

Sugarmade, Inc.  
Form 10-Q  
December 26, 2018

**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: September 30, 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**  
(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 December 26, 2018, there were 617,912,116 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 SEPTEMBER 30, 2018**

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## **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**

|  | September 30,<br>2018<br>(Unaudited) | June 30, 2018<br>(Audited) |
|--|--------------------------------------|----------------------------|
| Assets   |                                      |                            |
| Current assets:  |                                      |                            |
| Cash   | \$ 120,749                           | \$ 42,121                  |
| Accounts receivable, net   | 383,404                              | 453,623                    |
| Inventory, net   | 679,664                              | 531,249                    |
| Loan receivables   | 141,522                              | 157,872                    |
| Other current assets   | 930,625                              | 756,565                    |
| Total current assets   | 2,255,964                            | 1,941,432                  |
| Equipment, net   | 183,376                              | 195,180                    |
| Intangible assets, net   | 12,250                               | 12,600                     |
| Other assets   | 38,751                               | 38,751                     |
| Total assets   | \$ 2,490,340                         | \$ 2,187,963               |
| Liabilities and Stockholders' Equity (Deficiency)  |                                      |                            |
| Current liabilities:   |                                      |                            |
| Note payable due to bank   | \$ 25,982                            | \$ 25,982                  |
| Accounts payable and accrued liabilities   | 1,423,946                            | 1,707,641                  |
| Customer deposits  | 600,839                              | 329,509                    |
| Unearned revenue   | 40,903                               | 110,142                    |
| Other payable  | 278,747                              | 241,771                    |
| Accrued interest   | 559,276                              | 493,365                    |
| Accrued compensation and personnel related payables  | 732,673                              | 869,673                    |
| Note Payable   | 20,000                               | 20,000                     |
| Notes payable – related parties  | 23,000                               | 23,000                     |
| Loans payable  | 317,729                              | 329,029                    |
| Loans payable – related parties  | 301,392                              | 30,000                     |
| Convertible notes payable, net   | 1,594,380                            | 2,399,941                  |
| Derivative liabilities   | 2,423,716                            | 3,069,616                  |
| Warrants liabilities   | 17,675                               | 40,400                     |
| Shares to be issued  | 2,556,000                            | 2,691,000                  |
| Total liabilities  | 10,916,259                           | 12,381,069                 |
| Stockholders' equity (deficiency):   |                                      |                            |
| Preferred stock (\$0.001 par value, 10,000,000 shares authorized, none issued and outstanding)   | —                                    | —                          |
| Common stock (\$0.001 par value, 1,990,000,000 shares authorized, 280,107,717 and 246,135,203 shares issued and outstanding at September 30, 2018 and June 30, 2018, respectively) | 280,109                              | 246,136                    |

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|   |              |              |
|---|--------------|--------------|
| Additional paid-in capital                              | 25,888,378   | 21,952,560   |
| Shares to be issued, preferred shares                   | 2,000,000    | 2,000,000    |
| Shares to be issued, common shares                      | 874,446      | 467,996      |
| Accumulated deficiency                                  | (37,468,851) | (34,859,799) |
| Total stockholders' equity (deficiency)                 | (8,425,919 ) | (10,193,106) |
| Total liabilities and stockholders' equity (deficiency) | \$2,490,340  | \$2,187,963  |

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

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Table of Contents**Sugarmade, Inc. and Subsidiary****Condensed Consolidated Statements of Operations****For the three months ended September 30, 2018 and 2017**

