

Surna Inc.
Form 10-Q
August 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2018

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 every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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]
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 August 13, 2018, the number of outstanding shares of common stock of the registrant was 222,471,602.

Surna Inc.

Quarterly Report on Form 10-Q

For The Three Months Ended June 30, 2018

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In this Quarterly Report on Form 10-Q, unless otherwise indicated, the “Company”, “we”, “us” or “our” refer to Surna Inc. and, where appropriate, its wholly owned subsidiary.

CAUTIONARY STATEMENT

This Quarterly Report on Form 10-Q, including “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 2, contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical facts, but are based on current management expectations that involve substantial risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of these terms or other similar words. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements including, but not limited to, any projections of revenue, gross profit, earnings or loss, tax provisions, cash flows or other financial items; any statements of the plans, strategies or objectives of management for future operations; any statements regarding current or future macroeconomic or industry-specific trends or events and the impact of those trends and events on us or our financial performance; any statements regarding pending investigations, legal claims or tax disputes; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing.

These forward-looking statements are subject to known and unknown risks, uncertainties, assumptions and other factors that could cause our actual results of operations, financial condition, liquidity, performance, prospects, opportunities, achievements or industry results, as well as those of the markets we serve or intend to serve, to differ materially from those expressed in, or suggested by, these forward-looking statements. These forward-looking statements are based on assumptions regarding our present and future business strategies and the environment in which we operate. Important factors that could cause those differences include, but are not limited to:

our business prospects and the prospects of our existing and prospective customers;

the inherent uncertainty of product development;

regulatory, legislative and judicial developments, especially those related to changes in, and the enforcement of, cannabis laws;

increasing competitive pressures in our industry;

our relationships with our customers and suppliers;

general economic conditions or conditions affecting demand for the products offered by us in the markets in which we operate, being less favorable than expected;

changes in our business strategy or development plans, including our expected level of capital expenses and working capital;

our ability to attract and retain qualified personnel;

our ability to raise equity and debt capital to fund our growth strategy, including possible acquisitions;

future revenue being lower than expected; and

our intention not to pay dividends.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Quarterly Report on Form 10-Q should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in “Item 1A – Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, as updated from time to time in the Company’s filings with the U.S. Securities and Exchange Commission (the “SEC”). You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. Except as required by the federal securities laws, we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q. The forward-looking statements and projections contained in this Quarterly Report on Form 10-Q are excluded from the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended (the “Securities Act”).

PART I — FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****Surna Inc.****Condensed Consolidated Balance Sheets****(Unaudited)**

| | June 30, 2018 | December 31, 2017 |
|---|--------------------|----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$1,628,880 | \$2,468,199 |
| Accounts receivable (net of allowance for doubtful accounts of \$108,949 and \$105,267, respectively) | 229,950 | 422,589 |
| Other receivables | 25,661 | 550 |
| Inventory, net | 454,296 | 522,622 |
| Prepaid expenses | 264,418 | 293,458 |
| Total Current Assets | 2,603,205 | 3,707,418 |
| Noncurrent Assets | | |
| Property and equipment, net | 576,462 | 401,356 |
| Goodwill | 631,064 | 631,064 |
| Intangible assets, net | 37,529 | 37,985 |
| Deposits | 51,000 | 51,000 |
| Total Noncurrent Assets | 1,296,055 | 1,121,405 |
| TOTAL ASSETS | \$3,899,260 | \$4,828,823 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable and accrued liabilities | \$1,253,097 | \$1,969,263 |
| Deferred revenue | 1,413,074 | 1,011,871 |
| Amounts due to shareholders | - | 6,927 |
| Derivative liabilities | - | 410,880 |
| Total Current Liabilities | 2,666,171 | 3,398,941 |
| NONCURRENT LIABILITIES | | |
| Deferred rent | 115,668 | 17,396 |

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| | | |
|---|--------------------|--------------------|
| Total Noncurrent Liabilities | 115,668 | 17,396 |
| TOTAL LIABILITIES | 2,781,839 | 3,416,337 |
| Commitments and Contingencies (Note 8) | | |
| SHAREHOLDERS' EQUITY | | |
| 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; 221,471,602 and 206,248,522 shares issued and outstanding, respectively | 2,215 | 2,062 |
| Additional paid in capital | 24,001,891 | 20,664,563 |
| Accumulated deficit | (22,887,457) | (19,254,911) |
| Total Shareholders' Equity | 1,117,421 | 1,412,486 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$3,899,260 | \$4,828,823 |

