SECURITIES & EXCHANGE COMMISSION EDGAR FILING

Surna Inc.

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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, 2020

OR

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

Commission File Number: 000-54286

SURNA INC.
(Exact name of registrant as specified in its charter)

Nevada	**27-3911608**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1780 55th Street, 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 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.

Large Accelerated Filer	[ ]	**Accelerated Filer**	[ ]
Non-accelerated Filer	[X]	**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]**

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
N/A	N/A	N/A

As of August 11, 2020, the number of outstanding shares of common stock of the registrant was 236,526,638.

Surna Inc.
Quarterly Report on Form 10-Q
For the Quarterly Period Ended June 30, 2020

Table of Contents

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 impact on our business and that of our customers of the government's current and future response to the Covid-19 pandemic necessary to protect our staff and the staff of our customers in the conduct of our business;
- the overall Covid-19 post-lockdown business climate in our industry;
- our overall financial condition, including our reduced revenue, cash flow from operating activities and cash balance due to the Covid-19 pandemic economic response and its consequences;
- 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 that may adversely affect demand for the products offered by us in the markets in which we operate;
- 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 operations and growth strategy, including possible acquisitions;
- our ability to identify, complete and integrate potential strategic acquisitions;
- future revenue being lower than expected;
- our ability to convert our backlog into revenue in a timely manner, or at all; 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, 2019, 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

	June 30, 2020 (Unaudited)	December 31, 2019
ASSETS		
Current Assets		
Cash and cash equivalents	$ 235,438	$ 922,177
Accounts receivable (net of allowance for doubtful accounts of $154,823 and $151,673, respectively)	83,321	138,357
Inventory, net	804,600	1,231,243
Prepaid expenses and other	196,680	269,491
Total Current Assets	1,320,039	2,561,268
Noncurrent Assets		
Property and equipment, net	208,232	257,923
Goodwill	631,064	631,064
Intangible assets, net	7,516	11,930
Deposits	-	51,000
Operating lease right-of-use asset	440,138	534,133
Total Noncurrent Assets	1,286,950	1,486,050
TOTAL ASSETS	$ 2,606,989	$ 4,047,318
LIABILITIES AND SHAREHOLDERS' (DEFICIT) EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 1,753,786	$ 1,832,959
Deferred revenue	867,989	1,444,472
Accrued equity compensation	69,900	503,466
Current portion of operating lease liability	227,008	217,843
Total Current Liabilities	2,918,683	3,998,740
NONCURRENT LIABILITIES		
Note payable and accrued interest	555,047	-
Other liabilities	20,241	-
Operating lease liability, net of current portion	288,682	404,209
Total Noncurrent Liabilities	863,970	404,209
TOTAL LIABILITIES	3,782,653	4,402,949
Commitments and Contingencies (Note 7)	-	-
SHAREHOLDERS' (DEFICIT) EQUITY		
Preferred stock, $0.00001 par value; 150,000,000 shares authorized; 42,030,331 shares issued and outstanding	420	420
Common stock, $0.00001 par value; 350,000,000 shares authorized; 236,526,638 and 228,216,638 shares issued and outstanding, respectively	2,366	2,283
Additional paid in capital	26,058,307	25,326,593
Accumulated deficit	(27,236,757)	(25,684,927)
Total Shareholders' (Deficit) Equity	(1,175,664)	(355,631)
TOTAL LIABILITIES AND SHAREHOLDERS' (DEFICIT) EQUITY	$ 2,606,989	$ 4,047,318

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,	
	2020	**2019**	**2020**	**2019**
Revenue, net	$ 1,682,424	$ 4,210,393	$ 3,492,349	$ 5,981,623
Cost of revenue	1,407,599	2,762,601	2,761,000	4,043,758
Gross profit	274,825	1,447,792	731,349	1,937,865
Operating expenses:				
Advertising and marketing expenses	95,053	167,287	243,974	291,913
Product development costs	74,848	111,581	219,796	228,514
Selling, general and administrative expenses	710,536	1,032,605	1,819,529	2,203,191
Total operating expenses	880,437	1,311,473	2,283,299	2,723,618
Operating income (loss)	(605,612)	136,319	(1,551,950)	(785,753)
Other (expense) income:				
Other (expense) income, net	1,077	3,296	15,397	25,173
Interest expense	(8,982)	-	(15,277)	-
Total other (expense) income	(7,905)	3,296	120	25,173
Income (loss) before provision for income taxes	(613,517)	139,615	(1,551,830)	(760,580)
Income taxes	-	-	-	-
Net income (loss)	$ (613,517)	$ 139,615	$ (1,551,830)	$ (760,580)
Income (loss) per common share – basic and dilutive	$ (0.00)	$ 0.00	$ (0.01)	$ (0.00)
Weighted average number of common shares outstanding, basic and dilutive	236,526,638	227,635,539	233,794,550	227,250,142

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

Surna Inc.
Condensed Consolidated Statements of Changes in Shareholders' Equity (Deficit)
For the Three and Six Months Ended June 30, 2020 and 2019
(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 March 31, 2020	42,030,331	420	236,526,638	-	$ 2,366	$ 25,984,402	$ (26,623,240)	$ (636,052)
Fair value of vested restricted stock units awarded to employees	-	-	-	-	-	6,291	-	6,291
Fair value of vested stock options granted to employees and directors	-	-	-	-	-	67,614	-	67,614
Net loss	-	-	-	-	-	-	(613,517)	(613,517)
Balance June 30, 2020	42,030,331	$ 420	236,526,638	-	$ 2,366	$ 26,058,307	$ (27,236,757)	$ (1,175,664)

	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, 2019	42,030,331	420	228,216,638	1,560,000	$ 2,283	$ 25,326,593	$ (25,684,927)	$ (355,631)
Common shares issued or to be issued on settlement of restricted stock units and award of stock bonuses	-	-	8,310,000	(1,560,000)	83	(83)	-	-
Fair value of vested restricted stock units awarded to employees	-	-	-	-	-	25,163	-	25,163
Fair value of vested stock options granted to employees and directors	-	-	-	-	-	706,634	-	706,634
Net loss	-	-	-	-	-	-	(1,551,830)	(1,551,830)
Balance June 30, 2020	42,030,331	$ 420	236,526,638	-	$ 2,366	$ 26,058,307	$ (27,236,757)	$ (1,175,664)

	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' (Deficit)
Balance March 31, 2019	42,030,331	$ 420	227,536,638	120,000	$ 2,275	$ 24,893,733	$ (25,246,556)	$ (350,128)
Common shares issued on settlement of restricted stock units and award of stock bonuses, vested restricted stock units canceled	-	-	120,000	(120,000)	2	(2)	-	-
Fair value of vested restricted stock units awarded to employees	-	-	-	-	-	89,614	-	89,614
Fair value of vested stock options granted to employees and consultants	-	-	-	-	-	102,297	-	102,297
Fair value of vested incentive stock bonuses awarded to employees	-	-	-	-	-	15,368	-	15,368
Net income	-	-	-	-	-	-	139,615	139,615
Balance June 30, 2019	42,030,331	$ 420	227,656,638	-	$ 2,277	$ 25,101,010	$ (25,106,941)	$ (3,234)

	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 (Deficit)
Balance December 31, 2018	42,030,331	$ 420	224,989,794	1,000,000	$ 2,250	$ 24,538,027	$ (24,346,361)	$ 194,336
Common shares issued on settlement of restricted stock units and award of stock bonuses, vested restricted stock units canceled	-	-	1,680,000	(1,000,000)	17	(17)	-	-
Common shares issued as compensation for services	-	-	986,844	-	10	74,990	-	75,000
Fair value of vested restricted stock units awarded to employees	-	-	-	-	-	182,369	-	182,369

Fair value of vested stock options granted to employees and consultants	-	-	-	-	-	275,074	-	275,074
Fair value of vested incentive stock bonuses awarded to employees	-	-	-	-	-	30,567	-	30,567
Net loss	-	-	-	-	-	-	(760,580)	(760,580)
Balance June 30, 2019	42,030,331	$ 420	227,656,638	-	$ 2,277	$ 25,101,010	$ (25,106,941)	$ (3,234)

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

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

	For the Six Months Ended June 30, 2020	For the Six Months Ended June 30, 2019
Cash Flows From Operating Activities:		
Net loss	$ (1,551,830)	$ (760,580)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and intangible asset amortization expense	60,987	97,503
Compensation paid in equity	731,797	563,010
Provision for doubtful accounts	3,150	10,384
Provision for excess and obsolete inventory	191,446	(181,986)
Loss on disposal of assets	4,124	58,024
Lease deposit	51,000	-
Changes in operating assets and liabilities:		
Accounts receivable	51,886	(191,309)
Inventory	235,197	507,037
Prepaid expenses and other	72,811	(779,794)
Accounts payable and accrued liabilities	(90,178)	394,782
Deferred revenue	(576,483)	1,964,068
Accrued interest	1,047	-
Deferred Social Security Taxes	20,241	-
Lease liability, net	(12,368)	(8,846)
Accrued equity compensation	(433,566)	-
Net cash provided by (used in) operating activities	(1,240,739)	1,672,293
Cash Flows From Investing Activities		
Net cash used in investing activities	-	-
Cash Flows From Financing Activities		
Proceeds from issuance of note payable	554,000	-
Net cash provided by financing activities	554,000	-
Net increase (decrease) in cash	(686,739)	1,672,293
Cash, beginning of period	922,177	253,387
Cash, end of period	$ 235,438	$ 1,925,680
Non-cash investing and financing activities:		
Interest paid	$ -	$ -
Income taxes paid	$ -	$ -

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

Note 1 – General

Description of Business

Surna Inc. (the “Company”) was incorporated in Nevada on October 15, 2009. The Company designs, engineers and sells cultivation technologies for controlled environment agriculture including: (i) liquid-based process cooling systems and other climate control systems, (ii) air handling equipment and systems, (iii) a full-service engineering package for designing and engineering commercial scale thermodynamic systems specific to cannabis cultivation facilities, and (iv) automation and control devices, systems and technologies used for environmental, lighting and climate control. Our customers include commercial, state- and provincial-regulated cannabis growers in the U.S. and Canada as well as other international locations, including those growers building new facilities and those expanding or retrofitting existing facilities. Currently, our revenue stream is derived primarily from supplying our products, services and technologies to commercial indoor and hybrid sealed greenhouse facilities ranging from several thousand to more than 100,000 square feet. Headquartered in Boulder, Colorado, we leverage our experience in this space to bring value-added climate control solutions to our customers that help improve their overall crop quality and yield, optimize energy and water efficiency, and satisfy the evolving state and local codes, permitting and regulatory requirements. Although our customers do, we neither produce nor sell cannabis.

Financial Statement Presentation

The accompanying unaudited condensed consolidated financial statements of the Company 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, 2020 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2020. The balance sheet as of December 31, 2019 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, 2019. The notes to the unaudited condensed consolidated financial statements are presented on a going concern basis.

