Surna Inc.
Form 10-Q
August 15, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016

OR

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

Commission File Number: 000-54286

SURNA INC.

(Exact name of registrant as specified in its charter)

Nevada	**27-3911608**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1780 55th St., Suite C, Boulder, Colorado	**80301**
(Address of principal executive offices)	(Zip code)

(303) 993-5271

(Registrant's telephone number, including area code)

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the last 90 days. **YES [X] 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 (SS 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). **YES [X] NO [ ]**

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

Large Accelerated Filer	**[ ]**	**Accelerated Filer**	**[ ]**
Non-accelerated Filer *(Do not check if smaller reporting company)*	**[ ]**	**Smaller Reporting Company**	**[X]**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). **YES [ ] NO [X]**

As of August 12, 2016, there were 145,898,850 shares of the registrant's common stock outstanding (which include 630,715 shares that were inadvertently issued but have not yet been cancelled as of the aforementioned date).

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (this "Form 10-Q") contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements contained in this Form 10-Q other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans, and our objectives for future operations, are forward-looking statements. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties, and assumptions, including those described in Part II, Item 1A, "Risk Factors" in this Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the future events and trends discussed in this Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Unless expressly indicated or the context requires otherwise, the terms "Surna," the "Company," "we," "us," and "our" in this Form 10-Q refer to Surna Inc., a Nevada corporation, and, where appropriate, its wholly owned subsidiary.

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Surna Inc.

Condensed Consolidated Balance Sheets

	June 30, 2016 Unaudited	December 31, 2015
ASSETS		
Current Assets		
Cash	$302,854	$330,557
Accounts receivable (net of allowance for doubtful accounts of $85,000 and $40,873, respectively)	882,871	299,194
Notes receivable	177,218	207,218
Inventory	833,069	1,261,802
Prepaid expenses	149,564	193,969
Total Current Assets	2,345,576	2,292,740
Noncurrent Assets		
Property and equipment, net	118,091	162,530
Intangible assets, net	648,345	647,464
Total Noncurrent Assets	766,436	809,994
TOTAL ASSETS	$3,112,012	$3,102,734
LIABILITIES AND SHAREHOLDERS’ DEFICIT		
Current Liabilities		
Accounts payable and accrued liabilities	$1,476,079	$2,066,803
Deferred revenue	1,669,950	986,445
Current portion long term debt	-	1,551
Amounts due shareholders	60,945	216,995
Convertible promissory notes, net	1,981,694	1,227,761
Convertible accrued interest	396,854	201,257
Derivative liability on conversion feature	-	472,967
Derivative liability on warrants	225,405	139,192
Total Current Liabilities	5,810,927	5,312,971
Noncurrent Liabilities		

Amounts due shareholders-long term	31,775	-
Convertible promissory notes, net	-	523,822
Convertible accrued interest	-	80,674
Vehicle loan	-	32,564
Total Noncurrent Liabilities	31,775	637,060
TOTAL LIABILITIES	5,842,702	5,950,031
Commitments and Contingencies	-	-
SHAREHOLDERS' DEFICIT		
Preferred stock, $0.00001 par value; 150,000,000 shares authorized; 77,220,000 shares issued and outstanding	772	772
Common stock, $0.00001 par value; 350,000,000 shares authorized; 145,268,135 and 125,839,862 shares issued and outstanding, respectively	1,452	1,259
Paid in capital	9,780,598	8,214,271
Accumulated deficit	(12,513,512)	(11,063,599)
Total Shareholders' Deficit	(2,730,690)	(2,847,297)
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIT	$3,112,012	$3,102,734

The accompanying notes are integral to the unaudited condensed consolidated financial statement.