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

Surna Inc.**Condensed Consolidated Statements of Operations****(Unaudited)**

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|--|--|----------------|--------------------------------------|----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue, net | \$2,007,745 | \$1,741,893 | \$4,062,473 | \$3,334,985 |
| Cost of revenue | 1,484,320 | 1,328,895 | 3,157,034 | 2,493,651 |
| Gross profit | 523,425 | 412,998 | 905,439 | 841,334 |
| Operating expenses: | | | | |
| Advertising and marketing expenses | 223,903 | 209,737 | 434,919 | 315,942 |
| Product development costs | 56,917 | 96,294 | 132,089 | 190,083 |
| Selling, general and administrative expenses | 1,659,862 | 1,303,611 | 3,660,778 | 2,121,571 |
| Total operating expenses | 1,940,682 | 1,609,642 | 4,227,786 | 2,627,596 |
| Operating loss | (1,417,257) | (1,196,644) | (3,322,347) | (1,786,262) |
| Other income (expense): | | | | |
| Interest and other income, net | 16,312 | 342 | 16,490 | 3,293 |
| Interest expense | - | (14,620) | (35) | (41,734) |
| Amortization of debt discount on convertible promissory notes | - | (26,072) | - | (53,120) |
| Loss on extinguishment of debt | - | - | - | (415,000) |
| Gain on change in fair value of derivative liabilities | - | 163,714 | 21,403 | 218,714 |
| Total other income (expense) | 16,312 | 123,364 | 37,858 | (287,847) |
| Loss before provision for income taxes | (1,400,945) | (1,073,280) | (3,284,489) | (2,074,109) |
| Income taxes | - | - | - | - |
| Net loss | \$(1,400,945) | \$(1,073,280) | \$(3,284,489) | \$(2,074,109) |
| Loss per common share – basic and dilutive | \$(0.01) | \$(0.01) | \$(0.02) | \$(0.01) |
| Weighted average number of common shares outstanding, basic and dilutive | 217,447,043 | 183,294,028 | 213,814,978 | 175,955,929 |

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

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Surna Inc.**Condensed Consolidated Statement of Changes in Shareholders' Equity****For the Six Months Ended June 30, 2018****(Unaudited)**

| | Preferred Stock | | Common Stock | | | | | |
|--|---------------------|--------|---------------------|-------------------------------------|---------|----------------------------------|------------------------|-------------------------|
| | Number of Shares | Amount | Number of Shares | Number of Shares to be Issued | Amount | Additional Paid in Capital | Accumulated Deficit | Shareholders' Equity |
| Balance | | | | | | | | |
| December 31, 2017 | 77,220,000 | \$772 | 206,248,522 | - | \$2,062 | \$20,664,563 | \$(19,254,911) | 1,412,486 |
| Cumulative effect of changes due to adoption of ASC 606 revenue recognition | - | - | - | - | - | - | 56,912 | 56,912 |
| Adjusted balance | | | | | | | | |
| January 1, 2018 to reflect adoption of ASC 606 | 77,220,000 | \$772 | 206,248,522 | - | \$2,062 | \$20,664,563 | \$(19,197,999) | \$1,469,398 |
| Extinguishment of derivative liability upon exercise of investor warrants | - | - | - | - | - | 389,477 | - | 389,477 |
| Common shares issued on cashless exercise of former director and investor warrants | - | - | 2,666,865 | - | 26 | (26) | - | - |
| Common shares issued on exercise of investor | - | - | 125,000 | - | 1 | 18,374 | - | 18,375 |