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.

Going Concern

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. Since inception, the Company has financed its activities principally through debt and equity financing, customer deposits and revenues from completed contracts. Management expects to incur additional losses and cash outflows in the foreseeable future in connection with its operating activities. Management believes that the economic dislocations in the overall economy, in the near term, will adversely impact our revenues, losses and cash flows. 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 2020 do not meet management’s expectations, or additional capital is not available, management believes it has the ability to reduce certain expenditures, although these reductions may not be sufficient to be able to continue the Company’s operations. 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 overall economy, 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 from 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.

Use of Estimates

Management makes 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: allocation of transaction prices to performance obligations under contracts with customers, standalone selling prices, timing of expected revenue recognition on remaining performance obligations under contracts with customers, valuation of intangible assets, valuation of equity-based compensation, valuation of deferred tax assets and liabilities, warranty accruals, accounts receivable and inventory allowances, and legal contingencies.

Income (Loss) Per Common Share

Basic income (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding during the period without consideration of common stock equivalents. Diluted net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding and potentially dilutive common stock equivalents, including stock options, warrants and restricted stock units and other equity-based awards, except in cases where the effect of the common stock equivalents would be antidilutive. Potential common stock equivalents consist of common stock issuable upon exercise of stock options and warrants and the vesting of restricted stock units using the treasury method.

During the three and six months ended June 30, 2020 and 2019, there were warrants and options outstanding to purchase Company common stock and restricted stock units that were convertible into shares of the Company's common stock. During the three month period ended June 30, 2020 and the six month periods ended June 30, 2020 and 2019, the Company incurred a net loss and consequently the common share equivalents of these potentially dilutive equity instruments have not been included in the calculations of loss per share because such inclusion would have been anti-dilutive. During the three month period ended June 20, 2019, the Company did recognize a net profit, however, the exercise price of the warrants and options outstanding and the tax cost of converting the restricted stock units into shares of the Company's common stock substantially exceeded the market value of the Company's' common shares during the period and consequently the common share equivalents of these potentially dilutive equity instruments have not been included in the calculations of income per share.

Goodwill

The Company recorded goodwill in connection with its acquisition of Hydro Innovations, LLC in July 2014. Goodwill is reviewed for impairment annually or more frequently when events or changes in circumstances indicate that fair value of the reporting unit has been reduced to less than its carrying value. The Company performs a quantitative impairment test annually on December 31 by comparing the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is considered not impaired. An impairment charge would be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. The Company determined that it has one reporting unit.

During the six months ended June 30, 2020, the Company concluded that the projected impact of the COVID-19 pandemic on its sales, contract completion and revenues in the near term, together with the volatility in its share price during the quarter represented potential indicators of impairment. Accordingly, the Company performed an interim impairment analysis at June 30,2020, and concluded that no impairment relating to goodwill existed at June 30, 2020.

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 "revenue standard") to all contracts and elected the modified retrospective method.

Under the revenue standard, a performance obligation is a promise in a contract with a customer to transfer a distinct good or service to the customer. Most of the Company's contracts contain multiple performance obligations that include engineering and technical services as well as the delivery of a diverse range of climate control system equipment and components, which can span multiple phases of a customer's project life-cycle from facility design and construction to equipment delivery and system installation and start-up.

A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. When there are multiple performance obligations within a contract, the Company allocates the transaction price to each performance obligation based on standalone selling price. When estimating the selling price, the Company uses various observable inputs. The best observable input is the Company's actual selling price for the same good or service, however, this input is generally not available for the Company's contracts containing multiple performance obligations. For engineering services, the Company estimates the standalone selling price by reference to certain physical characteristics of the project, such as facility size and mechanical systems involved, which are indicative of the scope and complexity of the mechanical engineering services to be provided. For equipment sales, the standalone selling price is determined by forecasting the expected costs of the equipment and then adding an appropriate margin, based on a range of acceptable margins established by management. Depending on the nature of the performance obligations, the Company may use a combination of different methods and observable inputs if certain performance obligations have highly variable or uncertain standalone selling prices. Once the selling prices are determined, the Company applies the relative values to the total contract consideration and estimates the amount of the transaction price to be recognized as each performance obligation is fulfilled.

The Company recognizes revenue for the sale of goods when control transfers to the customer, which primarily occurs at the time of shipment. The Company's historical rates of return are insignificant as a percentage of sales and, as a result, the Company does not record a reserve for returns at the time the Company recognizes revenue. The Company has elected to exclude from the measurement of the transaction price all taxes (e.g., sales, use, value added, and certain excise taxes) that are assessed by a governmental authority in connection with a specific revenue-producing transaction and collected by the Company from the customer. Accordingly, the Company recognizes revenue net of sales taxes. The revenue and cost for freight and shipping is recorded when control over the sale of goods passes to the Company's customers.

The Company also has performance obligations to perform certain engineering services that are satisfied over a period of time. Revenue is recognized from this type of performance obligation as services are rendered based on the percentage completion towards certain specified milestones.

The Company offers assurance-type warranties for its products and products manufactured by others to meet specifications defined by the contracts with customers and does not have any material separate performance obligations related to these warranties. The Company maintains a warranty reserve based on historical warranty costs.

Applying the practical expedient in ASC 606-10-32-18, which the Company has elected, the Company does not adjust the promised amount of consideration for the effects of a significant financing component since the Company expects, at contract inception, that the period between when the Company transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. Accordingly, the remaining performance obligations related to customer contracts does not consider the effects of the time value of money.

Applying the practical expedient in ASC 340-40-25-4, the Company recognizes the incremental costs of obtaining contracts as an expense when incurred since the amortization period of the assets that the Company otherwise would have recognized is one year or less. These costs include certain sales commissions and incentives, which are included in selling, general and administrative expenses, and are payable only when associated revenue has been collected and earned by the Company.

The Company does not have material amounts of contract assets since revenue is recognized as control of goods is transferred or as services are performed. Contract liabilities consist of advance payments and deferred revenue.

For the three and six months ended June 30, 2020, the Company recognized revenue of $205,170 and $1,064,875, respectively, related to the deferred revenue at January 1, 2020. For the three and six months ended June 30, 2019, the Company recognized revenue of $76,684 and $470,444, respectively, related to the deferred revenue at January 1, 2019.

Remaining performance obligations, or backlog, represents the aggregate amount of the transaction price allocated to the remaining obligations that the Company has not performed under its customer contracts. The Company has elected not to use the optional exemption in ASC 606-10-50-14, which exempts an entity from such disclosures if a performance obligation is part of a contract with an original expected duration of one year or less. Accordingly, the information disclosed about remaining performance obligations includes all customer contracts, including those with an expected duration of one year or less.

Industry uncertainty, project financing concerns, and the licensing and qualification of our prospective customers, which are out of the Company’s control, make it difficult for the Company to predict when it will recognize revenue on its remaining performance obligations. There are risks that the Company may not realize the full contract value on customer projects in a timely manner or at all, and completion of a customer’s cultivation facility project is dependent upon the customer’s ability to secure funding and real estate, obtain a license and then build their cultivation facility so they can take possession of the equipment. Accordingly, the time it takes for customers to complete a project, which corresponds to when the Company is able to recognize revenue, is driven by numerous factors including: (i) the large number of first-time participants interested in the indoor cannabis cultivation business; (ii) the complexities and uncertainties involved in obtaining state and local licensure and permitting; (iii) local and state government delays in approving licenses and permits due to lack of staff or the large number of pending applications, especially in states where there is no cap on the number of cultivators; (iv) the customer’s need to obtain cultivation facility financing; (v) the time needed, and coordination required, for our customers to acquire real estate and properly design and build the facility (to the stage when climate control systems can be installed); (vi) the large price tag and technical complexities of the climate control and air sanitation system; (vii) the availability of power; and (viii) delays that are typical in completing any construction project.

As of June 30, 2020, the Company’s remaining performance obligations, or backlog, was $5,592,000, of which $3,024,000, or 54%, was attributable to customer contracts for which the Company has only received an initial advance payment to cover the allocated value of the Company’s engineering services (“engineering only paid contracts”). There is the risk that the equipment portion of these engineering only paid contracts will not be completed or will be delayed. The reasons include the customer being dissatisfied with the quality or timeliness of the Company’s engineering services, delay or abandonment of the project because of the customer’s inability to obtain project financing or licensing, or other reasons such as a challenging business climate including an overall post-Covid-19 economic downturn, or change in business direction. After the customer has made an advance payment for a portion of the equipment to be delivered under the contract (“partial equipment paid contracts”), the Company is typically better able to estimate the timing of revenue recognition since the risks and delays associated with licensing, permitting and project funding are typically mitigated once the initial equipment payment is received. There is significant uncertainty regarding the timing of the Company’s recognition of revenue on its remaining performance obligations, and there is no certainty that these will result in actual revenues. The backlog at June 30, 2020, includes booked sales orders of $1,658,000 from several customers that the Company does not expect to be realized until 2022, if at all. Given the present economic uncertainty arising from the impact of the novel coronavirus COVID-19, the Company believes that several of its current contracts may be delayed or canceled.

The remaining performance obligations expected to be recognized through 2022 are as follows:

	2020	2021	2022	Total
Remaining performance obligations related to engineering only paid contracts	$ 1,084,000	$ 1,381,000	$ 559,000	$ 3,024,000
Remaining performance obligations related to partial equipment paid contracts	1,363,000	106,000	1,099,000	$ 2,568,000
Total remaining performance obligations	$ 2,447,000	$ 1,487,000	$ 1,658,000	$ 5,592,000

The following table sets forth the Company's revenue by source:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2020	2019	2020	2019
Equipment and systems sales	$ 1,486,948	$ 3,748,275	$ 3,093,894	$ 5,240,804
Engineering and other services	157,086	373,386	288,677	595,795
Shipping and handling	38,390	88,732	109,778	145,024
Total revenue	$ 1,682,424	$ 4,210,393	$ 3,492,349	$ 5,981,623

Accounting for Share-Based Compensation

The Company recognizes the cost resulting from all share-based compensation arrangements, including stock options, restricted stock awards and restricted stock units that the Company grants under its equity incentive plan in its condensed consolidated financial statements based on their grant date fair value. The expense is recognized over the requisite service period or performance period of the award. Awards with a graded vesting period based on service are expensed on a straight-line basis for the entire award. Awards with performance-based vesting conditions, which require the achievement of a specific company financial performance goal at the end of the performance period and required service period, are recognized over the performance period. Each reporting period, the Company reassesses the probability of achieving the respective performance goal. If the goals are not expected to be met, no compensation cost is recognized and any previously recognized amount recorded is reversed. If the award contains market-based vesting conditions, the compensation cost is based on the grant date fair value and expected achievement of market condition and is not subsequently reversed if it is later determined that the condition is not likely to be met or is expected to be lower than initially expected.