|  | Three months ended<br>September 30, |                |
|--|-------------------------------------|----------------|
|  | 2018                                | 2017           |
|  | (Unaudited)                         | (Audited)      |
| Revenues, net  | \$1,445,010                         | \$1,177,214    |
| Cost of goods sold:                                  | 1,059,418                           | 852,949        |
| Gross profit   | 385,591                             | 324,264        |
| Operating expenses:                                  |                                     |                |
| Selling, general and administrative expenses         | 913,872                             | 1,018,988      |
| Total operating expenses                             | 913,872                             | 1,018,988      |
| Loss from operations                                 | (528,281 )                          | (694,724 )     |
| Non-operating income (expense):                      |                                     |                |
| Other income   | 255                                 | —              |
| Interest expense                                     | (281,378 )                          | (131,633 )     |
| Change in fair value of derivative liabilities       | (1,641,457 )                        | (140,653 )     |
| Other expense  | —                                   | (122,325 )     |
| Gain on debt conversion                              | 8,763                               | —              |
| Loss on debt settlement                              | (161,675 )                          | —              |
| Amortization of debt discount                        | (28,006 )                           | —              |
| Warrant Expense                                      | 22,725                              | —              |
| Total non-operating income (expense)                 | (2,080,772 )                        | (394,610 )     |
| Net income (loss)                                    | \$(2,609,053 )                      | \$(1,089,334 ) |
| Basic net income (loss) per share                    | \$(0.01 )                           | \$(0.01 )      |
| Diluted net income (loss) per share                  | \$(0.01 )                           | \$(0.01 )      |
| Basic weighted average common shares outstanding     | 264,975,211                         | 231,376,890    |
| Diluted weighted average common shares outstanding * | 264,975,211                         | 231,376,890    |

\* 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*

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Table of Contents**Sugarmade, Inc. and Subsidiary****Condensed Consolidated Statements of Cash Flows For****the three months ended September 30, 2018 and 2017****(Unaudited)**

|  | For the three months<br>ended September 30, |               |
|--|---|---------------|
|  | <b>2018</b>                                 | 2017          |
| Cash flows from operating activities:                                      |   |               |
| Net loss   | \$(2,609,053)                               | \$(1,089,334) |
| Adjustments to reconcile net loss to cash flows from operating activities: |   |               |
| Initial valuation of debt discount   | (262,500 )                                  | —             |
| Loss on settlement   | 161,675                                     | —             |
| Amortization of debt discount  | 455,084                                     | 91,906        |
| Stock based compensation   | 197,500                                     | 180,000       |
| Change in fair value of derivative liability                               | 1,641,457                                   | 152,790       |
| Amortization of Intangible Assets  | 350   | —             |
| Change in exercise of warrant  | (22,725 )                                   | —             |
| Depreciation and amortization  | 11,804                                      | 13,506        |
| Changes in assets and liabilities:   |   |               |
| Accounts receivable  | 70,219                                      | (243,064 )    |
| Inventory  | (148,415 )                                  | 47,646        |
| Prepayment, deposits and other receivables                                 | (174,058 )                                  | —             |
| Other assets   | —   | 100,631       |
| Bank overdraft   | —   | 30,729        |
| Accounts payable and accrued liabilities                                   | (270,920 )                                  | 10,459        |
| Customer deposits  | 271,330                                     | (52,101 )     |
| Unearned revenue   | (69,239 )                                   | 51,412        |
| Interest Payable   | 100,201                                     | —             |
| Accrued interest and Other payables  | 36,976                                      | 33,998        |
| Net cash used in operating activities                                      | (610,314 )                                  | (692,508 )    |
| Cash flows from investing activities:                                      |   |               |
| Acquisition of intangible assets   | —   | (11,755 )     |
| Acquisition of property and equipment                                      | —   | (127,541 )    |
| Net cash used in investing activities                                      | —   | (139,316 )    |
| Cash flows from financing activities:                                      |   |               |
| Proceeds from shares to be issued  | —   | 104,690       |
| Proceeds from shares issuance  | 235,000                                     | —             |
| Proceeds from convertible notes  | 267,500                                     | 660,468       |

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|  |            |            |
|--|------------|------------|
| Payment to Note payable-related parties                  | —          | (11,666 )  |
| Proceeds (Repayment) from(to) loans                      | (11,300 )  | (44,637 )  |
| Proceeds from loan payable-related parties               | 271,392    | 12,015     |
| Proceeds from advance share issuance                     | (90,000 )  | 104,690    |
| Loan receivable  | 16,350     | 10,000     |
| Net cash provided by financing activities                | 688,942    | 730,870    |
| Net increase (decrease) in cash                          | 78,628     | (100,954 ) |
| Cash paid during the period for:                         |            |            |
| Cash, beginning of period                                | 42,121     | 101,880    |
| Cash, end of period                                      | \$ 120,749 | \$ 926     |
| Supplemental disclosure of non-cash financing activities |            |            |
| Shares issued for conversion of convertible debt         | 872,857    | —          |
| Reduction in derivative liability due to conversion      | 2,714,433  | —          |
| Debt discount related to convertible debt                | 427,077    | —          |
| Debts settled through shares issuance                    | 12,775     | 416,304    |

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

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**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 through our subsidiary, Sugarmade, Inc., a California corporation ("SWC Group, Inc., - CA"). As of the end of the reporting period, June 30, 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 a distributor of paper products derived from non-wood sources. We are headquartered in Monrovia, California, a suburb of Los Angeles, with two (2) additional warehouse locations in Southern California. As of date of this filing, we employ 7 full-time workers.