| | | | | | | | | | |
|---|------------|-------|-------------|-----------|---------|--------------|----------------|---|-----------------------|
| warrants and employee options | | | | | | | | | |
| Common shares issued or to be issued on settlement of restricted stock units and award of stock bonuses | - | - | 5,610,000 | 1,000,000 | 56 | (56 |) | - | - |
| Common shares issued as compensation for services | - | - | 1,583,715 | - | 17 | 378,619 | - | - | 378,636 |
| Common shares issued in settlement agreement | - | - | 800,000 | - | 8 | 226,392 | - | - | 226,400 |
| Fair value of vested restricted stock units awarded to employees and directors | - | - | - | - | - | 796,874 | - | - | 796,874 |
| Fair value of vested stock options granted to employees | - | - | - | - | - | 40,184 | - | - | 40,184 |
| Fair value of vested incentive stock bonuses awarded to employees | - | - | - | - | - | 277,566 | - | - | 277,566 |
| Common shares issued for cash, net | - | - | 7,562,500 | - | 76 | 1,209,924 | - | - | 1,210,000 |
| Repurchase of common shares from related party | - | - | (3,125,000 |) | - | (31 |) | - | (399,969) (400,000) |
| Purchase of option to repurchase preferred stock from related party | - | - | - | - | - | - | (5,000 |) | (5,000) |
| Net loss | - | - | - | - | - | - | (3,284,489 |) | (3,284,489) |
| Balance June 30, 2018 | 77,220,000 | \$772 | 221,471,602 | 1,000,000 | \$2,215 | \$24,001,891 | \$(22,887,457) | | \$1,117,421 |

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

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Surna Inc.**Condensed Consolidated Statements of Cash Flows****(Unaudited)**

| | For the Six Months Ended June 30, | |
|---|--------------------------------------|---------------|
| | 2018 | 2017 |
| Cash Flows From Operating Activities: | | |
| Net loss | \$(3,284,489) | \$(2,074,109) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and intangible asset amortization expense | 71,061 | 23,042 |
| Amortization of debt discounts | - | 32,957 |
| Amortization of original issue discount on notes payable | - | 20,163 |
| Gain on change in derivative liabilities | (21,403) | (218,715) |
| Compensation paid in equity | 1,493,260 | 391,969 |
| Provision for doubtful accounts | 3,682 | - |
| Provision for excess and obsolete inventory | (4,001) | - |
| Loss on extinguishment of debt | - | 415,000 |
| Changes in operating assets and liabilities: | | |
| Accounts and other receivable | 163,846 | (101,530) |
| Inventory | 72,327 | 164,312 |
| Prepaid expenses | 29,040 | (87,595) |
| Accounts payable and accrued liabilities | (491,075) | 188,320 |
| Deferred revenue | 458,115 | (724,463) |
| Accrued interest | - | (9,602) |
| Deferred rent | (1,728) | - |
| Net cash used in operating activities | (1,511,365) | (1,980,251) |
| Cash Flows From Investing Activities | | |
| Capitalization of intangible assets | (1,550) | (19,431) |
| Purchases of property and equipment | (226,615) | (5,832) |
| Proceeds from payment of tenant improvement allowance | 100,000 | - |
| Cash disbursed for equipment held for lease | (16,237) | - |
| Payments received on note receivable | - | 157,218 |
| Net cash (used in) provided by investing activities | (144,402) | 131,955 |
| Cash Flows From Financing Activities | | |
| Cash proceeds from sale of common stock and warrants | 1,210,000 | 2,685,000 |
| Payments on convertible notes payable | - | (270,000) |
| Proceeds from issuance of notes payable | - | 500,000 |
| Proceeds from exercises of stock options | 3,375 | - |
| Proceeds from exercise of investor warrants | 15,000 | - |

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| | | |
|---|-------------|-------------|
| Repurchase of common shares from related party | (400,000) | - |
| Purchase of option to repurchase preferred stock from related party | (5,000) | - |
| Payments on loans from shareholders | (6,927) | (33,178) |
| Net cash provided by financing activities | 816,448 | 2,881,822 |
| Net (decrease) increase in cash | (839,319) | 1,033,526 |
| Cash, beginning of period | 2,468,199 | 319,546 |
| Cash, end of period | \$1,628,880 | \$1,353,072 |
| Supplemental cash flow information: | | |
| Interest paid | \$35 | \$- |
| Non-cash investing and financial activities: | | |
| Conversions of promissory notes and accrued interest to common stock | \$- | \$639,155 |
| Equity issued in settlement | \$226,400 | \$- |
| Extinguishment of derivative liability on cashless exercise of warrants | \$389,477 | \$- |
| Unpaid purchases of equipment and other assets | \$1,309 | \$- |

