Products Group Inc. (DPG), Stephen Pinto, Lewis Cohen and Heidi Estiva, who were former sales agents for the Company. Stephen Pinto is the Company's former Chairman. The defendants have filed a counterclaim alleging that they were induced to make a series of investments in the Company by material misrepresentations and/or omissions made by the Company. As of the date of this filing, the parties have settled all issues.
- On December 11, 2013, the Company was served with a complaint from two Convertible Note Holders and investors in the Company, Lovitt & Hannan, Inc. Salary Deferral Plan FBO J. Thomas Hannan, Attorney at Law 401K Plan and Trust, and Kevin M. Kearney. The Company's former CEO, Scott Lantz, was also named in the suit. On February 21, 2017, the Company signed a settlement agreement with the plaintiffs. Under the terms of the settlement agreement, the Company agreed to pay the plaintiffs \$227,000 to settle all claims against the Company, which included the payoff of the two notes outstanding within one (1) week. Upon

Edgar Filing: Sugarmade, Inc. - Form 10-Q

receipt of all payments, plaintiffs will surrender for cancellation 230,000 of the Company's shares within ten (10) days. The parties agreed that all claims against the Company would be satisfied through such payments and that the matter would be fully resolved. As of June 30, 2018, third-parties had purchased two (2) notes of approximately \$80,000, reducing the Company's exposure by \$80,000. As of the date of this filing the balance for accrued legal settlement for Hannan vs Sugarmade has been reduced to \$227,000, plus interest until the date of complete payoff.

-12-

Table of Contents

- On May 24, 2014, the Labor Commissioner, State of California issued an Order, Decision or Award of the Labor Commissioner against the Company in the amount of \$56,365. On October 28, 2014, the Company entered into a settlement agreement, which was effective October 28, 2014, to resolve a judgment against the Company via the issuance of 502,533 restricted shares and a \$30,000 cash payment. As of December 31, 2018, the shares have not been issued yet.

There can be no assurances the ultimate liability relative to these law suits will not exceed what is outlined above.

6. Other Current Assets

As of December 31, 2018 and June 30, 2018, other current assets consisted of the following:

	For the periods ended	
	December 31, 2018	June 30, 2018
Prepaid Deposit	\$1,725,000	\$355,500
Prepaid Inventory	103,213	92,737
Employees Advance	46,303	41,303
Prepaid Expenses	89,726	246,260
Other	22,201	20,765
Total:	\$1,986,443	\$756,565

7. Intangible Asset

On August 21, 2017, the Company entered into an intellectual property assignment agreement with Sound Decisions to revamp the company's shoplifty website to generate and attract more traffic from potential customers. The Company made a payment of \$14,000 for the website (intellectual property). The Company amortized this use right as intangible asset over ten years, and recorded amortization expense of \$700 and \$1,400 as of December 31, 2018 and June 30, 2018, respectively.

8. Convertible Notes

As of December 31, 2018 and June 30, 2018, the balance owing on convertible notes, net of debt discount, with terms as described below was \$876,386 and \$2,399,941, respectively.

Convertible notes issued prior the year ended June 30, 2017 were as follows:

Convertible note 1: On August 24, 2012, the Company entered into a convertible promissory note with an accredited investor for \$25,000. The note has a term of six (6) months with an interest rate of 10% and is convertible to common shares at a 25% discount of the average of 30 days prior to the conversion date. As of December 31, 2018, the note is in default.

Convertible note 2: On September 18, 2012, the Company entered into a convertible promissory note with an accredited investor for \$25,000. The note has a term of six (6) months with an interest rate of 10% and is convertible to common shares at a 25% discount of the average of 30 days prior to the conversion date. As of December 31, 2018, the note is in default.

Table of Contents

Convertible note 3: On December 21, 2012, the Company entered into a convertible promissory note with an accredited investor for \$100,000. The note has a term of six (6) months with an interest rate of 10% and is convertible to common shares at a 25% discount of the average of 30 days prior to the conversion date. As of December 31, 2018, the note is in default.

Convertible note 4: On December 19, 2016, the Company entered into a convertible promissory note with an accredited investor for \$20,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount. As of December 31, 2018, the note has been fully converted.

Convertible note 5: On January 17, 2017, the Company entered into a convertible promissory note with an accredited investor for \$25,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Convertible note 6: On January 20, 2017, the Company entered into a convertible promissory note with an accredited investor for \$80,000. The note has a term of seven (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Convertible note 7: On February 8, 2017, the Company entered into a convertible promissory note with an accredited investor for \$50,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Convertible note 8: On February 24, 2017, the Company entered into a convertible promissory note with an accredited investor for \$66,023. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Convertible note 9: On February 9, 2017, the Company entered into a convertible promissory note with an accredited investor for \$50,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Convertible note 10: On February 28, 2017, the Company entered into a convertible promissory note with an accredited investor for \$75,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount. As of December 31, 2018, the note has been fully converted.

Convertible note 11: On March 1, 2017, the Company entered into a convertible promissory note with an accredited investor for \$100,000. The note has been purchased by other investor in total amount of \$156,067 with a term of nine (9) months with an interest rate of 10% and is convertible to common shares at a 45% discount to the then current market price of our shares. As of September 30, 2018, there were \$92,500 has been converted into the Company's common stock and the Company incurred two conversion default penalties in total of \$60,751. As of June 30, 2018, the remaining principal balance was \$124,318. As of December 31, 2018, the Company converted \$63,567 and the remaining balance of note was \$60,751.

Convertible note 12: On March 23, 2017, the Company entered into a convertible promissory note with an accredited investor for \$70,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Table of Contents

Convertible note 13: On February 16, 2017, the Company entered into a convertible promissory note with an accredited investor for \$30,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Convertible note 14: On March 31, 2017, the Company entered into a convertible promissory note with an accredited investor for \$200,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount to the then current market price of our shares. As of December 31, 2018, the note has been fully converted.