Our Board of Directors believes the legal cannabis-related supply sector could be highly lucrative for the Company, and thus we plan to pursue a strategy of expanding operations within this area. According to the State of Legal Marijuana Markets Report (4th Edition), published by Arc View Market Research and produced by New Frontier, California is the largest medical marijuana program in the country among states where medical marijuana is currently legal. The California market is fueled by the state's large size, longevity as the first-in-the-nation medical marijuana program, and low barriers to patient access. Even with California's newly passed recreational marijuana law, which will significantly tighten the program with new restrictions; the market is still projected to reach \$2.6 billion in sales in 2020. That is nearly double Colorado's \$1.5 billion, and over five times the size of the markets in Arizona, Oregon, and Michigan for that year. If legalized in 2016, the medical marijuana markets in Ohio and Pennsylvania will become two of the largest in the country by 2020. According to the data, a handful of states in the western U.S. project to command over 50% of the medical marijuana market by 2020. As more and more states legalize both medical and recreational cannabis, we believe our company can benefit from our Internet and e-commerce marketing activities.

As of the date of this filing, our main business operation, CarryOutSupplies.com, is a producer and wholesaler of custom printed and generic supplies servicing more than 3,000 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 approximately 40% market share of generic and printed products within the take-out frozen yogurt and ice cream industries.

Sugarmade, Inc. was founded in 2010. As is explained below, in 2014, CarryOutSupplies.com was acquired by Sugarmade, Inc., creating the Company as it is today. Relative to Sugarmade Paper, our third- party contract manufacturer uses bagasse and bamboo, as opposed to wood products significantly reducing its manufacturing carbon footprint, energy consumption, and attendant water pollution during the manufacture of its products. This allows us to offer our unique, exclusive, tree-free paper products at price-parity equal to or less than current recycled fiber products already on the market. Our products are unique and we believe offer an ideal solution for those consumers (both corporate and individual) seeking to meet their sustainability mandates or personal environmentally conscious goals, at a price that is equal to or less than current recycled products.

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During September of 2016, the Company completed negotiations for and signed a license agreement with HUY FONG FOODS, INC. ("HFFI"), the maker of Sriracha Hot Chili Sauce. Under the terms of the agreement, the Company is granted license to use the licensed marks of HFFI on and for products the Company is currently in process of designing and testing. Based on this agreement and a separate license agreement signed during 2015 with Seasoning Stix International, LLC, the Company plans to introduce a new culinary seasoning product named Sriracha Seasoning Stix. Sriracha Seasoning Stix are encapsulated Huy Fong Sriracha Sauce and other seasonings in the form of a stick, which are inserted into meat, fish and poultry prior to cooking. Sriracha Seasoning Stix are a hard solid at room temperature, but as heat is applied the sticks begin to liquefy allowing the meat fibers to act like a sponge absorbing the seasonings and flavors that had previously been encapsulated in the stick. The Company launched its SrirachaStix.com web platform using Shopify on October 1, 2017, and aggressive marketing tactic has been implemented via a nationwide advertising and social media campaign. As of the date of this filing, this newly built website had already generated over \$150,000 in online revenue.

***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 September 30, 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 three months ended September 30, 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.

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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.

### *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 \$383,404 as of September 30, 2018 and of \$453,623 as of June 30, 2018.



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***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 September 30, 2018 and June 30, 2018, the balance for the inventory totaled \$679,664 and \$531,249, respectively. Obsolescence reserve at September 30, 2018 and June 30, 2018 were \$120,486, respectively.

***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.

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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 September 30, 2018.

***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 Black-Scholes-Merton 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:

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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.

