

SECURITIES & EXCHANGE COMMISSION EDGAR FILING

Grom Social Enterprises, Inc.

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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, 2019

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes 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"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input 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

As of May 20, 2019, 144,960,760 shares of the registrant's common stock were outstanding.

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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 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 Company’s 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. 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.

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 [Unaudited Consolidated Balance Sheets as of March 31, 2019 and December 31, 2018](#)
- F-2 [Interim Unaudited Consolidated Statements of Operations for the Three Months Ended March 31, 2019 and 2018](#)
- F-3 [Unaudited Consolidated Statements of Stockholders Equity\(Deficit\) as March 31, 2019 and 2018](#)
- F-5 [Interim Unaudited Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2019 and 2018](#)
- F-6 [Notes to Interim Unaudited Consolidated Financial Statements](#)

GROM SOCIAL ENTERPRISES INC.
Consolidated Balance Sheets (Unaudited)

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 762,500	\$ 633,593
Accounts receivable, net	756,862	1,123,493
Inventory, net	8,501	9,018
Prepaid expenses and other current assets	572,097	449,840
Total current assets	<u>2,099,960</u>	<u>2,215,944</u>
Operating lease right of use assets	1,068,213	–
Property and equipment, net	1,015,855	1,036,313
Goodwill	8,853,261	8,853,261
Intangible assets, net	6,243,442	6,340,171
Deferred tax assets, net -- noncurrent	252,491	249,833
Other assets	74,364	114,601
Total assets	<u>\$ 19,607,586</u>	<u>\$ 18,810,123</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 639,319	\$ 682,285
Accrued liabilities	1,438,715	1,433,037
Advanced payments and deferred revenues	1,045,031	1,120,228
Convertible debentures, net -- current	2,212,125	676,223
Senior secured promissory notes, net -- current	–	3,828,818
Related party payables	1,027,430	1,181,645
Income taxes payable	–	41,097
Total current liabilities	<u>6,362,620</u>	<u>8,963,333</u>
Convertible debentures, net of loan discounts	4,968,587	2,410,614
Lease liabilities	1,073,761	–
Contingent purchase consideration	429,000	429,000
Other noncurrent liabilities	227,189	224,797
Total liabilities	<u>13,061,157</u>	<u>12,027,744</u>
Commitments and contingencies	–	–
Stockholders' Equity:		
Preferred stock, \$0.001 par value. 25,000,000 shares authorized; 800,000 and zero shares issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	800	–
Common stock, \$0.001 par value. 200,000,000 shares authorized; 144,830,718 and 138,553,655 shares issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	144,831	138,554
Additional paid-in capital	53,643,794	52,254,286
Accumulated earnings (deficit)	(47,100,846)	(45,457,207)
Accumulated other comprehensive income	(142,150)	(153,254)
Total stockholders' equity	<u>6,546,429</u>	<u>6,782,379</u>
Total liabilities and equity	<u>\$ 19,607,586</u>	<u>\$ 18,810,123</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, 2019	Three Months Ended March 31, 2018
Sales	\$ 1,966,860	\$ 2,032,672
Cost of goods sold	814,502	777,739
Gross margin	<u>1,152,358</u>	<u>1,254,933</u>
Operating expenses:		
Depreciation and amortization	222,428	200,101
Selling and marketing	28,099	55,912
General and administrative	1,519,720	1,368,546
Professional fees	290,769	382,555
Stock-based compensation	16,200	76,193
Total operating expenses	<u>2,077,216</u>	<u>2,083,307</u>
Income (loss) from operations	(924,858)	(828,374)
Other income (expense)		
Interest income (expense), net	(376,160)	(263,093)
Gain (loss) on settlement of debt	(363,468)	-
Other gains (losses)	20,847	345
Total other income (expense)	<u>(718,781)</u>	<u>(262,748)</u>
Income (loss) before income taxes	(1,643,639)	(1,091,122)
Provision for income taxes (benefit)	-	-
Net income (loss)	<u>(1,643,639)</u>	<u>(1,091,122)</u>
Convertible preferred stock beneficial conversion feature and other discounts accreted as a deemed dividend	<u>(644,205)</u>	<u>-</u>
Net loss attributable to common stockholders	\$ <u>(2,287,844)</u>	\$ <u>(1,091,122)</u>
Basic and diluted earnings (loss) per common share	\$ <u>(0.02)</u>	\$ <u>(0.01)</u>
Weighted-average number of common shares outstanding:		
Basic and diluted	<u>140,020,849</u>	<u>125,643,201</u>
Comprehensive loss:		
Net income (loss)	\$ (1,643,639)	\$ (1,091,122)
Foreign currency translation adjustment	11,104	(41,595)
Comprehensive income (loss)	<u>\$ (1,632,535)</u>	<u>\$ (1,132,717)</u>