Surna Inc.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue	$1,891,472	$1,677,950	$4,390,077	$2,548,845
Cost of revenue	1,576,920	1,326,769	2,986,864	2,009,505
Gross margin	314,552	351,181	1,403,213	539,340
Operating expenses:				
Advertising and marketing expenses	29,031	92,480	42,534	175,454
Product development costs	93,947	128,454	200,226	309,443
Selling, general and administrative expenses	490,771	821,020	1,094,670	1,624,762
Total operating expenses	613,749	1,041,954	1,337,430	2,109,659
Operating income (loss)	(299,197)	(690,773)	65,783	(1,570,319)
Other income (expense):				
Interest and other income, net	2,319	-	8,484	-
Interest expense	(61,709)	(128,299)	(334,681)	(288,559)
Amortization of debt discount on convertible promissory notes	(480,533)	(584,248)	(903,202)	(1,011,048)
(Loss) gain on change in derivative liabilities	135,420	426,710	(286,297)	474,873
Total other (expense)	(404,503)	(285,837)	(1,515,696)	(824,734)
Loss from continuing operations before provision for income taxes	(703,700)	(976,610)	(1,449,913)	(2,395,053)
Provision for income taxes	-	-	-	-
Net loss	(703,700)	(976,610)	(1,449,913)	(2,395,053)
Other comprehensive income (expense)			-	-
Comprehensive loss	$(703,700)	$(976,610)	$(1,449,913)	$(2,395,053)
Loss per common share – basic and dilutive	$(0.00)	$(0.01)	$(0.01)	$(0.02)
Weighted average number of common shares outstanding, both basic and dilutive	143,516,260	122,707,813	136,889,845	118,680,260

The accompanying notes are integral to the unaudited condensed consolidated financial statements.

Surna Inc.

Condensed Consolidated Statements of Changes in Shareholders' Deficit
For the Six Months Ended June 30, 2016

(Unaudited)

	Preferred Stock		Common Stock					
	Number of Shares	Amount	Number of Shares	Amount	Paid in Capital	Accumulated Deficit	Comprehensive Income (Loss)	Shareholders' Deficit
Balance December 31, 2015	77,220,000	$ 772	125,839,862	$ 1,259	$ 8,214,271	$ (11,063,599)	$ -	$ (2,847,297)
Common shares issued pursuant to conversion of debt and accrued interest, net of unamortized debt discount	-	-	17,888,828	179	888,905	-	-	889,084
Reclassification of derivative liability to equity pursuant to conversion of debt	-	-	-	-	673,050	-	-	673,050
Common shares issued to employees as compensation	-	-	46,045	-	4,028	-	-	4,028
Issuance of common shares in connection with exercises of stock options	-	-	1,493,400	14	344	-	-	358
Net loss	-	-	-	-	-	(1,449,913)	-	(1,449,913)
Balance June 30, 2016	77,220,000	$ 772	145,268,135	$ 1,452	$ 9,780,598	$ (12,513,512)	$ -	$ (2,730,690)

The accompanying notes are integral to the unaudited condensed consolidated financial statements.

Surna Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the Six Months Ended June 30,	
	2016	2015
Cash Flows from Operating Activities:		
Net loss	$(1,449,913)	$(2,395,053)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and intangible asset amortization expense	29,360	30,548
Amortization of debt discounts	1,003,591	1,011,049
Amortization of original issue discount on notes payable	40,806	-
Gain on change in derivative liability	286,297	(474,873)
Employee compensation paid in stock	4,028	-
Provision for doubtful accounts	44,127	-
Gain on sale of assets other	1,850	-
Changes in operating assets and liabilities:		
Accounts and note receivable	(627,804)	(423,813)
Inventory	428,733	(305,435)
Prepaid expenses	44,405	(272,348)
Accounts payable and accrued liabilities	(590,724)	317,080
Deferred revenue	683,505	1,015,122
Accrued interest	189,713	267,858
Deferred compensation	(25,600)	-
Other	(2,213)	-
Cash provided by (used in) operating activities	60,161	(1,229,865)
Cash Flows From Investing Activities		
Purchase of intangible assets	(3,813)	-
Purchase of property and equipment	(15,126)	(15,089)
Proceeds from the sale of property and equipment	31,000	-
Cash disbursed for note receivable	(20,000)	(135,000)
Cash received on note receivable	50,000	-
Cash provided by (used in) investing activities	42,061	(150,089)
Cash Flows From Financing Activities		
Proceeds from issuances of convertible promissory notes	-	911,250
Proceeds from exercises of stock options	358	-
Payments on loans	(34,115)	(3,681)
Payments on loans from shareholders	(96,168)	-
Payments to related parties	-	(72,076)
Cash (used in) provided by financing activities	(129,925)	835,493

Net decrease in cash	(27,703)	(544,461)
Cash, beginning of period	330,557	689,963
Cash, end of period	$302,854	$145,502
Supplemental cash flow information:		
Interest paid	$-	$1,833
Income tax paid	$-	$-
Non-cash investing and financial activities:		
Conversions of promissory note balances to common stock	$889,905	$-
Derivative liability on convertible promissory notes and warrants	$673,050	$-

The accompanying notes are integral to the unaudited condensed consolidated financial statements.