Convertible note 15 & 16: On May 17, 2017, the Company entered a convertible promissory note with an investor for a total amount of \$1,375,000 (after \$10,000 legal and due diligence fee) with an OID of \$125,000, the note will be fulfilled through a series of funding. The note is due 12 months after each funding date and bear an interest rate of 10%. The conversion price for the note is 55% of the lowest closing bid for the 20 consecutive trading days prior to the conversion date. In connection with the note, the investor will also receive warrants and is calculated based on 15% of the maturity amount. The warrants have a life of four years with exercise price of \$0.15 per share and have cashless exercise option. The Company had outstanding balance of \$921,004 as of the year ended June 30, 2018. The fair value of the warrants were \$40,400 as of June 30, 2018. During the six months ended December 31, 2018, the Company converted \$525,000 into the Company's common stock, the remaining balance of the note was \$396,004 as of December 31, 2018 and the fair value of the warrant liability was \$14,480. As of December 31, 2018, the note is in default and bears a default interest rate of 22% per annum.

Convertible notes issued during the year ended June 30, 2018 were as follows:

Convertible note 17: On July 17, 2017, the Company entered into a convertible promissory note with an accredited investor for \$164,900. The note has a term of one year with an interest rate of 8% and is convertible to common shares at a fixed conversion price of \$0.025. As of December 31, 2018, the note has been fully converted.

Convertible note 18: On August 3, 2017, the Company entered into a convertible promissory note with an accredited investor for \$150,000. The note has a term of six (6) months with an interest rate of 10% and is convertible to common shares at a 45% discount to average of 3 lowest trading price during last 20 trading days. As of December 31, 2018, the note has been fully converted.

Convertible note 19: On August 22, 2017, the Company entered into a convertible promissory note with an accredited investor for \$35,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount of average two lowest price of last 20 trading days prices. As of December 31, 2018, the note has been fully converted.

Convertible note 20: On September 15, 2017, the Company entered into a convertible promissory note with an accredited investor for \$150,000. The note has a term of six (6) months with an interest rate of 10% and is convertible to common shares at a 45% discount to average of 3 lowest trading price during last 20 trading days. As of December 31, 2018, the note has been fully converted.

Convertible note 21: On September 26, 2017, the Company entered into a convertible promissory note with an accredited investor for \$15,000. The note has a term of six (6) months with an interest rate of 8% and is convertible to common shares at a 40% discount of average two lowest price of last 20 trading days prices. As of December 31, 2018, the note has been fully converted.

Table of Contents

Convertible note 22: On December 7, 2017, the Company entered into a convertible promissory note with an accredited investor for \$50,000. The note has a term of one year with an interest rate of 8% and is convertible to common shares at a fixed conversion price of \$0.05. As of December 31, 2018, the note has been fully converted.

Convertible notes issued during the six months ended December 31, 2018 were as follows:

Convertible note 23: On September 20, 2018, the Company entered a convertible promissory note with an investor for a total amount of \$267,500 (includes \$5,000 legal fee and an OID of \$12,500). The note is due 360 days and bear an interest rate of 8%. The conversion price for the note is 55% of the lowest closing bid for the 20 consecutive trading days prior to the conversion date.

Convertible note 24: On October 5, 2018, the Company entered a convertible promissory note with an investor for a total amount of \$250,000 (includes \$5,000 OID). The note is due 360 days and bear an interest rate of 8%. The conversion price for the note is 45% of average three lowest closing bid for the 20 consecutive trading days prior to the conversion date.

Convertible note 25: On November 1, 2018, the Company entered into a convertible promissory note with an accredited investor for \$100,000. The note has a term of one year with an interest rate of 8% and is convertible to common shares at a fixed conversion price of \$0.07.

Convertible note 26: On November 16, 2018, the Company entered into a convertible promissory note with an accredited investor for \$80,000. The note has a term of one year with an interest rate of 8% and is convertible to common shares at a fixed conversion price of \$0.07.

Convertible note 27: On November 16, 2018, the Company entered into a convertible promissory note with an accredited investor for \$40,000. The note has a term of one year with an interest rate of 8% and is convertible to common shares at a fixed conversion price of \$0.07.

Convertible note 28: On December 3, 2018, the Company entered into a convertible promissory note with an accredited investor for \$35,000. The note has a term of one year with an interest rate of 8% and is convertible to common shares at a fixed conversion price of \$0.07.

Edgar Filing: Sugarmade, Inc. - Form 10-Q

Convertible note 29: On December 26, 2018, the Company entered a convertible promissory note with an investor for a total amount of \$250,000 (includes \$5,000 OID). The note is due 360 days and bear an interest rate of 8%. The conversion price for the note is 45% of average three lowest closing bid for the 20 consecutive trading days prior to the conversion date.

-16-

Table of Contents

As of the period ended December 31, 2018, the Company's convertible notes consisted of following:

<u>Balance</u> <u>as of</u> <u>06.30.2018</u>	<u>Default</u> <u>Penalty</u>	<u>Addition</u> <u>(Repayment)</u>	<u>Conversion</u> <u>in</u> <u>Principal</u>	<u># of</u> <u>shares</u>	<u>Balance</u> <u>as of</u> <u>12.31.2018</u>	<u>Due Date</u>	<u>Interest</u> <u>Rate</u>	<u>Conversion</u> <u>Price</u>
25,000	—	—	—	—	25,000	2/24/2013	14 %	75% of the average of 30 days prior to the conversion date.
25,000	—	—	—	—	25,000	3/18/2013	14 %	75% of the average of 30 days prior to the conversion date.
100,000	—	—	—	—	100,000	6/21/2013	14 %	75% of the average of 30 days prior to the conversion date.
20,000	—	—	20,000	1,160,391	—	7/17/2017	10 %	40% discount of average price of last 20 trading days prices
25,000	—	—	25,000	1,426,674	—	7/17/2017	8 %	40% discount of average two lowest price of last 20 trading days prices
50,000	—	—	50,000	2,931,188	—	8/8/2017	8 %	40% discount of average two lowest price of last 20 trading days prices
80,000	—	—	80,000	4,530,846	—	7/20/2017	8 %	40% discount of average two lowest price of last 20 trading days prices
66,023	—	—	66,023	3,712,324	—	8/24/2017	8 %	40% discount of average two lowest price of last 20 trading days prices
50,000	—	—	50,000	2,390,805	—	8/9/2017	8 %	40% discount of average two lowest price of last 20 trading days prices

