

Sugarmade, Inc.  
Form 10-Q  
November 23, 2016

**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, 2016

**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.)

**167 N. Sunset Avenue, City of Industry, CA 91744**

(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 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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer  
Non-accelerated filer

Accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
No

At November 23, 2016, there were 203,227,491 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, 2016**

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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 those 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.

[\(table of contents\)](#)**PART 1: Financial Information****Item I****Sugarmade, Inc. and Subsidiary****Consolidated Balance Sheets**

	September 30, 2016 (Unaudited)	June 30, 2016
Assets		
Current assets:		
Cash	\$ 14,422	\$ 911
Accounts receivable, net	57,341	117,866
Inventory, net	341,346	468,262
Loan receivables	20,000	20,000
Other current assets	112,368	84,505
Total current assets	545,477	691,543
Equipment, net	67,505	78,453
Other assets	23,281	23,281
Total assets	\$ 636,263	\$ 793,277
Liabilities and Stockholders' Deficiency		
Current liabilities:		
Bank overdraft	\$ 45,704	\$ 28,377
Note payable due to bank	25,982	25,982
Accounts payable and accrued liabilities	1,230,895	1,481,961
Customer deposits	182,320	248,299
Unearned revenue	51,240	93,522
Other payable	241,307	296,259
Accrued interest	268,116	272,708
Accrued compensation and personnel related payables	11,403	11,403
Notes payable due to others	85,666	85,666
Loans payable	712,926	427,581
Convertible notes payable, net	365,000	394,167
Derivative liabilities	458,000	701,000
Total liabilities	3,678,559	4,066,923
Stockholders' deficiency:		
Preferred stock (\$0.001 par value, 10,000,000 shares authorized,		

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none issued and outstanding)	—	—
Common stock (\$0.001 par value, 300,000,000 shares authorized, 200,740,944 and 178,685,388 shares issued and outstanding at Sept 30 and June 30, 2016 respectively	200,741	178,686
Additional paid-in capital	21,023,583	17,151,379
Shares to be issued, preferred shares	2,000,000	2,000,000
Shares to be issued, common shares	101,157	1,246,000
Accumulated deficit	(26,367,777)	(23,849,712)
Total stockholders' deficiency	(3,042,296 )	(3,273,647 )
Total liabilities and stockholders' deficiency	\$636,263	\$793,277

*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****Consolidated Statements of Operations****For the three months ended September 30, 2016 and 2015****(Unaudited)**

	Three months ended September 30,	
	2016	2015
Revenues, net	\$1,127,554	\$1,402,911
Cost of goods sold:		
Materials and freight costs	699,651	928,659
Total cost of goods sold	699,651	928,659
Gross profit	427,903	474,252
Operating expenses:		
Selling, general and administrative expenses	489,495	701,909
Total operating expenses	489,495	701,909
Loss from operations	(61,592 )	(227,657 )
Non-operating income (expense):		
Interest expense	(12,363 )	(15,067 )
Change in fair value of derivative liabilities	243,000	(498,000 )
Loss on extinguishment of debt	(17,295 )	—
Other expense	(10,553 )	(9,501 )
Total non-operating income (expense)	202,789	(522,568 )
Net income (loss)	\$141,197	\$(750,225 )
Basic and diluted net income (loss) per share	\$0.00	\$(0.00 )
Diluted net income (loss) per share	\$0.00	\$(0.00 )
Basic and diluted weighted average common shares outstanding	184,439,011	157,745,198

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





[\(table of contents\)](#)**Sugarmade, Inc. and Subsidiary****Condensed Consolidated Statements of Cash Flows****For the three months ended September 30, 2016 and 2015****(Unaudited)**

	For the three months ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income (loss)	\$ 141,197	\$(750,225)
Adjustments to reconcile net loss to cash flows from operating activities:		
Loss on extinguishment of liability	17,295	—
Change in fair value of derivative liability	(243,000)	498,000
Depreciation and amortization	10,948	—
Changes in operating assets and liabilities		
Accounts receivable	60,525	(190,814)
Inventory	126,916	273,020
Other assets	(22,865 )	(21,387 )
Bank overdraft	17,327	10,624
Accounts payable and accrued liabilities	(251,069)	(211,661)
Customer deposits	(65,978 )	(25,773 )
Unearned revenue	(42,282 )	—
Accrued interest and other payables	(45,848 )	44,986
Net cash used in operating activities	(296,834)	(373,230)
Cash flows from investing activities:		
Loan receivables	—	(3,500 )
Payment for acquisition of property and equipment	—	(4,177 )
Net cash used in investing activities	—	(7,677 )
Cash flows from financing activities:		
Proceeds from shares to be issued	25,000	—
Proceeds from issuance of common stock	—	150,000
Proceeds from (repayments of) loan	285,345	(211,438)
Payments for note payable	—	(105,000)
Proceeds from EB-5 investment	—	500,000
Net cash provided by financing activities	310,345	333,562
Net increase (decrease) in cash	13,511	(47,345 )
Cash, beginning of period	911	58,260

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Cash, end of period	\$14,422	\$10,915
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Supplemental disclosure of cash flow information:

Cash paid during the period for:

Interest	\$—	\$—
Income taxes	\$7,769	\$—

Supplemental disclosure of non-cash financing activities

Debts settled through shares issuance	\$42,862	\$—
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*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 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, Sept 30, 2016, 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 City of Industry, California, a suburb of Los Angeles, with two additional warehouse locations in Southern California. As of date of this filing, we employ 21 full and part-time workers and contractors.