The grant date fair value of stock options is based on the Black-Scholes Option Pricing Model (the "Black-Scholes Model"). The Black-Scholes Model requires judgmental assumptions including volatility and expected term, both based on historical experience. The risk-free interest rate is based on U.S. Treasury interest rates whose term is consistent with the expected term of the option. 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. During the six months ended June 30, 2020, the valuation assumptions used to determine the fair value of each option award on the date of grant were: expected stock price volatility ranged from 121.64% to 122.48%; expected term in years 5 and risk-free interest rate ranged from .02% to 1.38%.

The grant date fair value of restricted stock and restricted stock units is based on the closing price of the underlying stock on the date of the grant.

The Company has elected to reduce share-based compensation expense 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.

In June 2018, the Financial Accounting Standards Board ("FASB") adopted ASU 2018-07, *Compensation — Stock Compensation (Topic 718) — Improvements to Nonemployee Share-Based Payment Accounting*, which expanded the scope of Topic 718 to include all share-based payment transactions for acquiring goods and services from nonemployees. ASU 2018-07 specifies that *Topic 718* applies to all share-based payment transactions in which the grantor acquires goods and services to be used or consumed in its own operations by issuing share-based payment awards. ASU 2018-07 also clarifies that *Topic 718* does not apply to share-based payments used to effectively provide (1) financing to the issuer, or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under ASC 606. ASU 2018-07 is effective for the Company's fiscal year beginning January 1, 2019. While the Company grants stock options to nonemployees, the adoption of ASU 2018-07 has not had a material impact on its consolidated results of operations, cash flows and financial position.

The following is a summary of share-based compensation expenses included in the condensed consolidated statements of operations for the three and six months ended June 30, 2020 and 2019:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2020	2019	2020	2019
Share-based compensation expense included in:				
Cost of revenue	$ 8,558	$ 2,801	$ 17,116	$ 5,163
Advertising and marketing expenses	2,088	840	5,000	1,680
Product development costs	4,343	420	10,888	840
Selling, general and administrative expenses	92,353	203,218	265,227	555,327
Total share-based compensation expense included in consolidated statement of operations	$ 107,342	$ 207,279	$ 298,231	$ 563,010

Included in the expense for the three and six months ended June 30, 2020, is an accrual for $33,436 and $69,897, respectively, in respect of the 2020 Annual Employee Incentive Compensation Plan.

Concentrations

Three customers accounted for 21%, 21% and 15% of the Company's revenue for the three months ended June 30, 2020 and two customers accounted for 16% and 10% of the Company's revenue for the six months ended June 30, 2020. One customer accounted for 58% and 44% of the Company's revenue for the three and six months ended June 30, 2019, respectively.

Three customers accounted for 41%, 35% and 19% of the Company's accounts receivable for the six months ended June 30, 2020. For the six months ended June 30, 2019, one customer accounted for 59% of the Company's accounts receivable.

Recently Issued Accounting Pronouncements

In March 2020, the FAS issued ASU No. 2020-04 " *Reference Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting" ("ASU 2020-04").* ASU 2020-04 provides optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. The amendments are effective for the Company as of March 12, 2020 through December 31, 2022. The Company does not expect this ASU to have a material impact on its consolidated results of operations, cash flows and financial position.

In January 2020, the FASB issued ASU No. 2020-01, *Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)—Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* (a consensus of the Emerging Issues Task Force). This update clarifies whether an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative and how to account for certain forward contracts and purchased options to purchase securities. For public entities, this guidance is effective for fiscal years beginning after December 15, 2020. The Company does not expect this ASU to have a material impact on its consolidated results of operations, cash flows and financial position.

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes,* which simplifies the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. ASU 2019-12 is effective for fiscal years beginning after December 15, 2020. Early adoption is permitted. The Company does not expect this ASU to have a material impact on its consolidated results of operations, cash flows and financial position.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820) – Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, which modifies the disclosure requirements on fair value measurements in Topic 820. The amendment will be effective for reporting periods beginning after December 15, 2019, and early adoption is permitted. The adoption of this ASU has not had a material impact on the Company's consolidated results of operations, cash flows and financial position.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 replaces the incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans and other financial instruments, the Company will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. In November 2018, the FASB issued ASU 2018-19, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses,* which clarifies that receivables arising from operating leases are not within the scope of *Subtopic 326-20*, but, instead, the impairment of receivables arising from operating leases are accounted for in accordance with *Topic 842, Leases*. In November 2019, the FASB issued ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses,* to clarify, correct errors in, or improve the codification of Topic 326 and make the codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019. Entities may early adopt the amendments within this ASU but not prior to the fiscal years beginning after December 15, 2018. The adoption of this ASU has not had a material impact on the Company's consolidated results of operations, cash flows and financial position.

Other accounting standards that have been issued or proposed by FASB that do not require adoption until a future date are not expected to have a material impact on the financial statements upon adoption. The Company does not discuss recent pronouncements that are not anticipated to have an impact on or are unrelated to its financial condition, results of operations, cash flows or disclosures.

Note 2 – Leases

In February 2016 the FASB issued ASU 2016-02, *Leases (Topic 842)*("ASC 842" or the "new lease standard"). The Company adopted ASC 842 as of January 1, 2019, using the effective date method.

The new standard provides a number of optional practical expedients in transition. The Company has elected to apply the "package of practical expedients" which allow the Company to not reassess: (i) whether existing or expired arrangements contain a lease, (ii) the lease classification of existing or expired leases, or (iii) whether previous initial direct costs would qualify for capitalization under the new lease standard. The Company has also elected to apply the short-term lease exemption for all leases with an original term of less than 12 months, for purposes of applying the recognition and measurements requirements in the new lease standard.

Upon adoption, the Company recognized its lease for manufacturing and office space (the "Facility Lease") on the balance sheet as an operating lease right-of-use asset in the amount of $714,416 and as a lease liability of $822,374. The Facility Lease commenced September 29, 2017 and continues through August 31, 2022. The Company has the option to renew the Facility Lease for an additional five years. However, the renewal option to extend the Facility Lease is not included in the right-of-use asset or lease liability as the option is not reasonably certain of exercise. The Company regularly evaluates the renewal option and when it is reasonably certain of exercise, the Company will include the renewal period in its lease term.

Beginning September 1, 2018, and each subsequent September 1 during the term, the monthly rent under the Facility Lease will increase by 3%. Total rent under the current building lease is charged to expense over the term of the lease on a straight-line basis, resulting in the same monthly rent expense throughout the lease. The difference between the rent expense amount and the actual rent paid is recorded to operating lease liability on the Company's condensed consolidated balance sheets.

Under the Facility Lease, the landlord agreed to pay the Company or the Company's contractors for tenant improvements made by the Company not to exceed $100,000, which were used for normal tenant improvements. The Company determined that these improvements were not specialized and could be utilized by a subsequent tenant and, as such, the improvements were considered assets of the lessor. As of January 1, 2019, the unamortized amount of tenant improvement allowance of $81,481 was treated as a reduction in measuring the right-of-use asset.

Under the Facility Lease, the Company pays the actual amounts for property taxes and insurance, excludes such payments from lease contract consideration, and records such payments as incurred. The Company also pays the landlord for common area maintenance, which is considered a non-lease component. For the Facility Lease, the Company has not elected the accounting policy to include both the lease and non-lease components as a single component and account for it as the lease.

In determining the right-of-use asset and lease liability, the Company applied a discount rate to the minimum lease payments under the Facility Lease. ASC 842 requires the Company to use the rate of interest that the Company would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment. Since the discount rate is not implicit in the lease agreement, we utilized an estimated incremental borrowing rate provided by the Company's depository bank.

The lease cost, cash flows and other information related to the Facility Lease were as follows:

		For the Six Months Ended June 30, 2020
Operating lease cost	$	108,444
Operating cash outflow from operating lease	$	69,811

		As of June 30, 2020
Operating lease right-of-use assset	$	440,138
Operating lease liability, current	$	227,008
Operating lease liability, long-term	$	288,682
Remaining lease term		2.2 years
Discount rate		5.00%

Future annual minimum lease payments on the Facility Lease as of June 30, 2020 were as follows:

2020 (excluding the six months ended June 30, 2020)	$	123,227
2021		251,360
2022		170,891
Total minimum lease payments		545,478
Less imputed interest		(29,788)
Present value of minimum lease payments	$	515,690

During the six months ended June 30, 2020, the Company entered into an agreement with its landlord to apply its rent deposit of $51,000 to rent payments due during the period. The deposit required on the lease will be reduced to approximately $32,000 and will be payable in 12 monthly installments from January through December of 2021. Further, the landlord also agreed to defer payment of fifty percent of the three months of lease payments (base rent only) for the period July to September 2020. The deferred lease payments amount to approximately $30,000 and will be payable in 12 monthly installments from January to December 2021.

Note 3 – Inventory

Inventory consisted of the following:

	June 30, 2020	December 31, 2019
Finished goods	$ 791,061	$ 1,041,369
Work in progress	5,359	3,851
Raw materials	271,001	257,399
Allowance for excess & obsolete inventory	(262,821)	(71,376)
Inventory, net	$ 804,600	$ 1,231,243

Overhead expenses of $18,903 and $31,831 were included in the inventory balance as of June 30, 2020, and December 31, 2019, respectively.

Advance payments on inventory purchases are recorded in prepaid expenses until title for such inventory passes to the Company. Prepaid expenses included approximately $99,000 and $164,000 in advance payments for inventory for the periods ended June 30, 2020, and December 31, 2019, respectively.

Note 4 – Property and Equipment

Property and equipment consisted of the following:

	June 30, 2020	December 31, 2019
Furniture and equipment	$ 400,096	$ 389,090
Vehicles	15,000	15,000
Leasehold improvements	215,193	215,193
	630,289	619,283
Accumulated depreciation	(422,057)	(361,360)
Property and equipment, net	$ 208,232	$ 257,923

Depreciation expense was $60,697 and $63,101 for the six months ended June 30, 2020, and December 31, 2019, respectively. For the six months ended June 30, 2020, $2,760 was allocated to cost of sales and $690 was allocated to inventory with the remainder recorded as selling, general and administrative expense. For the six months ended December 31, 2019, $2,804 was allocated to cost of sales and $700 was allocated to inventory with the remainder recorded as selling, general and administrative expense.

Note 5 – Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following:

	June 30, 2020	December 31, 2019
Accounts payable	$ 1,204,918	$ 1,299,015
Sales commissions payable	38,595	69,532
Accrued payroll liabilities	241,550	169,052
Product warranty accrual	182,734	185,234
Other accrued expenses	85,989	110,127
Total	$ 1,753,786	$ 1,832,959

Note 6 – Note Payable and Accrued Interest

On April 22, 2020, the Company entered into a note payable with its current bank in the principal amount of $554,000, for working capital purposes.