-17-

Table of Contents

75,000	—75,000	4,378,547	—	7/31/2017	8 %	40% discount of average two lowest price of last 20 trading days prices
124,318	—63,567	3,919,404	60,751	12/1/2017	10%	45% discount of lowest price of last 20 trading days prices
70,000	—70,000	4,067,072	—	9/23/2017	8 %	40% discount of average two lowest price of last 20 trading days prices
30,000	—30,000	1,500,010	—	8/16/2017	8 %	Greater of 40% discount to average of 3 lowest trading price during last 20 trading days or \$.05
200,000	—200,000	11,557,652	—	9/30/2017	8 %	40% discount of average two lowest price of last 20 trading days prices
921,004	—525,000	17,521,702	396,004	5/12/2018	22%	45% discount of lowest price of last 20 trading days prices
150,000	—150,000	3,745,330	—	5/3/2018	10%	45% discount to average of 3 lowest trading price during last 20 trading days
164,900	—164,900	6,596,000	—	7/17/2018	8 %	The conversion price shall be \$0.025 per share
35,000	—35,000	691,184	—	8/22/2018	8 %	40% discount of average two lowest price of last 20 trading days prices

-18-

Table of Contents

15,000	—	—	15,000	294,114	—	9/26/2018	8%	40% discount of average two lowest price of last 20 trading days prices
50,000	—	—	50,000	1,000,000	—	12/7/2018	8%	The conversion price shall be \$0.05 per share
—	—	267,500	—	—	267,500	9/15/2019	8%	55% discount of lowest price of last 20 trading days prices
—	—	250,000	—	—	250,000	10/5/2019	8%	45% discount of average three lowest price of last 20 trading days prices
—	—	100,000	—	—	100,000	10/31/2019	8%	The conversion price shall be \$0.07 per share
—	—	80,000	—	—	80,000	11/15/2019	8%	The conversion price shall be \$0.07 per share
—	—	40,000	—	—	40,000	11/15/2019	8%	The conversion price shall be \$0.07 per share
—	—	35,000	—	—	35,000	12/2/2019	8%	The conversion price shall be \$0.07 per share
—	—	250,000	—	—	250,000	12/26/2019	8%	45% discount of average three lowest price of last 20 trading days prices
2,426,245	1,022,500	1,819,490	75,167,248	1,629,255				

In connection with the convertible debt, debt discount balance as of December 31, 2018 and June 30, 2018 were \$752,869 and \$26,303 respectively and were being amortized and recorded as interest expenses over the term of the convertible debt.

Table of Contents

As of the period ended December 31, 2018, the Company's debt discount consisted of following:

Note	Date	Due Date	OID	Amortization in FY 2018	Debt Discount Balance at 6/30/2018	Amortization in 6 months ended 12/31/2018	Debt Discount Balance at 12/31/2018
8/22/2017	8/22/2018	\$35,000	\$29,918	\$5,082	\$5,082	\$ —	
9/26/2017	9/26/2018	15,000	11,384	3,616	3,616	—	
7/17/2017	7/17/2018	164,900	160,445	4,455	4,455	—	
12/7/2017	12/7/2018	50,000	36,849	13,151	13,151	—	
9/20/2018	9/15/2019	12,500	—	—	3,542	8,958	
9/20/2018	9/15/2019	250,000	—	—	70,833	179,167	
10/5/2018	10/5/2019	5,000	—	—	1,192	3,808	
10/5/2018	10/5/2019	245,000	—	—	58,397	186,603	
11/1/2018	11/1/2019	84,286	—	—	13,855	70,431	
11/16/2018	11/16/2019	36,571	—	—	4,509	32,063	
11/16/2018	11/16/2019	18,286	—	—	2,254	16,031	
12/3/2018	12/3/2019	10,000	—	—	767	9,233	
12/26/2018	12/26/2019	5,000	—	—	68	4,932	
12/26/2018	12/26/2019	245,000	—	—	3,356	241,644	
Total:			\$41,302		\$26,303	\$185,077	\$752,869

9. Derivative liabilities

The derivative liability is derived from the conversion features in note 8 and stock warrant in note 10. All were valued using the Binomial option pricing model using the assumptions detailed below. As of December 31, 2018 and June 30, 2018, the derivative liability was \$1,734,338 and \$3,069,616, respectively. The Company recorded \$2,019,927 loss and \$140,653 loss from changes in derivative liability during the three months ended September 30, 2018 and 2017, respectively. The Binomial Option Price Model with the following assumption inputs:

	December 31, 2018
Annual dividend yield	—
Expected life (years)	0.5-1.00
Risk-free interest rate	2.49-2.72 %
Expected volatility	118-175 %

	September 30, 2018
Annual dividend yield	—
Expected life (years)	0.5-1.00

Risk-free interest rate 2.15-2.37%
Expected volatility 87-123 %

-20-

Table of Contents

	June 30, 2018	
Annual dividend yield	—	
Expected life (years)	0.15-1.00	
Risk-free interest rate	1.08-2.12	%
Expected volatility	103-202	%

Fair value of the derivative is summarized as below:

Beginning Balance, June 30, 2018	\$3,069,616
Additions	427,076
Mark to Market	1,641,457
Reclassification to APIC due to conversions	(2,714,433)
Balance, September 30, 2018	\$2,423,716
Additions	865,503
Mark to Market	2,019,927
Reclassification to APIC due to conversions	(3,574,808)
Balance, December 31, 2018	\$1,734,338

10. Stock warrants

In connection with the issuance of the promissory notes in 2012, the investors in the aggregate received two-year warrants to purchase up to a total of 50,000 shares of common stock at an exercise price of \$0.50 per share, and two-year warrants purchasing up to a total of 81,250 shares of common stock at an exercise price of \$0.01 per share. For purposes of accounting for the detachable warrants issued in connection with the convertible notes, the fair value of the warrants was estimated using the Binomial option pricing formula. The value of all warrants granted at the date of issuance totaled \$508,413 and was recorded as a discount to the notes payable. The amount was amortized over the nine (9) month term of the respective convertible note as additional interest expense.

