

SECURITIES & EXCHANGE COMMISSION EDGAR FILING

Grom Social Enterprises, Inc.

Form: 10-Q

Date Filed: 2018-05-15

Corporate Issuer CIK: 1662574

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2018

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act

For the transition period from _____ to _____

Commission File Number: 000-55585

Grom Social Enterprises, Inc.

(Exact name of registrant as specified in its charter)

Florida

46-5542401

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

2060 NW Boca Raton Blvd. #6, Boca Raton, Florida

33431

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (561) 287-5776

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input checked="" type="checkbox"/>

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

The number of shares of the registrant's only class of common stock issued and outstanding was 126,224,861 shares as of May 11, 2018.

Grom Social Enterprises

Table of Contents

Part I – FINANCIAL INFORMATION

Item 1.	Financial Statements	2
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	3
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	6
Item 4.	Controls and Procedures	6

Part II – OTHER INFORMATION

Item 1.	Legal Proceedings	7
Item 1A.	Risk Factors	7
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	7
Item 3.	Defaults upon Senior Securities	7
Item 4.	Mine Safety Disclosures	7
Item 5.	Other Information	7
Item 6.	Exhibits	7

CAUTIONARY STATEMENT ON FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based upon our current assumptions, expectations and beliefs concerning future developments and their potential effect on our business. In some cases, you can identify forward-looking statements by the following words: “may,” “will,” “could,” “would,” “should,” “expect,” “intend,” “plan,” “anticipate,” “believe,” “approximately,” “estimate,” “predict,” “project,” “potential,” “continue,” “ongoing,” or the negative of these terms or other comparable terminology, although the absence of these words does not necessarily mean that a statement is not forward-looking. This information may involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from the future results, performance or achievements expressed or implied by any forward-looking statements.

Factors that may cause or contribute actual results to differ from these forward-looking statements include, but are not limited to, for example:

- adverse economic conditions;
- the Company’s ability to raise capital to fund a portion of its operations
- the Company’s ability to monetize its gromsocial.com database of users
- industry competition
- the Company’s ability to integrate its acquisitions
- the inability to attract and retain qualified senior management and technical personnel; and
- other risks and uncertainties related to the social media, animation services, nutritional products and web filtering services marketplace and our business strategy.

All forward-looking statements speak only as of the date of this Report. We undertake no obligation to update any forward-looking statements or other information contained herein. Stockholders and potential investors should not place undue reliance on these forward-looking statements. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements in this report are reasonable, we cannot assure stockholders and potential investors that these plans, intentions or expectations will be achieved.

These forward-looking statements represent our intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors. Many of those factors are outside of our control and could cause actual results to differ materially from the results expressed or implied by those forward-looking statements. Considering these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of the Quarterly Report on Form 10-Q. All subsequent written and oral forward-looking statements concerning other matters addressed in this Quarterly Report on Form 10-Q and attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this Quarterly Report on Form 10-Q.

Except to the extent required by law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, a change in events, conditions, circumstances or assumptions underlying such statements, or otherwise.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Our unaudited consolidated financial statements included in this Form 10-Q are as follows:

- F-1 [Consolidated Balance Sheets as of March 31, 2018 \(Unaudited\) and December 31, 2017](#)
- F-2 [Interim Unaudited Consolidated Statements of Operations for the Three Months Ended March 31, 2018 and 2017](#)
- F-3 [Interim Unaudited Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2018 and 2017](#)
- F-4 [Notes to Interim Unaudited Financial Statements](#)

GROM SOCIAL ENTERPRISES, INC.
Consolidated Balance Sheets

	March 31, 2018 (unaudited)	December 31, 2017 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 406,850	\$ 436,869
Accounts receivable	638,305	445,388
Inventory	411,130	426,998
Prepaid expenses and other current assets	932,819	1,035,379
Total current assets	<u>2,389,104</u>	<u>2,344,634</u>
Property and equipment, net	939,213	849,893
Goodwill	8,800,761	8,800,761
Intangible assets, net	6,650,357	6,768,857
Deferred tax assets	194,581	201,290
Other assets	78,634	81,345
Total assets	<u>\$ 19,052,650</u>	<u>\$ 19,046,780</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 557,679	\$ 882,504
Accrued liabilities	1,641,725	1,592,726
Advanced payments and deferred revenues	999,195	1,184,624
Convertible debentures, net -- current	24,653	75,000
Senior secured promissory notes, net -- current	38,475	-
Related party payables	2,463,962	2,076,640
Income taxes payable	45,397	46,963
Total current liabilities	<u>5,771,086</u>	<u>5,858,457</u>
Convertible debentures, net of loan discounts	2,054,539	1,463,273
Senior secured promissory notes, net of loan discounts	3,558,185	3,953,661
Contingent purchase consideration	429,000	429,000
Other noncurrent liabilities	229,580	237,495
Total liabilities	<u>12,042,390</u>	<u>11,941,886</u>
Commitments and contingencies	-	-
Stockholders' Equity:		
Preferred stock, \$0.001 par value. 10,000,000 shares authorized; zero shares issued and outstanding	-	-
Common stock, \$0.001 par value. 200,000,000 shares authorized; 126,115,017 and 124,273,548 shares issued and outstanding as of March 31, 2018 and December 31, 2017, respectively	126,115	124,274
Additional paid-in capital	48,937,774	47,901,532
Accumulated earnings (deficit)	(41,934,690)	(40,843,568)
Accumulated other comprehensive income	(118,939)	(77,344)
Total stockholders' equity	<u>7,010,260</u>	<u>7,104,894</u>
Total liabilities and equity	<u>\$ 19,052,650</u>	<u>\$ 19,046,780</u>

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

GROM SOCIAL ENTERPRISES, INC.

Consolidated Statements of Operations and Comprehensive Loss (Unaudited)

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Sales	\$ 2,032,672	\$ 1,708,681
Cost of goods sold	<u>777,739</u>	<u>737,863</u>
Gross margin	1,254,933	970,818
Operating expenses:		
Depreciation and amortization	200,101	283,551
Selling and marketing	55,912	40,470
General and administrative	1,368,546	1,187,968
Professional fees	382,555	735,188
Stock based compensation	<u>76,193</u>	<u>1,554,831</u>
Total operating expenses	<u>2,083,307</u>	<u>3,802,008</u>
Income (loss) from operations	(828,374)	(2,831,190)
Other income (expense)		
Interest income (expense), net	(263,093)	(102,738)
Other gains (losses)	<u>345</u>	<u>11,694</u>
Total other income (expense)	<u>(262,748)</u>	<u>(91,044)</u>
Income (loss) before income taxes	(1,091,122)	(2,922,234)
Provision for income taxes (benefit)	<u>-</u>	<u>-</u>
Net income (loss)	<u>(1,091,122)</u>	<u>(2,922,234)</u>
Basic and diluted earnings (loss) per common share	\$ <u>(0.01)</u>	\$ <u>(0.03)</u>
Weighted-average number of common shares outstanding:		
Basic and diluted	125,643,201	102,753,883
Comprehensive loss:		
Net income (loss)	\$ (1,091,122)	\$ (2,922,234)
Foreign currency translation adjustment	<u>(41,595)</u>	<u>(3,919)</u>
Comprehensive income (loss)	<u>\$ (1,132,717)</u>	<u>\$ (2,926,153)</u>

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

GROM SOCIAL ENTERPRISES, INC.
Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Cash flows from operating activities of continuing operations:		
Net income (loss)	\$ (1,091,122)	\$ (2,922,234)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	200,101	283,551
Amortization of debt discount	152,797	45,426
Common stock issued in exchange for fees and services	66,375	724,498
Deferred taxes	6,709	1,481
Stock based compensation	76,193	1,554,831
Changes in operating assets and liabilities:		
Accounts receivable	(192,917)	(852,833)
Inventory	15,869	51,983
Prepaid expenses and other current assets	174,559	(112,457)
Other assets	2,711	(569)
Accounts payable	(153,448)	(70,645)
Accrued liabilities	48,999	166,072
Advanced payments and deferred revenues	(185,429)	525,377
Income taxes payable and other noncurrent liabilities	(9,481)	(2,409)
Related party payables	387,321	583,000
Net cash provided by (used in) operating activities	(500,763)	(24,928)
Cash flows from investing activities:		
Purchase of fixed assets	(170,921)	(56,678)
Net cash provided by (used in) investing activities	(170,921)	(56,678)
Cash flows from financing activities:		
Proceeds from exercise of common stock purchase warrants, net of issuance costs	61,500	65,000
Proceeds from issuance of convertible debentures	671,760	-
Repayments of convertible debentures	(50,000)	-
Net cash provided by (used in) financing activities	683,260	65,000
Effect of exchange rates on cash and cash equivalents	(41,595)	(3,916)
Net increase (decrease) in cash and cash equivalents	(30,019)	(20,522)
Cash and cash equivalents at beginning of period	436,869	443,494
Cash and cash equivalents at end of period	\$ 406,850	\$ 422,972
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ -	\$ -
Cash paid for income taxes	\$ -	\$ -
Supplemental disclosure of non-cash investing and financing activities:		
Common stock issued for financing costs incurred in connection with convertible and promissory notes	\$ 589,839	\$ -
Common stock issued in connection with long term service contracts	\$ 72,000	\$ -
Common stock issued to reduce accounts payable and other accrued liabilities	\$ 171,376	\$ -
Discount for beneficial conversion features on convertible debentures	\$ 801	\$ -

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

GROM SOCIAL ENTERPRISES, INC.
Notes to Consolidated Unaudited Financial Statements
For the Three Month Interim Periods March 31, 2018 and 2017

1. NATURE OF OPERATIONS

Effective August 17, 2017, Grom Social Enterprises, Inc. (the "Company," "Grom," "we," "us," or "our"), a Florida corporation f/k/a Illumination America, Inc. ("Illumination"), consummated the acquisition of Grom Holdings, Inc. ("Grom Holdings"). Pursuant to the terms of the Share Exchange Agreement ("Share Exchange") that was entered into on May 15, 2017, the Company amended its Articles of Incorporation to increase its authorized capital to 200,000,000 shares of common stock, as well as to change its name to "Grom Social Enterprises, Inc." At the closing of the Share Exchange, the Company issued an aggregate of 110,853,883 shares of its common stock to the Grom Holdings shareholders, pro rata to their respective ownership percentage. Each share of Grom Holdings was exchanged for 4.17 shares of Illumination common stock. As a result, the stockholders of Grom Holdings are now stockholders of the Company and own approximately 92% of the Company's issued and outstanding shares of common stock.