The loan amount bears interest at 1% and was initially due on April 20, 2022. Subsequently, the term of the loan may now potentially be extended to April 20, 2025. The loan may be repaid in advance without penalty. The loan is also potentially forgivable in full provided proceeds are used for payment of payroll expenses, rent, utilities and mortgage interest and certain other terms and conditions are met. The loan has typical default provisions, including for change of ownership, general lender insecurity as to repayment, non-payment of amounts due, defaults on other debt instruments, insolvency, dissolution or termination of the business as a going concern and bankruptcy.

During the three months ended June 30, 2020, interest of $1,047 was accrued in respect of this note payable.

Note 7 – Commitments and Contingencies

Litigation

As of December 31, 2019, there were 6,750,000 restricted stock units that had not been settled due to a dispute with a former employee over the required withholding taxes to be paid to the Company for remittance to the appropriate tax authorities. The Company commenced an arbitration action against the former employee regarding the dispute. The former employee also made claims in the arbitration action against the Company for unpaid wages. As stated in a pleading in the arbitration, on March 9, 2020, the Company issued the former employee 6,750,000 shares of the Company's common stock in settlement of these restricted stock units after taking measures to mitigate the Company's exposure to penalties and liability for the failure to properly withhold income taxes. The Arbitrator has issued an interim award of approximately $10,000 in the Company's favor and finding against the former employee. The recipient continues to pursue separate litigation against the Company for recovery of alleged consulting fees owed for the 2015 calendar year prior to the recipient's appointment as an executive officer of the Company and discovery is ongoing in this case. Effective June 9, 2020, the Arbitrator issued his final award in the Company's favor. The Arbitrator found against the former employee and awarded the Company costs of $33,985, with interest at 8% per year. As further discussed in Note 11. Subsequent Events, below, effective July 22, 2020, the Colorado Court confirmed the Arbitration award and entered a final judgement in favor of the Company and against the former employee.

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.

Leases

The Company has a lease agreement for its manufacturing and office space. See Note 2.

Other Commitments

In the ordinary course of business, the Company enters into commitments to purchase inventory and may also provide indemnifications of varying scope and terms to customers, vendors, lessors, business partners, and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company's breach of such agreements, services to be provided by the Company, or from intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers and employees that will require the Company to, among other things, indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers, or employees. The Company maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its directors and certain of its officers and employees, and former officers, directors, and employees of acquired companies, in certain circumstances.

Note 8 – Equity Incentive Plan

Under the Company's 2017 Equity Incentive Plan, as may be modified and amended by the Company from time to time (the "2017 Equity Plan"), the Board of Directors (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. If any shares subject to an award are forfeited, expire, or otherwise terminate without issuance of such shares, the shares will, to the extent of such forfeiture, expiration, or termination, again be available for awards under the 2017 Equity Plan.

During the six months ended June 30, 2020, the Company issued shares of its common stock under the 2017 Equity Plan as follows:

- 1,000,000 shares to an employee in settlement of certain RSUs that vested December 31, 2019;
- 560,000 shares pursuant to a special incentive stock bonus approved by the Board for the period ended December 31, 2019; and
- 6,750,000 shares in settlement of restricted stock units to a former employee after taking measures to mitigate the Company's exposure to penalties and liability for the failure to properly withhold income taxes.as further discussed in *Note 7 – Commitments and Contingencies, Litigation* above.

As of June 30, 2020, awards related to 23,523,100 shares remain outstanding.

The total unrecognized compensation expense for unvested non-qualified stock options and RSUs at June 30, 2020, was $55,265, which will be recognized over approximately 1 year.

Non-Qualified Stock Options

A summary of the non-qualified stock options granted to employees and consultants under the 2017 Equity Plan during the six months ended June 30, 2020, are presented in the table below:

	Number of Options		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term		**Aggregate Intrinsic Value**
Outstanding, December 31, 2019	10,135,000	$	0.096	7.7	$	-
Granted	6,616,900	$	0.070	10.0	$	-
Exercised	-					
Forfeited	-					
Expired	(628,800)	$	0.080	9.4	$	-
Outstanding, June 30, 2020	16,123,100	$	0.086	8.1	$	-
Exercisable, June 30, 2020	14,123,100	$	0.086	8.0	$	-
Outstanding vested and expected to vest, June 30, 2020	16,123,100	$	0.086	8.1	$	-

During the three months ended June 30, 2020, 628,000 non-qualified stock options expired unexercised following the departure of two former employees.

A summary of non-vested non-qualified stock options activity for employees and consultants under the 2017 Equity Plan for the six months ended June 30, 2020, are presented in the table below:

	Number of Options		**Weighted Average Grant-Date Fair Value**		**Aggregate Intrinsic Value**		**Grant-Date Fair Value**
Nonvested, December 31, 2019	2,000,000	$	0.075	$	-	$	149,534
Granted	6,616,900	$	0.059			$	387,199
Vested	(6,616,900)	$	0.059			$	387,199
Forfeited	-					$	-
Expired	-					$	-
Nonvested, June 30, 2020	2,000,000	$	0.075	$	-	$	149,534

For the six months ended June 30, 2020 and 2019, the Company recorded $153,680 and $275,074 as compensation expense related to vested options issued to employees and consultants, net of forfeitures, respectively.

A summary of the non-qualified stock options granted to directors under the 2017 Equity Plan during the six months ended June 30, 2020, are presented in the table below:

	Number of Options		**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term**		**Aggregate Intrinsic Value ($000)**
Outstanding, December 31, 2019	900,000	$	0.135	7.6	$	-
Granted	6,500,000	$	0.057	8.5		
Exercised	-		-			
Forfeited/Cancelled	-		-			
Expired	-		-			
Outstanding, June 30, 2020	7,400,000	$	0.067	8.0	$	-
Exerciseable, June 30, 2020	6,400,000	$	0.073	8.5	$	-

A summary of non-vested non-qualified stock options activity for directors under the 2017 Equity Plan for the six months ended June 30, 2020, are presented in the table below:

	Number of Options	Weighted Average Grant-Date Fair Value	Aggregate Intrinsic Value	Grant-Date Fair Value
Nonvested, December 31, 2019	-	-	$ -	
Granted	6,500,000	0.057		$ 373,000
Vested	(5,500,000)	0.063		$ 344,000
Forfeited	-	-		$ -
Expired	-	-		$ -
Nonvested, June 30, 2020	1,000,000	0.029	$ 1,000	$ 29,000

During the six months ended June 30, 2020 and 2019, the Company incurred $49,488 and $0, respectively, as compensation expense related to 1,521,352 and 0 vested options, respectively, issued to directors.

Effective June 24, 2020, the Company issued 2 million non-qualified stock options under the 2017 Equity Plan to newly appointed directors. The options vested 50% upon grant and 50% on April 1, 2021, if the Director remains on the Board up to that time. The options have a term of 5 years and have an exercise price equal to the closing price of the Company's common stock on The OTC Markets on the day immediately preceding the grant date of $.029.

Restricted Stock Units

A summary of the RSUs awarded to employees, directors and consultants under the 2017 Equity Plan during the six months ended June 30, 2020, are presented in the table below:

	Number of Units	Weighted Average Grant-Date Fair Value	Aggregate Intrinsic Value
Outstanding, December 31, 2019	7,550,000	$ 0.128	$ 528,500
Granted	-	-	
Vested and settled with share issuance	(6,750,000)	$ 0.121	
Forfeited/canceled	(800,000)	$ 0.184	
Outstanding, June 30, 2020	-		

For the six months ended June 30, 2020 and 2019, the Company recorded $25,163 and $182,369, respectively, as compensation expense related to vested RSUs issued to employees, directors and consultants. The total intrinsic value of RSUs vested and settled with share issuance was $199,125 for the six months ended June 30, 2020.

Effective April 30, 2020, 800,000 RSUs vested. However, the holder elected to cancel the RSUs.

Note 9 – Warrants

Effective June 18, 2020, 500,000 warrants expired unexercised. The warrants were issued on June 19, 2017 with an exercise price of $0.35.

The following table summarized information about warrants outstanding at June 30, 2020.

Exercise price	Warrants Outstanding	Weighted Average Life of Outstanding Warrants In Months
0.2	14,734,000	6
0.25	7,562,500	12
	22,296,500	8

Note 10 – Income Taxes

As of June 30, 2020, the Company had U.S. federal and state net operating losses ("NOLs") of approximately $17,907,000, which will expire, if not utilized, in the years 2034 through 2037, however, NOLs generated subsequent to December 31, 2017 do not expire but may only be used against taxable income to 80%. However, in response to the novel coronavirus COVID-19, the Coronavirus Aid, Relief, and Economic Security Act temporarily repealed the 80% limitation for NOLs arising in 2018, 2019 and 2020. Pursuant to Section 382 of the Internal Revenue Code of 1986, as amended, use of the Company's NOLs carryforwards may be limited in the event of cumulative changes in ownership of more than 50% within a three-year period.

The Company must assess the likelihood that its net deferred tax assets will be recovered from future taxable income, and to the extent the Company believes that recovery is not likely, the Company establishes a valuation allowance. Management's judgment is required in determining the Company's provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recorded against the net deferred tax assets. The Company recorded a full valuation allowance as of June 30, 2020, and December 31, 2019. Based on the available evidence, the Company believes it is more likely than not that it will not be able to utilize its net deferred tax assets in the foreseeable future.

Note 11 – Subsequent Events

In accordance with ASC 855, *Subsequent Events*, the Company has evaluated all subsequent events through August 10, 2020, the date the financial statements were available to be issued. No material subsequent events occurred after June 30, 2020, other than as set out below:

As stated in Note 7, effective July 22, 2020, the Colorado Court confirmed the Arbitration award and entered a final judgement in favor of the Company and against a former employee. The Company can now commence collection of the costs of $33,985, with interest at 8% per year, awarded by the Arbitrator against the former employee.

During the month of July 2020, we entered into several new sales contracts totaling approximately $3.1 million, including our largest-ever contract for $2.8 million, most of which we expect to be realized as revenue in 2020.

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

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report, which include additional information about our accounting policies, practices, and the transactions underlying our financial results, as well as with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2019, as filed with the SEC. In addition to historical information, the following discussion and other parts of this Quarterly Report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to the factors discussed under "Cautionary Statements" appearing elsewhere herein and the risks and uncertainties described or identified in "Item 1A – Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2019, as updated from time to time in the Company's filings with the SEC, and Part II, Item 1A of this Quarterly Report entitled "Risk Factors."

Non-GAAP Financial Measures

To supplement our financial results on U.S. generally accepted accounting principles ("GAAP") basis, we use non-GAAP measures including net bookings, backlog, as well as adjusted net income (loss) which reflects adjustments for certain non-cash expenses such as stock-based compensation, certain debt-related items and depreciation expense. We believe these non-GAAP measures are helpful in understanding our past performance and are intended to aid in evaluating our potential future results. The presentation of these non-GAAP measures should be considered in addition to our GAAP results and are not intended to be considered in isolation or as a substitute for financial information prepared or presented in accordance with GAAP. We believe these non-GAAP financial measures reflect an additional way to view aspects of our operations that, when viewed with our GAAP results, provide a more complete understanding of factors and trends affecting our business. For purposes of this Quarterly Report, (i) "adjusted net income (loss)" and "adjusted operating income (loss)" mean GAAP net income (loss) and operating income (loss), respectively, after adjustment for non-cash equity compensation expense, debt-related items and depreciation expense, and (ii) "net bookings" means new sales contracts executed during the quarter for which we received an initial deposit, net of any adjustments including cancellations and change orders during the quarter.