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. We also hold a product supply and licensing agreement FreeHand® ThumbTray™ for the western part of the United States.

We are 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. 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. Our primary focus for this business unit as of filing of this report is the organization and administration of fundraisers and paper drives for schools, non-profits and other institutions.

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 Stixs International, LLC, the Company plans to introduce a new culinary seasoning product named Sriracha Seasoning Stixs. Sriracha Seasoning Stixs 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 Stixs 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 plans to introduce this product via a nationwide advertising and social media campaign during the December quarter of 2016.

## **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, 2015, 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 period ended June 30, 2015, filed on or about August 6, 2016. The interim results for the period ended September 30, 2015 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.

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***Going concern***

The Company sustained continued losses from operations during the three months ended September 30, 2016 and for the fiscal year ended June 30, 2016. The Company's continuation as a going concern is dependent on its ability to generate sufficient cash flows from operations to meet its obligations, in which it has not been successful, and/or obtaining additional financing from its shareholders or other sources, as may be required.

Our condensed consolidated financial statements have been prepared assuming that we will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. These condensed consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result should the Company be unable to continue as a going concern.

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

***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***

We recognize revenue in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") No. 605, *Revenue Recognition*. Revenue is recognized when an arrangement and a determinable fee

occur, and when collection is considered to be probable and products are delivered or title has been transferred. This generally occurs upon shipment of the merchandise, which is when legal transfer of title occurs. In the event that final acceptance of our product by the customer is uncertain, revenue is deferred until all acceptance criteria have been met. We currently have a consignment arrangement with two of our customers. We record revenue on consignment goods when the consigned goods are sold by the consignee and all other above mentioned revenue recognition criteria have been satisfied. Cash deposits received in connection with the sales of our products prior to their being delivered or acceptance if applicable is recorded as deferred revenue.

***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.

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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 \$57,341 as of September 30, 2016 and of \$117,866 as of June 30, 2016.

***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, 2016 and June 30, 2016, the balance for the inventory totaled \$341,346 and \$468,262, respectively. No amounts were recognized as an obsolescence reserve at September 30, 2016 and June 30, 2016.

***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, 2015.

***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. 5,819,105 potential shares issuable upon conversion of convertible debts and 0 potential shares issuable upon exercising of warrants were excluded in calculating diluted loss per share for the three months ended September 30, 2016 due to the fact that issuance of the shares is anti-dilutive as a result of the Company's net loss

***Fair value of financial instruments***

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

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

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

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

The Company used Level 2 inputs for its valuation methodology for the derivative liabilities in determining the fair value using the Black-Scholes option-pricing model with the following assumption inputs:

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	September 30, 2016
Annual dividend yield	—
Expected life (years)	0.45
Risk-free interest rate	0.18 %
Expected volatility	398 %

	June 30, 2016
Annual dividend yield	—
Expected life (years)	0.01
Risk-free interest rate	0.21 %
Expected volatility	449 %

	Carrying Value As of September 30, 2016	Fair Value Measurements at September 30, 2016 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Liabilities				
Derivative liabilities	\$ 458,000	\$ —	\$ 458,000	\$ —
Total	\$ 458,000	\$ —	\$ 458,000	\$ —

	June 30, 2016
Annual dividend yield	—
Expected life (years)	0.01
Risk-free interest rate	0.21 %
Expected volatility	449 %

	Carrying Value As of June 30, 2016	Fair Value Measurements at June 30, 2016 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Liabilities				
Derivative liabilities	\$ 701,000	\$ —	\$ 701,000	\$ —
Total	\$ 701,000	\$ —	\$ 701,000	\$ —

***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).



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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. Refer to Note 6 for details.

### **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 August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. The amendments in ASU 2014-15 are intended to define management’s responsibility to evaluate whether there is substantial doubt about an organization’s ability to continue as a going concern and to provide related footnote disclosures. The amendments in this standard are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. We are evaluating the effect, if any; adoption of ASU No. 2014-15 will have on our condensed consolidated financial statements.

In November 2014, the FASB issued ASU 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity. The amendments in ASU 2014-16 clarifies how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. The amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. The amendments in this standard

are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. We are evaluating the effect, if any; adoption of ASU No. 2014-16 will have on our condensed consolidated financial statements.

In November 2014, the FASB issued ASU No. 2014-17, Business Combinations (Topic 805): Pushdown Accounting. The amendments in ASU 2014-17 provide an acquired entity with an option to apply pushdown accounting in its separate financial statements upon occurrence of an event in which an acquirer obtains control of the acquired entity. The amendment in this standard is effective on November 18, 2014. After the effective date, an acquired entity can make an election to apply the guidance to future change-in-control events or to its most recent change-in-control event. We are evaluating the effect, if any; adoption of ASU No. 2014-17 will have on our condensed consolidated financial statements.