As a result of the acquisition of Grom Holdings, Inc. the Company now operates its business through five wholly-owned subsidiaries, including:

- Grom Social, Inc. ("Grom Social"), incorporated in the State of Florida in March 2012, operates our social media network designed for children.
- TD Holdings Limited ("TD Holdings"), which was acquired in July 2016, is incorporated in Hong Kong. Its operations are conducted through its subsidiary companies, Top Draw Animation Hong Kong Limited ("TDAHK") and Top Draw Animation, Inc ("Top Draw" or "TDA"). The group's principal activities, based in Manila, Philippines, are the production of animated films.
- Grom Educational Services, Inc. ("GES"), formed in February 2017, is a Florida corporation through which we operate our NetSpective Webfilter ("NetSpective") services that we provide to schools and libraries.
- Grom Nutritional Services, Inc. ("GNS") is a Florida corporation formed in April 2017 through which we intend to market and distribute four flavors of a nutritional supplement to children.
- Illumination America Lighting, Inc. ("IAL"), which operates our LED lighting business that was formerly Illumination, was our principal business prior to the Grom Holdings acquisition.

Retroactive Application of the Share Exchange Ratio

All references to share totals or values in this Form 10-Q, unless otherwise stated, have been adjusted, retroactively, to reflect the Share Exchange ratio of 4.17 as of August 17, 2017.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Going Concern

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates realization of assets and the satisfaction of liabilities in the normal course of business for the twelve-month period following the date of these financial statements. On a consolidated basis, the Company has incurred significant operating losses since inception.

Because the Company does not expect that existing operational cash flow will be sufficient to fund presently anticipated operations, this raises substantial doubt about the Company's ability to continue as a going concern. Therefore, the Company will need to raise additional funds and is currently exploring alternative sources of financing. Historically, the Company has raised capital through private placements, convertible debentures and officer loans as an interim measure to finance working capital needs, and may continue to raise additional capital through sale of Common Stock or other securities, and obtaining some short-term loans. The Company will be required to continue to do so until its consolidated operations become profitable. Also, the Company has, in the past, paid for consulting services with its Common Stock to maximize working capital, and intends to continue this practice where feasible.

Management's Representation of Interim Financial Statements

The accompanying unaudited consolidated financial statements have been prepared by the Company without audit pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted as allowed by such rules and regulations, and management believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements include all of the adjustments, which in the opinion of management are necessary to a fair presentation of financial position and results of operations. All such adjustments are of a normal and recurring nature. Interim results are not necessarily indicative of results for a full year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements at December 31, 2017 and 2016, as presented in the Company's Form 10-K filed on April 17, 2018 with the SEC.

Basis of Presentation

The Company has deemed the transfer of net assets to be a reverse acquisition in accordance with FASB ASC 805-40, "Reverse Acquisitions". The legal acquirer is Illumination America and the legal acquiree is Grom Holdings, Inc. However, the transaction was accounted for as a recapitalization effected by a share exchange, wherein Grom Holdings is considered the acquirer for accounting and financial reporting purposes. The assets and liabilities of the acquired entity have been brought forward at their book value and no goodwill has been recognized.

The consolidated financial statements of the Company have been prepared in accordance with GAAP and are expressed in United States dollars. For the three-month period ended March 31, 2018, the consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries: Grom Social, TD Holdings, GES, Illumination, GNS and IAL. TD Holdings was acquired on July 1, 2016; and GES was formed in January 2017 to house the NetSpective assets and business which was acquired on January 1, 2017.

GNS, which was formed in April 2017, had not recorded any material activity through the date of this report.

All intercompany accounts and transactions are eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to revenue recognition, valuation of accounts receivable and inventories, purchase price allocation of acquired businesses, impairment of long lived assets and goodwill, valuation of financial instruments, income taxes, and contingencies. The Company bases its estimates on historical experience, known or expected trends and various other assumptions that are believed to be reasonable given the quality of information available as of the date of these financial statements. The results of these assumptions provide the basis for making estimates about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

Revenue Recognition

On January 1, 2018, we adopted Accounting Standards Codification (“ASC”) Topic 606, Revenue from Contracts with Customers (“ASC 606”), using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC 605. As of and for the three months ended March 31, 2018, the consolidated financial statements were not materially impacted as a result of the application of Topic 606 compared to Topic 605.

Revenue from the production of animated films is recognized based upon substantial completion and delivery of the Company’s produced animated films on a per episodic basis. Substantial means that the animated films are 100% complete and is usually termed as a “first take”. In certain animation contracts, a certain percentage of the total contract price are withheld by the Company’s client for possible retakes and rejects over the finished products and are not recognized as revenue. A certain percentage of the episode price is required in advance as a down payment upon every inception of the animation of an episode and is initially recorded by the Company as deferred revenue.

Revenue is measured by reference to the fair value of consideration received or receivable by the Company for services provided, excluding value-added tax (VAT), if any, and trade discounts. Cost and expenses are recognized in the consolidated statements of comprehensive income upon utilization of the service or at the date they are incurred.

Revenue from subscription sales are recognized on a pro-rata basis over the subscription period. Typically, a subscriber purchases computer hardware and a service license for a period of use between one year to five years for software and support. The subscriber is billed in full at the time of the sale. The Company immediately recognizes any revenue attributable to the computer hardware as it is non-refundable. The advanced billing for software and service is initially recorded as deferred revenue and subsequently recognized as revenue evenly throughout the subscription period.

Fair Value Measurements

The Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 820 “Fair Value Measurements and Disclosures” (“ASC 820”) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable.

Level 3 - Unobservable inputs that are supported by little or no market activity, therefore requiring an entity to develop its own assumptions about the assumptions that market participants would use in pricing.

Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of March 31, 2018 and December 31, 2017. The Company uses the market approach to measure fair value for its Level 1 financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The respective carrying value of certain balance sheet financial instruments approximates its fair value. These financial instruments include cash, trade receivables, related party payables, accounts payable, accrued liabilities and short-term borrowings. Fair values were estimated to approximate carrying values for these financial instruments since they are short term in nature and they are receivable or payable on demand.

The estimated fair value of assets and liabilities acquired in business combinations and reporting units and long-lived assets used in the related asset impairment tests utilize inputs classified as Level 3 in the fair value hierarchy.

The Company determines the fair value of contingent consideration based on a probability-weighted discounted cash flow analysis. The fair value remeasurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in the fair value hierarchy. In each period, the Company reassesses its current estimates of performance relative to the stated targets and adjusts the liability to fair value. Any such adjustments are included as a component of Other Income (Expense) in the Consolidated Statements of Operations and Comprehensive Loss.

	Level 1	Level 2	Level 3
Earnout liability	\$ —	\$ —	\$ 429,000

The following table summarizes the change in the Company's financial assets and liabilities measured at fair value as of March 31, 2018 and December 31, 2017.

Fair value, January 1, 2017	\$ 1,931,707
Fair value of contingent consideration issued during the period	362,500
Change in fair value	(1,865,207)
Fair value, December 31, 2017	429,000
Fair value of contingent consideration issued during the period	—
Change in fair value	—
Fair Value, March 31, 2018	\$ 429,000

Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risk. Terms of convertible and other promissory notes are reviewed to determine whether they contain embedded derivative instruments that are required to be accounted for separately from the host contract and recorded on the balance sheet at fair value. The fair value of derivative liabilities is required to be revalued at each reporting date, with corresponding changes in fair value recorded in current period operating results.

Beneficial Conversion Features

In accordance with FASB ASC 470-20, "Debt with Conversion and Other Options" the Company records a beneficial conversion feature ("BCF") related to the issuance of convertible debt or preferred stock instruments that have conversion features at fixed rates that are in-the-money when issued. The BCF for the convertible instruments is recognized and measured by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital. The intrinsic value is generally calculated at the commitment date as the difference between the conversion price and the fair value of the common stock or other securities into which the security is convertible, multiplied by the number of shares into which the security is convertible. If certain other securities are issued with the convertible security, the proceeds are allocated among the different components. The portion of the proceeds allocated to the convertible security is divided by the contractual number of the conversion shares to determine the effective conversion price, which is used to measure the BCF. The effective conversion price is used to compute the intrinsic value. The value of the BCF is limited to the basis that is initially allocated to the convertible security.

Stock Purchase Warrants

The Company accounts for warrants issued to purchase shares of its common stock as equity in accordance with FASB ASC 480, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, Distinguishing Liabilities from Equity*.