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

GROM SOCIAL ENTERPRISES INC.
Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Value	Shares	Value				
Balance, January 1, 2018	—	\$ —	124,273,548	\$ 124,274	\$ 47,901,532	\$ (40,843,568)	\$ (77,344)	\$ 7,104,894
Net income (loss)	—	—	—	—	—	(1,091,122)	—	(1,091,122)
Change in foreign currency translation	—	—	—	—	—	—	(41,595)	(41,595)
Issuance of common stock in connection with the exercise of common stock purchase warrants	—	—	256,455	256	61,244	—	—	61,500
Issuance of common stock as compensation to employees, officers and/or directors	—	—	115,321	115	76,078	—	—	76,193
Issuance of common stock in exchange for consulting, professional and other services	—	—	197,500	197	138,178	—	—	138,375
Issuance of common stock in lieu of cash for loans payable and other accrued obligations	—	—	285,627	286	171,090	—	—	171,376
Issuance of common stock in connection with the issuance of convertible debenture(s)	—	—	186,566	187	109,652	—	—	109,839
Issuance of common stock in connection with the amendment of terms of promissory note(s)	—	—	800,000	800	479,200	—	—	480,000
Recognition of beneficial conversion features related to convertible debentures	—	—	—	—	800	—	—	800
Balance, March 31, 2018	—	\$ —	126,115,017	\$ 126,115	\$ 48,937,774	\$ (41,934,690)	\$ (118,939)	\$ 7,010,260

GROM SOCIAL ENTERPRISES INC.
Consolidated Statements of Changes in Stockholders' Equity (Unaudited) (continued)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Value	Shares	Value				
Balance, January 1, 2019	–	\$ –	138,553,655	\$ 138,554	\$ 52,254,286	\$ (45,457,207)	\$ (153,254)	\$ 6,782,379
Net income (loss)	–	–	–	–	–	(1,643,639)	–	(1,643,639)
Change in foreign currency translation	–	–	–	–	–	–	11,104	11,104
Issuance of Series A preferred stock in connection with sales made under private offerings	800,000	800	–	–	354,795	–	–	355,595
Issuance of common stock in connection with sales of Series A preferred stock	–	–	4,000,000	4,000	440,405	–	–	444,405
Beneficial conversion feature related to preferred stock	–	–	–	–	199,800	–	–	199,800
Deemed dividend on conversion of convertible preferred stock to common stock	–	–	–	–	(199,800)	–	–	(199,800)
Accretion of Series A preferred stock	–	–	–	–	440,405	–	–	444,405
Deemed dividend on accretion of Series A preferred stock	–	–	–	–	(440,405)	–	–	(440,405)
Issuance of common stock in exchange for consulting, professional and other services	–	–	1,377,338	1,377	348,268	–	–	349,645
Issuance of common stock in lieu of cash for accounts payable, loans payable and other accrued obligations	–	–	99,720	100	26,840	–	–	26,940
Issuance of common stock in connection with the amendment of terms of promissory note(s)	–	–	800,000	800	219,200	–	–	220,000
Balance, March 31, 2019	800,000	\$ 800	144,830,713	\$ 144,831	\$ 53,643,794	\$ (47,100,846)	\$ (142,150)	\$ 6,546,429