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In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The amendments in ASU 2015-02 are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures. The amendment in this standard is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. We are evaluating the effect, if any, adoption of ASU No. 2015-02 will have on our condensed consolidated financial statements.

**3. Concentration**

*Customers*

For the three months ended September 30, 2016 and September 30, 2015, our Company earned net revenues of \$1,127,554 and \$1,402,911 respectively. The vast majority of these revenues for the period ending September 30, 2016 were derived from a large number of customers, whereas the vast majority of these revenues for the period ending September 30, 2015 were derived from a limited number of customers. No customers accounted for over 10% of the Company's total revenues for the year ended September 30, 2016. The revenues for the period ending September 30, 2015, only reflect prior to the acquisition of SWC, and were revenues from Sugarmade, Inc.

*Suppliers*

For the three months end September 30, 2016, we purchased products for sale by CarryOutSupplies from several contract manufacturers located in Asia. A substantial portion of the Company's inventory is purchased from one supplier that functions as an independent foreign procurement agent. One supplier accounted for 65% and two suppliers each accounted for 8% of the Company's total inventory purchase in the three months ended September 30, 2016 and September 30, 2015 respectively.

**4. Litigation**

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 June 30, 2015, there were no legal claims currently pending or threatened against us 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. However, as of the date of this filing, we were involved in the following legal proceedings.

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As of the date of this filing, the Company is a plaintiff, in Contra Costa County, California, in a suit 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. Pinto is the Company's former Chairman of the board of directors. The Company plans to actively pursue this case. During November of 2014, the Company received notice that a cross complaint had been filed against the Company. The complaint alleges the parties were induced to make a series of investments in the Company by the material misrepresentations and omissions made by the Company. The Company believes the allegations are without merit. The Company plans to vigorously defend against such claims. No changes have occurred as of the filing date of this report.

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.



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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. The complaint alleges Hannan was induced to make a series of investments in the Company by the material misrepresentations and omissions made by the Company. We believe the Hannan case is now in the middle of depositions and it appears a trial is scheduled, tentatively, in the second quarter of 2017. We believe the claims in that case are still primarily of two categories, the first being repayment of the promissory notes and a series of allegations about improper investment solicitations and other misrepresentations. We believe the Company's exposure to the claim concerning the Notes may be approximately \$125,000. We also believe there could be some associated legal fees, but we do not believe this amount will be material.

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

**5. Convertible Notes**

As of September 30, 2016 and June 30, 2016 the balance owing on convertible notes was \$365,000 and 394,167 respectively. The convertible promissory notes must be repaid by our Company within six months from the date of issuance; accrue interest at the rate of 14%; and are subject to conversion at the election of the investors at such time as our Company has raised a minimum of \$500,000 in a subsequent equity financing. The conversion price will be the lower of 80% of the per share purchase price paid for by the new investors in the subsequent financing, or \$0.50 per share. Unless these promissory notes are converted or repaid earlier, our Company must pay the note-holders the amount of the then accrued interest on the three, six, and nine month anniversaries of the issue date. As of September 30, 2016, two convertible promissory in the amount of \$29,167 with accrued interest \$13,596.28, was converted to 1,503,928 restricted common shares.

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As of September 30, 2016, the Company's convertible notes consisted of following:

As of September 30, 2016

Note Type and Investor	Due Date	Balance	Discount	Carrying Value
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	40,000	—	40,000
Convertible Note	7/1/2016	50,000	—	50,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	100,000	—	100,000
Total Convertible Promissory Notes		\$365,000		\$365,000

As of June 30, 2016, the Company's convertible notes consisted of following:

As of June 30, 2016

Note Type and Investor	Due Date	Balance	Discount	Carrying Value
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	40,000	—	40,000
Convertible Note	7/1/2016	50,000	—	50,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	25,000	—	25,000
Convertible Note	7/1/2016	100,000	—	100,000
Convertible Note	7/1/2016	20,834	—	20,834
Convertible Note	7/1/2016	8,333	—	8,333
Total Convertible Promissory Notes		\$394,167		\$394,167

6. Derivative liabilities

The derivative liability is derived from the conversion features in note 5 and stock warrant in note 7. All were valued using the weighted-average Black-Scholes-Merton option pricing model using the assumptions detailed below. As of September 30, 2016 and June 30, 2016, the derivative liability was \$458,000 and \$701,000, respectively. The Company recorded \$243,000 gain and \$498,000 loss from changes in derivative liability during the three months ended September 30, 2016 and 2015, respectively. The Black-Scholes model with the following assumption inputs:

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	September 30, 2016
Annual dividend yield	—
Expected life (years)	0.45
Risk-free interest rate	0.18 %
Expected volatility	398 %

	June 30, 2016
Annual dividend yield	—
Expected life (years)	0.01
Risk-free interest rate	0.21 %
Expected volatility	449 %

**7. Stock warrants**

In connection with the issuance of the promissory notes, the investors in the aggregate received two-year warrants to purchase up to a total of 50,000 shares of common stock at \$0.50 per share, and two-year warrants purchasing up to a total of 81,250 shares of common stock at \$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 Black-Scholes-Merton 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 will be amortized over the nine 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. During the three months ended September 30, 2016, all the warrants were expired. There were no warrants outstanding at September 30, 2016.