Cash and cash equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents consist of cash on deposit with banks and money market funds, the fair value of which approximates cost. The Company maintains its cash balances with a high-credit-quality financial institution. At times, such cash may be in excess of the Federal Deposit Insurance Corporation-insured limit of \$250,000. The Company has not experienced any losses in such accounts, and management believes the Company is not exposed to any significant credit risk on its cash and cash equivalents.

Accounts receivable

Accounts receivable are customer obligations due under normal trade terms which are recorded at net realizable value. The Company establishes an allowance for doubtful accounts based on management's assessment of the collectability of trade receivables. A considerable amount of judgment is required in assessing the amount of the allowance. The Company makes judgments about the creditworthiness of each customer based on ongoing credit evaluations and monitors current economic trends that might impact the level of credit losses in the future. If the financial condition of the customers were to deteriorate, resulting in their inability to make payments, a specific allowance will be required.

Recovery of bad debt amounts previously written off is recorded as a reduction of bad debt expense in the period the payment is collected. If the Company's actual collection experience changes, revisions to its allowance may be required. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

Inventory

Materials are recorded at cost, determined using the first-in, first-out method. Work-in-process inventories are valued at the actual cost incurred for a specific project. The cost of work-in-process includes materials, direct labor, other direct costs and related production overheads.

Inventories are measured at the lower of cost or net realizable value. Historically, costs are generally lower in the case of the Company's inventories since all animation projects are contract based with guaranteed payments from its customers. Materials-in-transit, if any, are stated at invoice cost plus any importation or other incidental charges.

The Company may record a write-down against cost for inventory if necessary, based on a review of the movement and current condition of raw materials. The Company does not believe that any obsolescence exists on work in process. In the event of a dispute with a client regarding quality or specifications, the Company may incur additional costs because of retakes and editing in an effort to achieve customer satisfaction.

The Company believes that no write-down for obsolete inventory is necessary as of March 31, 2018 and December 31, 2017.

Property and equipment

Property and equipment are stated at cost or fair value if acquired as part of a business combination. Depreciation is computed by the straight-line method and is charged to operations over the estimated useful lives of the assets. Maintenance and repairs are charged to expense as incurred. The carrying amount and accumulated depreciation of assets sold or retired are removed from the accounts in the year of disposal and any resulting gain or loss is included in results of operations. The estimated useful lives of property and equipment are as follows:

Computers, software and office equipment	1 – 5 years
Machinery and equipment	3 – 5 years
Vehicles	5 years
Furniture and fixtures	5 – 10 years
Leasehold improvements	Lesser of lease term or estimated useful life

Construction in process is not depreciated until the construction is completed and the asset is placed into service.

Goodwill and Intangible Assets

Goodwill represents the future economic benefit arising from other assets acquired that could not be individually identified and separately recognized. The goodwill arising from the Company's acquisitions is attributable to the value of the potential expanded market opportunity with new customers. Intangible assets have either an identifiable or indefinite useful life. Intangible assets with identifiable useful lives are amortized on a straight-line basis over their economic or legal life, whichever is shorter. The Company's amortizable intangible assets consist of customer relationships and non-compete agreements. Their useful lives range from 1.5 to 10 years. The Company's indefinite-lived intangible assets consist of trade names.

Goodwill and indefinite-lived assets are not amortized but are subject to annual impairment testing unless circumstances dictate more frequent assessments. The Company performs an annual impairment assessment for goodwill during the fourth quarter of each year and more frequently whenever events or changes in circumstances indicate that the fair value of the asset may be less than the carrying amount. Goodwill impairment testing is a two-step process performed at the reporting unit level. Step one compares the fair value of the reporting unit to its carrying amount. The fair value of the reporting unit is determined by considering both the income approach and market approaches. The fair values calculated under the income approach and market approaches are weighted based on circumstances surrounding the reporting unit. Under the income approach, the Company determines fair value based on estimated future cash flows of the reporting unit, which are discounted to the present value using discount factors that consider the timing and risk of cash flows. For the discount rate, the Company relies on the capital asset pricing model approach, which includes an assessment of the risk-free interest rate, the rate of return from publicly traded stocks, the Company's risk relative to the overall market, the Company's size and industry and other Company specific risks. Other significant assumptions used in the income approach include the terminal value, growth rates, future capital expenditures and changes in future working capital requirements. The market approaches use key multiples from guideline businesses that are comparable and are traded on a public market. If the fair value of the reporting unit is greater than its carrying amount, there is no impairment. If the reporting unit's carrying amount exceeds its fair value, then the second step must be completed to measure the amount of impairment, if any. Step two calculates the implied fair value of goodwill by deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit as calculated in step one. In this step, the fair value of the reporting unit is allocated to all of the reporting unit's assets and liabilities in a hypothetical purchase price allocation as if the reporting unit had been acquired on that date. If the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized in an amount equal to the excess.

Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates, strategic plans and future market conditions, among others. There can be no assurance that the Company's estimates and assumptions made for purposes of the goodwill impairment testing will prove to be accurate predictions of the future. Changes in assumptions and estimates could cause the Company to perform impairment test prior to scheduled annual impairment tests.

The Company performed its annual fair value assessment at December 31, 2017 and 2016 on its subsidiaries with material goodwill and intangible asset amounts on their respective balance sheets and determined that no impairment exists.

Long-Lived Assets

The Company evaluates the recoverability of its long-lived assets whenever events or changes in circumstances have indicated that an asset may not be recoverable. The long-lived asset is grouped with other assets at the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. If the sum of the projected undiscounted cash flows is less than the carrying value of the assets, the assets are written down to the estimated fair value.

The Company evaluated the recoverability of its long-lived assets on March 31, 2018 and at December 31, 2017, respectively on its subsidiaries with material amounts on their respective balance sheets and determined that no impairment exists.

Income taxes

The Company accounts for income taxes under FASB ASC 740, "Accounting for Income Taxes". Under FASB ASC 740, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under FASB ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. FASB ASC 740-10-05, "Accounting for Uncertainty in Income Taxes" prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities.

The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company assesses the validity of its conclusions regarding uncertain tax positions on a quarterly basis to determine if facts or circumstances have arisen that might cause it to change its judgment regarding the likelihood of a tax position's sustainability under audit.

Foreign Currency Translation

The functional and reporting currency of TD Holdings and TDAHK is the Hong Kong Dollar. The functional and reporting currency of Top Draw is the Philippine Peso. Management has adopted ASC 830 "Foreign Currency Matters" for transactions that occur in foreign currencies. Monetary assets denominated in foreign currencies are translated using the exchange rate prevailing at the balance sheet date. Average monthly rates are used to translate revenues and expenses.

Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transaction. Exchange gains or losses arising from foreign currency transactions are included in the determination of net income for the respective periods.

Assets and liabilities of the Company's operations are translated into the reporting currency, United States dollars, at the exchange rate in effect at the balance sheet dates. Revenue and expenses are translated at average rates in effect during the reporting periods. Equity transactions are recorded at the historical rate when the transaction occurred. The resulting translation adjustment is reflected as accumulated other comprehensive income, a separate component of stockholders' equity in the statement of stockholders' equity.

Differences may arise in the amount of bad debt expense, depreciation expense and amortization expense reported in the Company's operating results as compared to the corresponding change in allowance for doubtful accounts, accumulated depreciation and accumulated amortization, respectively, due to foreign currency translation. These translation adjustments are reflected in accumulated other comprehensive income, a separate component of the Company's stockholders' equity.

Comprehensive Gain or Loss

ASC 220 "Comprehensive Income," establishes standards for the reporting and display of comprehensive income and its components in the financial statements. As of March 31, 2018, and December 31, 2017, the Company determined that it had items that represented components of comprehensive income and, therefore, has included a statement of comprehensive income in the financial statements.

Advertising expenses

Advertising costs are expensed as incurred and included in selling and marketing expenses.

Shipping and handling costs

Shipping and handling costs related to the acquisition of goods from vendors are included in cost of sales.

Basic and Diluted Net Income (Loss) Per Share

The Company computes net income (loss) per share in accordance with ASC 260, "Earnings per Share". ASC 260 requires presentation of both basic and diluted earnings per share ("EPS") on the face of the income statement. Basic EPS is computed by dividing net income (loss) available to common stockholders (numerator) by the weighted average number of shares outstanding (denominator) during the period. Diluted EPS gives effect to all dilutive potential common shares outstanding during the period using the treasury stock method and convertible preferred stock using the if-converted method. In computing diluted EPS, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options or warrants. Diluted EPS excludes all dilutive potential shares if their effect is anti-dilutive.

Recent accounting pronouncements

Under the Jumpstart Our Business Startups Act, or the JOBS Act, we meet the definition of an "emerging growth company." We have irrevocably elected to opt out of the extended transition period for complying with new or revised accounting standards pursuant to Section 107(b) of the JOBS Act. As a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies.

FASB ASU 2016-02, Leases (Topic 842) - ASU 2016-02 requires that a lessee recognize the assets and liabilities that arise from operating leases. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right **FASB ASU No. 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern,"** to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Public business entities should apply the amendments in ASU 2016-02 for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (i.e., January 1, 2019, for a calendar year entity). Early application is permitted for all public business entities and all nonpublic business entities upon issuance. The adoption of this standard is not expected to have a material impact on our financial position and results of operations.

The Company has implemented all new accounting pronouncements that are in effect and that may impact its financial statements and does not believe that there are any other new pronouncements that have been issued that might have a material impact on its financial position or results of operations.

