Surna Inc.
Form 10-Q
November 14, 2017

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 SEPTEMBER 30, 2017

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	(I.R.S. Employer

incorporation or organization) 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer, "accelerated filer," "non-accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

As of November 10, 2017, there were 191,265,919 shares of the registrant's common stock outstanding.

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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 the section entitled "Risk Factors" in the Annual Report on Form 10-K for the fiscal year ended December 31, 2016, as updated from time to time in the Company's filings with the U.S. Securities and Exchange Commission (the "SEC"). 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

	September 30, 2017 Unaudited	December 31, 2016
ASSETS		
Current Assets		
Cash and cash equivalents	$1,300,706	$319,546
Accounts receivable (net of allowance for doubtful accounts of $93,000 and $91,000 respectively)	274,762	47,166
Notes receivable	-	157,218
Inventory, net	554,170	747,905
Prepaid expenses	182,623	84,976
Total Current Assets	2,312,261	1,356,811
Noncurrent Assets		
Property and equipment, net	77,676	93,565
Intangible assets, net	680,267	667,445
Deposits	51,000	-
Total Noncurrent Assets	808,943	761,010
TOTAL ASSETS	$3,121,204	$2,117,821
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current Liabilities		
Accounts payable and accrued liabilities	$1,450,363	$1,337,853
Deferred revenue	1,241,819	1,421,344
Amounts due shareholders	21,676	57,398
Convertible promissory notes, net	-	761,440
Convertible accrued interest	-	161,031
Derivative liability on warrants	265,760	477,814
Total Current Liabilities	2,979,618	4,216,880
Noncurrent Liabilities		
Amounts due shareholders-long term	-	11,985
Total Noncurrent Liabilities	-	11,985

TOTAL LIABILITIES	2,979,618	4,228,865
SHAREHOLDERS' EQUITY (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; 189,865,919 and 160,744,916 shares issued and outstanding, respectively	1,898	1,607
Additional paid in capital	18,027,715	12,222,789
Accumulated deficit	(17,888,799)	(14,336,212)
Total Shareholders' Equity (Deficit)	141,586	(2,111,044)
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY(DEFICIT)	$3,121,204	$2,117,821

See accompanying notes to the unaudited condensed consolidated financial statements.

Surna Inc.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenue	$1,566,256	$1,170,760	$4,901,241	$5,560,837
Cost of revenue	1,175,047	753,624	3,668,698	3,742,321
Gross profit	391,209	417,136	1,232,543	1,818,516
Operating expenses:				
Advertising and marketing expenses	168,476	45,177	484,418	155,172
Product development costs	60,145	75,144	250,228	275,370
Selling, general and administrative expenses	1,396,957	533,694	3,518,528	1,559,070
Total operating expenses	1,625,578	654,015	4,253,174	1,989,612
Operating income (loss)	(1,234,369)	(236,879)	(3,020,631)	(171,096)
Other income (expense):				
Interest and other income, net	1,016	10,576	3,808	19,060
Interest expense	-	(89,203)	(41,233)	(282,657)
Amortization of debt discount on convertible promissory notes	(10,037)	(291,000)	(63,157)	(1,335,429)
Loss on extinguishment of debt	(228,428)	-	(643,428)	-
(Loss) gain on change in derivative liabilities	(6,660)	(62,000)	212,054	(348,297)
Total other income (expense)	(244,109)	(431,627)	(531,956)	(1,947,323)
Loss before provision for income taxes	(1,478,478)	(668,506)	(3,552,587)	(2,118,419)
Provision for income taxes	-	-	-	-
Net loss	(1,478,478)	(668,506)	(3,552,587)	(2,118,419)
Other comprehensive income (expense)	-	-	-	-
Comprehensive loss	$(1,478,478)	$(668,506)	$(3,552,587)	$(2,118,419)
Loss per common share – basic and dilutive	$(0.01)	$(0.00)	$(0.02)	$(0.02)
Weighted average number of shares outstanding, both basic and dilutive	184,912,253	145,268,135	179,470,179	139,684,359

See accompanying notes to the unaudited condensed consolidated financial statements.

Surna Inc.

Condensed Consolidated Statements of Changes in Shareholders' Equity (Deficit)

For the Nine Months Ended September 30, 2017

(Unaudited)

	Preferred Stock		Common Stock					
	Number of Shares	Amount	Number of Shares outstanding	Number of Shares to Be Issued	Amount	Additional Paid in Capital	Accumulated Deficit	Shareholders' Deficit
Balance December 31, 2016	77,220,000	$772	160,744,916	-	$1,607	$12,222,789	$(14,336,212)	$(2,111,044)
Common shares issued for conversion of debt and interest, net of unamortized debt discount	-	-	10,601,554	-	106	1,751,049	-	1,751,155
Value attributed to modification of warrants	-	-	-	-	-	59,000	-	59,000
Common shares issued with convertible notes payable	-	-	250,000	-	3	39,127	-	39,129
Common shares issued for cash, net	-	-	16,781,250	-	168	2,684,832	-	2,685,000
Fair value of warrants issued and options granted for compensation	-	-	-	-	-	415,570	-	415,570
Common shares issued as compensation for services	-	-	1,711,891	1,200,000	17	398,758	-	398,775

Common shares to be issued in settlement of restricted stock units awarded as compensation for consulting services	-	-	-	200,000	-	20,500	-	20,500
Fair value of vested restricted stock units awarded to employees and directors	-	-	-	-	-	218,677	-	218,677
Fair value of vested stock options granted to employees	-	-	-	-	-	217,411	-	217,411
Other common shares	-	-	(223,692)	-	(2)	2	-	-
Net loss	-	-	-	-	-	-	(3,552,587)	(3,552,587)
Balance September 30, 2017	77,220,000	$772	189,865,919	1,400,000	$1,898	$18,027,715	$(17,888,799)	$141,586

See accompanying notes to the unaudited condensed consolidated financial statements.