Surna Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company:

Surna Inc. ("Company" "We" "Us" or "Our") incorporated in the State of Nevada on October 15, 2009. On March 26, 2014, we acquired Safari Resource Group, Inc. ("Safari"), a Nevada corporation, whereby we became the sole surviving corporation after the acquisition of Safari. On July 25, 2014, we acquired 100% of the membership interest in Hydro Innovations, LLC, a Colorado limited liability company ("Hydro"), pursuant to which Hydro became a wholly-owned subsidiary of the Company.

We engineer and manufacture innovative technology and products that address the energy and resource intensive nature of indoor cultivation. Our focus lies in supplying industrial solutions to commercial indoor cannabis cultivation facilities. Our engineering team is tasked with creating novel energy and resource efficient solutions, including our signature liquid-cooled climate control platform. Our engineers continuously seek to create technologies that allow growers to easily meet the highly specific demands of a cannabis cultivation environment through temperature, humidity, light, and process control. Our objective is to provide intelligent solutions that improve the quality, control, and overall yield and efficiency of indoor cannabis cultivation. We are headquartered in Boulder, Colorado.

The Company's operations exclude the production or sale of marijuana.

Financial Statement Presentation:

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Pursuant to these rules and regulations, certain information and note disclosures, normally included in financial statements prepared in accordance with GAAP, have been condensed or omitted. GAAP requires management to make estimates and assumptions that affect reported amounts and related disclosures. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2016. The balance sheet as of December 31, 2015 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. For further information, refer to the consolidated financial statements and notes thereto contained in the Annual Report on Form 10-K for the year ended December 31, 2015. The notes to the unaudited condensed consolidated financial statements are presented on a continuing basis unless otherwise noted.

Basis of Consolidation and Reclassifications:

The condensed consolidated financial statements include the accounts of the Company and its controlled and wholly-owned subsidiary. Intercompany transactions, profits, and balances are eliminated in consolidation.

Certain reclassifications have been made to amounts in prior periods to conform to the current period presentation. All reclassifications have been applied consistently to the periods presented. The reclassifications had no impact on net loss or total assets and liabilities.

Use of Estimates:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and that affect the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates. In addition, any change in these estimates or their related assumptions could have an adverse effect on our operating results. Key estimates include: valuation of derivative liabilities, valuation of intangible assets, and valuation of deferred tax assets and liabilities.

Recent Accounting Pronouncements:

In May 2016, accounting guidance was issued to clarify the not yet effective revenue recognition guidance issued in May 2014. This additional guidance does not change the core principle of the revenue recognition guidance issued in May 2014, rather, it provides clarification of accounting for collections of sales taxes as well as recognition of revenue (i) associated with contract modifications, (ii) for noncash consideration, and (iii) based on the collectability of the consideration from the customer. The guidance also specifies when a contract should be considered "completed" for purposes of applying the transition guidance. The effective date and transition requirements for this guidance are the same as the effective date and transition requirements for the guidance previously issued in 2014, which is effective for interim and annual periods beginning on or after December 15, 2017. The Company has not yet determined the impact that this new guidance will have on its consolidated financial statements.

In April 2016, accounting guidance was issued pertaining to identifying performance obligations in contracts with customers and improving the operability and understandability of licensing implementation guidance. The guidance is effective for interim and annual periods beginning on or after December 15, 2017. The Company has not yet determined the impact of this new guidance on its consolidated financial statements.

In March 2016, accounting guidance was issued to improve the accounting for employee stock-based payments. The guidance simplifies accounting for stock-based award transactions specific to income tax consequences, the classification of awards as equity or liabilities, and the classification of award payments on the statement of cash flows. The guidance is effective for interim and annual periods beginning on or after December 15, 2016. The Company is currently assessing the impact that the adoption of this new guidance will have on its consolidated financial statements.