On various dates during June 2014 and December 2014 the Company and holders of certain convertible notes agreed to cancel warrants to purchase common shares in the Company and to extend the due dates on the Notes to July 1, 2016. \$0.50 warrants and “Bonus Warrants” priced at \$0.01, as defined in the original Convertible Note Purchase Agreements we cancelled pertaining to the Note and warrants acquired on the following dates for the following Convertible Notes and amounts. These warrants were expired on July 1, 2016.

On May 17, 2017, the Company entered a promissory note with an investor for a total amount of \$1,375,000 (after \$10,000 legal and due diligence fee) with an OID of \$125,000, the note will be fulfilled through a series of funding. In connection with the note, the investor will also receive warrants and is calculated based on 15% of the maturity amount. The warrants have a life of four years with an exercise price of \$0.15 per share and have cashless exercise option. The fair value of the warrants at the grant date was \$40,400. As of December 31, 2018 and June 30, 2018, the fair value of the warrant liability was \$14,480 and \$40,400, respectively. The Binomial Option Price Model with the

following assumption inputs:

-21-

Table of Contents

Warrants liability	December 31, 2018	
Annual dividend yield	—	
Expected life (years)	0.5	
Risk-free interest rate	2.45	%
Expected volatility	138	%
Warrants issued in May 2017	June 30, 2018	
Annual dividend yield	—	
Expected life (years)	0.5	
Risk-free interest rate	2.06	%
Expected volatility	151	%

Below is the movement of warrants for the period ending December 31, 2018:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining contractual life
Outstanding at June 30, 2016	131,250	\$ 0.20	
Expired	131,250	0.20	4
Granted	505,000	\$ 0.15	3.86
Outstanding at June 30, 2017	505,000	0.20	
Exercised	—	—	
Granted	—	\$ —	
Outstanding at June 30, 2018	505,000	\$ 0.15	0.5
Granted	—	—	
Exercised	—	—	
Outstanding at December 31, 2018	505,000	\$ 0.15	0.5

Note payable due to bank

During October 2011, we entered into a revolving demand note (line of credit) arrangement with HSBC Bank USA, with a revolving borrowing limit of \$150,000. The line of credit bears a variable interest rate of one quarter percent (0.25%) above the prime rate (3.25% as of December 31, 2013). In the event the deposit account is not established or minimum balance maintained, HSBC can charge a higher rate of interest of up to 4.0% above prime rate. As of December 31, 2018 and June 30, 2018, the loan principal balance was \$25,982. As of December 31, 2018, the note is in default.

Table of Contents

Note payable due to related party

On January 23, 2013, the Company entered into a promissory note with its former employee of the Company who owns less than 5% of the Company's stock. The original principal amount was \$40,000 and the note bore no interest. The note was payable upon demand. As of December 31, 2018 and June 30, 2018, this note had a balance of \$18,000.

On January 14, 2015, the Company entered into a promissory note with Richard Ko (an employee of the Company, who owns less than 5% of the Company's stock). The principle amount was \$30,000 and the note bore no interest. The note had a term of one (1) year and was due on January 14, 2016, and became payable upon demand after January 14, 2016. As of December 31, 2018 and June 30, 2018, this note had a balance of \$5,000 and \$20,000, respectively.

As of December 31, 2018 and June 30, 2018, the Company has an outstanding balance of notes payable due to related parties of \$23,000, respectively.

11. Stockholder's Deficiency

The Company is authorized to issue 1,990,000,000 shares of \$.001 par value common stock and 10,000,000 shares of \$.001 par value preferred stock.

During the year ended June 30, 2018, the Company issued 1,171,429 shares of common stock for cash in total amount of \$82,000.

During the year ended June 30, 2018, the Company issued 4,736,842 shares of common stock for services in total amount of \$180,000.

During the year ended June 30, 2018, the Company issued 13,492,560 shares of common stock to settle the old debt in total amount of \$306,810.

During the three months ended September 30, 2018, the Company issued 27,301,360 shares of common stock to settle debt in total amount of \$872,859.

Edgar Filing: Sugarmade, Inc. - Form 10-Q

During the three months ended September 30, 2018, the Company issued 2,971,154 shares of common stock for services in total amount of \$197,500.

During the three months ended September 30, 2018, the Company issued 3,700,000 shares of common stock for cash in total amount of \$185,000.

During the three months ended December 31, 2018, the Company issued 6,632,605 shares of common stock to settle the old debt in total amount of \$346,982, net with \$263,616 share to be issued, common stock.

During the three months ended December 31, 2018, the Company issued 47,865,888 shares of common stock for debt conversions in total amount of \$1,015,391.

During the three months ended December 31, 2018, the Company issued 4,142,857 shares of common stock for cash in total amount of \$220,000.

During the three months ended December 31, 2018, the Company issued 89,111,251 shares of common stock for service in total amount of \$6,082,851, net with \$390,830 share to be issued, common stock.

Table of Contents

During the three months ended December 31, 2018, the Company issued 10,000,000 shares of common stock for a LOI deposit in total amount of \$11,175,000.

During the three months ended December 31, 2018, the Company issued 200,000,000 shares of common stock for award to the certain master purchase agreement in total amount of \$18,000,000. The acquisition has not been fully completed as of December 31, 2018.