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Surna Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the Nine Months Ended September 30, 2017	2016
Cash Flows from Operating Activities:		
Net loss	$(3,552,587)	$(2,118,419)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and intangible asset amortization expense	34,087	43,870
Amortization of debt discounts on convertible notes	38,433	1,335,429
Amortization of original issue discount on notes payable	25,520	-
(Gain) loss on change in derivative liability	(212,054)	348,297
Compensation paid in equity	1,270,933	4,028
Provision for doubtful accounts	1,715	44,127
Provision for excess and obsolete inventory	208,801	-
Loss on sale of assets other	-	1,117
Loss on extinguishment of debt	643,428	-
Changes in operating assets and liabilities:		
Accounts and note receivable	(207,205)	186,945
Inventory	(15,066)	345,316
Prepaid expenses	(119,753)	17,211
Accounts payable and accrued liabilities	112,516	(864,937)
Deferred revenue	(179,525)	434,529
Accrued interest	(10,574)	282,657
Deferred compensation	-	(25,600)
Cash (used in) provided by operating activities	(1,961,331)	34,570
Cash Flows From Investing Activities:		
Cash disbursed for patent fees	(16,454)	(22,380)
Purchase of property and equipment	(14,566)	(15,126)
Proceeds from the sale of property and equipment	-	32,600
Cash disbursed for lease deposit	(51,000)	-
Cash disbursed for note receivable	-	(80,000)
Cash received from repayment of note receivable	157,218	100,000
Cash provided by investing activities	75,198	15,094
Cash Flows From Financing Activities:		
Proceeds from exercise of stock options	-	358
Cash proceeds from sale of common stock and warrants	2,685,000	-

Payments on convertible notes payable	(270,000)	-
Proceeds from issuance of notes payable	500,000	-
Payments on loans	-	(34,115)
Payments on loans from shareholders	(47,707)	(111,009)
Cash provided by (used in) financing activities	2,867,293	(144,766)
Net change in cash and cash equivalents	981,160	(95,102)
Cash and cash equivalents, beginning of period	319,546	330,557
Cash and cash equivalents, end of period	$1,300,706	$235,455
Supplemental cash flow information:		
Interest paid	$44,150	$-
Income tax paid	$-	$-
Non-cash investing and financing activities:		
Conversions of promissory notes and accrued interest to common stock	$1,205,856	$889,084
Derivative liability on convertible promissory notes and warrants	$-	$673,050
Equipment issued in settlement of debt	$-	$2,500

See accompanying notes to the unaudited condensed consolidated financial statements.

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Surna Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

September 30, 2017

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company:

Surna Inc. (the "Company") incorporated in Nevada on October 15, 2009. On March 26, 2014, the Company acquired Safari Resource Group, Inc. ("Safari"), a Nevada corporation, whereby the Company became the sole surviving corporation after the acquisition of Safari. In July 2014, the Company acquired 100% of the membership interests in Hydro Innovations, LLC, a Texas limited liability company ("Hydro"), pursuant to which Hydro became a wholly-owned subsidiary of the Company. The Company engineers and manufactures innovative technology and products that address the energy and resource intensive nature of indoor cultivation. The Company is focused on supplying industrial solutions to commercial indoor cannabis cultivation facilities. The Company's engineering team is tasked with creating novel energy and resource efficient solutions, including the Company's proprietary liquid-cooled climate control platform. The Company's engineers continuously seek to create technologies that allow growers to meet the specific demands of a cannabis cultivation environment through temperature, humidity, light, and process control. The Company's objective is to provide intelligent solutions that improve the quality, control and overall crop yield and efficiency of indoor cannabis cultivation. The Company is headquartered in Boulder, Colorado. The Company does not cultivate or distribute cannabis.

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 nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2017. The balance sheet as of December 31, 2016 has been derived from the audited financial statements at that date, but does not include all 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, 2016. The notes to the unaudited condensed consolidated financial statements are presented on a going concern basis unless otherwise noted.

Basis of Presentation:

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has experienced recurring losses since its inception. The Company incurred a net loss of approximately $3,553,000 for the nine months ended September 30, 2017, and had an accumulated deficit of approximately $17,889,000 as of September 30, 2017. Since inception, the Company has financed its activities principally through debt and equity financing and customer deposits. Management expects to incur additional losses and cash outflows in the foreseeable future in connection with its operating activities.

The Company’s consolidated financial statements have been presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

The Company is subject to a number of risks similar to those of other similar stage companies, including dependence on key individuals; successful development, marketing and branding of products; uncertainty of product development and generation of revenues; dependence on outside sources of financing; risks associated with research and development; dependence on third-party suppliers and collaborators; protection of intellectual property; and competition with larger, better-capitalized companies. Ultimately, the attainment of profitable operations is dependent on future events, including obtaining adequate financing to fund its operations and generating a level of revenues adequate to support the Company’s cost structure. In the first quarter of 2017, the Company extinguished convertible promissory notes in the principal amount of $510,000 through the issuance of shares of its common stock (See Note 2) and raised $2,685,000 in a private placement of the Company’s common stock and attached warrants to accredited investors (see Note 6). In the third quarter of 2017, the Company extinguished notes payable in the principal amount of $537,000 through the issuance of shares of its common stock (See Note 3).

The Company will likely need to raise debt and equity financing in the future in order to continue its operations and achieve its growth targets, however, there can be no assurance that such financing will be available in sufficient amounts and on acceptable terms, when and if needed, or at all. The precise amount and timing of the funding needs cannot be determined accurately at this time, and will depend on a number of factors, including market demand for the Company’s products and services, the success of product development efforts, the timing of receipts for customer deposits, the management of working capital, and the continuation of normal payment terms and conditions for purchase of goods and services. The Company believes its cash balances and cash flow from operations will not be sufficient to fund its operations and growth for the next twelve months. If the Company is unable to substantially increase revenues, reduce expenditures, or otherwise generate cash flows from operations, then the Company will likely need to raise additional funding to continue as a going concern from investors or through other avenues.