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The Company used Level 2 inputs for its valuation methodology for the derivative liabilities in determining the fair value using the Black-Scholes option-pricing model for the three months ended September 30, 2018.

|                        | Carrying<br>Value<br>As of<br>September<br>30,<br>2018 | Fair Value<br>Measurements at<br>September 30, 2018<br>Using Fair Value<br>Hierarchy |         |             |
|------------------------|--|--|---------|-------------|
|                        |  | Level 1  | Level 2 | Level 3     |
| Liabilities            |  |  |         |             |
| Derivative liabilities | \$2,423,716  | \$—  | \$—     | \$2,423,716 |
| Total                  | \$2,423,716  | \$—  | \$—     | \$2,423,716 |

|                         | June<br>30,<br>2018 | September 30,<br>2018 |
|-------------------------|---------------------|-----------------------|
| Expected life (years)   | 0.5                 | 0.5                   |
| Risk-free interest rate | 2.06 %              | 2.37 %                |
| Expected volatility     | 151 %               | 117 %                 |

|                        | Carrying<br>Value<br>As of<br>June 30,<br>2018 | Fair Value<br>Measurements at<br>June 30, 2018<br>Using Fair Value<br>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 Black-Scholes- Merton 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.

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**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.

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.

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**3. Concentration**

**Customers**

For the three months ended September 30, 2018 and 2017, our Company earned net revenues of \$1,445,010 and \$1,177,214 respectively. The vast majority of these revenues for the period ending September 30, 2018 were derived from a large number of customers, whereas the vast majority of these revenues for the period ending September 30, 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 September 30, 2018.

**Suppliers**

For the three months ended September 30, 2018, we purchased products for sale by the company's subsidiaries 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 28.40% and 21.60% of the Company's total inventory purchase for the three months ended September 30, 2018, respectively.

**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 manufacturer of cannabis and 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 Sept 30, 2018, the shares to be issued in connection with the acquisition of exclusive license rights has not been issued therefore the transaction has not been completed. \$550,000 in cash has been paid and reflected as a prepaid

deposit in other current assets on our balance sheet.

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**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 agreed to settlement terms. However, the settlement has not been finalized and is currently pending.
- 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 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.
- 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.

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

Table of Contents**6. Other Current Assets**

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

|                   | For the periods ended |               |
|-------------------|-----------------------|---------------|
|                   | September 30, 2018    | June 30, 2018 |
| Prepaid Deposit   | \$555,500             | \$355,500     |
| Prepaid Inventory | 114,673               | 92,737        |
| Employees Advance | 41,303                | 41,303        |
| Prepaid Expenses  | 209,421               | 246,260       |
| Other             | 9,728                 | 20,765        |
| Total:            | \$930,625             | \$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 \$350 and \$1,400 for the periods ended September 30, 2018 and June 30, 2018, respectively.

**8. Convertible Notes**

As of September 30, 2018 and June 30, 2018, the balance owing on convertible notes, net of debt discount, with terms as described below was \$1,594,380 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 September 30, 2018, the note is in default.

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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 September 30, 2018, the note is in default.

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 September 30, 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 September 30, 2018, the note is in default.

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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 September 30, 2018, the note is in default.

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 September 30, 2018, the note is in default.

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 September 30, 2018, the note is in default.

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 September 30, 2018, the note is in default.

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 September 30, 2018, the note is in default.

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 June 30, 2018, the note is in default.

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 September 30, 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 September 30, 2018, the note is in default.

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 September 30, 2018, the note is in default.

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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 September 30, 2018, the note is in default.

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 three months ended September 30, 2018, the Company converted \$425,000 into the Company's common stock, the remaining balance of the note was \$496,004 as of September 30, 2018 and the fair value of the warrant liability was \$17,675. As of September 30, 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 September 30, 2018, the note is in default.

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 September 30, 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 September 30, 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 September 30, 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 September 30, 2018, the note has been fully converted.

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.

Convertible notes issued during the period ended September 30, 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.