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, 2019	Three Months Ended March 31, 2018
Cash flows from operating activities of continuing operations:		
Net income (loss)	\$ (1,643,639)	\$ (1,091,122)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	222,428	200,101
Amortization of debt discount	147,875	152,797
Common stock issued in exchange for fees and services	349,645	66,375
Deferred taxes	(2,658)	6,709
Stock-based compensation	16,200	76,193
Loss on extinguishment of debt	363,468	-
Changes in operating assets and liabilities:		
Accounts receivable	366,631	(192,917)
Inventory	517	15,869
Prepaid expenses and other current assets	(138,456)	174,559
Operating lease right of use assets	5,548	-
Other assets	40,237	2,711
Accounts payable	(16,126)	(153,448)
Accrued liabilities	5,678	48,999
Advanced payments and deferred revenues	(75,197)	(185,429)
Income taxes payable and other noncurrent liabilities	(38,705)	(9,481)
Related party payables	(154,216)	387,321
Net cash provided by (used in) operating activities	(550,770)	(500,763)
Cash flows from investing activities:		
Purchase of fixed assets	(105,241)	(170,921)
Net cash provided by (used in) investing activities	(105,241)	(170,921)
Cash flows from financing activities:		
Proceeds from issuance of preferred stock, net of issuance costs	356,395	-
Proceeds from issuance of common stock, net of issuance costs	443,605	-
Proceeds from exercise of common stock purchase warrants, net of issuance costs	-	61,500
Proceeds from issuance of convertible debentures	-	671,760
Repayments of convertible debentures	(26,286)	(50,000)
Net cash provided by (used in) financing activities	773,714	683,260
Effect of exchange rates on cash and cash equivalents	11,204	(41,595)
Net increase (decrease) in cash and cash equivalents	128,907	(30,019)
Cash and cash equivalents at beginning of the period	633,593	436,869
Cash and cash equivalents at end of the period	\$ 762,500	\$ 406,850
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 67,073	\$ -
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 convertible and promissory notes payable	\$ -	\$ 171,376
Common stock issued to reduce accounts payable and other accrued liabilities	\$ 26,940	\$ -
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, 2019 and 2018

1. NATURE OF OPERATIONS

We operate our business through the following five wholly-owned subsidiaries:

- Grom Social, Inc. ("Grom Social") was incorporated in the State of Florida on March 5, 2012 and operates our social media network designed for children.
- TD Holdings Limited ("TD Holdings"), which was acquired in July 2016, was incorporated in Hong Kong on September 15, 2005. 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 are the production of animated films based in Manila, the Philippines.
- Grom Educational Services, Inc. ("GES"), was incorporated in the State of Florida on January 17, 2017, and operates our NetSpective Webfiltering services to schools and libraries.
- Grom Nutritional Services, Inc. ("GNS") was incorporated in the State of Florida on April 19, 2017. We intend to market and distribute four flavors of a nutritional supplement to children through GNS. GNS did not record any revenue in 2018.
- Illumination America Lighting, Inc. ("IAL"), was incorporated in the State of Florida on August 21, 2017. IAL operates our LED lighting business that was our principal business prior to the Share Exchange. IAL did not record any revenue in 2018.

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 the 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.

The Company does not expect that existing operational cash flow will be sufficient to fund presently anticipated operations and has incurred significant operating losses since inception and has a working capital deficit which 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 the sale of common stock or other securities, and short-term loans. The Company will be required to continue to do so until its consolidated operations become profitable. However, there can be no assurance that the Company will be successful in raising sufficient capital when needed.

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, 2018 and 2017, as presented in the Company's Form 10-K filed on April 16, 2019 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, 2019, the consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries: Grom Social, TD Holdings, GES, 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

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The guidance provided in ASC Topic 606 ("ASC 606") requires entities to use a five-step model to recognize revenue by allocating the consideration from contracts to performance obligations on a relative standalone selling price basis. Revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. The standard also requires new disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASC 606 also includes Subtopic 340-40, *Other Assets and Deferred Costs - Contracts with Customers*, which requires the deferral of incremental costs of obtaining a contract with a customer. This new guidance was initially effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016, and early adoption was not permitted. However, in July 2015, the FASB voted to defer the effective date of this ASU by one year for reporting periods beginning after December 15, 2017, with early adoption permitted as of the original effective date. As a result, the effective date for the Company is January 1, 2018.