In March 2016, accounting guidance was issued to clarify the application of previously issued revenue recognition guidance related to whether an entity is a principal or an agent. More specifically, this new guidance clarifies that the analysis must focus on whether the entity has control of the goods or services before they are transferred to the customer and provides additional guidance about how to apply the control principle when services are provided and when goods or services are combined with other goods or services. The guidance is effective for interim and annual periods beginning on or after December 15, 2017. The Company has not yet determined the impact that this new guidance will have on its consolidated financial statements.

In March 2016, accounting guidance was issued pertaining to accounting for derivatives and hedging activity. The guidance amends existing GAAP by clarifying that a change in the counterparty to a derivative instrument that has been designated as a hedging instrument does not, in and of itself, require de-designation of that hedging relationship, provided that all other hedge accounting criteria continue to be met. The amendment improves prior guidance by eliminating diversity in practice. The guidance is effective for interim and annual periods beginning on or after December 15, 2016. The guidance may be applied prospectively or using a modified retrospective approach to adjust retained earnings. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

In March 2016, additional accounting guidance was issued pertaining to accounting for derivatives and hedging activity. The guidance clarifies the steps required when assessing whether the economic characteristics and risks of call (put) options are clearly and closely related to the economic characteristics and risks of their debt hosts, which is one of the criteria for bifurcating an embedded derivative. Consequently, when a call (put) option is contingently exercisable, an entity does not have to assess whether the event that triggers the ability to exercise a call (put) option is related to interest rates or credit risks. The amendment improves prior guidance by eliminating diversity in practice in assessing embedded contingent call (put) options in debt instruments. The guidance is effective for interim and annual periods beginning on or after December 15, 2016. The Company is currently assessing the impact that the adoption of this new guidance will have on its consolidated financial statements.

In February 2016, accounting guidance was issued pertaining to leases to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The core principle of this guidance is that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The guidance is effective for interim and annual periods beginning on or after December 15, 2018. The Company is currently evaluating the impact that the adoption of this new guidance will have on its consolidated financial.

In January 2016, accounting guidance was issued on the classification and measurement of financial assets and liabilities (equity securities and financial liabilities) under the fair value option and the presentation and disclosure requirements for financial instruments. The guidance modifies how an entity measures equity investments and presents changes in the fair value of financial liabilities. Under the new guidance, an entity will have to measure at fair value those equity investments that do not result in consolidation and are not accounted for under the equity method, and an entity will have to recognize any changes in fair value in net income unless the investments qualify for the new practicality exception. That exception will apply to those equity investments that do not have a readily determinable fair value and do not qualify for the practical expedient to estimate fair value under the guidance, and, as such, these investments may be measured at cost. The guidance will be effective on January 1, 2018. The Company is currently assessing the impact that the adoption of this new guidance will have on its consolidated financial statements.

We continually assess any new accounting pronouncements to determine their applicability to us. Where it is determined that a new accounting pronouncement affects our financial reporting, we undertake a study to determine the consequence of the change to our financial statements and assure that there are proper controls in place to ascertain that our financial statements properly reflect the change. We have evaluated all other GAAP issued through the date the condensed financials were issued and believe that the adoption of these will not have a material impact on our financial statements.

NOTE 2 - GOING CONCERN

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business.

In the course of its development activities, the Company has sustained and continues to sustain losses. The Company cannot predict if or when the Company will generate profits. The Company has a deficit in working capital of approximately $3,465,000 as of June 30, 2016. Additionally, the Company has generated cumulative net losses of approximately $12,514,000 during the period from inception through June 30, 2016.

The Company has not yet established an ongoing source of revenues sufficient to cover its operating costs and allow it to continue as a going concern. The ability of the Company to continue as a going concern depends on it obtaining the adequate capital to fund operating losses until it becomes profitable. Management plans to continue as a going concern to achieve a profitable level of operations including generating cash through increased product sales, reducing planned expenditures, if necessary, and raising capital from investors. While management plans to take the steps necessary to extend the time period over which the then-available resources would be able to fund the operations, management cannot provide any assurances that the Company will be successful in accomplishing any of its plans. Additionally, there can be no assurance that, if such efforts are successful, the terms and conditions of such financing will be favorable. If the Company is unable to obtain adequate capital, it could be forced to cease operations.