3. ACCOUNTS RECEIVABLE, NET

The following table sets forth the components of the Company's accounts receivable at March 31, 2018 and December 31, 2017:

	<u>March 31,</u> <u>2018</u>	<u>December 31,</u> <u>2017</u>
Accounts receivable	\$ 638,305	\$ 445,388
Allowance for doubtful accounts	-	-
Total accounts receivable, net	<u>\$ 638,305</u>	<u>\$ 445,388</u>

As of March 31, 2018, and December 31, 2017, the Company evaluated its outstanding trade receivables and determined that its allowance for bad debts was sufficiently reserved. No bad debt expense was recorded during the three-month period ended March 31, 2018 and the year ended December 31, 2017.

During the three-month ended March 31, 2018, the Company had 5 customers that accounted for 86.5% revenues and 4 of those same customers that accounted for 67.2% of accounts receivable.

During the year ended December 31, 2017, the Company had four customers that accounted for approximately 71.6% of consolidated revenues and three customers that accounted for 77.3% of consolidated accounts receivable.

4. PREPAID EXPENSES AND OTHER CURRENT ASSETS

The following table sets forth the components of the Company's prepaid expenses and other current assets at March 31, 2018 and December 31, 2017:

	<u>March 31, 2018</u>	<u>December 31, 2017</u>
Collaborative development agreement	\$ 167,590	\$ 191,531
Vendor advances	72,624	43,219
Prepaid service agreements	485,773	578,732
Prepaid rent	41,640	55,211
Employee advance and other payroll related items	14,193	15,734
Other prepaid expenses and current assets	150,999	150,952
Total	<u>\$ 932,819</u>	<u>\$ 1,035,379</u>

Prepaid expenses and other assets represent prepayments made in the normal course and in which the economic benefit is expected to be realized within twelve months.

5. PROPERTY AND EQUIPMENT

The following table sets forth the components of the Company's property and equipment at March 31, 2018 and December 31, 2017:

	<u>March 31, 2018</u>			<u>December 31, 2017</u>		
	<u>Gross Carrying Amount</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Capital assets subject to depreciation:						
Computers, software and office equipment	\$ 1,795,946	\$ (1,339,414)	\$ 456,532	\$ 1,792,499	\$ (1,319,388)	\$ 473,111
Machinery and equipment	152,964	(85,408)	67,556	95,356	(88,342)	7,014
Vehicles	156,000	(112,974)	43,027	159,431	(110,098)	49,333
Furniture and fixtures	311,980	(268,023)	43,957	305,855	(273,768)	32,086
Leasehold improvements	736,771	(575,480)	161,291	654,309	(585,808)	68,502
Capital assets not subject to depreciation:						
Construction in progress	166,850	-	166,850	219,847	-	219,847
Total fixed assets	<u>\$ 3,320,511</u>	<u>\$ (2,381,299)</u>	<u>\$ 939,213</u>	<u>\$ 3,227,297</u>	<u>\$ (2,377,404)</u>	<u>\$ 849,893</u>

For the three-month period ended March 31, 2018 and the year ended December 31, 2017, the Company recorded depreciation expense of \$81,601 and \$277,047, respectively.

6. BUSINESS COMBINATIONS

Acquisition of TD Holdings Limited

On February 6, 2016, Grom Holdings entered into a letter of intent to acquire all of the stock of TD Holdings. Grom Holdings issued 417,000 shares of its common stock valued at \$0.58 per share, or \$240,000, in return for a period of exclusivity through May 31, 2016.

On June 20, 2016, Grom Holdings executed a share sale agreement with TD Holdings. Under the terms of the agreement, Grom Holdings paid \$12.0 million in consideration including \$3.5 million in cash, the issuance of \$4.0 million of its common stock and the issuance of \$4.5 million in 5% senior, secured promissory notes in exchange to the selling shareholders of TDA ("TDA Sellers") for all of the equity of TD Holdings. The 7,367,001 shares of the Company's common stock issued were subject to a twelve-month restrictive period from the date of the transaction closing. The transaction closed effective July 1, 2016.

The TDA Sellers were also entitled to receive \$329,644 in post-closing cash payments for the excess working capital, as defined by the agreement, on TD Holdings' closing balance sheet. These amounts were subject to certain adjustments, and payable on demand after the transaction closing date. As of December 31, 2016, the excess working capital obligation was fully satisfied.

Additionally, the former stockholders will have the opportunity for contingent, earn-out payments of up to \$5.0 million if certain revenue and EBITDA thresholds are achieved over the three-year post-closing period. The earn-out payments, if made, shall be payable 25% in cash and 75% in common stock. For the years ended December 31, 2017 and 2016 respectively no earn-out thresholds were achieved. -see Note 12, Debt, "Amendment of TDA Sellers Note".

Fair Value of Consideration Transferred and Recording of Assets Acquired

The following table summarizes the acquisition date fair value of the consideration paid, identifiable assets acquired, and liabilities assumed including an amount for goodwill:

Consideration Paid:

Cash and cash equivalents	\$	3,500,000
Common stock, 7,367,001 shares of Grom common stock (includes the 417,000 Letter of Intent shares)		4,240,000
Senior, secured promissory notes, net of discount of \$309,049		4,190,951
Working capital adjustment payable to sellers		329,644
Contingent purchase consideration		3,987,602
Fair value of total consideration	\$	<u>16,248,197</u>

Recognized amount of identifiable assets acquired, and liabilities assumed:

Financial assets:

Cash and cash equivalents	\$	1,024,424
Accounts receivables		693,406
Inventory		350,769
Prepaid and other assets		148,079
Property and equipment		405,191
Deferred tax assets		180,735

Identifiable intangible assets:

Customer relationships		1,526,282
Non-compete agreements		846,638
Trade name		4,386,247

Financial liabilities:

Accounts payable and accrued liabilities		(465,247)
Advance payments and deferred revenues		(697,752)
Other noncurrent liabilities		(254,631)
Total identifiable net assets		<u>8,144,141</u>
Goodwill		<u>8,104,056</u>
	\$	<u>16,248,197</u>

In estimating the fair value of the common stock issued, the Company considered, among other factors, the recent volume and pricing of capital raise activities. The Company valued the common stock shares at \$0.58 per share, which represents a 26% discount to the most recent issue price prior to the measurement date. The Company believes the discount represents a market participant perspective due to the large block and minimum six month holding period.

In determining the fair value of the promissory notes issued, the Company considered, among other factors, the market yields on debt securities depending on the time horizon and level of perceived risk of the specific investment. The Company arrived at an estimated market rate of 9.4% and calculated the present value of the \$4.0 million promissory note and its related interest to be \$3,690,951. As a result, the Company recorded a discount against the promissory notes of \$309,049. The discount is being amortized using the effective interest method over the life of the notes. For the year ended December 31, 2017, the Company recorded \$202,667 in interest expense related to the note discount.

On January 3, 2018, we entered into an amendment to the acquisition agreement with the TDA Sellers -see Note 12 Debt, "Senior Secured Promissory Notes". As part of the terms of the agreement, we issued an additional 800,000 restricted shares valued at \$480,000 of our common stock to the TDA Sellers, which was recorded as an additional note discount. For the three-month period ended March 31, 2018 the Company recorded \$122,998 in interest expense related to the note discount. The remaining discount balance at March 31, 2018 was \$441,815.

The fair value of the contingent consideration was estimated using a lattice model. The forecast future up and down movements were estimated based on historical EBITDA volatility of 22.2% which includes the years 2013-2015 and the trailing twelve months ended June 30, 2016. The weighted average probability of each scenario was calculated and discounted to present value at the weighted average cost of capital to arrive at \$3,987,602.

Goodwill represents the future economic benefit arising from other assets acquired that could not be individually identified and separately recognized. The goodwill arising from the acquisition is attributable to the value of the potential expanded market opportunity with new customers. The goodwill is not expected to be deductible for tax purposes.

In determining the purchase price allocation, the Company considered, among other factors, how a market participant would likely use the acquired assets. The estimated fair value of intangible assets was based on the income approach. The income approach requires a projection of the cash flow that the asset is expected to generate in the future. The projected cash flow is discounted to its present value using a rate of return, or discount rate, which accounts for the time value of money and the degree of risk inherent in the asset. The expected future cash flow that is projected should include all of the economic benefits attributable to the asset, including the tax savings associated with the amortization of the intangible asset value over the tax life of the asset. The income approach may take the form of a "relief-from-royalty" methodology, a cost savings methodology, a "with and without" methodology, or excess earnings methodology, depending on the specific asset under consideration.

The "relief-from-royalty" method was used to value the trade names acquired from TD Holdings. The "relief-from-royalty" method estimates the cost savings that accrue to the owner of an intangible asset that would otherwise be required to pay royalties or license fees on revenues earned through the use of the asset. The royalty rate used is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the intangible asset. The key assumptions in the prospective cash flows include an 11% compound annual sales growth rate over the five years period subsequent to the acquisition. The royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the existing trade names acquired were as follows: royalty rate of 7.0%, discount rate of 13.8%, and a tax rate of 40.0%. The trade names are expected to be used indefinitely and the value includes a terminal value, based on a long-term sustainable growth rate of 2.0%, of the after-tax royalty savings determined using a form of the Gordon Growth model.