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance. The Company adopted this ASU in accordance with the modified retrospective method, effective January 1, 2018, for all contracts 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 continue to be reported in accordance with legacy GAAP.

Under the applicable revenue recognition guidance for fiscal years 2017 and prior, these transactions were recognized when the amounts were billed to the customer.

As a result of the Company's transition to ASC 606, the Company recorded a net change in beginning retained earnings of \$263,741 on January 1, 2018, due to the cumulative effect of adopting ASC 606. For three months ended March 31, 2019, the Company recorded a total of \$1,793,763 of animation revenue from contracts with customers which include \$296,734 in additional revenue as a result of the adoption of ASC 606.

Under ASC 606 the Company's animation revenues are generated primarily from contracts with customers for preproduction and production services related to the development of animated movies and television series. TDA preproduction activities include producing storyboards, location design, model and props design, background color and color styling. For production, TDA focuses on library creation, digital asset management, background layout scene assembly, posing, animation and after-effects. We provide our services under fixed-price contracts. Under fixed-price contracts, we agree to perform the specified work for a pre-determined price. To the extent our actual costs vary from the estimates upon which the price was negotiated, we will generate more or less profit or could incur a loss.

We account for a contract after it has been approved by all parties to the arrangement, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

We evaluate the services promised in each contract at inception to determine whether the contract should be accounted for as having one or more performance obligations. The services in our contracts are distinct from one another as the referring parties typically can direct all, limited, or single portions of the various preproduction and production activities required to create and design an entire episode to us and we, therefore, have a history of developing stand-alone selling prices for all of these distinct components. Accordingly, our contracts are typically accounted for as containing multiple performance obligations.

We determine the transaction price for each contract based on the consideration we expect to receive for the distinct services being provided under the contract.

We recognize revenue as performance obligations are satisfied and the customer obtains control of the services. In determining when performance obligations are satisfied, we consider factors such as contract terms, payment terms and whether there is an alternative future use of the product or service. Substantially all of our revenue is recognized over time as we perform under the contract due to the contractual terms present in each contract which irrevocably transfer control of the work product to the customer as the services are performed.

For performance obligations recognized over time, revenue is recognized based on the extent of progress towards completion of the performance obligation, generally using the percentage-of-completion cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer as we incur costs on our contracts. Under the percentage-of-completion cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs to complete the performance obligation.

Webfiltering revenue

Revenue from subscription sales for webfiltering at NetSpective is 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, and control of the hardware has passed to the customer. The advanced billing for software and service is initially recorded as deferred revenue and subsequently recognized as revenue over time evenly throughout the subscription period. Adoption of ASC 606 had no impact on NetSpective's revenues.

Substantially all of the revenue at TDA and Netspective comes from the North American in the form of animation and webfiltering services, respectively. Historically and going forward, TDA's business is concentrated on five to eight key clients, that vary from year to year based upon discrete projects which become available based on the popularity of a particular TV series, or the expected acceptance of new animated series. TDA receives advance payments for a significant portion of the work it performs. Netspective, as consistent with industry practice receives full payment in advance of providing webfiltering services over a period of one to five years. Revenue recognition under ASC 606 and historically was unrelated to the timing of milestone or advance payments. Netspective's business is focused on forty to fifty US-based school districts located in the US. Both TDA and Netspective earn revenue via services transferred over time to the client. Approximately 10% of Netspective's business is recognized at a point in time due to the non-refundable sale of computer hardware associated with web filtering services.

Contract Assets and Liabilities

Revenues from NetSpective contracts are all billed in advance and therefore represent contract liabilities until fully recognized on a ratable basis over the contract life. Animation revenue contracts vary with movie contracts typically allowing for progress billings over the contract term while other episodic development activities are typically billable upon delivery of the performance obligation for an episode. These episodic activities typically create unbilled contract assets between episode delivery dates while movies can create contract assets or liabilities based on the progress of activities versus the arranged billing schedule.