As of December 31, 2018 and June 30, 2018, the Company had 637,860,318 and 246,135,203 shares of its common stock issued and outstanding.

12. Related party transactions

As of December 31, 2018 and June 30, 2018, the Company had outstanding balance of \$23,000 owed to various related parties.

13. Loans payable

On June 26, 2017, SGMD entered a straight promissory note with a company (whose major shareholder is the former director of the Company) for borrowing \$150,820 with maturity date on March 31, 2018; the note bears an interest rate of 12%, commencing on October 31, 2017, and on the last day of each month thereafter until the notes is paid in full, the Company shall make an interest payment. As of October 2017, they are no long a related party. As of June 30, 2018, the outstanding balance under this note was \$150,820. As of December 31, 2018, the note has been fully settled into 1,508,200 shares of the Company's common stock.

During the year ended June 30, 2017, the Company entered a series of short-term loan agreements with Greater Asia Technology Limited (Greater Asia) for borrowing \$375,000, with interest rate at 40% - 50% of the principal balance. As of December 31, 2018 and June 30, 2018, the outstanding balance with Greater Asia loans were \$168,008 and \$140,125, respectively. As of December 31, 2018, the note was in default.

On July 1, 2016, the Company entered into a repayment agreement with its employee for \$20,280 at no interest. As of December 31, 2018 and June 30, 2018, the Company has an outstanding balance of \$4,084 and \$4,285.

Edgar Filing: Sugarmade, Inc. - Form 10-Q

On January 30, 2018, SGMD entered a straight promissory note with an individual with one or more on demand loan with maturity date on January 30, 2019 and no interest shall be charged to the Company. As of December 31, 2018, the outstanding balance under this note was \$10,000.

As of December 31, 2018 and June 30, 2018, the Company had an outstanding loan balance of \$172,948 and \$329,029, respectively.

Table of Contents

14. Loan payable – related parties

On July 7, 2016, SWC received a loan from an employee. The amount of the loan bore no interest and amortized on a monthly basis over the life of the loan. As of December 31, 2018 and June 30, 2018, the balance of the loan were \$30,000 and \$30,000, respectively.

From time to time, SWC would receive short-term loans from company former director for its working capital needs.

As of December 31, 2018 and June 30, 2018, the Company had outstanding balance of \$25,634 and \$0, respectively.

As of December 31, 2018 and June 30, 2018, the total loan payable to related party was \$55,634 and \$30,000, respectively.

15. Shares to be issued – liability

During the year ended June 30, 2018, the Company had entered into multiple private placement agreements and had increased potential shares to be issued under liability in total amount of \$1,798,000.

During the three months ended September 30, 2018, the Company issued 3,700,000 shares of the Company's common stock for cash in total amount of \$185,000. Share to be issued is reduced by \$185,000 due to such issuance.

During the three months ended September 30, 2018, the Company had entered into a multiple private placement agreement and had increased potential shares under liability by 1,000,000 shares, for total amount of \$50,000.

During the three months ended December 31, 2018, the Company issued 45,307,142 shares of the Company's common stock for cash & services in total amount of \$2,506,000. Share to be issued is reduced by \$2,506,000 due to such issuance.

As of December 31, 2018 and June 30, 2018, the Company had balance of \$50,000 and \$2,691,000 share to be issued.

Table of Contents

16. Shares to be issued –equity

As of the year ended June 30, 2018, the Company had entered into multiple private placement agreements and had increased potential shares to be issued under common stock in total amount of \$467,996.

During the three months ended September 30, 2018, the Company had entered into multiple private placement agreements and had increased potential shares to be issued under common stock in total amount of \$95,000. The shares have been issued as of December 31, 2018.

During the three months ended September 30, 2018, the Company had entered into multiple service agreements and had increased potential shares to be issued for service compensation in total amount of \$137,000. The shares have been issued as of December 31, 2018.

During the three months ended September 30, 2018, the Company had entered into debt settlement and had increased potential shares to be issued for debt settlement under common stock in total amount of \$174,450. The shares have been issued as of December 31, 2018.

As of the three months ended September 30, 2018 and year ended June 30, 2018, the Company had entered into multiple private placement agreements and had increased potential shares to be issued under preferred stock in total amount of \$2,000,000, respectively. The shares have been issued as of December 31, 2018.

As of December 31, 2018, the Company had total potential shares to be issued under common stock and preferred stock in total amount of \$0.

17. Commitments and contingencies

On February 23, 2018 the Company entered into lease agreement for a new office space as part of the plan to expand operation, the lease is set to commence Commencing March 1, 2018. The term of the lease is for a (5) Five Years with 1 month free on the 1st year of the term. The monthly rent on the 1st year will be \$11,770 with a 3% increase for each subsequent year. Total commitment for the full term of the lease will be \$737,367. As of the date of this filing, this property became the headquarter of the company.

18. Subsequent events

On January 8, 2019, the Company issued a convertible note to an accredited investor for proceeds to the Company in the amount of \$105,000.

On January 22, 2019, the Company issued a convertible note to an accredited investor for proceeds to the Company in the amount of \$100,000.

On January 23, 2019, the Company issued 2,364,066 shares of the Company's common stock for debt conversions in total amount of \$75,000.

On January 24, 2019, the Company issued a convertible note to an accredited investor for proceeds to the Company in the amount of \$53,000.

On February 6, 2019, the Company issued 4,995,084 shares of the Company's common stock for debt conversions in total amount of \$127,000.

On February 21, 2019, the Company entered into an acknowledgement and representation letter with BizRight LLC under the terms and consideration of the master marketing agreement dated December 13, 2017. BizRight LLC has executed an asset purchase agreement with BZRCH, Inc., a Nevada corporation to retain all or part of BizRight's assets.