Our backlog, remaining performance obligations and net bookings may not be indicative of future operating results, and our customers may attempt to renegotiate or terminate their contracts for a number of reasons, including delays in or inability to obtain project financing or licensing or abandonment of the project entirely. Accordingly, there can be no assurance that contracts included in the backlog or remaining performance obligations will actually generate revenues or when the actual revenues will be generated.

Overview

We design, engineer and sell cultivation technologies for controlled environment agriculture including: (i) liquid-based process cooling systems and other climate control systems, (ii) air handling equipment and systems, (iii) a full-service engineering package for designing and engineering commercial scale thermodynamic systems specific to cannabis cultivation facilities, and (iv) automation and control devices, systems and technologies used for environmental, lighting and climate control. Our customers include commercial, state- and provincial-regulated cannabis growers in the U.S. and Canada as well as other international locations, including those growers building new facilities and those expanding or retrofitting existing facilities. Currently, our revenue stream is derived primarily from supplying our products, services and technologies to commercial indoor and hybrid sealed greenhouse facilities ranging from several thousand to more than 100,000 square feet.

Headquartered in Boulder, Colorado, we leverage our experience in this space to bring value-added climate control solutions to our customers that help improve their overall crop quality and yield, optimize energy and water efficiency, and satisfy the evolving state and local codes, permitting and regulatory requirements. Although our customers do, we neither produce nor sell cannabis.

Shares of our common stock are traded on the OTC Markets under the ticker symbol "SRNA."

Impact of the COVID-19 Pandemic on Our Business

The impact of the government and economic response to the COVID-19 pandemic has resulted in reduced demand across the majority of our markets and disrupted work on current projects. In the near-term, the COVID-19 pandemic is expected to have adverse effects on our sales, project implementation, operating margins, and working capital. As of the date of this filing, significant uncertainty exists concerning the magnitude and duration of the economic impact of the COVID-19 pandemic.

In response to the anticipated economic disruption arising from the impact of the novel coronavirus COVID-19, in late March 2020 the Company downsized operations to preserve cash resources, implementing workforce reductions, reductions of salaried employee compensation (including all executives and the CEO) and reduction of hours worked, cutting costs and focusing its operations on customer-centric sales and project management activities.

Following the receipt of loan funds in April 2020, the Company reinstated all staff who previously had been placed on furlough. Staff receiving salaries of $100,000 per year or less were restored to their full salaries. All executives, including the CEO, had their compensation reduced to the greater of $100,000 per year or 75% of their previous salary level. The Company re-engaged its staff so as to be able to fulfill its current customer contracts and any new sales orders and to continue its marketing and selling efforts

Effective June 8, 2020, the Company furloughed several employees and implemented further 25% salary reductions for all remaining salaried employees. All hourly employees were moved to part-time status.

Due to the speed with which the COVID-19 pandemic developed and the resulting uncertainty, including the depth and duration of the disruptions to customers and suppliers, its future effect on our business, results of operations, and financial condition cannot be predicted. Despite this uncertainty, we have various contingency plans to reduce costs to mitigate the impact of the COVID-19 pandemic to the best of our ability, although they may not be sufficient for us to avoid reduced sales, increased losses and reduced operating cash flows.

Refer to *Risk Factors*, included in Part II, Item 1A of this Quarterly Report on Form 10-Q below, for further discussion of the possible impact of the COVID-19 pandemic on our business.

Our Growth Strategy

We believe there are fundamentally three ways to grow a business: (i) increase the number of customers, (ii) increase the average revenue per order, or (iii) increase the frequency of orders. Our growth strategy is threefold:

1. Sell proverbial “Chevys.” In addition to “Cadillac” -level products, sell “Chevy” or equivalent products to satisfy a wider range of points along the demand curve. Anticipated result: Increase the number of customers.

We have a sales and marketing program that generates many prospective customer relationships. However, our limited range of higher cost products, mostly chilled water systems, reduces the number of customer prospects who can afford to buy from us. We continue to plan a broadening of our product line to include lower- and mid-cost products, such as split systems and packaged roof top units, as well as other technology solutions, so that a broader group of growers can take advantage of our engineering expertise and capabilities. We believe these new products and services will increase our addressable market and increase sales, further leveraging our investment in sales and marketing.

2. Sell proverbial “steering wheels.” Sell our customers the automated facilities control systems they need—directly. Anticipated result: Increase average order size.

Growing live plants indoors in a controlled environment is a technically demanding business, and a failed crop can cost a grower significant foregone revenue. We believe our licensed professional engineers are some of the industry’s leading experts in the design of such facilities, and we seek to extend that leadership into more advanced technology products.

Last year we introduced our SentryIQ™ control system. If our climate control design and products are the proverbial car, then SentryIQ™ is the proverbial steering wheel—one is needed to direct the car where to go. Before SentryIQ™, we had to send our customers elsewhere for controls to regulate their cultivation environments, but we now have the ability to capture that revenue. To date, we have signed eight contracts for controls systems with an aggregate value of over $900,000.

Our next step down this technology and innovation road will be the eventual development of the equivalent of a self-driving car. Growers will tell the control system what they want to achieve, and the system will sense the environment and direct the climate control system to achieve the grower's goals. These systems will be able to integrate data analytics—and eventually deploy artificial intelligence—to optimize multiple variables to maximize the grower's profits. While we are in the early stages of development of these technology-driven systems, we believe it is important for us to become a player in this market because it expands our addressable market for both sensors and software while offering the possibility of higher margins and recurring revenue over time.

3. Add more proverbial "dealers." Engage in one or more strategic relationships with other technology leaders that serve our industry. Anticipated result: Increase the number of customers.

Strategic relationships might include referral marketing agreements, co-development of unique integrated solutions with best-in-class partners, and acquisitions. To extend the automotive analogy, engaging in these types of relationships is like adding more dealers to sell our products, at little cost to us. During Q1 2020 we joined the GroAdvisor group (www.groadvisorworldwide.com) and began joint marketing initiatives with the group. GroAdvisor is a group of seven companies each with expertise in selected technologies necessary to build a cultivation facility such as lighting, buildings, modular grow rooms, fertigation, etc. Surna provides its expertise in environmental controls to the group and its prospective customers.

If some of these strategic alliances are successful in driving top-line revenue for us and our partners, over time these relationships could develop into more exclusive arrangements or evolve into possible acquisitions or a source of strategic capital for us. There can be no assurance that we will be able to successfully execute any of these strategic initiatives. Efforts will be primarily focused on working with new strategic partners to co-market each other's products and services and possibly jointly develop new and improved products and services with cannabis-specific applications, as opposed to exclusively seeking acquisitions.

Our business plan has six key objectives in mind:

1. Reduce prior reliance on new build facility projects which generate inconsistent revenue and cash flow;

2. Increase emphasis on retrofit and expansion projects, especially from multi-facility operators, which typically provide a more predictable and accelerated completion and revenue stream;

3. Establish revenue from "lifecycle" operational and facility management offerings;

4. Increase our gross margin by shifting our focus to value-added technology services and proprietary, customized equipment;

5. Operate with disciplined expense, cash and working capital management; and

6. Become financially self-sustaining by attempting to achieve operating cash flow breakeven and profitability.

Our Commercial-Scale Projects

During the first six months of 2020, we entered into sales contracts for two new build projects and one expansion project, each with a contract value over $100,000, which we refer to as commercial-scale projects. These new contracts totaled $1,005,000, which consisted of $467,000 for the new build projects (46%) and $538,000 for the expansion project (54%).

Our Bookings, Backlog and Revenue

During the three months ended June 30, 2020, we executed new sales contracts with a total contract value of $509,000 and had positive change orders of $186,000. However, during this same period, we cancelled four sales contracts with a total remaining contract value of $2,296,000. These cancellations were based on discussions with customers who have abandoned their projects. After adjustments for these change orders and cancellations, our net bookings in the three months ended June 30, 2020 were $(1,601,000), representing a decrease of $2,728,000 (or 242%) from net bookings of $1,127,000 in the first quarter of 2020.

Effective June 1, 2020, we received notification that an existing customer contract with an outstanding balance of work to be performed of $1,984,051 had been terminated due to the customer permanently ceasing operations for a lack of funding for the project. While we do not know definitively why project bookings declined in the first half of 2020, we believe that uncertainty due to the impact of the response to the Covid 19 pandemic and disruption in the capital markets has contributed to a slowdown in new construction for cultivation facilities. However, retail sales of cannabis products have continued their strong growth during 2020 and appear to be continuing. This gives us optimism that cultivation facilities will continue to be built to meet the growing demand for cannabis products.

Further, as at June 30, 2020, we have noticed delays in both project commitments (bookings) and in completions on a number of our existing contracts.

As the cultivation facility market matures and grows, we believe more competitors are and will be entering the market. We believe this competition will likely come from: (i) large equipment providers who are more aggressively pursuing the cannabis market, and (ii) local and national engineering firms who have elected to enter the market which they had previously chosen not to serve because of the nature of the industry.

Our backlog at June 30, 2020 was $5,592,000, a decrease of $3,283,000, or 37%, from March 31, 2020. The decrease in backlog is the result of our lower net bookings in the second quarter and contract cancellations. Our backlog at June 30, 2020 includes booked sales orders of $1,658,000 (30% of the total backlog) from several customers that we do not expect to be realized until 2022, if at all. We believe the sales orders in this portion of our backlog may be abandoned by our customers or ultimately cancelled.

The following table sets forth: (i) our beginning backlog (the remaining contract value of outstanding sales contracts for which we have received an initial deposit as of the previous period), (ii) our net bookings for the period (new sales contracts executed during the period for which we received an initial deposit, net of any adjustments including cancelations and change orders during the period), (iii) our recognized revenue for the period, and (iv) our ending backlog for the period (the sum of the beginning backlog and net bookings, less recognized revenue).