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	Number of Shares	Weighted Average Exercise Price
Outstanding at June 30, 2014	\$ 180,000	\$ 0.20
Granted	—	—
Exercised	—	—
Forfeited September 30, 2014	38,750	0.09
Forfeited December 31, 2014	10,000	0.04
Outstanding at June 30, 2015	131,250	0.20
Outstanding at June 30, 2016	131,250	0.20
Expired	131,250	0.20
Outstanding at September 30, 2016	\$—	\$ —

Following is a summary of the status of warrants outstanding at June 30, 2016:

Date Issued	Exercise Price	Number of Shares	Expiration Date
8/17/12	\$ 0.01	6,250	7/1/2016
8/20/12	\$ 0.01	6,250	7/1/2016
9/10/12	\$ 0.01	10,000	7/1/2016
9/13/12	\$ 0.01	12,500	7/1/2016
9/18/12	\$ 0.01	6,250	7/1/2016
10/5/12	\$ 0.01	2,500	7/1/2016
10/25/12	\$ 0.01	6,250	7/1/2016
1/31/13	\$ 0.01	6,250	7/1/2016
10/22/12	\$ 0.01	25,000	7/1/2016
8/24/12	\$ 0.50	50,000	8/24/16
Total warrants as of June 30, 2016		131,250	

**8. Note payable**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 September 30, 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, 2016 and June 30, 2015, the loan principal balance was \$25,982.

Note payable to others

On January 23, 2013, the Company entered into a promissory note with Mira Ablaza (a former employee of the Company 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, 2016, this note had a balance of \$23,000.

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On December 31, 2013, the Company entered into a promissory note with Calvin Kwong (an employee of the Company, whom owns less than 5% of the Company's stock). The principal amount was \$20,000 and the interest rate on the note was 10%. The note had a term of six months. However, this note was now payable upon demand per the oral agreement with the lender. As of September 30, 2016, this note had a balance of \$20,000.

On January 13, 2014, the Company entered into a promissory note with Tsz Ming Wong (an employee of the Company, whom owns less than 5% of the Company's stock). The principal amount was \$25,000 and the note bore no interest. The note had a term of 24 months and was due on January 13, 2016, and became payable upon demand after January 13, 2016. As of September 30, 2016, this note had a balance of \$12,666.

On January 14, 2015, the Company entered into a promissory note with Richard Ko (an employee of the Company, whom 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 year and was due on January 14, 2016, and became payable upon demand after January 14, 2016. As of September 30, 2016, this note had a balance of \$30,000.

On July 11, 2016, the Company received a loan from Greater Asia Technology for \$150,000. There were loan fees of \$8,000 associated with origination of the loan, which bears 40% annual interest and is due on January 15, 2017. As of September 30, 2016, this note had a balance of \$150,000.

On September 26, 2016, the Company received a loan from Greater Asia Technology for \$100,000. The loan bears 40% annual interest and is due on November 25, 2017. As of September 30, 2016, this note had a balance of \$100,000.

On September 26, 2016, the Company received a loan from Greater Asia Technology for \$12,500. The loan bears 100% annual interest and is due on November 23, 2017. As of September 30, 2016, this note had a balance of \$12,500.

**9. Shares issued for services**

On June 30, 2016, the Company granted a consultant, Yang Zuo, 1,527,778 restricted shares with fair value of \$50,000 for compensation for services provided to the Company.

On June 30, 2016, the Company granted a consultant, Tony Thai, 1,527,778 restricted shares with fair value of \$50,000 for compensation for services provided to the Company.

On June 30, 2016, the Company granted a CEO, Jimmy Chan, 5,000,000 restricted shares with fair value of \$450,000 in lieu of salary.

On June 30, 2016, the Company granted Director, Waylon Huang, 3,000,000 restricted shares with fair value of \$90,000 in lieu of salary.

On June 30, 2016, the Company granted Director, Richard Ko, 3,000,000 restricted shares with fair value of \$270,000 in lieu of salary.

On April 1, 2016, the Company granted a consulting agreement with Katherine Zuniga and/or K Marie Marketing, LLC, 8,000,000 restricted shares with fair value of \$320,000 for marketing and sales related services. These shares were fully vested as of April 1, 2016.