Table of Contents

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

As reported on Form 8-K filed on April 10, 2018 with the Securities and Exchange Commission, or SEC, BF Borgers CPA (“Borgers”) was dismissed as the independent registered public accounting firm for the Company effective as of March 21, 2018. The dismissal of Borgers was approved by the Company’s Board of Directors. Other than an explanatory paragraph included in Borgers’ audit report for the Company’s fiscal year ended December 31, 2017, 2016 and 2015 relating to the uncertainty of the Company’s ability to continue as a “going concern”, the audit report of Borgers on the Company’s financial statements for the last three fiscal years ended December 31, 2017, 2016 and 2015, did not contain an adverse opinion or a disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope or accounting principles. During the Company’s 2017, 2016 and 2015 fiscal years and through March 21, 2018, (1) there were no disagreements with Borgers on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to the satisfaction of Borgers, would have caused Borgers to make reference to the subject matter of the disagreements in connection with their report, and (2) there were no “reportable events” as that term is defined in Item 304(a)(1)(v) of Regulation S-K.

As a result of the dismissal of Borgers as the independent registered public accounting firm for the Company, on April 2, 2018, the Company engaged L&L CPAS, PA, a PCAOB and CPAB registered firm (“L&L”). Neither we, nor anyone on our behalf, has consulted with L&L regarding (i) the type of final audit opinion that might be rendered on the Company’s financial statements and neither a written report nor oral advice was provided to the Company that L&L concluded was an important factor considered by the Company in reaching a decision as to any accounting, auditing, or financial reporting issue, (ii) any matter that was the subject of a disagreement within the meaning of Item 304(a)(1)(iv) of Regulation S-K, or (iii) any reportable event within the meaning of Item 304(a)(1)(v) of Regulation S-K.

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis may include statements regarding our expectations with respect to our future performance, liquidity, and capital resources. Such statements, along with any other non-historical statements in the discussion, are forward-looking. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, factors listed in other documents we file with the Securities and Exchange Commission (SEC). We do not assume an obligation to update any forward- looking statement. Our actual results may differ materially from those contained in or implied by any of the forward-looking statements in this Form 10-Q. See “SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS” above.

Sugarmade, Inc. (hereinafter referred to as “we”, “us” or “the/our Company”) is a publicly traded company incorporated in state of Delaware. Our previous legal name was Diversified Opportunities, Inc. Our Company primarily operates through our subsidiary, Sugarmade, Inc., a California corporation (“SWC Group, Inc., - CA”). We are headquartered in Monrovia, California, a suburb of Los Angeles, with an additional warehouse location in Southern California. As of

date of this filing, we employ 21 full and part-time workers and contractors.

As of the end of the reporting period, December 31, 2018, we were involved in several businesses including, the supply of products to the quick service restaurant sub-sector of the restaurant industry and as an importer, distributor and marketer of hydroponic supplies to various agricultural sectors. We had previously been a marketer of culinary seasoning products Seasoning Stix and Sriracha Seasoning Stix and a marketer of tree-free paper products. These products were discontinued during 2018 in order to focus the majority of our corporate resources on the marketing of hydroponic supplies.

As of the date of this filing and moving into the future, our primary focus we be on supplying the hydroponic and indoor/outdoor cultivation agricultural market sectors, including the cannabis cultivation, processing and distribution sectors. While our entrance into this business sector was announced during late November 2017, we did not begin to recognize revenues from these operation until later in calendar 2018.

Table of Contents

Our board of directors believes the Company has a significant market opportunity to act as a supplier to the legal cannabis cultivation, processing and distribution market sectors. We approach these markets as a supplier of products to legal market participants and do not engage in the business of cultivating, processing or distributing cannabis or any products that contain cannabis. While our primary focus has been on companies engaged in such business operations on the west coast of the United States, our business has significantly expanded as legal medical and recreational cannabis business activities have proliferated into many other states.

While our business is rapidly expanding across most of the United States and across the west coast, California remains an important marketplace due both the sheer size of the State's economy and due to the rapid embrace of legalization. We also believe the Company has strong revenue expansion opportunities within the retail hydroponic agricultural sector as these businesses are complementary to our current business. We are currently in process of analyzing several acquisitions for expansion in this area.

In December of 2017, we announced a Master Marketing Agreement with BizRight, LLC where the Company would market BizRight's products. The Company also gained an option to acquire all of BizRight's operations. We began recognizing revenues under this marketing agreement during late calendar 2018 and expect to begin recognizing an increasing amount of revenue under the Master Marketing Agreement as we move further into calendar 2019.

Also during 2017, Sugarmade announced the signing of an exclusive distribution agreement for California, Oregon and Washington with privately held Plantation Corp. for its BudLife preservation technology based on integration of specialized gases and natural agents that dramatically extends the useful life of medical marijuana up to six (6) months by actively monitoring the internal containers environment and automatically adjusting its atmosphere as needed. Sugarmade has conducted initial product prototype testing of the BudLife product, realizing positive results. Sugarmade plans to move forward as Plantation's distribution partner upon availability of the BudLife product line. As of the end of the reporting period, the Company is awaiting final product availability in order to begin marketing the products under the Agreement.

During October 2018, the Company signed a Letter of Intent to acquire Sky Unlimited, LLC doing business as Athena United, a Southern California-based, supplier of hydroponic cultivation supplies to the wholesale sector and to large commercial cultivators. Athena United operates its ecommerce website at www.AthenaUnited.com. Under the terms of the Agreement, which contains both binding and non-binding elements, Sugarmade will acquire all of the outstanding capital stock and the business operations for a combination of cash and common shares of Sugarmade. Athena United, and its associated operations, is believed to be one of the larger operators in this market sector and is producing revenues of approximately \$40 million per year, is profitable, and cash flow positive. Should the Company be successful in its acquisition efforts, the operation would be integrated under the Sugarmade corporate umbrella with Sugarmade assuming all operations and recognizing all revenues and profits.

During January of 2019, the Company announced its intention to acquire a retail location of Washington State-based Hydro4Less. The operation is expected to produce approximately \$5 million in revenues and to be profitable during

calendar 2019. Additionally, via the pending transaction, Sugarmade will gain an option to purchase two additional Hydro4Less retail operations, which are currently producing in excess of \$20 million annually. Should all three Hydro4Less acquisitions close, Sugarmade will increase its annual revenues by approximately \$25 million per year.