	For the quarter ended				
	June 30, 2019	September 30, 2019	December 31, 2019	March 31, 2020	June 30, 2020
Backlog, beginning balance	$ 11,543,000	$ 13,023,000	$ 10,143,000	$ 9,558,000	$ 8,875,000
Net bookings, current period	$ 5,690,000	$ 2,644,000	$ 3,134,000	$ 1,127,000	$ (1,601,000)
Recognized revenue, current period	$ 4,210,000	$ 5,524,000	$ 3,719,000	$ 1,810,000	$ 1,682,000
Backlog, ending balance	$ 13,023,000	$ 10,143,000	$ 9,558,000	$ 8,875,000	$ 5,592,000

The completion of a customer's new build facility project is dependent upon the customer's ability to secure funding and real estate, obtain a license and then build their cultivation facility so they can take possession of the equipment. Accordingly, the time it takes for these customers to complete a new build project, which corresponds to when we are able to recognize revenue, is driven by numerous factors including: (i) the large number of first-time participants interested in the indoor cannabis cultivation business; (ii) the complexities and uncertainties involved in obtaining state and local licensure and permitting; (iii) local and state government delays in approving licenses and permits due to lack of staff or the large number of pending applications, especially in states where there is no cap on the number of cultivators; (iv) the customer's need to obtain cultivation facility financing; (v) the time needed, and coordination required, for our customers to acquire real estate and properly design and build the facility (to the stage when climate control systems can be installed); (vi) the large price tag and technical complexities of the climate control and air sanitation system; (vii) the availability of power; and (viii) delays that are typical in completing any construction project.

As has historically been the case for the Company at each quarter-end, there remains significant uncertainty regarding the timing of revenue recognition of our backlog. As of June 30, 2020, 54% of our backlog was attributable to customer contracts for which we have only received an initial advance payment to cover our engineering services ("engineering only paid contracts"). There are always risks that the equipment portion of our engineering only paid contracts will not be completed or will be delayed, which could occur if the customer is dissatisfied with the quality or timeliness of our engineering services, there is a delay or abandonment of the project due to the customer's inability to obtain project financing or licensing, or the customer determines not to proceed with the project due to economic factors, such as declining cannabis wholesale prices in the state.

In contrast, after the customer has made an advance payment for a portion of the equipment to be delivered under the contract ("partial equipment paid contracts"), we typically are better able to estimate the timing of revenue recognition since the risks and delays associated with licensing, permitting and project funding are typically mitigated once the initial equipment payment is received. As of June 30, 2020, 46% of our backlog was attributable to partial equipment paid contracts.

We have provided an estimate in our condensed consolidated financial statements for when we expect to recognize revenue on our remaining performance obligations (i.e., our Q2 2020 backlog), using separate time bands, with respect to engineering only paid contracts and partial equipment paid contracts. We estimate that we will recognize approximately 44% of our Q2 2020 backlog during the remainder of 2020, or $2.4 million. However, there continues to be significant uncertainty regarding the timing of our recognition of revenue on our Q2 2020 backlog. Refer to the *Revenue Recognition* section of note 1 in our condensed consolidated financial statements, included as part of this Quarterly Report for additional information on our estimate of future revenue recognition on our remaining performance obligations.

Our backlog, remaining performance obligations and net bookings may not be indicative of future operating results, and our customers may attempt to renegotiate or terminate their contracts for a number of reasons, including delays in or inability to obtain project financing or licensing or abandonment of the project entirely. Accordingly, there can be no assurance that contracts included in backlog or remaining performance obligations will actually generate revenues or when the actual revenues will be generated. Net bookings and backlog are considered non-GAAP financial measures, and therefore, they should be considered in addition to, rather than as a substitute for, our GAAP measures for recognized revenue, deferred revenue and remaining performance obligations. Further, we can provide no assurance as to the profitability of our contracts reflected in remaining performance obligations, backlog and net bookings.

Results of Operations

Comparison of Three Months Ended June 30, 2020 and 2019

Revenues and Cost of Goods Sold

Revenue for the three months ended June 30, 2020 was $1,682,000, compared to $4,210,000 for the three months ended June 30, 2019, representing a decrease of $2,528,000, or 60%.

Cost of revenue decreased by $1,355,000, or 49%, from $2,763,000 for the three months ended June 30, 2019 to $1,408,000 for the three months ended June 30, 2020.

The gross profit for the three months ended June 30, 2020 was $275,000 compared to $1,448,000 for the three months ended June 30, 2019, a decrease of 81%. Gross profit margin decreased by eighteen percentage points from 34% for the three months ended June 30, 2019 to 16% for the three months ended June 30, 2020 primarily due to an increase in variable costs as described below.

Our fixed costs (which include engineering, service, manufacturing and project management salaries and benefits and manufacturing overhead) totaled $283,000, or 17% of total revenue, for the three months ended June 30, 2020 as compared to $373,000, or 9% of total revenue, for the three months ended June 30, 2019. The decrease of $91,000 was primarily due to a decrease in salaries and benefits (including stock-based compensation) of $90,000.

Our variable costs (which include the cost of equipment, outside engineering costs, shipping and handling, travel and warranty costs) totaled $1,125,000, or 67% of total revenue, in the three months ended June 30, 2020 as compared to $2,389,000, or 57% of total revenue, in the three months ended June 30, 2019. The decrease in variable costs was primarily due to lower equipment costs as a result of lower revenue of $1,242,000. However, equipment costs as a percent of revenue increased by 2%. Other factors included: (i) a decrease in warranty costs of $85,000 which was the result of a reimbursement from a customer for costs incurred in 2019 related to a failure later deemed to be non-warranty, (ii) a decrease in shipping and handling of $56,000, (iii) a decrease in travel to customer facilities of $36,000, (iv) a decrease in outside engineering services of $31,000 offset by (v) an increase in excess and obsolete inventory of $186,000 related to the delay and potential cancellation of one customer's current project.

We continue to focus on gross margin improvement through a combination of, among other things, more disciplined pricing, better absorption of our fixed costs as we convert our increased bookings into revenue, and the implementation over time of lower-cost supplier alternatives.

Operating Expenses

Operating expenses decreased to $880,000 for the three months ended June 30, 2020 from $1,311,000 for the three months ended June 30, 2019, a decrease of $431,000, or 33%. The operating expense decrease consisted of: (i) a decrease in selling, general and administrative expenses ("SG&A expenses") of $322,000, (ii) a decrease in advertising and marketing expenses of $72,000, and (iii) a decrease in product development expense of $37,000.

The decrease in SG&A expenses for the three months ended June 30, 2020 compared to the three months ended June 30, 2019, was due primarily to: (i) a decrease of $111,000 in stock-related compensation expense to employees, consultants and directors, (ii) a decrease in accounting, consulting and other professional fees of $86,000, (iii) a decrease in loss on asset disposal of $58,000, (iv) a decrease of $55,000 in commissions, (v) a decrease in travel of $32,000, (vi) a decrease of $24,000 in board fees, (vii) a decrease of $18,000 in depreciation, offset by (viii) an increase in salaries and benefits of $32,000 and (iv) an increase in bad debt expense of $24,000.

The decrease in marketing expenses was primarily due to (i) a decrease in expenses related to trade shows of $57,000 and (ii) a decrease in advertising and promotion of $12,000.

The decrease in product development costs was due to (i) a decrease in material costs of $25,000 and (ii) a decrease in salaries and benefits (including stock compensation) of $12,000.

Operating Income (Loss)

We had an operating loss of $606,000 for the three months ended June 30, 2020, as compared to an operating income of $136,000 for the three months ended June 30, 2019, an increase of $742,000, or 544%. The operating loss for the three months ended June 30, 2020 included $107,000 of non-cash, stock-based compensation and $29,000 of depreciation expense, compared to $207,000 of non-cash, stock-based compensation and $47,000 of depreciation expense for the three months ended June 30, 2019. Excluding these non-cash items, our operating loss increased by $860,000, or 220%.

Other Income (Expense)

We had other expense (net) of $8,000 for the three months ended June 30, 2020 compared to other income (net) of $3,000 for the three months ended June 30, 2019.

Net Income (Loss)

Overall, we had net loss of $614,000 for the three months ended June 30, 2020, as compared to a net income of $140,000 for the three months ended June 30, 2019, an increase of $753,000, or 539%. The net loss for the three months ended June 30, 2020 included $107,000 of non-cash, stock-based compensation and $29,000 of depreciation expense, compared to $207,000 of non-cash, stock-based compensation and $47,000 of depreciation expense for the three months ended June 30, 2019. Excluding these non-cash items, our net loss increased by $871,000, or 221%.

Comparison of Six Months Ended June 30, 2020 and 2019

Revenues and Cost of Goods Sold

Revenue for the six months ended June 30, 2020 was $3,492,000, compared to $5,982,000 for the six months ended June 30, 2019, representing a decrease of $2,490,000, or 42%.

Cost of revenue decreased by $1,283,000, or 32%, from $4,044,000 for the six months ended June 30, 2019 to $2,761,000 for the six months ended June 30, 2020.

The gross profit for the six months ended June 30, 2020 was $731,000 compared to $1,938,000 for the six months ended June 30, 2019, a decrease of 62%. Gross profit margin decreased by 11 percentage points from 32% for the six months ended June 30, 2019 to 21% for the six months ended June 30, 2020 primarily due to an increase in variable costs as described below.

Our fixed costs (which include engineering, service, manufacturing and project management salaries and benefits and manufacturing overhead) totaled $582,000, or 17% of total revenue, for the six months ended June 30, 2020 as compared to $677,000, or 11% of total revenue, for the six months ended June 30, 2019. The decrease of $95,000 was primarily due to a decrease in salaries and benefits (including stock-based compensation) of $108,000, offset by an increase in fixed overhead of $13,000.

Our variable costs (which include the cost of equipment, outside engineering costs, shipping and handling, travel and warranty costs) totaled $2,179,000, or 62% of total revenue, in the six months ended June 30, 2020 as compared to $3,367,000, or 56% of total revenue, in the six months ended June 30, 2019. The decrease in variable costs was primarily due to lower equipment costs as a result of lower revenue. Other factors included: (i) a decrease in warranty of $92,000 which was partially the result of a reimbursement from a customer for costs incurred in 2019 related to a failure later deemed to be non-warranty, (ii) a decrease in shipping and handling of $63,000, (iii) a decrease in travel for client visits of $24,000, (iv) a decrease of $20,000 in outside engineering costs, offset by (v) an increase in excess and obsolete inventory of $197,000 related to the delay and potential cancellation of one customer's current project and (vi) an increase in project management consulting of $24,000.

We continue to focus on gross margin improvement through a combination of, among other things, more disciplined pricing, better absorption of our fixed costs as we convert our increased bookings into revenue, and the implementation over time of lower-cost supplier alternatives.

Operating Expenses

Operating expenses decreased to $2,283,000 for the six months ended June 30, 2020, from $2,724,000 for the six months ended June 30, 2019, a decrease of $441,000, or 16%. The operating expense decrease consisted of: (i) a decrease in selling, general and administrative expenses ("SG&A expenses") of $384,000, (ii) a decrease in advertising and marketing expenses of $48,000 and (iii) a decrease in product development expense of $9,000.