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As of the period ended September 30, 2018, the Company's convertible notes consisted of following:

| <u>Balance</u><br><u>as of</u><br><u>06.30.2018</u> | <u>Default</u><br><u>Penalty</u> | <u>Addition/</u><br><u>Repayment</u> | <u>Conversion</u><br><u>in</u><br><u>principal</u> | <u># of</u><br><u>shares</u> | <u>Balance</u><br><u>as of</u><br><u>09.30.2018</u> | <u>Due Date</u> | <u>Interest</u><br><u>Rate</u> | <u>Conversion</u><br><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  | 7/17/2017       | 10 %                           | 40% discount of average price of last 20 trading days prices                                      |
| 25,000  | —                                | —                                    | —  | —                            | 25,000  | 7/17/2017       | 8 %                            | 40% discount of average two lowest price of last 20 trading days prices                           |
| 50,000  | —                                | —                                    | —  | —                            | 50,000  | 8/8/2017        | 8 %                            | 40% discount of average two lowest price of last 20 trading days prices                           |
| 80,000  | —                                | —                                    | —  | —                            | 80,000  | 7/20/2017       | 8 %                            | 40% discount of average two lowest price of last 20 trading days prices                           |
| 66,023  | —                                | —                                    | —  | —                            | 66,023  | 8/24/2017       | 8 %                            | 40% discount of average two lowest price of last 20 trading days prices                           |
| 50,000  | —                                | —                                    | —  | —                            | 50,000  | 8/9/2017        | 8 %                            | 40% discount of average two lowest price of last 20 trading days prices                           |
| 75,000  | —                                | —                                    | —  | —                            | 75,000  | 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  | 9/23/2017       | 8 %                            | 40% discount of average two lowest price of last 20 trading days prices                           |
| 30,000  | —                                | —                                    | —  | —                            | 30,000  | 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   | 9/30/2017       | 8 %                            | 40% discount of average two lowest price of last  |

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|                  |                |                |                   |                  |         |           |      |   |
|------------------|----------------|----------------|-------------------|------------------|---------|-----------|------|---|
| 921,004          | —              | —              | 425,000           | 14,907,323       | 496,004 | 5/12/2018 | 22 % | 20 trading days prices<br>45% discount of lowest<br>price of last 20 trading<br>days prices |
| 150,000          | —              | —              | 150,000           | 3,745,330        | —       | 5/3/2018  | 10 % | 45% discount to average<br>of 3 lowest trading price<br>during last 20 trading<br>days      |
| 150,000          | —              | —              | 150,000           | 3,744,005        | —       | 6/15/2018 | 10 % | 42% discount to average<br>of 3 lowest trading price<br>during last 20 trading<br>days      |
| 164,900          | —              | —              | —                 | —                | 164,900 | 7/17/2018 | 8 %  | The conversion price<br>shall be \$0.025 per share  |
| 35,000           | —              | —              | 35,000            | 691,184          | —       | 8/22/2018 | 8 %  | 40% discount of average<br>two lowest price of last<br>20 trading days prices               |
| 15,000           | —              | —              | 15,000            | 294,114          | —       | 9/26/2018 | 8 %  | 40% discount of average<br>two lowest price of last<br>20 trading days prices               |
| 50,000           | —              | —              | —                 | —                | 50,000  | 12/7/2018 | 8 %  | The conversion price<br>shall be \$0.05 per share   |
| —                | —              | 267,500        | —                 | —                | 267,500 | 9/15/2019 | 8 %  | 55% discount of lowest<br>price of last 20 trading<br>days prices                           |
| <b>2,426,245</b> | <b>267,500</b> | <b>838,567</b> | <b>27,301,360</b> | <b>1,855,178</b> |         |           |      |   |

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In connection with the convertible debt, debt discount balance as of September 30, 2018 and June 30, 2018 were \$260,798 and \$26,303 respectively and were being amortized and recorded as interest expenses over the term of the convertible debt.

As of the period ended September 30, 2018, the Company's debt discount consisted of following:

| Note Date | Due Date  | OID       | Amortization in FY 2018 | Debt Discount Balance 6/30/2018 | Amortization in 9/30/2018 | Debt Discount Balance 9/30/2018 |
|-----------|-----------|-----------|-------------------------|---------------------------------|---------------------------|---------------------------------|
| 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 | 850,000   | 36,849                  | 13,151                          | 7,562                     | 5,589                           |
| 9/20/2018 | 9/15/2019 | 12,500    | —                       | —                               | 347                       | 12,153                          |
| 9/20/2018 | 9/15/2019 | 250,000   | —                       | —                               | 6,944                     | 243,056                         |
| Total:    |           | \$527,400 | \$41,302                | \$26,303                        | \$28,006                  | \$260,798                       |