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. The Company bases its estimates on historical experience and on various other assumptions that it believes 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 the Company’s operating results. Key estimates include: valuation of derivative liabilities, valuation of intangible assets, and valuation of deferred tax assets and liabilities.

Warrants Issued in Connection with Financings:

The Company generally accounts for warrants issued in connection with financings as a component of equity, unless there is a possibility that the Company may have to settle the warrants in cash. For warrants issued with the deemed possibility of a cash settlement, the Company records the fair value of the issued warrants as a liability at each reporting date and records changes in the estimated fair value as a non-cash gain or loss in the condensed consolidated statements of operations. The fair values of have been determined using the Black Scholes Merton Option Pricing valuation model, or the Black-Scholes Model. The Black-Scholes Model provides for assumptions regarding volatility, call and put features and risk-free interest rates within the total period to maturity. These values are subject to a significant degree of judgment on the part of the Company.

Fair value measurements

The Company evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level to classify them for each reporting period. There have been no transfers between fair value measurements levels during the three months ended September 30, 2017. The carrying amounts for cash, accounts receivable and accounts payable, accrued expenses and other current liabilities approximate fair value due to their short-term nature.

The authoritative guidance on fair value measurements establishes a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. The following are the hierarchical levels of inputs to measure fair value:

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2: Observable inputs that reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
Level 3: Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

The following table sets forth the Company's assets and liabilities that were measured at fair value as of September 30, 2017 and December 31, 2016 by level within the fair value hierarchy:

	As of September 30, 2017				As of December 31, 2016			
	Level I	Level II	Level III	Fair Value	Level I	Level II	Level III	Fair Value
Financial liabilities:								
Derivative liabilities - warrants	$–	$ –	$265,760	$265,760	$–	$ -	$477,814	$477,814
Total financial assets (liabilities)	$-	$ -	$265,760	$265,760	$-	$ -	$477,814	$477,814

The estimated fair value of the derivative liability associated with the Company's warrants is calculated using the Black-Scholes option pricing model.

Net Income (Loss) Per Share

In accordance with ASC Topic 280 – "Earnings Per Share", the basic loss per common share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding. Diluted loss per common share is computed similar to basic loss per common share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. As of September 30, 2017, there are approximately 19,143,050 shares of common stock issuable upon the exercise of certain outstanding options and warrants and vesting of certain restricted stock units that have been excluded from the computation of diluted net loss per share because the effect would have been anti-dilutive.

Recent Accounting Pronouncements:

In May 2017, the FASB issued Accounting Standards Update (ASU) No. 2017-09, *Compensation – Stock Compensation (Topic 718) – Scope of Modification Accounting*, to clarify when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new standard, modification is required only if the fair value, the vesting conditions, or the classification of an award as equity or liability changes as a result of the change in terms or conditions. The amendments are effective for all entities for annual periods beginning after December 15, 2017, including interim periods within those annual periods, and will be applied prospectively. Early adoption is permitted. The Company is currently evaluating the effect that adopting this new accounting guidance will have on its consolidated results of operations, cash flows and financial position.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment* ("ASU 2017-04"). ASU 2017-04 simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. ASU 2017-04 is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently evaluating the effect that adopting this new accounting guidance will have on its consolidated results of operations, cash flows and financial position.

In May 2014, the FASB issued ASU 2014-09 (Topic 606), *Revenue from Contracts with Customers*. The new revenue recognition standard supersedes all existing revenue recognition guidance. Under this ASU, an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 and its related amendments are effective for reporting periods (including interim periods) beginning after December 31, 2017. The standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption ("modified retrospective method"). The Company currently plans to adopt the standard under the modified retrospective method effective January 1, 2018, which will be reflected in its financial statements as of and for the three months ended March 31, 2018. The Company is currently evaluating the effect that adopting this new accounting guidance will have on its consolidated financial statements, and is working with a consultant to assess the effects of the new standard on its internal processes, customer contracts, and future revenues.

NOTE 2 – CONVERTIBLE PROMISSORY NOTES

In the first quarter of 2017, the Company entered into note conversion and warrant amendment agreements (each an "Agreement" and together, the "Agreements") to: (i) amend the convertible promissory notes – series 2 ("Original Notes") to reduce the conversion price of such holder's Original Note and simultaneously cause the conversion of the outstanding amount under such Original Note into shares of common stock of the Company ("Conversion Shares"); and (ii) reduce the exercise price of the original warrant ("Original Warrants" and together with the amended notes and the amended warrants, the "Amendments"). Each Agreement was privately negotiated so the terms vary. Pursuant to the Agreements, the Original Notes were amended to reflect a reduced conversion price per share between $0.09 and $0.22. Additionally, pursuant to the Agreements, the Original Warrants were amended to reflect a reduced exercise price per share between $0.30 and $0.35, except for one Original Warrant to reflect a reduced exercise price of $0.15 per share. The term of one Original Warrant was also extended.

Pursuant to the Agreements, in the first quarter of 2017, the Company (i) converted Original Notes with an aggregate outstanding principal amount of $510,000 and accrued interest of $134,553 in exchange for the issuance of 5,001,554 shares of the Company's common stock, and (ii) amended Original Warrants to reduce their exercise price. In the first quarter of 2017, the Company also made payments of $314,150 to settle convertible promissory notes in the principal amount of $270,000 and accrued interest of $44,150. As of June 30, 2017, the Company had no convertible notes outstanding.