The fair value of customer relationships was valued using an income method. Net Operating Profit After Tax ("NOPAT") per customer is a function of the gross profit margin of the Company, applicable contributory assets (i.e., working capital, fixed capital, work force, brand, IPR&D) charges, and the discount rate reflecting the riskiness of the asset under valuation. NOPAT per customer was used to estimate the value of the customer relationships. The key assumptions used include a revenue attrition rate of 35%, an income tax rate of 40%, and a discount rate of 13.8%.

The "with and without" method was used to value the non-compete agreement which will be amortized over three years. The key assumptions used include an income tax rate of 40%, and a discount rate of 13.8%.

Acquisition of NetSpective Webfiltering

On January 1, 2017, Grom Holdings acquired the assets of NetSpective, a division of TeleMate.net Software (the "TeleMate"). Under the terms of the agreement, Grom Holdings paid \$1.0 million in consideration in the form of a \$1.0 million redeemable, convertible promissory note. The note bears interest at 0.68% per annum. All note principal and accrued interest is payable January 1, 2020. The note is convertible at the election of the sellers (the "Telemate Sellers") into the Company's common stock at a conversion rate of \$0.78 per share. Furthermore, if not previously converted by the Telemate Sellers, the note may be converted by the Company into shares of the Company's common stock at a rate of \$0.48 per share commencing on November 1, 2019.

The Telemate Sellers had the opportunity for contingent, earn-out payments of up to \$362,500 if certain net cash flow thresholds are achieved during the one-year post-closing period. The earn-out payments, if made, shall be payable entirely in common stock.

Consideration Paid:

Cash and cash equivalents	\$	–
Common stock, 41,700 shares paid with letter of intent		32,500
Senior, secured promissory notes		1,000,000
Financial liabilities assumed		521,735
Contingent purchase consideration		362,500
Fair value of total consideration	<u>\$</u>	<u>1,916,735</u>

Recognized amount of identifiable assets acquired, and liabilities assumed:

Financial assets:		
Intangible asset		
Brand name	\$	69,348
Software		1,134,435
Customer relationships		74,004
Financial liabilities:		
Deferred revenues		(521,735)
Write-down of purchase consideration		463,978
Goodwill		696,705
	<u>\$</u>	<u>1,916,735</u>

Additionally, since the valuation report reflected that the earnout threshold would not be reached, and the earnout was achieved, the Company recorded an additional expense of \$362,500 related to the acquisition of Netspective.

In determining the fair value of the convertible promissory note issued, the Company considered, among other factors, the market yields on debt securities for similar time horizons and level of perceived risk of the investment. Based on the conversion factors and interest rate contained in the note, the Company believes the note represents fair value.

We used a lattice model to estimate the fair value of the contingent consideration. We forecast future up and down movements based on the 9.7% historical volatility of "Net Cash Flow" which includes the years 2014-2016. The weighted average probability of each scenario was calculated and since it did not reach the earnout threshold, we did not record any contingent consideration provision.

The fair value of the internally developed software was estimated using a replacement cost approach similar to the Constructive Cost Model ("COCOMO") II. The model is an algorithmic software cost estimation tool that estimates the cost, effort, and schedule of a hypothetical software project. We estimated costs based on total lines of code in the program and labor cost rates for the required personnel, in addition to a profit component. Although this is a replacement cost model, we believe it represents fair value from a market participant perspective. The key assumptions used include average labor rates, total estimated labor hours, and an income tax rate of 40%.

In determining the purchase price allocation, the Company considered, among other factors, how a market participant would likely use the acquired assets. The estimated fair value of intangible assets was based on the income approach for customer relationships and tradename and a replacement cost method for the software programs. The income approach requires a projection of the cash flow that the asset is expected to generate in the future. The projected cash flow is discounted to its present value using a rate of return, or discount rate, which accounts for the time value of money and the degree of risk inherent in the asset. The expected future cash flow that is projected should include all of the economic benefits attributable to the asset, including the tax savings associated with the amortization of the intangible asset value over the tax life of the asset. The income approach may take the form of a “relief-from-royalty” methodology, a cost savings methodology, a “with and without” methodology, or excess earnings methodology, depending on the specific asset under consideration. The replacement cost model uses estimated current costs at the Measurement Date, plus a profit component.

The “relief-from-royalty” method was used to value the trade names acquired from TeleMate. The “relief-from-royalty” method estimates the cost savings that accrue to the owner of an intangible asset that would otherwise be required to pay royalties or license fees on revenues earned through the use of the asset. The royalty rate used is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the intangible asset. The key assumptions in the prospective cash flows include a 15% compound annual sales growth rate over the five years period subsequent to the acquisition. The royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the existing trade names acquired were as follows: royalty rate of 1.0%, discount rate of 17.1%, and a tax rate of 40.0%. The trade names are expected to be used indefinitely and the value includes a terminal value, based on a long-term sustainable growth rate of 2.0%, of the after-tax royalty savings determined using a form of the Gordon Growth model.

The fair value of customer relationships was valued using an income method. Net Operating Profit After Tax (“NOPAT”) per customer is a function of the gross profit margin of the Company, applicable contributory assets (i.e., working capital, fixed capital, work force, brand, IPR&D) charges, and the discount rate reflecting the riskiness of the asset under valuation. NOPAT per customer was used to estimate the value of the customer relationships. The key assumptions used include a revenue attrition rate of 10%, an income tax rate of 40%, and a discount rate of 17.1%.

7. GOODWILL AND INTANGIBLE ASSETS

The following table sets forth the changes in the carrying amount of the Company’s goodwill at March 31, 2018 and December 31, 2017:

Fair value, January 1, 2017	\$	8,104,056
Acquisition of NetSpective Webfiltering		696,705
Balance, December 31, 2017		8,800,761
Change in goodwill value		–
Fair Value, March 31, 2018	\$	8,800,761

The Company recorded amortization expense for intangible assets subject to amortization of \$118,500 for the three months ended March 31, 2018, and \$1,092,592 for the year ended December 31, 2017.

The following table sets forth the components of the Company’s intangible assets at December 31, 2018 and December 31, 2017:

	March 31, 2018				December 31, 2017		
	Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Intangible assets subject to amortization:							
Customer relationships	10.00	\$ 1,600,286	\$ (276,350)	\$ 1,323,936	\$ 1,600,286	\$ (236,343)	\$ 1,363,943
Mobile software applications	2.00	282,500	(262,500)	20,000	282,500	(240,729)	41,771
NetSpective webfiltering software	2.00	1,134,435	(283,609)	850,826	1,134,435	(226,887)	907,548
Noncompete agreements	1.50	846,638	(846,638)	–	846,638	(846,638)	–
Subtotal		3,863,859	(1,669,097)	2,194,762	3,863,859	(1,550,597)	2,313,262
Intangible assets not subject to amortization:							
Trade names	–	4,455,595	–	4,455,595	4,455,595	–	4,455,595
Total intangible assets		\$ 8,319,454	\$ (1,669,097)	\$ 6,650,357	\$ 8,319,454	\$ (1,550,597)	\$ 6,768,857

The following table provides information regarding estimated amortization expense for intangible assets subject to amortization for each of the following years ending December 31:

2018	\$	428,686
2019		386,916
2020		386,916
2021		386,915
2022		160,029
Thereafter		563,800
	<u>\$</u>	<u>2,313,262</u>

8. OTHER ASSETS

Other assets are comprised solely of guarantee deposits at TDA which are refundable upon termination of contract or delivery of subject matter of the contract. These are initially recorded at cost which is the fair value at the time of transaction and are subsequently measured at amortized cost.

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Trade payables are recognized initially at the transaction price and subsequently measured at the undiscounted amount of cash or other consideration expected to be paid. Accrued expenses are recognized based on expected amount required to settle the obligation or liability.

The following table sets forth the components of the Company's accrued liabilities at March 31, 2018 and December 31, 2017.

	<u>March 31,</u> <u>2018</u>	<u>December 31,</u> <u>2017</u>
Earnout consideration payable in connection with Netspective acquisition	\$ 362,500	\$ 362,500
Executive and employee compensation	826,088	838,689
Interest on convertible debentures and promissory notes	431,827	356,599
Other accrued expenses and liabilities	21,310	34,938
Total accrued liabilities	<u>\$ 1,641,725</u>	<u>\$ 1,592,726</u>

Accrued expenses for both include approximately \$138,000 for an estimated compromise settlement relating to tax deductions against supplier invoices in the Philippines at TDA. The Company in accordance with ASC 740-10 has determined that the recording of this amount is required because it is more likely than not that the tax will be assessed.

10. RELATED PARTY PAYABLES

In January 2016, Dr. Thomas J. Rutherford, a member of the Company's board of directors, purchased an unsecured, convertible note from Grom Holdings in the principal amount of \$200,000. The note bears interest at a rate of 9% per year and is payable semi-annually. In connection with the issuance of the convertible note, Grom issued to Dr. Rutherford 69,501 shares of common stock as an inducement to lend. In November 2016, Dr. Rutherford voluntarily converted his note, including inducement costs and accrued interest totaling \$23,000, into 309,973 shares of common stock.

Messrs. Darren Marks and Melvin Leiner, both officers of the Company, have made numerous loans to Grom to help fund operations. These loans are non-interest bearing and callable on demand. Neither Mr. Marks nor Mr. Leiner have any intention of calling these loans at present. The loan balances are classified as short-term obligations under Related Party Payables on the Company's balance sheet. During the three-month period ended March 31, 2018, Wayne Dearing, the managing director of TDH and his wife Stella Dearing made loans to the Company amounting to \$394,052 as of March 31, 2018. These loans were made to assist TDH's liquidity and helping to fund the capital expenditures to build out new office space at its facilities in Manila. These short-term demand loans are non-interest. The Company expects to repay by the end of the second quarter ended.