**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 September 30, 2018 and June 30, 2018, the derivative liability was \$2,423,716 and \$3,069,616, respectively. The Company recorded \$1,641,457 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:

|                         | <b>September 30, 2018</b> |   |
|-------------------------|---------------------------|---|
| Annual dividend yield   | —                         |   |
| Expected life (years)   | 0.5-1.00                  |   |
| Risk-free interest rate | 2.15-2.37%                |   |
| Expected volatility     | 87-123 %                  |   |
|                         | <b>June 30, 2018</b>      |   |
| 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:

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|   |             |
|---|-------------|
| 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 |

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Table of Contents**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 September 30, 2018 and June 30, 2018, the fair value of the warrant liability was \$17,675 and \$40,400, respectively. The Binomial Option Price Model with the following assumption inputs:

|                             |                               |   |
|-----------------------------|-------------------------------|---|
| Warrants liability          | <b>September 30,<br/>2018</b> |   |
| Annual dividend yield       | —                             |   |
| Expected life (years)       | 0.5                           |   |
| Risk-free interest rate     | 2.36                          | % |
| Expected volatility         | 117                           | % |
| Warrants issued in May 2017 | <b>June 30, 2018</b>          |   |
| 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 September 30, 2018:

|                                   | <b>Number of<br/>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>contractual<br/>life</b> |
|-----------------------------------|-----------------------------|--|--|
| Outstanding at June 30, 2016      | 131,250                     | \$ 0.20  |  |
| Granted                           | 131,250                     | 0.20   | 4  |
| Exercised                         | 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 September 30, 2018 | 505,000                     | \$ 0.15  | 0.5  |

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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 September 30, 2018 and June 30, 2018, the loan principal balance was \$25,982. As of September 30, 2018, the note is in default.

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 September 30, 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 September 30, 2018 and June 30, 2018, this note had a balance of \$5,000 and \$20,000, respectively.

As of September 30, 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.



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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.

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.

As of September 30, 2018 and June 30, 2018, the Company had 280,107,717 and 246,135,203 shares of its common stock issued and outstanding.

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**12. Common shares to be issued for services**

In September 2017, the Company issued 4,736,842 shares of commons stock for services. The fair value of the shares was valued at \$0.04, the closing price of the grant date. The shares have been issued at December 2018.

In September 2018, the Company entered into a settlement agreement with one of its vendors. The Company issued 1,500,000 shares of the Company's common stock to settle account payable balance of \$12,775. The fair value of the shares was valued at \$0.1163 per share, the closing price of the grant date. The Company recognized loss on debt settlement of \$161,675 as of September 30, 2018. The shares have been issued at December 2018.

**13. Related party transactions**

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

**14. Loans payable**

On October 1, 2017, SGMD entered a straight promissory note with Greater Asia Technology Limited (Greater Asia) for borrowing \$100,000 with maturity date on June 30, 2018; the note bears an interest rate of 33.33%. As of September 30, 2018, the note was in default and the outstanding balance under this note was \$79,524.

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 moth thereafter until the notes is paid in full, the Company shall make an interest payment. As of September 30, 2018 and June 30, 2018, the outstanding balance under this note was \$150,820. As of September 30, 2018. the note was in default. As of October 2017, they are no long a related party.

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 September 30, 2018 and June 30, 2018, the outstanding balance with Greater Asia loans were \$84,400 and \$140,125, respectively. As of September 30, 2018. the note was in default.

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On July 1, 2016, the Company entered into a repayment agreement with its employee for \$20,280 at no interest. As of September 30, 2018 and June 30, 2018, the Company has an outstanding balance of \$2,985 and \$4,285.

As of September 30, 2018 and June 30, 2018, the Company had an outstanding loan balance of \$317,729 and \$329,029, respectively from one (1) vendor of the Company.

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**15. 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 September 30, 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 LMK Capital, LLC (“LMK”) for its working capital needs. As of September 30, 2018 and June 30, 2018, the Company had outstanding balance of \$104,271 and \$0, respectively, borrowed from LMK Capital., LLC, a company affiliated with CEO Chan.

From time to time, SWC would receive short-term loans from company former director for its working capital needs. As of September 30, 2018 and June 30, 2018, the Company had outstanding balance of \$167,121 and \$0, respectively,

**16. 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.

As of September 30, 2018 and June 30, 2018, the Company had balance of \$2,556,000 and \$2,691,000 share to be issued.