Via the marketing agreement with BizRight, LLC and the acquisitions of Athena United and Hydro4Less, the Company believes it could become one of the largest and fast growing market participants in the cannabis and other agricultural supply/hydroponic industries. As has been also outlined and disclosed in other corporate filings, there can be no assurances these acquisitions will close and that such revenues will be realized by the Company.

Table of Contents

We plan to continue our business pursuits relative to our CarryOutSupplies.com business, which is a producer and wholesaler of custom printed and generic supplies servicing more than 2,000 quick service restaurants. Our products include double poly paper cups for cold beverage; disposable, clear, plastic cold cups, paper coffee cups, yogurt cups, ice cream cups, cup lids, cup sleeves, food containers, soup containers, plastic spoons and many other similar products for this market sector. CarryOutSupplies.com was founded in 2009. Carryoutsupplies management estimates it holds and approximately 20% to 30% market share of generic and printed products within the take out frozen yogurt and ice cream industries.

Employees and consultants

The company employees approximately 15 full-time and part-time workers, and consultants, most of whom work within the City of Monrovia, California headquarters location, while small numbers are in our distribution warehouse located in Duarte, California.

Overview and Financial Condition

Discussions with respect to our Company's operations included herein refer to our operating subsidiary, Sugarmade-CA. Our Company purchased Sugarmade-CA on May 9, 2011. As of the date of this filing, we had no other operations other than those of Sugarmade-CA. Information with respect to our Company's nominal operations prior to the Sugarmade Acquisition is not included herein.

Results of Operations

The following table sets forth the results of our operations for the three months ended December 31, 2018 and 2017.

	For the three months ended December 31,	
	2018	2017
Net Sales	1,445,269	938,754
Cost of Goods Sold:	1,071,033	657,249
Gross profit	374,236	281,505
Operating Expenses	3,823,085	1,033,316
Loss From Operations	(3,448,849)	(751,811)

Edgar Filing: Sugarmade, Inc. - Form 10-Q

Other non-operating Income (Expense):	(2,584,531)	(5,223,504)
Net Income (Loss)	(6,033,380)	(5,975,315)

Revenues

For the three-months ended December 31, 2018 and 2017, revenues were \$1,445,269 and \$938,754, respectively. The increase was primarily due to seasonality changes within the yogurt and restaurant supply industry.

Table of Contents

Cost of goods sold

For the three-month ended December 31, 2018 and 2017, costs of goods sold were \$1,071,033 and \$657,249 respectively. The increase was primarily due to the frozen yogurt sector expanding and preparing for the industry's pick-up in its seasonal trend.

Gross profit

For the three-month ended December 31, 2018 and 2017, gross profit was \$374,236 and \$281,505, respectively. The increase was primarily due to a combination of refocus on the types of products sold by the Company and pivot and expansion into a new industry.

Operating expenses

For the three-month ended December 31, 2018 and 2017, operating expenses were \$3,823,085 and \$1,033,316, respectively. The increase was attributable to issuing all of the stock compensation expenses for employees, legal, and consulting fees.

Other non-operating income (expense)

The Company had total other non-operating expense of \$2,584,531 and expense of \$5,223,504 for the three months ended December 31, 2018 and 2017, respectively. The decrease in non-operating income is related to the accounting for derivative liabilities.

Net income (loss)

Net loss totaled \$6,033,380 for the three month ended December 31, 2018, compared to a net loss totaling \$5,975,315 for the three-month ended December 31, 2017. The increase was attributable to issuing all of the stock compensation expenses for employees, legal, and consulting fees.

Edgar Filing: Sugarmade, Inc. - Form 10-Q

The following table sets forth the results of our operations for the six months ended December 31, 2018 and 2017.

	For the six months ended	
	December 31,	
	2018	2017
Net Sales	\$2,886,885	2,115,968
Cost of Goods Sold:	2,130,452	1,510,199
Gross profit	756,433	605,769
Operating Expenses	4,736,957	2,052,304
Loss From Operations	(3,980,524)	(1,446,535)
Other non-operating Income (Expense):	(4,661,909)	(5,618,114)
Net Income (Loss)	(8,642,433)	(7,064,649)

Revenues

For the six-months ended December 31, 2018 and 2017, revenues were \$2,886,885 and \$2,115,968, respectively. The increase was primarily due to seasonality changes within the yogurt and restaurant supply industry.

Table of Contents

Cost of goods sold

For the six-month ended December 31, 2018 and 2017, costs of goods sold were \$2,130,452 and \$1,510,199 respectively. The increase was primarily due to the frozen yogurt sector expanding and preparing for the industry's pick-up in its seasonal trend.

Gross profit

For the six-month ended December 31, 2018 and 2017, gross profit was \$756,433 and \$605,769, respectively. The increase was primarily due to a combination of refocus on the types of products sold by the Company and pivot and expansion into a new industry.

Operating expenses

For the six-month ended December 31, 2018 and 2017, operating expenses were \$4,736,957 and \$2,052,304, respectively. The increase was attributable to issuing all of the stock compensation expenses for employees, legal, and consulting fees.

Other non-operating income (expense)

The Company had total other non-operating expense of \$4,661,909 and expense of \$5,618,114 for the six months ended December 31, 2018 and 2017, respectively. The decrease in non-operating income is related to the accounting for derivative liabilities.

Net income (loss)

Net loss totaled \$8,642,433 for the six month ended December 31, 2018, compared to a net loss totaling \$7,064,649 for the six-month ended December 31, 2017. The increase was attributable to issuing all of the stock compensation expenses for employees, legal, and consulting fees.