The following table depicts the composition of our contract assets and liabilities as of March 31, 2019, and December 31, 2018:

	March 31, 2019	December 31, 2018
Animation contract assets	\$ 716,004	\$ 1,040,309
NetSpective contract assets	32,157	74,743
Other contract assets	8,701	8,441
Total contract assets	\$ 756,862	\$ 1,123,493
Animation contract liabilities	\$ 377,024	\$ 380,749
NetSpective contract liabilities	656,507	727,979
Other contract liabilities	11,500	11,500
Total contract liabilities	\$ 1,045,031	\$ 1,120,228

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, 2019, and December 31, 2018. 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.

The following table summarizes the change in the Company's financial assets and liabilities measured at fair value as of March 31, 2019, and December 31, 2018.

	Level 1	Level 2	Level 3
Earnout liability	\$ —	\$ —	\$ 429,000
Fair value, December 31, 2017			\$ 429,000
Change in fair value			—
Fair value, December 31, 2018			\$ 429,000
Change in fair value			—
Fair value, March 31, 2019			\$ 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 more than 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

Inventory consists of animation supplies used for the sole purpose of completing animation projects at Top Draw.

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 the 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 an impairment test prior to scheduled annual impairment tests.

The Company performed its annual fair value assessment at December 31, 2018, 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 December 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.

Right of use assets and lease liabilities

In February 2016, the FASB issued ASU No. 2016-02, "Leases" (ASC 842). The standard requires lessees to recognize almost all leases on the balance sheet as an ROU asset and a lease liability and requires leases to be classified as either an operating or a finance type lease. The standard excludes leases of intangible assets or inventory. The standard became effective for the Company beginning January 1, 2019. The Company adopted ASC 842 using the modified retrospective approach, by applying the new standard to all leases existing at the date of initial application. Results and disclosure requirements for reporting periods beginning after January 1, 2019 are presented under ASC 842, while prior period amounts have not been adjusted and continue to be reported in accordance with our historical accounting under ASC 840. The Company elected the package of practical expedients permitted under the standard, which also allowed the Company to carry forward historical lease classifications. The Company also elected the practical expedient related to treating lease and non-lease components as a single lease component for all equipment leases as well as electing a policy exclusion permitting leases with an original lease term of less than one year to be excluded from the ROU assets and lease liabilities.

Under ASC 842, the Company determines if an arrangement is a lease at inception. Right-of-Use ("ROU") assets and liabilities are recognized at commencement date based on the present value of remaining lease payments over the lease term. For this purpose, the Company considers only payments that are fixed and determinable at the time of commencement. As most of the Company's leases do not provide an implicit rate, the Company estimated the incremental borrowing rate in determining the present value of lease payments. The ROU asset also includes any lease payments made prior to commencement and is recorded net of any lease incentives received. The Company lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise such options.

Operating leases are included in operating lease right-of-use assets, operating lease liabilities, current and operating lease liabilities, non-current on the Company's condensed consolidated balance sheets.

As a result of the adoption of ASC 842 on January 1, 2019, the Company recorded both operating lease ROU assets of \$1,068,213 and operating lease liabilities of \$1,073,761 for the three months ended March 31, 2019. The adoption did not impact the Company's beginning retained earnings, or prior year consolidated statements of income and statements of cash flows.

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 the 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, 2019, and December 31, 2018, the Company determined that it had items that represented components of comprehensive income (loss) and, therefore, has included a statement of comprehensive income (loss) 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 the 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. These potential dilutive shares include 6,630,103 shares from convertible notes, 14,814,815 shares related to the conversion rights of the TDH Sellers Note, 31,043,000 vested stock options and 781,910 stock purchase warrants. 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

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, 2019, and December 31, 2018:

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Billed accounts receivable	\$ 484,752	\$ 419,802
Unbilled accounts receivable	272,110	703,691
Total accounts receivable	<u>\$ 756,862</u>	<u>\$ 1,123,493</u>

As of March 31, 2019, and December 31, 2018, 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, 2019 and the year ended December 31, 2018.

During the three-month period ended March 31, 2019, the Company had three customers that accounted for 71% revenues and one of those same customers that accounted for 23.5% of accounts receivable.