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On September 25, 2015, the Company entered into a consulting agreement with Tony Thai & George Zuo, respectively. The term is from the date of the agreement through June 30, 2016. Stock compensation to each shall be 10% of all revenue generated by a Restaurant Supplies website as of June 30, 2016, which will equal the restricted stock award ("Stock Award"). The consultant shall receive restricted common shares of the Company in the amount of the Stock Award, unless the amount of the Stock Award is less than \$50,000, in which case the amount of the Restricted Stock Award shall be assumed to be \$50,000. The share price at which the stock will be awarded shall be the average closing trading price of the common shares on the 22 trading days preceding June 30, 2016. As of June 30, 2016, the consultant shall receive a bonus amount equaling 7.5% of the net profitability of the website if the profitability margins of the business exceed 5% on a full year.

***10. Common shares issued for equity financing***

On September 28, 2016, the Company sold 250,000 shares of restricted common stock to an investor for \$12,500 pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended. Shares have not been issued.

On September 22, 2016, the Company sold 250,000 shares of restricted common stock to an accredited investors for \$12,500 pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended. Shares have not been issued.

On October 15, 2015, the Company sold 833,333 shares of restricted common stock to two accredited investors for \$25,000 pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended.

On October 7, 2015, the Company sold 1,250,000 shares of restricted common stock to an accredited investor for \$25,000 pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended.

On October 2, 2015, the Company sold 1,000,000 shares of restricted common stock to an accredited investor for \$30,000 pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended.

On August 27, 2015, the Company sold 2,500,000 shares of restricted common stock to each of two accredited investors for \$50,000 each pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended.

On July 14, 2015, the Company sold 1,666,667 shares of restricted common stock to an accredited investor for \$50,000 pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended.

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(table of contents)**11. Common shares reserved for future issuances**

**The following table summarizes shares of our common stock reserved for future issuance at September 30, 2016:**

Common shares to be issued under conversion feature	5,819,105
Common shares to be issued under \$0.01 warrants	—
Common shares to be issued under \$0.50 warrants	—
Total common shares reserved for future issuance	5,819,105

**The following table summarizes shares of our common stock reserved for future issuance at June 30, 2016:**

Common shares to be issued under conversion feature	11,702,118
Common shares to be issued under \$0.01 warrants	81,250
Common shares to be issued under \$0.50 warrants	50,000
Total common shares reserved for future issuance	11,833,368

**12. Related party transactions**

As of September 30, 2016, the Company had outstanding balance of \$276,013 borrowed from LMK Capital., LLC a company affiliated with CEO Chan. In addition, Mr. Richard Ko, a Director is owed \$30,000 and Director Waylon Huang \$16,546. These borrowings have no interest, and were payable upon demand.

On September 28, 2016, the Company sold 250,000 shares of restricted common stock to an investor for \$12,500 pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended. Who is currently working for the company as Senior accountant. Shares have not been issued.

**13. Loans payable**

On March 1, 2012, SWC entered an equipment loan agreement with a bank with maturity on January 1, 2017. The monthly payment is \$435. At September 30, 2016, the outstanding balance under this loan was \$1,777.

On July 1, 2012, SWC entered an equipment loan agreement with a bank with maturity on June 1, 2017. The monthly payment is \$255. At September 30, 2016, the outstanding balance under this loan was \$2,393.

On March 5, 2013, the company entered an equipment loan agreement with Toyota financial services with maturity date of April 4, 2018. As of September 30, 2016 the balance under this loan is \$9,155

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At September 30, 2016, the Company had outstanding balance of \$276,013 borrowed from LMK Capital., LLC a company affiliated with CEO Chan.

On January 5, 2016, the Company received a loan for \$100,000 from an investor. The note bears 0% annual interest and is due on December 31, 2017. As of September 30, 2016 the balance under this loan is \$90,000.

On July 9, 2016, the Company entered into loan agreements for \$150,000. Under the terms of the agreements the Company will make 6 months principal and interest payments. The loan bear a fixed interest of \$30,000. As of September 30, 2016 the balance under this loan is \$105,763.

On September 26, 2016, the Company entered into loan agreements for \$12,500 and \$100,000. Under the terms of the agreements the Company will make 52 weekly principal and interest payments totaling \$25,000 and \$140,000 for the loans, respectively, beginning on October 31, 2016 and November 2, 2016, respectively.

**14. Shares to be issued**

At September 30, 2016, the Company was obligated to issue 2,000,000 shares of Series B Convertible Preferred Stock for three EB-5 investments with the total amount of \$1,500,000. The Company received \$2,000,000 proceeds during the year ended June 30, 2016 with fair value of \$2,000,000. On April 1, 2015, the Company completed a series of transactions and amended its Articles of Incorporation creating a series of preferred stock of 10,000,000 shares, which shall be designated Series B Convertible Preferred Stock, par value \$0.001 per share (the "Series B Preferred Stock"). Series B will not be eligible for dividends. Five years from the date of issue (the "Conversion Date"), assuming the Series B investor is approved for I-526 under the U.S Government's EB-5 Investment Program, each Preferred Share will automatically convert into that number of Common Shares having a "fair market value" of the Initial Investment plus a five (5) percent annualized return on Initial Investment. Fair market value will be determined by averaging the closing sale price of a Common Share for the 40 trading days immediately preceding the date of conversion on the U.S. stock exchange on which Common Shares are publicly traded. The offering was made pursuant to SEC Rule 506 Section 4(2), which provides exemption from registration for transactions, which are not public offerings. The funds received were used for general working capital purposes and to accelerate order deliveries to customers.