The Company has accounted for the Agreements as debt extinguishment where by the difference between the reacquisition price of the debt and the net carrying amount of the extinguished debt was recognized as a loss during the first quarter of 2017. The following details the calculation of the loss on extinguishment of the notes payable – series 2 in the first quarter of 2017:

Carrying amount of debt	
Principal converted	$510,000
Accrued interest converted	134,553
Unamortized debt discount	(5,398)
Total carrying amount of debt	639,155
Reacquisition price of debt	
Fair value of shares of common stock issued	995,155
Warrant modification value	59,000
Total reacquisition price of debt	1,054,155
Loss on extinguishment of debt	$(415,000)

NOTE 3 – PROMISSORY NOTES

On February 9, 2017, the Company entered into a securities purchase agreement with two accredited investors pursuant to which the Company issued promissory notes in the aggregate original principal amount of $537,500. In addition, each investor received 125,000 shares, an aggregate of 250,000 shares, of the Company's common stock. The notes were unsecured, had an interest rate of 6%, per annum and were originally due and payable, with all accrued interest, on November 9, 2017. The total proceeds were approximately $500,000 with an original issue discount of approximately $37,500. The Company allocated the cash proceeds amount between the debt and shares issued on a relative fair value basis. Based on relative fair value, the Company allocated approximately $461,000 and $39,000 to the promissory notes and the shares of common stock, respectively. The original issue discount of $37,500 and fair value of the shares issued of $39,000 were amortized and expensed over the life of the loans. For the three and nine months ended September 30, 2017, the amortization expense was approximately $11,000 and approximately $50,000, respectively. In the event of a default under the terms of the promissory notes, the interest rate automatically increases to 18% per annum, until such time as the default event is cured. The events of default included suspension from trading of the Company's common stock, failure to pay principal or interest when due, commencement of bankruptcy or insolvency proceedings or a change of control.

On August 8, 2017, the Company executed an amendment (the "Amendment") with the holders of the promissory notes, each in the original principal amount of $268,750. The Amendment provides for each of the holder's notes to convert its principal into 2,800,000 shares, or 5,600,000 shares in the aggregate, of the Company's common stock, at a price per share of approximately $0.096. The Company's closing share price on August 7, 2017 was $0.135. In connection with this Amendment, the holders also agreed to surrender to the Company the portion of the promissory notes representing the accrued interest as the consideration for this Amendment, which approximates $16,900 in total. The transactions contemplated by the Amendment closed on August 22, 2017.

The Company has accounted for the Amendment as debt extinguishment whereby the difference between the reacquisition price of the debt and the net carrying amount of the extinguished debt was recognized as a loss during the third quarter of 2017. The following details the calculation of the loss on extinguishment of the notes payable in the third quarter of 2017:

Carrying amount of debt	
Principal converted	$537,500
Accrued interest converted	15,904
Unamortized debt discount	(25,832)
Total carrying amount of debt	527,572
Reacquisition price of debt	
Fair value of shares of common stock issued	756,000
Loss on extinguishment of debt	$(228,428)

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NOTE 4 – COMMITMENTS AND CONTINGENCIES

Litigation

From time to time, in the normal course of its operations, the Company is subject to litigation matters and claims. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict and the Company's view of these matters may change in the future as the litigation and events related thereto unfold. The Company expenses legal fees as incurred. The Company records a liability for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. An unfavorable outcome to any legal matter, if material, could have an adverse effect on the Company's operations or its financial position, liquidity or results of operations.

Internal Revenue Service Penalties

The Company has been penalized by the Internal Revenue Service for failure to file its Foreign Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, for the years 2009 through 2014 on a timely basis. The penalties approximate $115,000. The Company's request that the penalties be abated was initially denied by the Internal Revenue Service. The Company is appealing and believes the likelihood of abatement is high based on reasonable cause. However, there can be no assurance of any abatement until the Internal Revenue Service acts upon the appeal.

Stock Options of Former CEO

In March 2017, a former CEO of the Company requested to exercise an option to purchase 3,000,000 shares of the Company's common stock at an exercise price of $.00024 per share. The stock option expired in March 2017. The Company's Board of Directors (the "Board") has not approved the request for the issuance of the common stock under the stock option.

New Building Lease

On June 27, 2017, the Company executed a lease, to be effective September 29, 2017, for its manufacturing and office space. The term of the lease commenced September 29, 2017 and continues through August 31, 2022. The Company will occupy its current space at a rate of $12,967 per month until January 1, 2018. On January 2, 2018, the space will be expanded and the monthly rental rate will increase to $18,979 until August 31, 2018. Beginning September 1, 2018, the monthly rent will increase by 3% each year through the end of the lease. Pursuant to the lease, the Company made a security deposit of $51,000 on July 31, 2017 and received a $100,000 allowance for leasehold improvements. No leasehold improvements have been made as of September 30, 2017.

The following is a schedule by years of the minimum future lease payments on the building lease as of September 30, 2017.

Year ending December 31:	
2017	$38,901
2018	230,026
2019	236,926
2020	244,034
2021	251,355
Later years	170,888
Total future minimum lease payments	$1,172,130

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NOTE 5 – RELATED PARTY TRANSACTIONS

Keen Consulting Agreement

On May 10, 2017, the Board approved a three-year consulting agreement between the Company and Stephen Keen, a principal shareholder of the Company and a former officer and director. Under the consulting agreement, Mr. Keen will provide certain consulting services to the Company including research and development, new product design and innovations, existing product enhancements and improvements, and other technology advancements with respect to the Company's business and products in exchange for an annual consulting fee of $30,000. The consulting agreement also includes certain activity restrictions which prohibit Mr. Keen from competing with the Company. In connection with the execution of this consulting agreement, Mr. Keen resigned as a director of the Company on May 10, 2017. Mr. Keen's employment with the Company ceased as of April 28, 2017. Pursuant to the terms of this agreement, the Company paid Mr. Keen $7,500 and $12,500 for the three and nine months ended September 30, 2017, respectively.

Sterling Pharms Equipment Agreement

On May 10, 2017, the Board approved a three-year equipment, demonstration and product testing agreement between the Company and Sterling Pharms, LLC ("Sterling"), an entity controlled by Mr. Keen, which operates a Colorado-regulated cannabis cultivation facility currently under construction. Under this agreement, the Company has agreed to provide to Sterling certain lighting, environmental control, and air sanitation equipment for use at the Sterling facility in exchange for a quarterly fee of $16,500. Also, under this agreement, Sterling has agreed to allow the Company and its existing and prospective customers to have access to the Sterling facility for demonstration tours in a working environment, which the Company believes will assist it in the sale of its products. Sterling has also agreed to monitor, test and evaluate the Company's products installed at the Sterling facility and to collect data and provide feedback to the Company on the energy and operational efficiency and efficacy of the installed products, which the Company intends to use to improve, enhance and develop new or additional product features, innovations and technologies. In consideration for access to the Sterling facility to conduct demonstration tours and for the product testing and data to be provided by Sterling, the Company will pay Sterling a quarterly fee of $12,000.