Liquidity and Capital Resources

We have primarily financed our operations through the sale of unregistered equity and convertible notes payable. As of December 31, 2018, our Company had cash balance of \$159,671 current assets totaling \$3,238,056 and total assets of \$3,544,462. We had current and total liabilities totaling \$5,659,587. Stockholders' equity reflected a deficiency of \$2,115,125.

The following is a summary of cash provided by or used in each of the indicated types of activities during the six-months ended December 31, 2018 and 2017:

	2018	2017
Cash (used in) provided by:		
Operating activities	\$(1,060,982)	\$(1,111,362)
Investing activities	87,154	(144,906)
Financing activities	856,278	1,187,801

Table of Contents

Net cash used in operating activities was \$1,060,982 for the six months ended December 31, 2018, and \$1,111,362 for the six months ended December 31, 2017.

There were \$87,154 fixed assets and intangible assets purchased during the six months ended December 31, 2017 relating to investing activities.

Net cash provided by financing activities was \$856,278 for the six months ended December 31, 2018 and \$1,187,801 for the six months ended December 31, 2017.

Our capital requirements going forward will consist of financing our operations until we are able to reach a level of revenues and gross margins adequate to equal or exceed our ongoing operating expenses. Other than the notes payable discussed above, borrowings from our bank and the production credit facility with our suppliers, we do not have any credit agreement or source of liquidity immediately available to us.

Given estimates of our Company's future operating results and our credit arrangements with our suppliers, we are currently forecasting that we will need to secure additional financing to obtain adequate financial resources to reach profitability. As of the date of this report, we estimate that the cash necessary to implement our current business plan for the next twelve months is approximately \$2,000,000.

Based on our need to raise additional funds to implement our business plans for the next twelve months, we have included a discussion concerning the presentation of our financial statements on a going concern basis in the notes to our financial statements and our independent public accountants have included a similar discussion in their opinion on our financial statements through June 30, 2018. We will be required in the near future to issue debt or sell our Company's equity securities in order to raise additional cash, although there are no firm arrangements in place for any such financing at this time. We cannot provide any assurances as to whether we will be able to secure the necessary financing, or the terms of any such financing transaction if one were to occur. The failure to secure such financing could severely curtail our plans for future growth or in more severe scenarios, the continued operations of our Company.

Capital Expenditures

Our current plans do not call for our Company to expend significant amounts for capital expenditures for the foreseeable future beyond relatively insignificant expenditures for office furniture and information technology related equipment as we add employees to our Company. We are however continually evaluating the production processes of our third party contract manufacturers to determine if there are investments we could make in their processes to

achieve manufacturing improvements and significant cost savings. Any such desired investments would require additional cash above our current forecast requirements.

Critical Accounting Policies Involving Management Estimates and Assumptions

Please see the notes to our financial statements.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Intentionally omitted pursuant to Item 305(e) of Regulation S-K.

ITEM 4 – CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

-32-

Table of Contents

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance of achieving the desired control objectives. In reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

As required by the Securities and Exchange Commission Rule 13a-15(e) and Rule 15d-15(e), we carried out an evaluation, under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that as of December 31, 2018, our disclosure controls and procedures were ineffective due to the Company is relatively inexperienced with certain complexities within USGAAP and SEC reporting.

We have taken, and are continuing to take, certain actions to remediate the material weakness related to our lack of U.S. GAAP experience. We plan to hire additional credentialed professional staff and consulting professionals with greater knowledge and experience of U.S. GAAP and related regulatory requirements to oversee our financial reporting process in order to ensure our compliance with U.S. GAAP and other relevant securities laws. In addition, we plan to provide additional training to our accounting personnel on U.S. GAAP, and other regulatory requirements regarding the preparation of financial statements.

Notwithstanding the above identified material weakness, the Company's management believes that its condensed consolidated financial statements included in this report fairly present in all material respects the Company's financial condition, results of operations and cash flows for the periods presented and that this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

Changes in Internal Controls over Financial Reporting

There have not been any changes in our internal controls over financial reporting during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents

PART II: Other Information

ITEM 1 – RISK FACTORS

Investment in our common stock involves a high degree of risk. You should carefully consider the risks described below together with all of the other information included in this herein before making an investment decision. If any of the following risks actually occur, our business, financial condition or results of operations could suffer. In that case, the market price of our common stock could decline, and you may lose all or part of your investment. You should also read the section entitled “Special Notes Regarding Forward-Looking Statements” below for a discussion of what types of statements are forward-looking statements as well as the significance of such statements in the context of this report.

Investment in our common stock involves a high degree of risk. You should carefully consider the risks described below together with all of the other information included in this herein before making an investment decision. If any of the following risks actually occur, our business, financial condition or results of operations could suffer. In that case, the market price of our common stock could decline, and you may lose all or part of your investment.

The Company, as of the end of the 2018 fiscal year (June) was at a stage where it requires external capital to continue with its business. It must obtain additional significant capital in the future to continue its operations. There can be no certainty that the Company can obtain these funds.

ITEM 2 –UNREGISTERED SALES OF SECURITIES AND USE OF PROCEEDS

There were no sales of unregistered securities during the period.

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 – MINE SAFETY DISCLOSURES

None.

ITEM 5 – OTHER INFORMATION

None

-34-

Table of Contents

ITEM 6 – EXHIBITS

Exhibit No.	Description
31.1	(1) <u>Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	(1) <u>Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	(1) <u>Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS*	(1) XBRL Instance Document
101.SCH*	(1)

XBRL
Taxonomy
Extension
Schema

101.CAL* (1) XBRL
Taxonomy
Extension
Calculation
Linkbase

101.DEF* (1) XBRL
Taxonomy
Extension
Definition
Linkbase

101.LAB* (1) XBRL
Taxonomy
Extension Label
Linkbase

101.PRE* (1) XBRL
Taxonomy
Extension
Presentation
Linkbase

(1) Filed as an exhibit to this Report.

Table of Contents

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.

Sugarmade, Inc., a Delaware
corporation

February 21, 2019 By: /s/ Jimmy Chan
Jimmy Chan
CEO, CFO, and Director