Subsequent to September 30, 2016, the Company was obligated to issue 2,500,000 restricted common shares for equity financing of \$125,000.

Subsequent to September 30, 2016, the company was obligated to issue 2,486,547 restricted common shares for debt conversion.

**15. Commitments and contingencies**

On April 1, 2015, the Company entered into a lease for general office and warehouse in City of Industry, California with a lease term of one years. The Company renewed the lease to March 31, 2017. Monthly rent was \$11,884 up to March 31, 2016, and increased to \$13,238 from April 1, 2016 to March 31, 2017. Monthly rent increased to \$13,238 from April 1, 2016 to March 31, 2017.

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Future minimum annual rental payments required under operating leases as of September 30, 2016 were as below (by year):

2016 \$79,428  
Total \$79,428

**16. Acquisition of SWC Group, Inc.**

On July 16, 2014 the Company entered into an agreement to acquire City of Industry, California based SWC Group, Inc., a California Corporation, which does business as CarryOutSupplies.com. CarryOutSupplies.com is a producer and wholesaler of custom printed and generic takeout supplies. CarryOutSupplies.com, which services more than 32,500 takeout establishments, restaurants and other food service operators, is headquartered at 167 N Sunset Ave, City of Industry, CA 91744, with two additional warehouse locations in Southern California. The acquisition closed on October 28, 2014. On this date, the Board of Directors of the Company executed the final Acquisition and Share Exchange Agreement (the "Share Exchange Agreement") ratifying the Pending Acquisition. Under the terms of the Share Exchange Agreement, the Company will issue Thirty Five Million (35,000,000) common shares of the Company to the holders of CarryOutSupplies.com in exchange for all of the outstanding shares in CarryOutSupplies.com. The number of Company shares exchanged shall be modified to Forty Million (40,000,000) shares Thirty (30) days after the effective date of this Share Exchange Agreement should CarryOutSupplies.com demonstrate revenues for the three (3) month period ending June 30, 2014 did not fall below a level equal to 70% of the revenues for the three (3) month period ending June 30, 2013. The number of shares exchanged shall be modified to Seventy One Million (71,000,000) Seventy Five (75) days after the effective date of this Share Exchange Agreement should CarryOutSupplies.com demonstrate revenues for the three (3) month period ending September 30, 2014 did not fall below a level equal to 70% of the revenues for the three (3) month period ending September 30, 2013. As of the date of this filing, all of the 71,000,000 shares had been issued to the owners of CarryOutSupplies.com.

With the merger behind the Company now, we are in the process of rolling out three new verticals under the corporate umbrella; state side manufacturing and printing, ad support products, and online restaurant supplies catalogue. All of which is leveraging the strength of Sugarmade's core business.

The acquisition was accounted as transactions between entities under common control in accordance with ASC Topic 805-50-25 since both Sugarmade and CarryOutSupplies.com had one common major shareholder and officer. When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests, shall initially measure the recognized assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer. The following table summarizes the carrying values of the assets acquired and liabilities assumed at the date of acquisition (or transfer):

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Cash	\$209,214
Accounts receivable	388,399
Inventory	565,287
Other current assets	44,033
Security deposit	23,281
Loan receivables	312,521
Fixed assets	143,916
Intangible assets	3,039
Accounts payable	(1,727,870)
Credit card payable	(420,773 )
Due to Sugarmade	(685,000 )
Customer deposits	(234,197 )
Loans payable	(529,064 )
Other payables	(297,047 )
Long term notes payables	(460,000 )
Net assets at carrying value:	\$(2,664,261)

**17. Subsequent events**

On November 15, 2016, the Company issued a convertible note with warrants to an investor for \$75,000. The convertible promissory note must be repaid by our Company within 6 months from the date of issuance; accrues interest at the rate of 10%; The conversion price will be the lower of 50% of the lowest sale price for the Common Stock on the Principal Market during the twenty (20) consecutive trading days immediately preceding the conversion date.

On November 3, 2016, the Company issued a convertible note with warrants to an investor for \$75,000. The convertible promissory note must be repaid by our Company within 6 months from the date of issuance; accrues interest at the rate of 10%; The conversion price will be the lower of 50% of the lowest sale price for the Common Stock on the Principal Market during the twenty (20) consecutive trading days immediately preceding the conversion date.

On October 11, 2016, the Company entered into a financing agreement with the Autumn Group LLC (“Autumn”). Under the terms of the agreement Autumn provided a total of \$200,000 in financing. \$100,000 of this amount was for the purchase of 2,000,000 restricted common shares pursuant to an exemption from registration relying on Section 4(a)(2) and Rule 506b of Regulation D, under the Securities Act of 1933, as amended. An additional \$100,000 was provided to the Company as promissory notes to be paid back in 12 monthly payments of \$16,666.67 beginning December 1, 2016.