The decrease in SG&A expenses for the six months ended June 30, 2020, compared to the six months ended June 30, 2019, was due primarily to: (i) a decrease of $275,000 in stock-related compensation expense to employees, consultants and directors, (ii) a decrease in accounting, consulting and other professional fees of $113,000, (iii) a decrease in commissions of $66,000, (iv) a decrease of $54,000 for loss on asset disposal, (v) a decrease of $36,000 in depreciation and amortization, (vi) a decrease of $32,000 in travel, (vii) a decrease of $24,000 in board fees, offset by (viii) an increase in salaries, benefits and other employee related costs of $130,000 and (ix) an increase of $85,000 in legal fees.

The decrease in marketing expenses was primarily due to (i) a decrease in expenses related to trade shows of $72,000, offset by (ii) an increase in outside services of $22,000.

The decrease in product development costs was primarily due to a decrease in materials costs of $56,000 offset by an increase in salaries and benefits (including stock compensation) of $46,000.

Operating Income (Loss)

We had operating loss of $1,552,000 for the six months ended June 30, 2020, as compared to an operating loss of $786,000 for the six months ended June 30, 2019, an increase of $766,000, or 98%. The operating loss for the six months ended June 30, 2020 included $298,000 of non-cash, stock-based compensation and $58,000 of depreciation expense, compared to $548,000 of non-cash, stock-based compensation and $94,000 of depreciation expense for the six months ended June 30, 2019. Excluding these non-cash items, our operating loss increased by $1,052,000, or 732%.

Other Income (Expense)

We had other income (net) of $100 for the six months ended June 30, 2020 compared to other income (net) of $25,000 for the six months ended June 30, 2019. Other income for the six months ended June 30, 2019 consisted of income related to certain leased equipment which has since ceased.

Net Income (Loss)

Overall, we had net loss of $1,552,000 for the six months ended June 30, 2020 as compared to a net loss of $761,000 for the six months ended June 30, 2019, an increase of $791,000, or 104%. The net loss for the six months ended June 30, 2020 included $298,000 of non-cash, stock-based compensation and $58,000 of depreciation expense, compared to $548,000 of non-cash, stock-based compensation and $94,000 of depreciation expense for the six months ended June 30, 2019. Excluding these non-cash items, our net loss increased by $1,077,000, or 909%.

Financial Condition, Liquidity and Capital Resources

Cash and Cash Equivalents

As of June 30, 2020, we had cash and cash equivalents of $235,000, compared to cash and cash equivalents of $922,000 as of December 31, 2019, a decrease of 74%. The $687,000 decrease in cash and cash equivalents during the six months ended June 30, 2020, was the result of cash used by our operating activities of $1,241,000 offset by proceeds from the issuance of a note payable of $554,000. Our cash is held in bank depository accounts in certain financial institutions. During the six months ended June 30, 2020, we held deposits in financial institutions that exceeded the federally insured amount.

As of June 30, 2020, we had accounts receivable (net of allowance for doubtful accounts) of $83,000, inventory (net of excess and obsolete allowance) of $805,000, and prepaid expenses of $197,000 (including $99,000 in advance payments on inventory purchases). While we typically require advance payment before we commence engineering services or ship equipment to our customers, we have made exceptions requiring us to record accounts receivable, which carry a risk of non-collectability especially since most of our customers are funded on an as-needed basis to complete facility construction. We expect our exposure to accounts receivable risk to increase as we pursue larger projects.

As of June 30, 2020, we had a note payable of $554,000, total accounts payable and accrued expenses of $1,754,000, deferred revenue of $868,000, accrued equity compensation of $70,000 and the current portion of operating lease liability of $227,000. As of June 30, 2020, we had a working capital deficit of $1,599,000, compared to a working capital deficit of $1,437,000 as of December 31, 2019. The increase in our working capital deficit was primarily related to (i) a decrease in cash of $687,000, (ii) a decrease in inventory (net of reserve for excess and obsolete inventory of $427,000, (iii) a decrease in our deferred revenue (which represents cash received from customers in advance of the performance of services or the delivery of equipment) of $576,000 and (iv) a decrease in accrued equity compensation of $434,000.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain all available funds and any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future.

Summary of Cash Flows

The following summarizes our approximate cash flows for the six months ended June 30, 2020 and 2019:

	For the Six Months Ended June 30,	
	2020	**2019**
Net cash provided by (used in) operating activities	$ (1,241,000)	$ 1,672,000
Net cash used in investing activities	-	-
Net cash provided by financing activities	554,000	-
Net increase (decrease) in cash	$ (687,000)	$ 1,672,000

Operating Activities

We incurred a net loss for the six months ended June 30, 2020 of $1,552,000 and have an accumulated deficit of $27,237,000 as of June 30, 2020.

Cash used in operations for the six months ended June 30, 2020 was $1,241,000 compared to cash provided by operations of $1,672,000 for the six months ended June 30, 2019, an increase in cash usage of $2,913,000.

The increase in cash used in operating activities during the six months ended June 30, 2020 was primarily attributable to: (i) an increase in net loss of $791,000, and (ii) an increase of $2,566,000 in cash used to fund working capital, offset by $445,000 increase in non-cash operating charges.

The significant changes in working capital related to a $576,000 decrease in deferred revenue and a $434,000 decrease in accrued equity compensation.

The significant change in non-cash operating charges related to a $373,000 increase in the provision for excess and obsolete inventory and a $169,000 increase in the equity compensation issued.

Investing Activities

The Company undertook no investing activities during the six months ended June 30, 2020 or 2019.

Financing Activities

On April 22, 2020, the Company entered into a note payable with its current bank in the principal amount of $554,000, for working capital purposes. The Company undertook no financing activities during the six months ended June 30, 2019.

Going Concern

Our condensed consolidated financial statements for the quarter ended June 30, 2020, 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. Our independent registered public accounting firm included in its audit opinion on our consolidated financial statements for the year ended December 31, 2019, a statement that there is substantial doubt as to our ability to continue as a going concern, and our consolidated financial statements for the year ended December 31, 2019 were prepared assuming that we would continue as a going concern. We have determined that our ability to continue as a going concern is dependent on raising additional capital to fund our operations and ultimately on generating future profitable operations. There can be no assurance that we will be able to raise sufficient additional capital or eventually have positive cash flow from operations to address all of our cash flow needs. If we are not able to generate positive cash flow from operations or find alternative sources of cash, our business and shareholders will be materially and adversely affected. The foregoing factors raise substantial doubt about our ability to continue as a going concern for a period of one year from the date our condensed consolidated financial statements for the quarter ended June 30, 2020, are issued. Our condensed consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

Capital Raising

We believe our cash balances and cash flow from operations will be insufficient to fund our operations for the next 12 months. If we are unable to substantially increase revenues or otherwise generate cash flows from operations, we will need to raise additional funding to continue as a going concern. Based on management's estimate for our operational cash requirements, we will need to raise financing in the next six months in order to continue our operations and achieve our growth targets. There can be no assurance that we will be able to raise the necessary financing, when and if needed, on acceptable terms or at all. If our operating results do not meet management's expectations, or additional capital is not available, management believes it has the ability to reduce certain expenditures, although these reductions may not be sufficient to be able to continue the Company's operations. The precise amount and timing of our financing needs cannot be determined accurately at this time, and will depend on a number of factors, including the market demand for our products and services, management of working capital, and continuation of normal payment terms and conditions for purchase of our products and services.

While we made substantial improvement to our results in 2019, there is significant work ahead for us to execute on our growth plan and achieve fiscal self-sustainability. Historically, we have not been able to generate consistent revenues quarter-over-quarter. While we are pursuing new business opportunities with multi-facility operators and expansion projects, as well as broadening our product line, there is no assurance we will be successful booking any sales related to these opportunities and converting such bookings into cash and revenue. We also may not be able to achieve our growth and financial goals until 2021 or later, if at all. Additionally, we also have to factor in the economic consequences of the government response to the Covid 19 pandemic and the dislocation caused by the lock down and reduced commercial activity now being experienced in the United States and Canadian economies.

Inflation

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

Contractual Payment Obligations

As of June 30, 2020, our contractual payment obligations consisted of a building lease. On January 2, 2018, the leased space was expanded to 18,600 square feet and the monthly rental rate increased to $18,979 and beginning September 1, 2018, the monthly rent will increase by 3% each year through the end of the lease. Refer to Note 2 – *Leases* of the notes to the condensed consolidated financial statements, included as part of this Quarterly Report for a discussion of building lease.

During the three months ended June 30, 2020, the Company entered into an agreement with its landlord to defer fifty percent of the payment of three months of lease payments for the period July to September 2020. The deferred lease payments will be payable in 12 monthly installments from January to December 2021.

Commitments and Contingencies

Refer to Note 7 – *Commitments and Contingencies* of the notes to the condensed consolidated financial statements, included as part of this Quarterly Report for a discussion of commitments and contingencies.

Off-Balance Sheet Arrangements

We are required to disclose any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors. As of June 30, 2020, we had no off-balance sheet arrangements. During the six months ended June 30, 2020, we did not engage in any off-balance sheet financing activities other than those included in the "Contractual Payment Obligations" discussed above and those reflected in Note 6 of our condensed consolidated financial statements.

Recent Developments

Refer to Note 11 - *Subsequent Events* of the notes to condensed consolidated financial statements, included as part of this Quarterly Report for certain significant events occurring since June 30, 2020.

Critical Accounting Estimates

This discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Certain accounting policies are particularly important to the understanding of our financial position and results of operations and require the application of significant judgment by our management or can be materially affected by changes from period to period in economic factors or conditions that are outside of our control. As a result, they are subject to an inherent degree of uncertainty. In applying these policies, management uses their judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical operations, our future business plans and projected financial results, the terms of existing contracts, observance of trends in the industry, information provided by our customers, and information available from other outside sources, as appropriate. Actual results could materially differ from those estimates. Key estimates include: allocation of transaction prices to performance obligations under contracts with customers, standalone selling prices, timing of expected revenue recognition on remaining performance obligations under contracts with customers, valuation of intangible assets, valuation of equity-based compensation, valuation of deferred tax assets and liabilities, warranty accruals, accounts receivable and inventory allowances, and legal contingencies.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Principal Financial and Accounting Officer, which positions are currently held by the same person, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and Principal Financial and Accounting Officer concluded that as a result of material weakness in our internal control over financial reporting as described in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2019 filed with the SEC, our disclosure controls and procedures were not effective as of June 30, 2020.

We did not maintain effective controls over certain aspects of the financial reporting process because: (i) we lack a sufficient complement of personnel with a level of accounting expertise and an adequate supervisory review structure that is commensurate with our financial reporting requirements, (ii) there is inadequate segregation of duties due to the limitation on the number of our accounting personnel, and (iii) we have insufficient controls and processes in place to adequately verify the accuracy and completeness of spreadsheets that we use for a variety of purposes including revenue, taxes, stock-based compensation and other areas, and place significant reliance on, for our financial reporting.