On December 29, 2017, Messrs. Marks and Leiner agreed to convert an aggregate of \$500,000 of their combined loan balances into shares of our Common Stock, at a conversion price of \$0.50 per share, which was above the closing price of the Company's common stock of \$.30 on December 29, 2017. Mr. Marks converted \$333,333 of his loan into 666,666 shares; and Mr. Leiner converted \$166,667 into 333,334 shares. As a result of the transaction, Mr. Marks and Mr. Leiner's loan balances were reduced to \$1,291,018 and \$842,468, respectively. Mr. Marks and Mr. Leiner now beneficially own 15,204,731 and 9,313,136 shares of our Common Stock, respectively.

As of March 31, 2018, and December 31, 2017, after accounting for the taking the aggregate amount of loans made from the Company's executive officers through their family trusts were \$1,211,826 and \$1,215,442 respectively, for Mr. Marks; and \$858,083 and \$861,198, respectively, for Mr. Leiner.

On January 4, 2018, Mr. Marks and Mr. Leiner voluntarily agreed to defer a large portion of their demand loans until July 1, 2019. Mr. Marks agreed to defer \$915,442 of his loan balance, and Mr. Leiner agreed to defer \$561,198, leaving each individual with a current principal balance due of \$300,000.

Mr. Marks' son Zach and his wife Sarah are employees of Grom. Their annual salaries are \$90,000 and \$35,000, respectively. His sons Luke and Jack, and daughter Caroline are also employed by Grom as independent contractors. Their annual fees are \$18,000, \$7,200 and \$15,000, respectively.

During the years ended December 31, 2017 and 2016, the Company's two officers and Zach Marks each voluntarily agreed to defer portion of their salaries. As of March 31, 2018, and December 31, 2017 the group was collectively owed \$620,338 and \$617,213 respectively, in accrued salaries. See Note 9 – Accounts Payable and Accrued Liabilities.

11. OTHER NONCURRENT LIABILITIES

Other noncurrent liabilities are comprised solely of retirement benefit costs. The Philippine Republic Act (RA) No. 7641, mandates all private employers to provide retirement benefits to employees who upon reaching the age of sixty years or more, but not beyond sixty-five years, have served at least five years in the said establishment. The amount of retirement benefit was defined as "at least one-half month salary for every year of service, a fraction of at least six months being considered as one whole year".

The balance of the accrued retirement benefit cost as of March 31, 2018 and December 31, 2017 amounted to \$229,580 and \$237,495 respectively.

12. DEBT

Convertible Debentures

The following tables set forth the components of the Company's, convertible debentures as of March 31, 2018 and December 31, 2017:

	March 31, 2018	December 31, 2017
Redeemable unsecured convertible note -TeleMate	\$ 1,000,000	1,000,000
Principal value of secured convertible notes	1,372,486	676,223
Loan discounts	(293,294)	(137,950)
Less: Current portion	(24,653)	(75,000)
Total convertible notes, net	\$ 2,054,539	\$ 1,463,273

Redeemable unsecured convertible note -TeleMate

On January 1, 2017, the Company issued a three-year 0.68% redeemable convertible note for \$1,000,000 to TeleMate in connection with the acquisition of the NetSpective webfiltering assets from them. All note principal and accrued interest is payable January 1, 2020. The note is convertible at the election of the noteholders into the Company's common stock at a conversion rate of \$0.78 per share. Furthermore, if not previously converted by the noteholders, the note may be converted by the Company into shares of the Company's common stock at a rate of \$0.48 per share commencing on November 1, 2019.

Under the terms of the asset purchase agreement in which TeleMate had the obligation to collect certain monies on behalf of the Company, TeleMate failed to remit \$146,882 it had collected on the Company's behalf from NetSpective customers. As a result of TeleMate's non-payment, and to avoid litigation, on January 12, 2018 we entered into a First Modification to the Purchase and Sale Agreement (the "Modification").

Under the terms of the Modification, the TeleMate Sellers agreed to the following terms:

- To pay the Company \$10,000 per month against their outstanding balance of \$146,822. To date they have paid the Company \$30,000 and are current on their monthly payment obligations.
- They cannot exercise the conversion feature of their \$1.0 million promissory note, nor will any of the \$362,500 Earnout shares (464,744) until all payments are made in full.
- The December 31, 2019 maturity date of the \$1,000,000 convertible note is extended indefinitely, until all payments are made in full.
- All interest payments (\$6,800 annually) due from the Company to the TeleMate Sellers were suspended indefinitely until all payments are made in full.

Finally, assuming all payments are made and the TeleMate Sellers decide to exercise the conversion feature of their promissory note, they are now bound by a leakout agreement which will limit for a one-year period the amount of shares they can register for sale on a monthly basis.

Secured Convertible Notes- 2018

During the three-month period ended March 31, 2018, the Company privately placed a series of secured, convertible, original issue discount (OID) notes with accredited investors for gross proceeds of \$671,263. The Notes were issued with an OID discounts of 10.0%, or \$67,126. The debentures carried an interest rate of 10% per annum, payable semiannually in cash, for a two-year term with fixed conversion at a price per share if converted within the first year of issuance or fixed conversion price at \$0.78 converted during the two-year following issuance.

In connection with the issuance of these convertible debentures, the Company issued to its noteholders an aggregate of 186,566 shares of common stock as an inducement to lend. These shares were valued at \$109,839 or approximately \$0.59 per share. The Company recorded the value of these shares as a loan discount to be amortized as interest expense over the term of the related convertible debentures. The related amortization expense was \$29,799 for the three months ended March 31, 2018.

Secured Convertible Notes-2017

During the year ended December 31, 2017, the Company privately placed a series of secured, convertible, original issue discount (OID) notes with accredited investors for gross proceeds of \$601,223. The Notes were issued with an OID discounts of 10.0%, or \$60,122. The debentures carried an interest rate of 10% per annum, payable semiannually in cash, for a two-year term with fixed conversion at a price per share if converted within the first year of issuance or fixed conversion price at \$0.78 converted during the two-year following issuance.

In connection with the issuance of these convertible debentures, the Company issued to its noteholders an aggregate of 150,305 shares of common stock as an inducement to lend. These shares were valued at \$78,321 with share prices ranging between \$0.38 and \$0.54 per share. The Company recorded the value of these shares as a loan discount to be amortized as interest expense over the term of the related convertible debentures. The related amortization expense was \$4,543 for the year ended December 31, 2017.

Additionally, at the end of 2017, there were two convertible notes outstanding amounting to \$75,000 that had been issued in 2016 with a fixed conversion price of \$1.19.

Secured Convertible Notes-2016 activity

During the year ended December 31, 2016, the Company privately placed a series of secured, convertible debentures with accredited investors for gross proceeds of \$2,705,600. The debentures carried an interest rate of 9% per annum, payable semiannually in cash, for a two-year term with fixed conversion prices ranging from \$0.72 to \$0.96 per share if converted within the first year of issuance or fixed conversion prices ranging from \$1.20 to \$1.44 if converted during the year following issuance.

In connection with the issuance of these convertible debentures, the Company issued to its noteholders an aggregate of 884,244 shares of common stock as an inducement to lend. These shares were valued at \$667,332, with share prices ranging between \$0.72 and \$0.96 per share. The Company recorded the value of these shares as a loan discount to be amortized as interest expense over the term of the related convertible debentures.

All of the convertible debentures were analyzed at the time of their issuance for a beneficial conversion feature. In some instances, the Company concluded that a beneficial conversion feature existed. The beneficial conversion features were measured using the commitment-date stock price and were determined to aggregate \$67,917. This amount is recorded as a debt discount and is amortized as interest expense over the term of the related convertible debentures.

The Company has analyzed the convertible debentures for derivative accounting consideration and determined that derivative accounting does not apply.

Senior Secured Promissory Notes

The following tables set forth the components of the Company's senior, secured promissory notes at March 31, 2018 and December 31, 2017:

	March 31, 2018	December 31, 2017
Principal value of promissory notes	\$ 4,040,000	\$ 4,040,000
Loan discounts	(443,340)	(86,339)
Less current portion	(38,475)	-
Total promissory notes, net	<u>\$ 3,558,185</u>	<u>\$ 3,953,661</u>

Amendment of TDA Sellers Note

On January 3, 2018, we entered into an amendment to the acquisition agreement with the TDA Sellers (the "Amendment"):

- The TDA Sellers agreed to extend the maturity date of the \$4.0 million secured promissory note one year until July 1, 2019 (see 2016 description below);
- The interest rate on the Note during the one-year extension period from July 2, 2018 to July 1, 2019 was changed to 10%. The interest rate on the Note remained at 5%, payable annually in arrears, until June 30, 2018;
- During the one-year extension period, the interest will be paid quarterly in arrears, instead of annually in arrears. The first such quarterly interest payment of \$100,000 is due on September 30, 2018; and
- Under the terms of the terms acquisition agreement, the TDA Sellers had an opportunity to earn up to \$5.0 million in contingent Earnout Payments (as describe above). The original Earn out measurement period ended on December 31, 2018. As part of the consideration for the TDA Sellers agreeing to enter the Amendment, we agreed to extend the Earnout Period, one year, to December 31, 2019.

Also, as additional consideration, we issued an additional 800,000 restricted shares valued at \$480,000 of our common stock to the TDA Sellers. The amortization of this \$480,000 in additional discount amount to \$80,000 in interest during the three-month period ended March 31, 2018.