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

Surna Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1 – Description of Business

Surna Inc. (the “Company”) was incorporated in Nevada on October 15, 2009. The Company develops innovative technologies and products that monitor, control and or address the energy and resource intensive nature of indoor cannabis cultivation. Currently, the Company’s revenue stream is derived primarily from supplying industrial technology and products to commercial indoor cannabis cultivation facilities. Headquartered in Boulder, Colorado, the Company’s engineering and technical team provides solutions that allow growers to meet the unique demands of a cannabis cultivation environment through precise temperature, humidity, and process controls, energy and water efficiency, and satisfaction of the evolving code and regulatory requirements being imposed at the state and local levels. The Company’s objective is to leverage its experience in this space in order to bring value-added climate control solutions to its customers that help improve their overall crop quality and yield as well as optimize the resource efficiency of their controlled environment (i.e., indoor and greenhouses) cultivation facilities. The Company is not involved in the production or sale of cannabis.

Note 2 – Basis of Presentation; Summary of Significant Accounting Policies

Financial Statement Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“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. 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 six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2018. The balance sheet as of December 31, 2017 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, 2017. The notes to the unaudited condensed

consolidated financial statements are presented on a going concern basis unless otherwise noted.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has experienced recurring losses since its inception. The Company incurred a net loss of approximately \$3,284,000 for the six months ended June 30, 2018, and had an accumulated deficit of approximately \$22,887,000 as of June 30, 2018. 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 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 fulfill its development activities and generating a level of revenues adequate to support the Company's cost structure.

Surna Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

There can be no assurance that the Company will be able to raise debt or equity financing in sufficient amounts, when and if needed, on acceptable terms or at all. If results of operations for 2018 do not meet management's expectations, or additional capital is not available, management believes it has the ability to reduce certain expenditures. 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 the market demand for the Company's products and services, the quality of product development efforts, management of working capital, and continuation of normal payment terms and conditions for purchase of the Company's products. The Company believes its cash balances and cash flow from operations will be insufficient to fund its operations for the next 12 months. If the Company is unable to substantially increase revenues, reduce expenditures, or otherwise generate cash flows for operations, then the Company will need to raise additional funding to continue as a going concern.

The foregoing factors raise substantial doubt about the Company's ability to continue as a going concern for a period of one year from the date the financial statements are issued. These condensed consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

Basis of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its controlled and wholly-owned subsidiary, Hydro Innovations, LLC ("Hydro"). Intercompany transactions, profit, and balances are eliminated in consolidation.

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 revenue 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. Key estimates include: valuation of derivative liabilities, valuation of intangible assets, valuation of equity-based compensation, valuation of deferred tax assets and liabilities, warranty accruals, inventory allowances, and legal contingencies.

Fair Value Measurement

The Company records its financial assets and liabilities at fair value. The accounting standard for fair value provides a framework for measuring fair value, clarifies the definition of fair value, and expands disclosures regarding fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The accounting standard establishes a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

Level 2 - inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 - inputs are unobservable inputs based on the Company's assumptions used to measure assets and liabilities at fair value.

On a Recurring Basis

A financial asset's or liability's classification within the hierarchy is determined based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires management to make judgments and consider factors specific to the asset or liability.

Surna Inc.**Notes to Condensed Consolidated Financial Statements****(Unaudited)**

During the third quarter of 2015, the Company issued convertible notes (the “Notes”) to three accredited investors in the aggregate original principal amount of \$711,000, together with warrants to purchase up to an aggregate of 2,625,000 shares of the Company’s common stock (the “Warrants”). The Warrants, which were outstanding as of December 31, 2017, provided for a reduction in the exercise price in the event the Company issued common stock in a registered offering at a price below the exercise price. In such event, the exercise price under the Warrants would be reduced to the price of the common stock in the dilutive issuance. The Company determined that these outstanding Warrants subject to the exercise price reduction qualified as a derivative financial instrument.

During the first quarter of 2018, all of the outstanding Warrants were exercised on a cashless basis, and the Company extinguished the derivative liability of approximately \$389,000 and recorded an increase in additional paid-in capital of the same amount. The gain on change in derivative liabilities presented in the statements of operations for the six months ended June 30, 2018 represents the gain on derivatives through the date of the cashless exercise of these warrants.