As of September 30, 2017, Sterling Pharms had accepted substantially all the equipment under the agreement, but is in the process of completing the installation of the equipment. Pursuant to the terms of this agreement, the respective payments will begin upon the delivery and installation of the equipment.

In September 2017, the Company received a deposit from Sterling of $78,310 to purchase equipment unrelated to the lease. The Company purchased on behalf of Sterling additional equipment of $23,520 which is included in Other

Receivables.

Independent Director Compensation Plan

On August 8, 2017, the Board approved a compensation plan for the Company’s independent directors effective for the election or appointment of independent directors on or after May 31, 2017. Under this compensation plan, the Company will pay the independent directors an annual fee of $60,000, payable quarterly in advance on the first business day of each quarter, covering any regular or special meetings of the Board or any committee thereof attended in person, any telephonic meeting of the Board or any committee thereof in which the director participated, any non-meeting consultations with the Company’s management, and any other services provided by them as a director (other than services as the Chairman of the Board and lead independent director and the Chairman of the Company’s Audit Committee). The annual fee is paid 50% in cash and 50% in shares of the Company’s common stock, with the number of shares to be determined based on the closing price of the common stock on the date of issuance.

The Company pays the Chairman of the Board and lead independent director an additional annual fee of $15,000, payable quarterly in advance. The Company pays the Audit Committee Chairman an annual fee of $15,000, payable quarterly in advance, for his services as the Audit Committee Chairman. There is no additional compensation paid to members of the Audit Committee.

At the time of initial election or appointment, each director also receives an equity retention award in the form of non-qualified stock options to purchase shares of common stock, shares of common stock, or a combination thereof.

Employment Agreement with Current Chief Executive Officer

On September 6, 2017, the Board approved an employment agreement between the Company and its current Chief Executive Officer ("the CEO"), which included the grant of certain restricted stock units.

The initial term of the employment agreement commenced on August 17, 2017, the date of the CEO's appointment, and will continue until December 31, 2019. However, the Company and the CEO may terminate the employment agreement, at any time, with or without cause, by providing the other party with 30-days' prior written notice. In the event the CEO's employment is terminated by the Company during the initial term without cause, the CEO will be entitled to receive his base salary for an additional 30 days. Following the initial term, the Company and the CEO may extend the employment agreement for additional one-year terms by mutual written agreement.

The CEO will receive an annualized base salary of $180,000. Beginning December 31, 2017 and for each six-month period through December 31, 2019, the CEO will also be eligible to receive a special bonus of 1,000,000 shares of the Company's common stock, provided the Board has determined, in its sole discretion, that the CEO's performance has been average or better for such special bonus period.

The Board also granted the CEO a total of 3,000,000 restricted stock units, which vest based on the CEO's continued service and subject to the following performance thresholds: (i) 1,500,000 restricted stock units will vest on March 31, 2019 if the Company achieves 2018 revenue of $18,000,000, and (iii) 1,500,000 restricted stock units will vest on March 31, 2020 if the Company achieves 2019 revenue of $25,000,000.

In consideration of the grant of the restricted stock units and the eligibility for the special bonus, the CEO agreed to terminate and cancel the non-qualified stock options to purchase 900,000 shares of the Company's common stock, which were granted to him as an equity retention award in connection with his appointment to the Board on August 8, 2017.

In the event of a change of control involving the Company, (i) any restricted stock units not already vested will become vested (other than those restricted stock units that were previously forfeited due to failure to meet the performance threshold), and (ii) any remaining special bonuses related to any bonus period ending after the date of the change of control will become due and payable, provided the CEO continues to provide services to the Company on the date immediately preceding the date of the change of control.

On August 8, 2017, the CEO was awarded 600,000 shares of the Company’s common stock in consideration of services rendered to the Company prior to his appointment as a director. These shares were fully vested at the time of the award.

Resignation of Former Chief Executive Officer

On August 17, 2017, the Company’s then current Chief Executive Officer (the “Previous CEO”) notified the Board of his resignation, including his resignation as a director, effective August 17, 2017.

On August 17, 2017, the Company and the Previous CEO entered into an employment agreement pursuant to which the Previous CEO will continue his employment as the Company’s Vice President Business Development – West Coast, a non-executive officer position. The Previous CEO will focus his efforts and use his industry knowledge to assist the Company in developing the significant market opportunities resulting from the recent legalization of cannabis for recreational use in the State of California. The initial term of the employment agreement commences on August 17, 2017 and continues until March 31, 2018. The employment agreement may be extended beyond the initial term upon the mutual agreement of the Company and the Previous CEO.

On August 17, 2017, the Board also granted the Previous CEO a total of 9,000,000 restricted stock units, which vest in twelve (12) equal installments (750,000 restricted stock units per installment) commencing on the first business day of January 2018 and continuing on the first business day of each of the next eleven (11) calendar months, provided that the Previous CEO is employed by the Company on such vesting date or, if the initial term under the employment agreement has expired, the Previous CEO has not materially breached any non-competition, non-solicitation and other post-termination of employment obligations.

NOTE 6 – SHAREHOLDERS' EQUITY

Private Placement

In March 2017, the Company entered into a Securities Purchase Agreement (the "Agreement") with certain accredited investors (the "Investors"). The Company issued an aggregate of 16,781,250 investment units (the "Units"), for aggregate gross proceeds of $2,685,000. Each Unit consisted of one share of the Company's common stock and one warrant for the purchase of one share of the Company's common stock; however, one investor declined receipt of the warrant to purchase 468,750 shares of the Company's common stock.