During the year ended December 31, 2015, we raised a total of approximately $1,781,000 in connection with issuances of three series of convertible promissory notes. During the year ended December 31, 2014, we raised approximately $2,962,000 in connection with issuances of two series of convertible promissory notes. The Company has been in discussion with several investment firms and is evaluating the Company’s options for additional funding. The ability of the Company to continue as a going concern is dependent upon its ability to successfully accomplish its plans and eventually secure other sources of financing and attain profitable operations. The accompanying unaudited condensed consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

NOTE 3 - NOTES RECEIVABLE

On April 26, 2016, the Company entered into a non-binding letter of intent (“LOI”) to acquire substantially all of the assets of a third party (“Seller”). Per the terms of the Agreement, Company and Seller shall endeavor to close the transaction on or before August 31, 2016, which was extended to September 30, 2016 (“Exclusivity Period”). During the Exclusivity Period, the Company is required to provide the Seller a loan in the amount of $20,000 per month, up to a maximum of $80,000. A payment of $20,000 was made during the three-month period ended June 30, 2016.

NOTE 4 - CONVERTIBLE PROMISSORY NOTES

During the six months ended June 30, 2016, approximately $890,000 of the convertible promissory notes were converted into 17,888,828 shares of the Company’s common stock. The remaining balance as of June 30, 2016 was approximately $1,982,000 after debt discounts of approximately $555,000.

NOTE 5 - SUBSEQUENT EVENTS

There have been no significant events occurring after June 30, 2016.

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

The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes included elsewhere in this Form 10-Q, which include additional information about our accounting policies, practices, and the transactions underlying our financial results, as well as with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission (the "SEC"). In addition to our historical unaudited condensed consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Form 10-Q, particularly in Part II, Item 1A, "Risk Factors."

Overview

Surna develops, designs, and distributes cultivation technologies for controlled environment agriculture ("CEA"). The Company's customers include state-regulated cannabis cultivation facilities as well as traditional indoor agricultural facilities, including organic herb and vegetable producers. Surna's technologies include a comprehensive line of optimized lighting, environmental control, air sanitation, and cultivation facilities. These technologies are designed to meet the specific environmental conditions required for CEA and dramatically reduce energy and water consumption.

In addition, Surna offers mechanical design services specific to hydronic cooling, including mechanical equipment and piping design.

Recent Developments

No recent developments.

Critical Accounting Policies and Significant Judgments and Estimates

This discussion and analysis of our financial condition and results of operations is based upon our interim unaudited condensed consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Certain accounting policies are particularly important to the understanding of our financial positions and results of operations and require the application of significant judgment by our management or can be materially affected by changes from period to period in economic factors or conditions that are outside of our control. As a result, they are subject to an inherent degree of uncertainty. In applying these policies, management uses their judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical operations, our future business plans and projected financial results, the terms of existing contracts, observance of trends in the industry, information provided by our customers, and information available from other outside sources, as appropriate. For information regarding the Company's critical accounting policies as well as recent accounting pronouncements, see Note 1 to the consolidated financial statements.

Results of Operations

The following discussion should be read in conjunction with our condensed consolidated financial statements and the related notes included in this report

Comparison of the Three Months Ended June 30, 2016 and 2015

Revenues and Cost of Goods Sold

Revenue for the three months ended June 30, 2016 was approximately $1,891,000 as compared to $1,678,000 (13% increase) for the three months ended June 30, 2015. The increase in revenue is due to progress and ongoing legal and regulatory developments in an increasing number of states that permit and regulate cannabis cultivation and use for medical or recreational purposes. Our current and future revenue plan is dependent on the continued and increasing legality of the cannabis industry and our ability to effectively market our indoor agriculture products to this key segment as well as expand our reach to other markets.

Cost of revenue for the three months ended June 30, 2016 was approximately $1,577,000 (or 19% increase) as compared to $1,327,000 for the three months ended June 30, 2015. Gross margin decreased to 17% from 21% a year ago due to several factors including: (i) a warranty charge of approximately $455,000 the Company recorded during the three-months end June 30, 2016 for an estimated cost to replace a customer's system (ii) offset by price increases that took effect late in the third quarter of 2015, negotiation of favorable pricing with key suppliers in the fourth quarter of 2015, a sales mix that consisted of high margin products and reduced spend on installation projects as Surna exits that business.