**17. 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 in December 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 in December 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 in December 2018.

As of September 30, 2018, the Company had total potential shares to be issued under common stock in total amount of \$874,446.

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.

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**18. 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 1<sup>st</sup> year of the term. The monthly rent on the 1<sup>st</sup> 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.

**19. Subsequent events**

On October 7, 2018, a consultant paid the Company \$500 for an option exercised on June 8, 2018. The strike price of the option was \$0.001 per share. As of this date, the 500,000 common shares from the option exercise have yet to be issued.

On October 9, 2018, the Company issued shares in a debt settlement. A total of 500,000 shares were issued at a price of \$0.10 per shares, which settled the \$39,000 and interest owed by the Company.

On October 10, 2018, the Company issued a convertible note to an accredited investor for proceeds to the Company in the amount of \$250,000. The Company reserved 26,000,000 common shares for future maximum issuance for the eventual conversion.

On October 15, 2018, the Company signed a Letter of Intent to acquire Sky Unlimited, LLC doing business as Athena United (“Sky Unlimited”), a Southern California-based, supplier of hydroponic cultivation supplies to the wholesale sector and to large commercial cultivators. Upon execution of LOI, the Company will pay Sky Unlimited \$1,000,000 in common shares of Sugarmade at \$0.10 per share equal 10,000,000 shares, which will immediately vest as a non-refundable fee. Sugarmade will be granted 180 days to close on acquisition, If the acquisition is completed, Sky Unlimited will be compensated with cash and Sugarmade shares having a total value equaling one times annualized revenues realized by Sky Unlimited during last 2 quarters of 2018 calendar year. At the projected \$40,000,000 annualized revenue realization for Sky Unlimited for the period agreed, it is contemplated Sky Unlimited will be paid a total of \$8,000,000 in cash and \$32,000,000 in Sugarmade common shares at \$0.10 per share.

On October 16, 2018, the Company issued 2,500,000 common shares due to an accredited investor for an investment on December 21, 2017 in the amount of \$250,000 at \$0.05 per share.

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On October 16, 2018, the Company issued 10,00,000 common shares due to an accredited investor for an investment on December 21, 2017 in the amount of \$1,000,000 at \$0.10 per share.

In December 2018, the Company issued 1,000,000 shares of commons stock for services. The fair value of the shares was valued at \$0.136, the closing price of the grant date. The shares have been issued at December 2018.

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**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.



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**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, March 31, 2018, we were involved in several businesses including, 1) the supply of products to the quick service restaurant sub-sector of the restaurant industry, 2) as a distributor of paper products derived from non-wood sources and, 3) as a marketer of culinary seasoning products Seasoning Stix and Sriracha Seasoning Stix.

As of the date of this filing, the Company are involved in several businesses including:

- Supplying the hydroponic and indoor/outdoor cultivation agricultural market sectors, including the cannabis cultivation, processing and distribution sectors. While we supply products to these industries, none of our operations
- 1) involve the cultivation, processing, distribution or the engagement in any business operations regarding the cultivation, processing or distribution of any cannabis product or any product containing cannabis. While our entrance into this business sector was announced during late November 2017, we did not begin to recognize revenues from this operation until later in calendar 2018.
  - 2) The supply of genetic and custom printed products to the quick service restaurant sub-sector of the restaurant industry and,
  - 3) As a marketer and distributor of culinary seasoning products Seasoning Stix and Sriracha Seasoning Stix.

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, 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.

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During 2017, Sugarmade announced the signing of an exclusive distribution agreement for California, Oregon and Washington with privately held Plantation Corp. for its breakthrough 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.

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 25% to 40% market share of generic and printed products within the take out frozen yogurt and ice cream industries.

As of the end of the reporting period, September 30, 2018, we were also a distributor of paper made from 100% reclaimed sugarcane fiber, enhanced with bamboo. Sugarcane fiber, called bagasse, is a discarded byproduct of sugarcane production. As of the date of this filing, we have discontinued this business operation, as our board of directors determined superior revenue growth opportunities existed elsewhere within the marketplace.