We intend to take appropriate and reasonable steps to make the necessary improvements to remediate these deficiencies. We are committed to continuing to improve our financial organization including, without limitation, expanding our accounting staff and improving our systems and controls to reduce our reliance on the manual nature of our existing systems. However, due to our size and our financial resources, remediating the several identified weaknesses has not been possible and may not be economically feasible now or in the future.

Changes in Internal Control over Financial Reporting

There were no changes identified in connection with our internal control over financial reporting during the three months ended June 30, 2020, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

As of December 31, 2019, there were 6,750,000 restricted stock units that had not been settled due to a dispute with a former employee over the required withholding taxes to be paid to the Company for remittance to the appropriate tax authorities. The Company commenced an arbitration action against the former employee regarding the dispute. The former employee also made claims in the arbitration action against the Company for unpaid wages. As stated in a pleading in the arbitration, on March 9, 2020, the Company issued the former employee 6,750,000 shares of the Company's common stock in settlement of these restricted stock units after taking measures to mitigate the Company's exposure to penalties and liability for the failure to properly withhold income taxes The Arbitrator issued an interim award of approximately $10,000 in the Company's favor and a finding against the former employee. The recipient continues to pursue separate litigation against the Company for recovery of alleged consulting fees owed for the 2015 calendar year prior to the recipient's appointment as an executive officer of the Company and discovery is ongoing in this case. Effective June 9, 2020, the Arbitrator issued his final award in the Company's favor. The Arbitrator found against the former employee and awarded the Company costs of $33,985, with interest at 8% per year. Effective July 22, 2020, the Colorado Court confirmed the Arbitration award and entered a final judgement in favor of the Company and against the former employee. The Company can now commence collection of this debt.

Other than as set forth in the preceding paragraph, we are not currently a party to any material legal proceedings, nor are we aware of any pending or threatened litigation that would have a material adverse effect on our business, operating results, cash flows, or financial condition should such litigation be resolved unfavorably. We have and will continue to have commercial disputes arising in the ordinary course of our business.

Item 1A. Risk Factors

In addition to the information set forth in this Form 10-Q, you should also carefully review and consider the risk factors contained in our other reports and periodic filings with the SEC, including, without limitation, the risk factors and uncertainties contained under the caption "Item 1A—Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2019 that could materially and adversely affect our business, financial condition, and results of operations. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not known to us or that we currently consider to be immaterial to our operations. There have been no material changes in the significant factors that may affect our business and operations as described in "Item 1A—Risk Factors" of the Annual Report on 10-K for the year ended December 31, 2019 other than as set out below:

The COVID-19 pandemic and the measures taken in response thereto have adversely impacted, and may continue to adversely impact, the Company's operations and financial results.

In December 2019, a novel coronavirus disease was reported and in January 2020, the World Health Organization ("WHO") declared COVID-19 a Public Health Emergency of International Concern. On February 28, 2020, the WHO raised its assessment of the COVID-19 threat from high to very high at a global level due to the continued increase in the number of cases and affected countries, and on March 11, 2020, the WHO characterized COVID-19 as a pandemic. The COVID-19 pandemic has spread to over 200 countries and territories, including the U. S., and has spread to every state in the U.S. and has adversely affected global economies, financial markets and the overall environment for our business.

The global spread of COVID-19 has resulted in significant economic uncertainty and disruption. The extent to which our business and financial results are impacted will depend on numerous evolving factors which are uncertain and cannot be predicted, including: the duration and scope of the pandemic; governmental, business and individuals' actions taken in response; the effect on our customers and customers' demand for our services and products; the effect on our suppliers and disruptions to the global supply chain; our ability to sell and manufacture our products; disruptions to our operations resulting from the illness of any of our employees; restrictions or disruptions to transportation, including reduced availability of ground or air transport; the ability of our customers to pay for our products; and any closures of our facilities, our suppliers' facilities, and our customers' facilities. The effects of the COVID-19 pandemic have resulted and will result in additional expenses and lost or delayed revenue. We have been experiencing disruptions to our business as we implement modifications to travel, work locations and cancellation of events, among other modifications. In addition, the deterioration of macroeconomic conditions may impact the proper functioning of financial and capital markets, foreign currency exchange rates, commodity and energy prices, and interest rates. Even after the COVID-19 pandemic subsides, we may continue to experience adverse impacts to our business and financial results due to any economic recession or depression that has occurred, and due to any major public health crises that may occur in the future.

Although our current accounting estimates contemplate current and expected future conditions, as applicable, it is reasonably possible that actual conditions could differ from our expectations, which could materially affect our results of operations and financial position. In particular, a number of estimates have been and will continue to be affected by the ongoing COVID-19 pandemic. The severity, magnitude and duration, as well as the economic consequences of the COVID-19 pandemic, are uncertain, rapidly changing and difficult to predict. As a result, our accounting estimates and assumptions may change over time in response to COVID-19. Such changes could result in future impairments of goodwill, intangible assets, long-lived assets, incremental credit losses on accounts receivable, or excess and obsolete inventory. Any of these events could amplify the other risks and uncertainties described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019, and could have an adverse effect on our business and financial results.

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

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

Director Appointments

On June 24, 2020, the Board appointed James R. "Randy" Shipley and Nicholas J. "Nick" Etten as directors of the Company to fill two existing vacancies. Each new director will serve as a director until the next annual meeting of shareholders and until his respective successor is duly elected and qualified. In connection with the appointment of each new director, the Board determined that each person is an "independent director" as such term is defined in Rule 5605(a)(2) of the NASDAQ Stock Market. There were no arrangements or understandings between either of these persons and the Company or any other persons to which each new director was selected as a director.

James R. Shipley

Randy Shipley, age 65, has been the Chief Strategy Officer of GroAdvisor and the Vice-President of Sales and a member of the executive leadership team at VividGro since 2017. GroAdvisor provides supply chain management and solutions to cultivation operations through a cooperative of industry leaders in environmental services, lighting, building structures and green technologies. VividGrow is a company that provides agricultural technology for consumer and commercial applications. From 2014 to 2017 Mr. Shipley, acting in several executive roles, helped build multiple business lines for MJIC Inc. (now Manifest 7); these roles included being a member of the board of directors, Chairman and President. Mr. Shipley has been active in the cannabis business, where he has founded various summits such as the Marijuana Investor Summit and been involved in many educational workshops and business expos. Previously, Mr. Shipley was an officer and chief revenue officer with Carrier Access Corporation (CACS), a public company trading on Nasdaq. Prior to Carrier Access, Mr. Shipley worked at Williams Companies in their telecommunications divisions.

Mr. Shipley has been selected for service on the Board because of his experience in and commitment to the cannabis industry, his demonstrated and consistent record of success as an executive and entrepreneur, and his extensive network of contacts in the cannabis industry.

Nicholas J. Etten.

Nick Etten, age 52, joined Acreage Holdings in 2018 where he is currently the Head of Government Affairs. Acreage is a vertically integrated, multi-state operator of cannabis licenses and assets in the U.S. In 2017 he founded the Veterans Cannabis Project where he continues to serve as Chairman. Veterans Cannabis Project (VCP) is an organization dedicated to advocating on behalf of cannabis access issues for U.S. military veterans. From 2015 to 2017, Mr. Etten set aside his career to provide care for his seriously ill son. Mr. Etten's career has been focused on the growth equity market, and prior to Acreage, he held positions including Vice President of Global Business Development for FreightWatch International, and Director of Corporate Development for Triple Canopy. Mr. Etten was an investment professional at Trident Capital, where he focused on the cyber-security space, and an investment banker at Thomas Weisel Partners.

Mr. Etten has been selected for service on the Board because of his experience in and commitment to the cannabis industry, his experience with multi-site cannabis operators, his demonstrated and consistent record of success as an executive, and his extensive network of contacts in the cannabis industry and investment banking world.

Board Compensation Plan

Both new independent directors are subject to Surna's compensation plan for independent directors (the "Plan"), which was adopted by the Board on June 24, 2020. Under the Plan, each such independent director will receive an equity award consisting of a grant of non-qualified stock options to purchase 1,000,000 shares of the Company's common stock. The options will vest 50% upon grant and 50% on April 1, 2021, if the Director remains on the Board up to that time. The options have a term of 5 years and have an exercise price equal to the closing price of the Company's common stock on The OTC Markets on the day immediately preceding the grant date. Options will also provide that they will expire 3 months after the termination of service to the Company for any reason.

The board of directors, acting unanimously, may also grant additional stock options to the independent directors, no more frequently than every six months in recognition of special services as a director to the Company, which award will not be greater than 1,000,000 per award, with an exercise period of not greater than three years, on the same general terms as the award on initial election or appointment.

Item 6. Exhibits

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

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SURNA INC.
(the "Registrant")

Dated: August 11, 2020	By:	*/s/ Anthony K. McDonald*
		Anthony K. McDonald Chief Executive Officer and President (Principal Executive Officer)
Dated: August 11, 2020	By:	*/s/ Anthony K. McDonald*
		Anthony K. McDonald Principal Financial and Accounting Officer

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
31.1 *	Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 *	Certification of Principal Financial and Accounting Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Principal Financial and Accounting, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Schema
101.CAL*	XBRL Taxonomy Calculation Linkbase
101.DEF*	XBRL Taxonomy Definition Linkbase
101.LAB*	XBRL Taxonomy Label Linkbase
101.PRE*	XBRL Taxonomy Presentation Linkbase

* Filed herewith.
** Furnished herewith.

Exhibit 31.1

CERTIFICATION PURSUANT TO RULE 13a-14(a) and 15d-14(a)
UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, Anthony K. McDonald, the Chief Executive Officer of Surna Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of Surna Inc. for the quarterly period ended June 30, 2020;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated August 11, 2020.

By: *\/s/ Anthony K. McDonald*

Anthony K. McDonald
Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO RULE 13a-14(a) and 15d-14(a)
UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, Anthony K. McDonald, the Principal Financial and Accounting Officer of Surna Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of Surna Inc. for the quarterly period ended June 30, 2020;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated August 11, 2020.

By: *\/s/ Anthony K. McDonald*

Anthony K. McDonald
Principal Financial and Accounting Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q for the quarter ended June 30, 2020 (the “Report”) of Surna Inc. (the “Registrant”), as filed with the Securities and Exchange Commission on the date hereof, I, Anthony K. McDonald, the Chief Executive Officer of the Registrant, hereby certify, to the best of my knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

	/s/ Anthony K. McDonald
Name:	Anthony K. McDonald, Chief Executive Officer
Date:	August 11, 2020

This certification accompanies this Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

Exhibit 32.2

CERTIFICATION PURSUANT TO SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q for the quarter ended June 30, 2020 (the "Report") of Surna Inc. (the "Registrant"), as filed with the Securities and Exchange Commission on the date hereof, I, Anthony K. McDonald, the Principal Financial and Accounting Officer of the Registrant, hereby certify, to the best of my knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

	/s/ Anthony K. McDonald
Name:	Anthony K. McDonald, Principal Financial and Accounting Officer
Date:	August 11, 2020

This certification accompanies this Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.