Operating expenses for the three months ended June 30, 2016 were approximately $614,000 as compared to $1,042,000 (41% decrease) for the three months ended June 30, 2015. The decrease in advertising and marketing expenses from $93,000 to $29,000 (69% decrease) was due to a heavier emphasis on advertising in the prior year and a focus on reigning in costs in the current year. The decrease in product development costs from $129,000 to $94,000 (27% decrease) was due to the product life cycle of the Surna reflector product, which has moved from development stage in the first quarter of 2015 to production stage in the first quarter of 2016. The decrease in general and administrative expenses from $821,000 to $491,000 (40% decrease) is due to reductions in personnel as well as a focus on cost containment.

We incurred net other expenses of $405,000 for the three months ended June 30, 2016 compared to $286,000 (42% increase) for the three months ended June 30, 2015. The increase was due in part to smaller gain on the change in derivative liabilities, which was offset by marginal decrease in the interest expense and amortization of debt discount on convertible promissory notes. The derivative liability gains for the three months ended June 30, 2016 decreased because the remaining convertible promissory notes converted in April 2016 caused the remaining life to decrease. With the shorter remaining life, the beneficial conversion feature fair value decrease. The interest expense and amortization of debt discount on convertible promissory notes for the three months ended June 30, 2016 was marginally less than the same period 2015. The decrease is due the fact that a significant number of the convertible promissory notes converted in the first quarter and second quarter of 2016.

For the three months ended June 30, 2016 and 2015, we had no federal taxable income due to utilization of net operating loss carryforwards for the current quarter and operating losses in the second quarter of 2015.

Overall, we realized a net operating loss of approximately $704,000 for the three months ended June 30, 2016 as compared to a net operating loss of approximately $977,000 for the three months ended June 30, 2015.

Comparison of the Six Months Ended June 30, 2016 and 2015

Revenue for the six months ended June 30, 2016 was approximately $4,390,000 as compared to $2,549,000 (72% increase) for the six months ended June 30, 2015. The increase in revenue is due to progress and ongoing legal and regulatory developments in an increasing number of states that permit and regulate cannabis cultivation and use for medical or recreational purposes. Our current and future revenue plan is dependent on the continued and increasing legality of the cannabis industry and our ability to effectively market our indoor agriculture products to this key segment as well as expand our reach to other markets.

Cost of revenue for the six months ended June 30, 2016 was approximately $2,987,000 (or 49% increase) as compared to $2,010,000 for the six months ended June 30, 2015. Gross margin increased to 32% from 21% a year ago due to several factors including: (i) a warranty charge of approximately $455,000 the Company recorded during the three-month end June 30, 2016 for an estimated cost to replace a customer's system (ii) offset by price increases that took effect late in the third quarter of 2015, negotiation of favorable pricing with key suppliers in the fourth quarter of 2015, a sales mix that consisted of high margin products and reduced spending on installation projects as Surna exits that business.

Operating expenses for the six months ended June 30, 2016 were approximately $1,337,000 as compared to $2,110,000 (37% decrease) for the six months ended June 30, 2015. The decrease in advertising and marketing expenses from $176,000 to $43,000 (76% decrease) was due to a heavier emphasis on advertising in the prior year and a focus on reigning in costs in the current year. The decrease in product development costs from $309,000 to $200,000 (35% decrease) was due to the product life cycle of the Surna reflector product, which has moved from development stage in the first quarter of 2015 to production stage in the first quarter of 2016. The decrease in general and administrative expenses from $1625,000 to $1,095,000 (33% decrease) is due to reductions in personnel as well as a focus on cost containment.

We incurred net other expenses of $1,516,000 for the six months ended June 30, 2016 compared to $825,000 (84% increase) for the six months ended June 30, 2015. The increase in total other expense was due in part to loss on change in derivative liabilities and an increase in interest expense, which were offset by a marginal decrease in amortization of debt discount on convertible promissory notes. Stock price increases during the first quarter of 2016 drove a loss on change in derivatives of approximately $422,000, which was offset by an approximate gain of $135,000 during the second quarter of 2016, as compared to an approximate gain of $475,000 for the six months ended June 30, 2015.

For the six months ended June 30, 2016 and 2015, we had no federal taxable income due to utilization of net operating loss carryforwards for the current quarter and operating losses in the second quarter of 2015.

Overall, we realized a net operating loss of approximately $1,450,000 for the six months ended June 30, 2016 as compared to a net operating loss of approximately $2,395,000 for the six months ended June 30, 2015.