Pursuant to each of the warrants, the holder thereof may, subject to the terms of the warrant, at any time on or after six months after the date of the warrant and on or prior to the close of business on the date that is the third anniversary of the date of the warrant, purchase up to the number of shares of the Company's common stock as set forth in the respective warrant. The exercise price per share of the common stock under each warrant is $0.26, subject to adjustment as provided in the warrant. Each warrant is callable at the Company's option commencing six months from the date of the warrant, provided the Company's common stock trades at a volume weighted average price ("VWAP") of $0.42 or greater (subject to adjustment) for five consecutive trading days (the "Call Condition"). Commencing at any time after the date on which the Call Condition is satisfied, the Company has the right, upon 30 days' notice to the holder given not later than 30 trading days after the date on which the Call Condition is satisfied, to redeem the number of warrant shares specified in the applicable Call Condition at a price of $0.01 per warrant share, subject to the terms of the warrant.

Equity Issued as Compensation for Services

<u>Warrants Issued to Former Director</u>

On May 31, 2017, in connection with the resignation of a former director, the Company agreed to issue the former director three individual warrants to purchase: (i) 900,000 shares ("Warrant 1"), (ii) 460,525 shares ("Warrant 2"), and (iii) 460,525 shares ("Warrant 3") (collectively, the "Warrants") of the Company's common stock for a period of five years. Warrant 1 was granted on June 20, 2017, is fully vested, and can be exercised beginning December 21, 2017 at an exercise price of $0.114 per share with the option for a cashless exercise. Warrants 2 and 3 were granted on June 20, 2017, are fully vested, and can be exercised beginning December 21, 2017 at an exercise price of $0.0005 per share with the option for a cashless exercise. The Company recorded approximately $207,000 of compensation expense for the fair value the Warrants on the grant date. The fair value of the Warrants at the date of grant was determined using the Black-Scholes Option Pricing Model. The assumptions used in the Black-Scholes Option Pricing Model were term of the Warrants of 5 years, volatility rate of 119.96%, quarterly dividends 0%, and a risk-free interest rate of 1.77%.

Warrants Issued to Investment Bank

On June 18, 2017, for services rendered in connection with the conversion of the Original Notes, the Company issued to an investment bank or its designees a warrant (“Banker Warrant”) to purchase, at an exercise price $0.35 per share, 500,000 shares of the Company’s common stock for a period of three years. The Banker Warrants were fully vested on the date of issuance and may be exercised beginning December 20, 2017. The Company recorded approximately $55,000 of expense for the fair value the Banker Warrant on the date of issuance. The fair value of the Banker Warrants at date of issuance was determined using the Black-Scholes Option Pricing Model. The assumptions used in the Black-Scholes Option Pricing Model were term of the Banker Warrant of 3 years, volatility rate of 120.02%, rate of quarterly dividends 0% and a risk-free interest rate of 1.52%.

Common Shares Issued to Employee

During the first quarter of 2017, the Company issued to an employee 40,000 shares of common stock which were valued at approximately $9,000 on the date of issuance.

Common Shares Issued to Director

On March 14, 2017, the Company issued to its Chairman of the Board (the "Chairman") 700,000 shares of common stock as an equity retention award. These shares were valued, using the closing price for the Company's common stock, as of the date of ratification for total value of $122,000, which was expensed as compensation.

2014 Stock Ownership Plan

As of December 31, 2016, the Company had non-qualified stock options to purchase 6,177,600 shares of the Company's common stock, with an exercise price of $0.00024, outstanding under the 2014 Stock Ownership Plan of Safari Resource Group, Inc. (the "2014 Stock Plan"). Upon the adoption of the Company's 2017 Equity Incentive Plan (the "2017 Equity Plan"), there will be no further awards under the 2014 Stock Plan.

In March 2017, in a private transaction, certain principal shareholders of the Company, assigned to the Previous CEO, non-qualified stock options to purchase 3,088,800 shares of the Company's common stock outstanding under the 2014 Stock Plan. The principal shareholders informed the Company that they agreed to assign these options as an incentive (i) for the Previous CEO to complete the negotiations with the Company's convertible noteholders to convert their notes into shares of the Company's common stock, and (ii) for the Previous CEO to complete a private placement of the Company's common stock. The Previous CEO thereupon delivered a purported notice of exercise of the options to the Company just prior to the expiration of the options. The Company erroneously reported in its Form 10-K for the year ended December 31, 2016 that the common stock underlying these options had been issued during the three months ended March 31, 2017. Prior to the Company's acceptance of the notice of exercise and issuances of these shares in response thereto, in May 2017, the Previous CEO and the principal shareholders entered into a rescission agreement to nullify the March 2017 assignment transaction. Pursuant to their terms, the options have expired.

In March 2017, a former CEO of the Company, holding non-qualified options to 3,088,800 shares of the Company's common stock outstanding under the 2014 Stock Plan, requested to exercise options with respect to 3,000,000 shares at an exercise price of $.00024 per share. The Board has not approved the request for the issuance of the common stock underlying these exercised options. All of these options expired in March 2017.

As of September 30, 2017, there are no options outstanding under the 2014 Stock Plan.

2017 Equity Incentive Plan

On August 1, 2017, the Board adopted and approved the 2017 Equity Plan in order to attract, motivate, retain, and reward high-quality executives and other employees, officers, directors, consultants, and other persons who provide services to the Company by enabling such persons to acquire an equity interest in the Company. Under the 2017 Equity Plan, the Board (or the compensation committee of the Board, if one is established) may award stock options, stock appreciation rights ("SARs"), restricted stock awards ("RSAs"), restricted stock unit awards ("RSUs"), shares granted as a bonus or in lieu of another award, and other stock-based performance awards. The 2017 Equity Plan allocates 50,000,000 shares of the Company's common stock ("Plan Shares") for issuance of equity awards under the 2017 Equity Plan. As of September 30, 2017, the Company has granted, under the 2017 Equity Plan, awards in the form restricted shares for services rendered by independent directors and consultants, non-qualified stock options and RSUs.