As a result of the amendment, the Company has classified the promissory note as a long-term obligation on our balance sheet for the period ended December 31, 2017.

On June 20, 2016, the Company issued a secured promissory note to the shareholders of TD Holdings in connection with the share sale agreement. The note totaled \$4.0 million, bears interest at 5.0% per annum and is due on the earlier of (i) June 20, 2018 or (ii) the date on which the Company successfully completes a qualified initial public offering as defined in the agreement. The note is collateralized by all of the assets of TD Holdings. See amendment to the TDH Seller's Note (above).

Maturities of the Company's borrowings for each of the next five years are as follows:

2018	\$	65,000
2019	\$	5,701,223
2020	\$	646,263
2021	\$	—
2022	\$	—

13. STOCKHOLDERS' EQUITY

Preferred Stock

The Company is authorized to issue 25,000,000 shares of Preferred Stock at a par value of \$0.001. No shares of Preferred Stock were issued and outstanding as of either March 31, 2018 or December 31, 2017.

Common stock

The Company is authorized to issue 200,000,000 shares of common stock at a par value of \$0.001 and had 126,115,017 and 124,273,548 shares of common stock issued and outstanding as of March 31, 2018 and December 31, 2017, respectively.

Common Stock Issued in Private Placements

During the three-month period ended March 31, 2018 and the year ended December 31, 2017, the Company did not issue any shares of stock in private placements.

Common Stock Issued in Connection with the Exercise of Warrants

During the three months ended March 31, 2018, the Company issued 256,455 shares of common stock for proceeds of \$61,244 under a series of stock warrant exercises with a share price of approximately \$0.24 per share.

During the year ended December 31, 2017, the Company issued 6,530,220 shares of common stock for proceeds of \$1,566,000 under a series of stock warrant exercises with a share price of approximately \$0.24 per share.

Common Stock Issued in Exchange for Consulting, Professional and Other Services

During the three months ended March 31, 2018, the Company issued 115,321 shares of common stock with a fair market value of \$76,193 to employees, officers and directors in lieu of cash payment. Additionally, the Company issued 197,500 shares of common stock with a fair value of \$138,375 to consultants and other professionals in lieu of cash payments.

During the year ended December 31, 2017, the Company issued 1,156,931 shares of common stock with a fair market value of \$835,225 to employees, officers and directors in lieu of cash payment. Additionally, the Company issued 3,264,965 shares of common stock with a fair value of \$1,892,735 to consultants and other professionals in lieu of cash payments.

Each share issuance made in exchange for services was valued based upon the trading price of the Company's common stock on the OTC markets.

Common Stock Issued In lieu of Cash for Loans Payable and Other Accrued Obligations

During the three months ended March 31, 2018, the Company issued 285,627 shares of common stock with a fair market value of \$171,376 to satisfy loans payable and other accrued obligations.

During the year ended December 31, 2017, the Company issued 1,045,870 shares of common stock with a fair market value of \$533,000 to satisfy loans payable and other accrued obligations.

Common Stock Issued in Connection with the Issuance of Convertible Debentures

During the three months ended March 31, 2018 the Company issued 186,566 shares of common stock with a fair market value of \$78,321 to investors as an inducement to lend in connection with the issuance of its unsecured, convertible notes. The fair value of the shares was recorded as interest expense in the Company's consolidated financial statements. See Note 12 – Debt.

During the year ended December 31, 2017 the Company issued 150,305 shares of common stock with a fair market value of \$78,322 to investors as an inducement to lend in connection with the issuance of its unsecured, convertible notes. The fair value of the shares was recorded as interest expense in the Company's consolidated financial statements. See Note 12 – Debt.

Common Stock Issued in the Acquisition of a Business

During the year ended December 31, 2017, the Company issued 300,000 shares valued at \$147,000 with the acquisition of a business,

Common Stock Issued in the Acquisition of Intangible Assets

During the year ended December 31, 2017 the company issued 83,400 shares in connection with the acquisition of certain intangible assets valued at \$60,000

Common Stock issued in Connection with the Amendment of the Terms of a Promissory note

During the three months ended March 31, 2018, we issued 800,000 shares valued at \$480,000 in connection with the amendment we negotiated to the \$4.0 million dollar TDA Sellers Note -see Note 11

Stock Purchase Warrants

The stock purchase warrants have been accounted for as equity in accordance with FASB ASC 480, Accounting for Derivative Financial Instruments indexed to, and potentially settled in, a company's own stock, distinguishing liabilities from equity.

The following table reflects all outstanding and exercisable warrants at March 31, 2018 and December 31, 2017. All stock warrants are exercisable for a period between three and five years from the date of issuance.

	Number of Warrants Outstanding	Weighted Avg. Exercise Price	Weighted Avg. Contractual Life (Yrs)
Balance January 1, 2017	7,608,154	\$ 0.26	0.75
Warrants issued	567,166	\$ 1.50	2.25
Less : Warrants exercised	(7,107,765)	\$ 0.24	
Warrants forfeited	(29,190)	\$ 0.24	
Balance December 31, 2017	1,038,365	\$ 1.36	2.38
Warrants issued	—		
Less : Warrants exercised	(256,455)		
Balance March 31, 2018	781,910	\$ 1.36	2.13

Stock Options

The following table represents all outstanding and exercisable stock options as of March 31, 2018.

	Options issued	Options forfeited	Options outstanding	Vested options	Strike Price	Weighted Average Remaining Life In Years
	7,735,350	—	7,735,350	7,735,350	\$ 0.24	5.0
	9,695,250	417,000	9,278,250	9,278,250	\$ 0.36	1.2
	938,250	938,250	—	—	\$ 0.48	
	13,135,500	3,544,500	9,591,000	9,591,000	\$ 0.72	2.0
	5,421,000	1,042,500	4,378,500	4,300,313	\$ 0.78	2.9
Total	36,925,350	(5,942,250)	30,983,100	30,904,913		2.6

For the three months ended March 31, 2018 and the year ended December 31, 2017, the Company recorded \$0- and \$1,823,408 in stock-based compensation expense, respectively related to these stock options.

14. COMMITMENTS AND CONTINGENCIES

In the United States we lease approximately 1,000 square feet of office space in Boca Raton, Florida at the rate of \$2,000 per month pursuant to a three-year lease expiring in October 2018. Our Florida office houses our corporate headquarters and administrative staff.

Our animation business leases portions of 3 floors comprising in the aggregate approximately 28,800 square feet in the West Tower of the Philippine Stock Exchange Centre in Pasig City, Manila. The space is used for administration and production purposes and we pay approximately \$22,533 per month in the aggregate for such space (which increases by approximately 5% per year. These leases expire in December 2022.

We opened a new 1,400 square foot office in Norcross, Georgia on January 1, 2018 to house our NetSpective division. The monthly rent pursuant to a five-year lease which expires in December 2023, is \$2,055 per month which increases by approximately 3% annually.

15. SUBSEQUENT EVENTS

Subsequent to March 31, 2018 the Company has issued \$461,111 in two-year convertible OID notes at 15% interest to four accredited investors.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our financial statements and notes thereto included herein. In connection with, and because we desire to take advantage of, the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, we caution readers regarding certain forward-looking statements in the following discussion and elsewhere in this Quarterly Report and in any other statement made by, or on our behalf, whether or not in future filings with the Securities and Exchange Commission. Forward looking statements are statements not based on historical information and which relate to future operations, strategies, financial results or other developments. Forward looking statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and many of which, with respect to future business decisions, are subject to change. These uncertainties and contingencies can affect actual results and could cause actual results to differ materially from those expressed in any forward-looking statements made by, or on our behalf. We disclaim any obligation to update forward looking statements.

Overview

Effective August 17, 2017 (the "Effective Date"), we consummated the acquisition of Grom Holdings. Pursuant to the terms of the Share Exchange, we amended our Articles of Incorporation to increase our capitalization to 200,000,000 shares of common stock authorized, as well as to change our name to "Grom Social Enterprises, Inc." On the Effective Date, we issued an aggregate of 110,853,883 shares of our common stock to the Grom Holdings shareholders, pro rata to their respective ownership. Each share of Grom Holdings was exchanged for 4.17 shares of Illumination common stock. As a result, the stockholders of Grom Holdings are now stockholders of the Company and the Grom Holdings shareholders own approximately 92% of our issued and outstanding shares of common stock.

As a result of the acquisition of Grom Holdings we now operate our business through five wholly-owned subsidiaries, including:

- Grom Social which operates the Company's social media network designed for children.
- TD Holdings whose operations are conducted through its subsidiary companies, TDAHK and TDA. TD Holdings principal activities, based in Manila, Philippines, are the production of animated films.
- GES which the Company operates its NetSpective webfiltering services that is provided to schools and libraries.
- GNS through which the Company intends to market and distribute four flavors of a nutritional supplement to children.
- IAL, which operates the LED business that was Illumination America's principal business prior to the Grom Holdings acquisition.

As described above, we deemed the transfer of net assets to be a reverse acquisition in accordance with FASB ASC 805-40, "Reverse Acquisitions". The legal acquirer is Illumination America and the legal acquiree is Grom Holdings, Inc. However, the transaction was accounted for as a recapitalization effected by a share exchange, wherein Grom Holdings is considered the acquirer for accounting and financial reporting purposes. The assets and liabilities of the acquired entity have been brought forward at their book value and no goodwill has been recognized.