Financial liabilities carried at fair value, measured on a recurring basis were as follows:

| | As of June 30, 2018 | | | | | As of December 31, 2017 | | | | |
|-----------------------------------|---------------------|---------|---------|------------|---------------------|-------------------------|---------|-----------|------------|---------------------|
| | Level 1 | Level 2 | Level 3 | Fair Value | Gain ⁽¹⁾ | Level 1 | Level 2 | Level 3 | Fair Value | Gain ⁽²⁾ |
| Financial liabilities: | | | | | | | | | | |
| Derivative liabilities - warrants | \$- | \$ - | \$ - | \$ - | \$21,403 | \$- | \$ - | \$410,880 | \$410,880 | \$66,934 |
| Total financial liabilities | \$- | \$ - | \$ - | \$ - | \$21,403 | \$- | \$ - | \$410,880 | \$410,880 | \$66,934 |

(1) The gain on change in derivative liabilities presented in the statements of operations for the six months ended June 30, 2018 represents the gain on derivatives through the cashless exercise of all of the associated warrants during the first quarter of 2018.

(2) Represents the gain on change in derivative liabilities for the twelve months ended December 31, 2017.

The change in the balance of the warrant derivative liabilities during the first quarter of 2018 was calculated based on the closing price of the Company's common stock on the settlement date and the net shares issued under the Warrants, which is classified as a gain on change in derivative liabilities in the condensed consolidated statements of operations.

On a Non-Recurring Basis

Intangible assets that are amortized are evaluated for recoverability whenever adverse effects or changes in circumstances indicate that the carrying value may not be recoverable. The recoverability test consists of comparing the undiscounted projected cash flows with the carrying amount. Should the carrying amount exceed undiscounted projected cash flows, an impairment loss would be recognized to the extent the carrying amount exceeds fair value.

For the Company's indefinite-lived goodwill, the impairment test consists of comparing the fair value, determined using the market value method, with its carrying amount. An impairment loss would be recognized for the carrying amount in excess of its fair value. The Company concluded that no impairment relating to intangible assets or goodwill existed at June 30, 2018.

Due to their short-term nature, the carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses, approximate fair value.

Revenue Recognition

On January 1, 2018, the Company adopted Accounting Standards Update ("ASU") 2014-09 (Topic 606), *Revenue from Contracts with Customers* and all the related amendments ("ASC 606" or the "new revenue standard") to all contracts and elected the modified retrospective method. The results for periods before 2018 were not adjusted for the new revenue standard and the cumulative effect of the change in accounting was recognized through accumulated deficit at the date of adoption. The comparative financial information presented has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company expects the impact of the adoption of the new revenue standard to be immaterial to its net income (loss) on an ongoing basis.

Surna Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

The cumulative effect of the changes made to the condensed consolidated balance sheet for the adoption of the new revenue standard as of January 1, 2018 was as follows:

| | Balance as of December 31, 2017 | Adjustments Due to ASC 606 | Balance as of January 1, 2018 |
|----------------------|---------------------------------------|----------------------------------|-------------------------------------|
| Balance Sheet | | | |
| Liabilities | | | |
| Deferred Revenue | \$1,011,871 | \$ (56,912) | \$954,959 |
| Shareholders' Equity | | | |
| Accumulated deficit | \$(19,254,911) | \$ 56,912 | \$(19,197,999) |

In accordance with the new revenue standard's requirements, the disclosure of the impact of adoption on the condensed consolidated income statements and balance sheets for the three and six months ended June 30, 2018 (including insignificant true-up adjustments related to the first quarter of 2018 which have been reflected in the three months ended June 30, 2018) was as follows:

| | For the Three Months Ended | | | For the Six Months Ended | | |
|------------------|----------------------------|--|---------------------------------------|--------------------------|--|---------------------------------------|
| | June 30, 2018 | | | June 30, 2018 | | |
| | As Reported | Balances Without Adoption of ASC 606 | Effect of Change Higher/(Lower) | As Reported | Balances Without Adoption of ASC 606 | Effect of Change Higher/(Lower) |
| Income Statement | | | | | | |
| Revenues | | | | | | |
| Revenues | \$2,007,745 | \$2,024,685 | \$ (16,940) | \$4,062,473 | \$4,061,973 | \$ 500 |