During the year ended December 31, 2018, the Company had three customers that accounted for 50.1% of revenues and one customer that accounted for 9.2% of 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, 2019, and December 31, 2018:

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Collaborative development agreement	\$ 71,824	\$ 95,766
Prepaid rent	32,111	31,773
Vendor advances	6,159	7,867
Prepaid service agreements	183,884	174,920
Employee advance and other payroll related items	20,903	16,208
Other prepaid expenses and current assets	257,216	123,306
Total	<u>\$ 572,097</u>	<u>\$ 449,840</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, 2019 and December 31, 2018:

	March 31, 2019			December 31, 2018		
	Gross Carrying Amount	Accumulated Depreciation	Net Book Value	Gross Carrying Amount	Accumulated Depreciation	Net Book Value
Capital assets subject to depreciation:						
Computers, software and office equipment	\$ 2,024,205	\$ (1,597,372)	\$ 426,833	\$ 1,937,987	\$ (1,508,104)	\$ 429,883
Machinery and equipment	169,515	(106,220)	63,295	167,731	(99,900)	67,831
Vehicles	148,580	(100,394)	48,186	153,927	(120,728)	33,199
Furniture and fixtures	385,605	(293,744)	91,861	381,248	(284,410)	96,838
Leasehold improvements	1,042,662	(656,982)	385,680	1,031,687	(623,125)	408,562
Total fixed assets	<u>\$ 3,770,567</u>	<u>\$ (2,754,712)</u>	<u>\$ 1,015,855</u>	<u>\$ 3,672,580</u>	<u>\$ (2,636,267)</u>	<u>\$ 1,036,313</u>

For the three-month period ended March 31, 2019, and the year ended December 31, 2018, the Company recorded depreciation expense of \$125,699 and \$395,556, respectively.

6. LEASES

The Company has entered into operating leases primarily for real estate. These leases have terms which range from three years to five years, and often include one or more options to renew or in the case of equipment rental, to purchase the equipment. These operating leases are listed as separate line items on the Company's March 31, 2019 Consolidated Balance Sheet and represent the Company's right to use the underlying asset for the lease term. The Company's obligation to make lease payments are also listed as separate line items on the Company's March 31, 2019 Consolidated Balance Sheet.

Operating lease right-of-use assets and liabilities commencing after January 1, 2019 are recognized at commencement date based on the present value of lease payments over the lease term. Based on the present value of the lease payments for the remaining lease term of the Company's existing leases, the Company recognized right-of-use assets and lease liabilities for operating leases of approximately \$1,068,213 in assets and \$1,045,031 in liabilities as of March 31, 2019. In the three months ended March 31, 2019, the Company recognized approximately \$93,242 in total lease costs

Because the rate implicit in each lease is not readily determinable, the Company uses its incremental borrowing rate to determine the present value of the lease payments.

Information related to the Company's operating right-of-use assets and related lease liabilities were as follows:

	Three Months Ended March 31, 2019
Cash paid for operating lease liabilities	\$ 87,459
Weighted-average remaining lease term	10%
Weighted-average discount rate	10%
Minimum future lease payments ended March 31, 2019	\$ 1,347,149
2020	352,888
2021	367,636
2022	335,659
2023	28,589

7. GOODWILL AND INTANGIBLE ASSETS

The following table sets forth the changes in the carrying amount of the Company's goodwill at March 31, 2019, and December 31, 2018:

Balance, December 31, 2017	\$	8,800,761
Acquisition of Bonnie Boat assets		52,500
Balance, December 31, 2018	\$	8,853,261
Activity for the period ended March 31, 2019		—
Balance March 31, 2019	\$	<u>8,853,261</u>

The Company recorded amortization expense for intangible assets subject to amortization of \$96,729 for the three months ended March 31, 2019, and \$1,092,592 for the year ended December 31, 2018.