Sugarmade is also a distributor of culinary seasoning products Sriracha Stix and Seasoning Stix. During September of 2016, the Company completed negotiations for and signed an agreement with HUY FONG FOODS, INC. ("HFFI"), the maker of Sriracha Hot Chili Sauce, under which the Company became a party to a license with Huy Fong Foods, Inc. gaining permission from Huy Fong Foods, Inc. to use the licensed marks for the limited products and purposes permitted by the license. Based on this agreement and a separate marketing and sales agreement signed with Seasoning Stix International, LLC, the Company markets a culinary seasoning product named Sriracha Seasoning Stix. Sriracha Seasoning Stix are encapsulated Huy Fong Sriracha Sauce and other seasonings in the form of a stick, which are inserted into meat, fish and poultry prior to cooking. All trademarks, service marks and intellectual property remain the property of the respective owners.

## **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.

Table of Contents**Results of Operations**

The following table sets forth the results of our operations for the three months ended September 30, 2018 and 2017.

|                                       | <b>For the three months<br/>ended<br/>September 30,</b> |             |
|---------------------------------------|---|-------------|
|                                       | <b>2018</b>   | <b>2017</b> |
| Net Sales                             | 1,445,010   | 1,177,214   |
| Cost of Goods Sold:                   | 1,059,418   | 852,949     |
| Gross profit                          | 385,591   | 324,264     |
| Operating Expenses                    | 913,872   | 1,018,988   |
| Loss From Operations                  | (528,281 )  | (694,724 )  |
| Other non-operating Income (Expense): | (2,080,772)   | (394,610 )  |
| Net Income (Loss)                     | (2,609,053)   | (1,089,334) |

## Revenues

For the three-months ended September 30, 2018 and 2017, revenues were \$1,445,010 and \$1,177,214, respectively. The decrease was primarily due to research and development, business consultants and specialists for upcoming business acquisitions, and expansion of internal resources.

## Cost of goods sold

For the three-month ended September 30, 2018 and 2017, costs of goods sold were \$1,059,418 and \$852,949 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 September 30, 2018 and 2017, gross profit was \$385,591 and \$324,264, 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 September 30, 2018 and 2017, operating expenses were \$913,872 and \$1,018,988, respectively. The decrease was attributable to lower stock compensation expense as the company engaged certain industry experts to help the company expanding its markets.

Other non-operating income (expense)

The Company had total other non-operating expense of \$2,080,772 and expense of \$394,610 for the three months ended September 30, 2018 and 2017, respectively. The increase in non-operating income is related to the accounting for derivative liabilities.

Net income (loss)

Net loss totaled \$2,609,053 for the three month ended September 30, 2018, compared to a net loss totaling \$1,089,334 for the three-month ended September 30, 2017. The increase in net income was primarily due the increasing in total non-operating expenses.

Table of Contents**Liquidity and Capital Resources**

We have primarily financed our operations through the sale of unregistered equity and convertible notes payable. As of September 30, 2018, our Company had cash balance of \$120,749 current assets totaling \$2,255,964 and total assets of \$2,490,340. We had current and total liabilities totaling \$10,916,259. Stockholders' equity reflected a deficiency of \$8,425,919.

The following is a summary of cash provided by or used in each of the indicated types of activities during the three-months ended September 30, 2018 and 2017:

|                             | <b>2018</b> | <b>2017</b> |
|-----------------------------|-------------|-------------|
| Cash (used in) provided by: |             |             |
| Operating activities        | \$(610,314) | \$(692,508) |
| Investing activities        | —           | (139,316)   |
| Financing activities        | 688,942     | 730,870     |

Net cash used in operating activities was \$610,314 for the three months ended September 30, 2018, and \$692,508 for the three months ended September 30, 2017.

There were \$139,316 fixed assets purchased during the three months ended September 30, 2017 relating to investing activities.

Net cash provided by financing activities was \$688,942 for the three months ended September 30, 2018 and \$730,870 for the three months ended September 30, 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.



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**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**

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 September 30, 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 September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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**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

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**ITEM 6 – EXHIBITS**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 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 pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>                    |
| 32.2               | (1) <u>Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted</u>  |

pursuant to  
Section 906 of  
the  
Sarbanes-Oxley  
Act of 2002

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.

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**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**

December 26, 2018 By: /s/ Jimmy Chan  
Jimmy Chan  
CEO, CFO, and Director

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