Liquidity and Capital Resources

The following summarizes our cash flows:

	For the Six Months Ended June 30,	
	2016	2015
Cash provided by (used in) operating activities	$60,000	$(1,230,000)
Cash flows provided by (used in) investing activities	42,000	(150,000)
Cash flows (used in) provided by financing activities	(130,000)	835,000
Net change in cash	$(28,000)	$(545,000)

We have never reported net income. We incurred net losses for the six months ended June 30, 2016 and 2015 and have an accumulated deficit of approximately $12,514,000 as of June 30, 2016. We had working capital deficits (current liabilities exceed current assets) of approximately $3,465,000 and $3,020,000 as of June 30, 2016 and December 31, 2015, respectively. We have not been able to generate sufficient cash from operating activities to fund our ongoing operations. Since our inception, we have raised capital through private sales of common stock and debt securities. Our future success is dependent upon our ability to achieve profitable operations and generate cash from operating activities. There is no guarantee that we will be able to generate enough revenue and/or raise capital to support our operations. As of June 30, 2016 and December 31, 2015, we had a cash balance of approximately $303,000 and $331,000, respectively.

Cash Requirements

Our ability to fund our growth and meet our obligations on a timely basis is dependent on our ability to match our available financial resources to our growth strategy, which includes acquisitions for cash or a combination of cash and debt. The decisions we make with regard to acquisitions drive the level of capital required and the level of our financial obligations. Management has determined the Company’s June 30, 2016 cash balance of approximately $303,000 will not be sufficient to fund the Company’s operations over the next twelve months. Based on management’s estimate for operational cash requirements and without modifications to our existing payment obligations or receipt of additional funding, we will require additional capital to continue our operations beyond November 2016.

If we are unable to generate cash flow from operations or adjustment to our payment arrangements or from successfully raising sufficient additional capital through future debt and equity financings or strategic and collaborative ventures with potential partners, we would likely have to reduce the size and scope of our acquisitions.

We have suffered recurring losses from operations. The continuation of our Company is dependent upon our Company attaining and maintaining profitable operations and raising additional capital as needed. In this regard, we have raised additional capital through equity offerings and loan transactions and, in the short term, will seek to raise additional capital in such manners to fund our operations. Our officers and shareholders have not made any written or oral agreement to provide us additional financing. There can be no assurance that we will be able to continue to raise capital on terms and conditions that are deemed acceptable to us.

Operating Activities

Cash provided by operations for the six months ended June 30, 2016 was approximately $60,000 compared to cash used in operations of approximately $1,230,000 for the six months ended June 30, 2015. The fluctuation was due to the reduction in the recorded net loss.

Investing Activities

Cash provided by investing activities for the six months ended June 30, 2016 was approximately $42,000 compared to cash used by investing activities of approximately $150,000 for the six months ended June 30, 2015. This fluctuation reflects the $135,000 of cash invested in Agrisoft in 2015 and the $50,000 cash receipt against the note receivable from Agrisoft in 2016.

Financing Activities

Cash used in financing activities for the six months ended June 30, 2016 was approximately $130,000 compared to cash provided by financing activities of approximately $836,000 for the six months ended June 30, 2015. No debt was issued in the current period compared to the $911,250 of convertible promissory note issuances in the comparable prior year period.

Inflation

In the opinion of management, inflation has not and will not have a material effect on our operations in the immediate future. Management will continue to monitor inflation and evaluate the possible future effects of inflation on our business and operations.

Contractual Payment Obligations

We have obligations under notes payable and a non-cancelable operating lease. As of June 30, 2016, these contractual obligations totaled approximately $3,176,000.

Off-Balance Sheet Arrangements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information under this item.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer ("CEO") and principal financial and accounting officer ("PFAO"), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this Form 10-Q. Based on this evaluation, our CEO and PFAO concluded that, because of certain material weaknesses in our internal control over financial reporting as described in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC, our disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act were not effective as of June 30, 2016.

The Company did not maintain effective controls over certain aspects of the financial reporting process because we lacked a sufficient complement of personnel with a level of accounting expertise and an adequate supervisory review structure that is commensurate with our financial reporting requirements. In addition, there was inadequate segregation of duties due to the limitation on the number of our accounting personnel.