Equity-based compensation costs are classified in the Company's consolidated financial statements in the same manner as if such compensation was paid in cash. The following is a summary of equity-based compensation costs under the 2017 Equity Plan included in the Company's consolidated statements of operations for the three and nine months ended September 30, 2017:

	Three months	Nine months
Equity-based compensation expense included in:		
Cost of revenue	$38,104	$38,104
Advertising and marketing expenses	7,259	7,259
Product development costs	2,640	2,640
Selling, general and administrative expenses	578,151	877,856
Total equity-based compensation expense included in consolidated statement of operations	$626,154	$925,859

Equity-based compensation expense is reduced for forfeitures as the forfeitures occur since the Company does not have historical data or other factors to appropriately estimate the expected employee terminations and to evaluate whether particular groups of employees have significantly different forfeiture expectations.

The total unrecognized compensation expense for unvested equity-based compensation awards at September 30, 2017, was $1,304,660, which will be recognized over approximately 2.25 years. This unrecognized compensation expense does not include the potential future compensation expense related to equity awards which are subject to vesting based on certain revenue and bookings thresholds for 2017, 2018 and 2019 being satisfied (the "Performance-based Awards"). As of September 30, 2017 and the grant date, the Company has determined that the likelihood of performance levels being obtained is remote.

Restricted Stock Awards

On August 8, 2017, the CEO was awarded 600,000 shares of restricted stock under the 2017 Equity Plan in consideration of services rendered to the Company prior to his appointment as a director. These restricted shares were fully vested at the time of the award and the value attributable to these shares, which were issued in August 2017, was $84,000 as calculated using the fair value of the Company's common stock on August 7, 2017. See Note 5 – Related Party Transactions – Employment Agreement with Current Chief Executive Officer.

On August 8, 2017, the Company awarded 111,113 restricted shares under the 2017 Equity Plan to independent directors in lieu of the payment of cash fees earned during the second quarter of 2017. These restricted shares were fully vested at the time of the award. The value attributable to these shares, which were issued in August 2017, was $15,000 as calculated using the fair value of the Company's common stock on August 7, 2017. As of September 30, 2017, the independent directors are owed cash fees of $15,000 which will be paid in the form of fully vested restricted shares in November 2017.

On August 8, 2017, the Company awarded 260,778 restricted shares under the 2017 Equity Plan to a consultant who provided corporate and financial services to the Company. These restricted shares were awarded in lieu of cash fees earned for the April, May, June and July 2017 and were fully vested at the time of the award. The value attributable to these shares, which were issued in August 2017, was $35,000 as calculated using the fair value of the Company's common stock on August 7, 2017. As of September 30, 2017, the consultant is owed cash fees of $15,000 which will be paid in the form of fully vested restricted shares in November 2017.

On September 6, 2017, the Company awarded 1,200,000 restricted shares under the 2017 Equity Plan to an employee as compensation. These restricted shares were fully vested at the time of the award. The value attributable to these shares, which were issued in October 2017, was $134,280 as calculated using the fair value of the Company's common stock on September 6, 2017. These shares are reflected as shares to be issued in the Company's Statement of Changes in Shareholders' Equity (Deficit).

Non-Qualified Stock Options

On August 8, 2017, the Board granted to certain independent directors non-qualified stock options, under the 2017 Equity Plan, to purchase a total of 1,800,000 shares of the Company’s common stock at an exercise price of $0.135 per share for a period of ten years. These options vest 50% on date of grant and the remaining 50% on March 1, 2018, provided they are still serving as a director on such date. On August 17, 2017, one of these independent directors was appointed the CEO and, in consideration of the grant of the restricted stock units and the eligibility for the special bonus, the CEO agreed to terminate and cancel the non-qualified stock options to purchase 900,000 shares of the Company’s common stock previously granted to him.

During the third quarter of 2017, the Board granted to certain employees non-qualified stock options, under the 2017 Equity Plan, to purchase a total of 12,355,000 shares of the Company’s common stock at an exercise price equal to the closing market price of the Company’s common stock on the day before the grant. The terms of the options are summarized as follows:

(a) Non-qualified stock options to purchase 1,805,000 shares at an exercise price of $0.135 per share granted to certain employees on August 8, 2017, which vest based on the employee’s continued service over 2.75 years, as follows: (i) 661,672 options will vest if the employee remains employed at various dates during 2017, (ii) 571,665 options will vest if the employee remains employed at various dates during 2018, and (iii) 571,663 options will vest if the employee remains employed at various dates during 2019, and have a term of 10 years. As of September 30, 2017, non-qualified stock options to purchase 60,000 shares have expired.

(b) Non-qualified stock options to purchase 1,300,000 shares at an exercise price of $0.121 per share granted to a former employee on August 17, 2017, which were fully vested on the grant date and have a term of three years.

(c) Non-qualified stock options to purchase 1,200,000 shares at an exercise price of $0.135 per share granted to certain employees on August 8, 2017, which vest based on the employee’s continued service and subject to the following performance thresholds: (i) 400,000 options will vest if the Company achieves $8,000,000 and $10,000,000 of revenue and new bookings, respectively, for the year end December 31, 2017, (ii) 400,000 options will vest if the Company achieves 2018 revenue of $18,000,000, and (iii) 400,000 options will vest if the Company achieves 2019 revenue of $25,000,000.

(d) Non-qualified stock options to purchase 4,050,000 shares at an exercise price of $0.121 per share granted to certain employees on August 17, 2017, which vest based on the employee’s continued service and subject to the following performance thresholds: (i) 800,000 options will vest if the Company achieves $8,000,000 and $10,000,000 of revenue and new bookings, respectively, for the year end December 31, 2017, (ii) 1,300,000 options will vest if the Company achieves 2018 revenue of $18,000,000, and (iii) 1,950,000 options will vest if the Company achieves 2019 revenue of $25,000,000.