Results of operations for the three months ended March 31, 2018 and 2017 include the operations of Grom and its five wholly owned subsidiaries. It does not include the operating results of Illumination America.

Retroactive Application of the Share Exchange Ratio

All references to common stock totals or values in this Quarterly Report, unless otherwise stated have been adjusted, retroactively, to reflect the Share Exchange ratio of 4.17 as of August 17, 2017.

RESULTS OF OPERATIONS

Comparison of Results of Operations for the quarter ended March 31, 2018 and March 31, 2017

Revenue

During the three months ended March 31, 2018 we generated revenues of \$2,032,672 compared to revenues of \$1,708,681 during the three-month period ended March 31, 2017, an increase of \$323,991, or 19%. The increase is due to increase revenues at TDH offset by a decline in revenues at Netspective webfiltering. Since both businesses are contract based the timing of revenues from quarter to quarter may change.

Subscription and advertising revenue generated by our gromsocial.com website and from our "MamaBear" mobile software safety application for the period ended March 31, 2018 was nominal. We expect to start generating increasing revenue from these sources in the second half of 2018. Additionally, we expect generate revenues from our new nutritional product supplement for children that we also expect to launch in the second half of 2018. However, there can be no assurances we will be successful in generating increasing revenue from these sources.

Gross margin

Gross margin is calculated by subtracting cost of sales from revenue. Gross margin percentage is calculated by dividing gross margins by revenue. Our gross margins vary significantly by subsidiary. Margins at our largest subsidiary, TDA are approximately 45-55%, margins for our web filtering revenues are typically in the 75-78% range, and margins at our lighting business have historically been between 12-18%. Additionally, margins within subsidiary vary from quarter to quarter and from year to year due to the nature of the business of each subsidiary. Therefore, our consolidated blended gross margin will be subject to significant fluctuation from period to period until we increase our revenue to higher levels. Current gross margins percentages may not be indicative of future gross margin performance.

Gross margin for the periods ended March 31, 2018 and 2017 were 61.7% and 56.8 %, respectively. The increase in gross margin for the year ended 2018 compared to 2017, is primarily attributable to improved margins at both our animation and webfiltering divisions.

Operating expenses

Operating expenses were \$2,083,307 for the three-month period ended March 31, 2018, compared to \$3,802,008 for same period ended in 2017, or a decrease of \$1,718,701. The decrease in 2018 is primarily attributable to a reduction of approximately \$1,478,000 in stock-based compensation, and due to a reduction of approximately \$352,000 in professional fees, offset by an increase in general and administrative expense of approximately \$180,000.

Interest Expense

Interest expense is comprised of cash interest payable on the Note due to the TDA Sellers, as well as interest payable on convertible notes, and amortization of note discounts. Interest expense was \$263,903 for the three-month period ended March 31, 2018 compared to the same period in 2017. The significant increase is to an increase in debt, the amortization of note discounts including the note discount of \$480,000 related to the amendment of the note due to the TDA Sellers -see Note 12 Debt.

Other Income

Other income for the periods ended March 31, 2018 and 2017 was \$345 and \$11,694, respectively and was comprised of royalty income earned on film projects at TD Holdings.

Net loss

Net loss for the period ended March 31, 2018 was \$1,091,122 or (\$0.01) per share compared to a net loss of \$2,922,234 during the same period ended March 31, 2017. The reduction in the operating losses is primarily in legal and professional fees of approximately \$352,000 in 2018 compared to 2017.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2018, we had \$406,850 in cash.

During the three months ended March 31, 2018, net cash used in operating activities was \$500,763 compared to net cash used of \$24,928 during the same period in 2017. The increase of \$475,835 in net cash used in operating activities is primarily attributable changes in operating assets of approximately \$200,000, and a reduction of approximately \$658,000 in common stock and fees exchanged for services offset by a decrease in operating loss, net of stock-based compensation of approximately \$353,000.

Net cash used in investing activities during the period ended March 31, 2018 increased approximately \$114,000 compared to the same period in 2017 and is directly attributable to an increase in the purchase of fixed assets in the same amount.

Net cash provided by financing activities was \$683,260 for the three months ended March 31, 2018 compared to \$65,000 for the same period in 2017. The increase in net cash provided by financing activities of \$618,260 is primarily due to \$671,760 in proceeds from convertible notes in 2018 compared to zero in the same period in 2017.

Our consolidated financial statements have been prepared assuming we will continue as a going concern, which contemplates realization of assets and the satisfaction of liabilities in the normal course of business for the twelve-month period following the date of these financial statements. We have incurred annual losses since inception and expect we may incur additional losses in future periods. Additionally, as of March 31, 2018, excluding related party payables to our officers and principal shareholders which are not anticipated to be paid for the foreseeable future, we had a working capital deficit of \$918,020.

We currently have a monthly consolidated cash operating loss of approximately \$125,000 to \$150,000, or approximately \$1,800,000 per year. In order to fund our operations, we believe we will be required to raise approximately \$2,000,000. As of the date of this Form 10-Q we have no commitment from any investment banker or other traditional funding sources and, while we have had discussions with various potential funding sources, we have no definitive agreement with any third party to provide us with financing, either debt or equity. The failure to obtain the financing necessary to allow us to continue to implement our business plan will have a significant negative impact on our anticipated results of operations.

We expect to reduce our monthly cash operating loss through improved profitability. There can be no assurance we will be successful. Historically we have successfully funded our losses through equity issuances, debt issuance and through officer loans. We expect to be able to continue to fund our operating losses in a similar manner and believe that we can secure capital on reasonable terms although there can be no assurances.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of March 31, 2018 and December 31, 2017.

Critical Accounting Estimates

Our financial statements and accompanying notes have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires management to make estimates, judgments and assumptions that affect reported amounts of assets, liabilities, revenues and expenses. We continually evaluate the accounting policies and estimates used to prepare the financial statements. The estimates are based on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual amounts and results could differ from these estimates made by management. Certain accounting policies that require significant management estimates and are deemed critical to our results of operations or financial position are discussed in our Form 10-K for the year ended December 31, 2017, Critical Accounting Policies section of Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

As required by Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), we have carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2018. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer. Based on this evaluation, our CEO and CFO have concluded that our disclosure controls and procedures were effective as of March 31, 2018 at reasonable assurance levels.

Inherent Limitations – Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdown can occur because of simple error or mistake. In particular, many of our current processes rely upon manual reviews and processes to ensure that neither human error nor system weakness has resulted in erroneous reporting of financial data.

We believe that our financial statements presented in this quarterly report on Form 10-Q fairly present, in all material respects, our financial position, results of operations, and cash flows for the period presented herein.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the last quarterly period covered by this report that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. *Legal Proceedings.*

We are not a party to any legal proceeding that we believe will have a material adverse effect upon our business or financial position and no such action has been threatened.

Item 1A. *Risk Factors.*

There have been no material changes to the risk factors disclosed in “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on April 17, 2018.

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

During the three-month period ended March 31, 2018, we did not receive any proceeds from the sale of equity securities.

Item 3. *Defaults upon Senior Securities.*

None.

Item 4. *Mine Safety Disclosures.*

Not applicable.

Item 5. *Other Information.*

None.

Item 6. *Exhibits.*

31.1 [Rule 13a-14\(a\)/15d-14\(a\) Certification of Chief Executive Officer](#)
31.2 [Rule 13a-14\(a\)/15d-14\(a\) Certification of Chief Financial Officer](#)
32 [Chief Executive Officer and Chief Financial Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)

101.INS XBRL Instance Document
101.SCH XBRL Taxonomy Extension Schema Document
101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF XBRL Taxonomy Extension Definition Linkbase Document
101.LAB XBRL Taxonomy Extension Labels Linkbase Document
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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.

Date: May 15, 2018

By: /s/ Darren Marks
Darren Marks
Chief Executive Officer, President and Chairman
(Principal Executive Officer)

Date: May 15, 2018

By: /s/ Melvin Leiner
Melvin Leiner
Chief Operating Officer, Executive Vice President, Chief Financial
Officer, Director and Secretary (Principal Financial and Accounting
Officer)

**CERTIFICATION PURSUANT TO
18 USC, SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES OXLEY ACT OF 2002**

I, Darren Marks, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Grom Social Enterprises, Inc.;
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 in order 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(s) 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 controls 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 procedure 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 upon 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 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(s) 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: May 15, 2018

/s/ Darren Marks

Darren Marks, Chief Executive Officer, President and Chairman
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO
18 USC, SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES OXLEY ACT OF 2002**

I, Melvin Leiner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Grom Social Enterprises, Inc.;
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 in order 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(s) 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 controls 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 procedure 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 upon 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 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(s) 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: May 15, 2018

/s/ Melvin Leiner

Melvin Leiner, Chief Operating Officer, Executive Vice President, Chief Financial Officer, Director and Secretary (Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO
18 USC, SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with this quarterly report of Grom Social Enterprises, Inc. (the "Company") on Form 10-Q for the three month period ended March 31, 2018, as filed with the Securities and Exchange Commission on May 15, 2018 (the "Report"), we, the undersigned, in the capacities and on the date indicated below, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

1. The Report fully complies with the requirements of Rule 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 15, 2018

/s/ Darren Marks
Darren Marks, Chief Executive Officer, President and Chairman
(Principal Executive Officer)

Dated: May 15, 2018

/s/ Melvin Leiner
Melvin Leiner, Chief Operating Officer, Executive Vice President, Chief Financial
Officer, Director and Secretary (Principal Financial and Accounting Officer)