We intend to take appropriate and reasonable steps to make the necessary improvements to remediate these deficiencies. However, due to our size and nature, segregation of all conflicting duties has not always been possible and may not be economically feasible.

Changes in Internal Control Over Financial Reporting

For the quarter ended June 30, 2016, there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not presently a party to any material legal proceedings, nor is the Company aware of any pending or threatened litigation that would have a material adverse effect on the Company's business, operating results, cash flows, or financial condition should such litigation be resolved unfavorably.

Item 1A. Risk Factors

In addition to the information set forth in this quarterly report on Form 10-Q, you should also carefully review and consider the risk factors contained in our other reports and periodic filings with the SEC, including, without limitation, the risk factors contained under the caption "Item 1A—Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015 that could materially and adversely affect our business, financial condition, and results of operations. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations. There have been no material changes in the significant factors that may affect our business and operations as described in "Item 1A—Risk Factors" of the Annual Report on 10-K for the year ended December 31, 2015.

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

During the three months ended June 30, 2016, the Company issued a total of 6,843,972 shares of common stock in exchange for the conversion of a total of $384,328 in principal and interest to a total of three holders of its Series 3 Convertible Promissory Notes in reliance on an exemption from registration under Section 4(a)(2) under the Securities Act.

On June 24, 2016, the Company issued 10,000 shares of common stock to an employee of the Company as compensation for the employee's services in reliance on an exemption from registration under Section 4(a)(2) under the Securities Act

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

Because this Form 10-Q is being filed within four business days from the date of the reportable event, we have elected to make the following disclosure in this Form 10-Q instead of in a Current Report on Form 8-K under Item 5.02.

On August 12, 2016, the Company's board of directors appointed Dean S Skupen to serve as Director of External Reporting and designated him as Principal Financial and Accounting Officer. Mr. Skupen, age 56, has been self-employed since 2009. He has been the sole director and officer of DSS Consulting Corp. ("DSS Consulting") since its inception in 2012, and he will continue to serve in those roles. DSS Consulting is not a parent, subsidiary, or otherwise an affiliate of Surna Inc. Mr. Skupen's professional focus has been on providing accounting and financial services and counseling to both private and publicly traded micro-cap companies. Previously Mr. Skupen was a principal of Stonefield Josephson, Inc, prior to its merger with Marcum, LLP. He currently holds an inactive certified public accountant license in the State of California and holds a bachelor's degree in accounting from the University of Southern California. Mr. Skupen will be responsible for coordinating the Company's public reporting responsibilities and earns compensation of $4000 monthly. Mr. Skupen does not have any family relationships with any of the officers or directors of the Company. Also, Mr. Skupen does not have an interest in any transaction required to be reported pursuant to Item 404(a) of Regulation S-K under Securities Act.

<u>Press Releases Announcing Earnings Call and Financial Results</u>

On August 11, 2016, the Company issued a press release announcing the date of our earnings call. The press release is attached hereto as Exhibit 99.1

On August 15, 2016, the Company issued a press release announcing our financial condition and results of operations for the three and six months ended June 30, 2016. The press release is attached hereto as Exhibit 99.2.

The foregoing information, including the exhibits related thereto, is furnished in response to Item 2.02 of Form 8-K and shall not be deemed "filed" for purposes of Section 18 of the Exchange Act, nor shall it be deemed incorporated by reference in any disclosure document of the Company, except as shall be expressly set forth by specific reference in such document.

Item 6. Exhibits

The documents listed in the Exhibit Index of this Form 10-Q are incorporated by reference or are filed with this Form 10-Q, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

SIGNATURES

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

Date : August 15, 2016	SURNA INC.	
	By:	*/s/ Trent Doucet* Trent Doucet, President and Chief Executive Officer (Principal Executive Officer)
	By:	*/s/ Dean S Skupen* Dean S Skupen, Director of External Reporting (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description
10.1	Promissory Note Amendment effective April 15, 2016 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on April 20, 2016).
10.2*	Consulting Agreement effective August 12, 2016.
31.1*	Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Principal Financial and Accounting Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Principal Executive Officer and Principal Financial and Accounting Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1**	Press Release, dated August 11, 2016, announcing the date for the Company's release of financial condition and results of operations.
99.2**	Press Release, dated August 15, 2016, announcing financial condition and results of operations.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

** Furnished herewith.