(e) Non-qualified stock options to purchase 4,000,000 shares at an exercise price of $0.112 per share granted to an employee on September 9, 2017, which vest based on the employee’s continued service and subject to the following performance thresholds: (i) 750,000 options will vest if the Company achieves $8,000,000 and $10,000,000 of revenue and new bookings, respectively, for the year end December 31, 2017, (ii) 1,250,000 options will vest if the Company achieves 2018 revenue of $18,000,000, and (iii) 2,000,000 options will vest if the Company achieves 2019 revenue of $25,000,000.

The Company uses the Black-Scholes Option Pricing Model to determine the fair value of options granted. Option-pricing models require the input of highly subjective assumptions, particularly for the expected stock price volatility and the expected term of options. Changes in the subjective input assumptions can materially affect the fair value estimate. The expected stock price volatility assumptions are based on the historical volatility of the Company's common stock over periods that are similar to the expected terms of grants and other relevant factors. The Company derives the expected term based on historical experience and other relevant factors concerning expected employee behavior with regard to option exercise. The risk-free interest rate is based on U.S. Treasury yields for a maturity approximating the expected term calculated at the date of grant. The Company has never paid any cash dividends on its common stock and the Company has no intention to pay a dividend at this time; therefore, the Company assumes that no dividends will be paid over the expected terms of option awards.

The Company determines the assumptions used in the valuation of option awards as of the date of grant. Differences in the expected stock price volatility, expected term or risk-free interest rate may necessitate distinct valuation assumptions at those grant dates. As such, the Company may use different assumptions for options granted throughout the year. The valuation assumptions used to determine the fair value of each option award on the date of grant were: expected stock price volatility 117.13% - 120.6%; expected term in years 5.0 - 7.5 and risk free interest rate 1.71% - 2.07%

A summary of the non-qualified stock options granted to employees under the 2017 Equity Plan as of September 30, 2017, and changes during the nine months then ended, are presented in the table below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding as of December 31, 2016	-	$ -	-	-
Granted	12,355,000	0.121	9.9	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Expired	(60,000)	0.135	9.9	-
Outstanding as of September 30, 2017	12,295,000	0.121	9.9	-
Expected to vest as of September 30, 2017	3,045,000	0.129	9.9	-

As of September 30, 2017, of the options to purchase 12,295,000 shares outstanding, options to purchase 9,250,000 shares are performance-based and the Company has determined that the likelihood of performance levels being obtained is remote as of the date of grant and September 30, 2017. Based on the low level of obtaining the performance level, the fair value of these performance-based options was negligible as of the grant date and September 30, 2017.

A summary of the non-qualified stock options granted to the directors under the 2017 Equity Plan as of September 30, 2017, and changes during the nine months then ended, are presented in the table below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)

Outstanding as of December 31, 2016	-	$ -	-	-
Granted	1,800,000	0.135	9.9	-
Exercised	-	-	-	-
Forfeited/Cancelled	(900,000)	0.135	9.9	-
Expired	-	-	-	-
Outstanding and expected to vest as of September 30, 2017	900,000	0.135	9.9	-

The total fair value of vested options issued to employees and directors and recorded as compensation expense was $303,000 and $371,000 for the three and nine months ended September 30, 2017, respectively. Compensation expense for the nine months ended September 30, 2017 includes $68,000 for cancelled options.

Restricted Stock Units

On August 8, 2017, the Company awarded 700,000 restricted stock units to the Chairman based on the retention agreement between the Company and the Chairman entered into in March 2017 prior to his appointment. These restricted stock units will vest on March 1, 2018, provided he remains a director on such date, and will be settled by the issuance of one share of common stock for each vested restricted stock unit.

On June 12, 2017, the Company entered into a consulting agreement for a sales and business development services. The consulting term ended on September 1, 2017. The consultant was compensated with an award of 200,000 restricted stock units, which vested on the following dates: 66,667 units on July 7, 2017, 66,667 units on August 4, 2017 and 66,666 units on September 1, 2017. Each vested restricted stock unit will be settled by the issuance of one share of common stock. The Company will account for these restricted stock units using the graded vesting method with the total value of the restricted stock units calculated on the date the shares of common stock are issued to the consultant. For accounting purposes, the restricted stock units will be revalued at each reporting date with the final value being the date the shares of common stock are issued to the consultant. The Company recorded an expense of $17,000 and $21,000 for the three and nine months ended September 30, 2017, respectively. The Company issued 200,000 shares of common stock to settle the vested restricted stock units on October 3, 2017 which are reflected as shares to be issued in the Company’s Statement of Changes in Shareholders’ Equity (Deficit).

During the third quarter of 2017, the Company also issued 12,700,000 restricted stock units to employees as follows:

(a) On August 17, 2017, the Company granted 700,000 restricted stock units to certain employees which vest at various times during the first quarter of 2018, provided the employee remains employed as of the vesting date.

(b) On August 17, 2017, the Company granted to the Previous CEO 9,000,000 restricted stock units, which vest in 12 equal installments (750,000 restricted stock units per installment) commencing on the first business day of January 2018 and continuing on the first business day of each of the next 11 calendar months, provided that the Previous CEO is employed by the Company on such vesting date or, if the initial term under the employment agreement has expired, the Previous CEO has not materially breached any non-competition, non-solicitation and other post-termination of his employment obligations.

(c) On September 6, 2017, the Company granted 3,000,000 restricted stock units to the CEO, which vest based on the CEO’s continued service and subject to the following performance thresholds: (i) 1,500,000 restricted stock units will vest if the Company achieves 2018 revenue of $18,000,000, and (ii) 1,500,000 restricted stock units will vest if the Company achieves 2019 revenue of $25,000,000.

All of the foregoing restricted stock unit awards will be settled by the issuance of one share of common stock for each vested restricted stock unit.

A summary of the restricted stock units awarded to employees, directors and consultants under the 2017 Equity Plan as September 30, 2017 and changes during the period then ended, are presented in the table below:

	Number of Units	Weighted Average Grant-Date Fair Value
Unvested as of December 31, 2016	-	$ -