As of September 30, 2016, two convertible promissory in the amount of \$29,167 with accrued interest \$13,596.28, was converted to 1,503,928 restricted common shares. These shares were issued on Oct 3, 2016.



On November 9, 2016, the company issued 982,620 shares to reduce \$50,000 of convertible debt with accrued interest of \$24,955.

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

On November 2, 2015, the Company dismissed its independent registered public accounting firm, MJF & Associates, APC. The Registrant's Board of Directors made the decision to dismiss MJF & Associates, APC and engage Anton & Chia, LLC. as Registrant's independent registered public accounting firm, as described below. During Registrant's two most recent fiscal years and any subsequent interim period before such dismissal, there were no substantial disagreements with MJF & Associates, APC on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which remain unresolved. On November 2, 2015 the Registrant engaged Anton & Chia, LLC. as Registrant's independent registered public accounting firm.

On November 11, 2014, the Company dismissed its independent registered public accounting firm, Anton & Chia, LLC. The Registrant's Board of Directors made the decision to dismiss Anton & Chia, LLC and engage MJF & Associates, APC as Registrant's independent registered public accounting firm, as described below. During Registrant's two most recent fiscal years and any subsequent interim period before such dismissal, there were no substantial disagreements with Anton & Chia, LLC on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which remain unresolved. On November 11, 2014 the Registrant engaged MJF & Associates, APC as Registrant's independent registered public accounting firm.

On July 20, 2011, our Company engaged Anton & Chia, LLP ("A&C") as its independent registered public accounting firm effective July 20, 2011. The decision to engage A&C was approved by our Company's audit committee. A&C previously audited the financial statements of our wholly owned subsidiary Sugarmade, Inc. (incorporated in California – "Sugarmade-CA") as of December 31, 2010 and 2009 and for the year ended December 31, 2010 and the period March 2, 2009 (inception) to December 31, 2009.

Michael Cronin, Certified Public Accountant was the independent registered public accountant of Diversified Opportunities, Inc. and resigned as the independent registered public accountant effective July 20, 2011. The reports of Mr. Cronin on our Company's consolidated financial statements for the past two fiscal years did not contain an adverse opinion or disclaimer of opinion, nor were they modified as to uncertainty, audit scope, or accounting principles, other than to state that there is substantial doubt as to the ability of our Company to continue as a going concern.

During our Company's two most recent fiscal years and the subsequent interim period up to the resignation of Mr. Cronin, there have not been any disagreements between our Company and Mr. Cronin, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements if not resolved to the satisfaction of Mr. Cronin would have caused Mr. Cronin to make reference thereto in its reports on our Company's audited financial statements.

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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.

The Company’s primary business, via its CarryOutSupplies.com business operation, is providing custom and generic printed supplies for the quick service sector of the restaurant industry, with an emphasis on yogurt and ice cream establishments. Many of these establishments are underserved by the larger suppliers that usually require restaurant customers to order large quantities of custom and generic printed paper and other products. CarryOutSupplies allows these smaller establishments to gain the marketing and advertising benefits of customized printed products without tying up large amounts of working capital.

The Company is in process of significantly increasing the number of products offered to the restaurant industry. Whereas the current product emphasis is limited mainly to custom and generic printed items, a new division of the Company, called CaliRestaurantSupplies.com, will expand both the number of products offered and the target market for the Company. The Company already services approximately 2,500 takeout establishments, restaurants, and other food service operators via a product offering of approximately 2,000 items. CaliRestaurantSupplies will expand the Company’s target market to include virtually every type of restaurant and institutional food service operation and the scope of products offered to include virtually every type of non-food product purchased by restaurants. The Company plans to offer over 6,000 products by mid-calendar 2016 and over 20,000 products by year-end via its CaliRestaurantSupplies.com website.

The Company’s is also a distributor printer and copier paper derived from non-wood sources via its Sugamade Paper product. Third party contract manufacturers use agricultural residuals, namely bagasse (derived from sugar cane) and bamboo, as opposed to wood products, significantly reducing the 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. The Company markets this tree free paper product via school and organization fund-raisers and directly to corporations and institutions.

In October of 2014, Sugarmade entered into an agreement to acquire City of Industry, California based S W C Group, Inc., a California Corporation, which does business as CarryOutSupplies.com.

**Employees and consultants**

The company employees approximately 21 full-time and part-time workers, and consultants, most of whom work within the City of Industry headquarters location.

[\(table of contents\)](#)**Overview and Financial Condition**

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

**Results of Operations**

The following table sets forth the results of our operations for the three months ended September 30, 2016 and 2015. Certain columns may not add due to rounding.

	For the three months ended September 30,	
	2016	2015
Net Sales	1,127,554	1,402,911
Cost of Goods Sold:	699,651	928,659
Gross profit	427,903	474,252
Operating Expenses	489,495	701,909
Loss From Operations	(61,592 )	(227,657 )
Other non-operating Income (Expense):	202,789	(522,568 )
Net Income (Loss)	141,197	(750,225 )

**Revenues**

For the three-month periods ending September 30, 2016 and September 30, 2015, revenues were \$1,127,554 and \$1,402,911, respectively. The decrease was primarily due to a refocus on the types of products sold by the Company, specifically elimination of low gross margin and unprofitable product lines and a renewed focus on higher growth and higher gross margin products.

**Cost of goods sold**

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For the three-month periods ending September 30, 2016 and September 30, 2015, costs of goods sold were \$699,651 and \$928,659 respectively. The decrease was primarily due to a refocus on the types of products sold by the Company, specifically elimination of low gross margin and unprofitable product lines and a renewed focus on higher growth and higher gross margin products.

### Gross profit

For the three months period ending September 30, 2016 and September 30, 2015, gross profit were \$427,903 and \$474,252, respectively. The decrease was primarily due to a refocus on the types of products sold by the Company, specifically elimination of low gross margin and unprofitable product lines and a renewed focus on higher growth and higher gross margin products. While this resulted in a decrease in the overall gross profit, the change in business focus result in a significantly higher gross margin percentage of revenues.

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Operating expenses

For the three-month periods ending September 30, 2016 and September 30, 2015, operating expenses were \$489,495 and \$701,909, respectively. The decrease was primarily due the normalizing of business functions due to the acquisition of SWC Group, dba CarryOutSupplies.com outlined in Note 19, and cost cutting programs implemented by management during the period.

Other non-operating income expense.

The Company had total other non-operating income of \$202,789 and a loss of \$522,568 for the three months ending September 30, 2016 and September 30, 2015, respectively. The decrease was primarily due the normalizing of business functions due to the acquisition of SWC Group, dba CarryOutSupplies.com outlined in Note 19, and the significantly lower charges related to the accounting for derivative liabilities.

Net income (loss)

Net income totaled \$141,197 for the three month period ending September 30, 2016, compared to a net loss totaling \$750,225 for the three-month period ending September 30, 2015. The decrease was primarily due the normalizing of business functions due to the acquisition of SWC Group, dba CarryOutSupplies.com outlined in Note 19, the refocus on higher margin product lines and cost cutting programs implemented by management during the period.

**Liquidity and Capital Resources**

We have primarily financed our operations through the sale of unregistered equity and convertible notes payable. As of September 30, 2016, our Company had cash balance of \$14,422, current assets totaling \$545,477 and total assets of \$636,263. We had current and total liabilities totaling \$3,678,559. Stockholders' equity reflected a deficit of \$3,042,296

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, 2016 and 2015:

2016	2015
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Cash (used in) provided by:

Operating activities	\$(296,834)	\$(373,230)
Investing activities	—	(7,677 )
Financing activities	310,345	333,562

Net cash used in operating activities was \$296,834 for the three months ending September 30, 2016, and \$373,230 for the three months ending September 30, 2015. The decrease of net cash flows used in operating activities was primarily due to the normalizing of business functions due to the acquisition of SWC Group, dba CarryOutSupplies.com outlined in Note 19 and due to the elimination of acquisition and restructuring expenses incurred during the September 30, 2014 period.

No cash was generated during the three months ended September 30, 2016 relating to investing activities. Net cash used in investing activities was \$7,677 for the three months ended September 30, 2015.

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Net cash provided by financing activities totaled \$310,345 for the three months ended September 30, 2016. Net cash provided by financing activities totaled \$333,562 for the three months ended September 30, 2015. The difference was due to increased sales of equities during the three months ended September 30, 2015.

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, 2016. We will be required in the near future to issue debt or sell our Company's equity securities in order to raise additional cash, although there are no firm arrangements in place for any such financing at this time. We cannot provide any assurances as to whether we will be able to secure the necessary financing, or the terms of any such financing transaction if one were to occur. The failure to secure such financing could severely curtail our plans for future growth or in more severe scenarios, the continued operations of our Company.

**Capital Expenditures**

Our current plans do not call for our Company to expend significant amounts for capital expenditures for the foreseeable future beyond relatively insignificant expenditures for office furniture and information technology related equipment as we add employees to our Company. We are however continually evaluating the production processes of our third party contract manufacturers to determine if there are investments we could make in their processes to achieve manufacturing improvements and significant cost savings. Any such desired investments would require additional cash above our current forecast requirements.

**Critical Accounting Policies Involving Management Estimates and Assumptions**

Please see the notes to our financial statements.

**ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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## **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 December 31, 2014, our disclosure controls and procedures were ineffective due to the Company is relatively inexperienced with certain complexities within USGAAP and SEC reporting.

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

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

### **Changes in Internal Controls over Financial Reporting**

There have not been any changes in our internal controls over financial reporting during the quarter ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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**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 2015 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 pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS*	(1)XBRL Instance Document
101.SCH*	(1)XBRL Taxonomy Extension Schema
101.CAL*	(1)XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	(1)XBRL Taxonomy Extension Definition Linkbase
101.LAB*	(1)XBRL Taxonomy Extension Label Linkbase
101.PRE*	(1)XBRL Taxonomy Extension Presentation Linkbase

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(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**

November 23, 2016 By: /s/ Jimmy Chan  
Jimmy Chan  
CEO, CFO, and Director