The following table sets forth the components of the Company's intangible assets at March 31, 2019, and December 31, 2018:

	March 31, 2019				December 31, 2018			
	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	(436,378)	1,163,908	\$ 1,600,286	\$ (396,371)	\$ 1,203,915	
Mobile software applications	2.00	282,500	(282,500)	—	282,500	(282,500)	—	
NetSpective webfiltering software	2.00	1,134,435	(510,496)	623,939	1,134,435	(453,774)	680,661	
Noncompete agreements	1.50	846,638	(846,638)	—	846,638	(846,638)	—	
Subtotal		3,863,859	(2,076,012)	1,787,847	3,863,859	(1,979,283)	1,884,576	
Intangible assets not subject to amortization:								
Trade names		4,455,595	—	4,455,595	4,455,595	—	4,455,595	
Total intangible assets		<u>\$ 8,319,454</u>	<u>\$ (2,076,012)</u>	<u>\$ 6,243,442</u>	<u>\$ 8,319,454</u>	<u>\$ (1,979,283)</u>	<u>\$ 6,340,171</u>	

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

2019	\$	290,185
2020		386,916
2021		386,916
2022		160,029
2023		160,029
Thereafter		403,772
	\$	<u>1,787,847</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 the expected amount required to settle the obligation or liability.

The following table sets forth the components of the Company's accrued liabilities on March 31, 2019, and December 31, 2018.

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Earnout consideration payable in connection with Netspective acquisition	\$ 362,500	\$ 362,500
Executive and employee compensation	772,571	792,402
Interest on convertible debentures and promissory notes	268,176	210,221
Other accrued expenses and liabilities	35,468	67,914
Total accrued liabilities	<u>\$ 1,438,715</u>	<u>\$ 1,433,037</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

The Company has engaged the Chief Executive Officer, Darren Mark's family to assist in the development of the Grom Social website and to create original content for the site. Since these individuals have been responsible for creating in excess of 500 episodes of original content. Mr. Marks wife Sarah; his sons Zach the founder of Grom, Luke, Jack, Dawson, and his daughters Caroline and Victoria all work for the Company either as employees or contractors.

- The amount they were paid for the year ended December 31, 2018 are as follows: Sarah \$33,600, Zach \$90,000, Luke \$33,800, Jack \$5,400, Victoria \$6,750 and Caroline \$11,250. The total annual compensation payable to these six individuals for the period ended December 31, 2018, was \$180,800.
- For the three-month period ended March 31, 2019, these individuals were paid a total of \$39,638.

The Company believes the amounts paid to these individuals is below market rate for the value of the services performed. This expenditure for services provided by the Marks family is expected to continue for the foreseeable future. Members of the Marks family are actively involved on a daily basis in creating all of the current content for the website which includes numerous videos on social responsibility, anti-bullying, digital citizenship, unique blogs, and special events.

Liabilities Due to Executive and Other Officers

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. No such loans have been made to the Company since the year December 31, 2017. The loan balances are classified as short-term obligations under Related Party Payables on the Company's balance sheet.

During 2017 and 2018 Mr. Marks and Mr. Leiner on several occasions agreed to convert a portion of their loans into equity. These transactions are summarized as follows:

<u>Name</u>	<u>Date</u>	<u>Amount of Loan Principal Converted to Equity</u>	<u>Share Price Used for conversion</u>	<u>Closing price of Grom common stock on the date of conversion</u>	<u>Shares issued</u>
Darren Marks	12/29/2017	333,333	\$ 0.50	0.30	666,666
	10/15/2018	333,333	\$ 0.31	0.19	1,075,268
Melvin Leiner	12/29/2017	166,667	\$ 0.50	0.30	333,334
	10/15/2018	166,667	\$ 0.31	0.19	537,635

The outstanding amount due to Mr. Marks and Mr. Leiner's LLC's were \$418,488 and \$469,506; and \$404,246 and \$451,944 as of March 31, 2019, and December 31, 2018, respectively. Additionally, we owed \$50,000 to Dr. Rutherford our director who extended a short-term loan to the Company, and \$154,623 to Wayne and his wife Stella Dearing who have extended loans to Top Draw animation to assist with its liquidity. The amounts due to Mr. Rutherford and the Dearings were outstanding as of March 31, 2019 and December 31, 2018.

As of March 31, 2019, and December 31, 2018, the balances in related party payables were \$1,027,430 and \$1,181,645 respectively.

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, 2019 and December 31, 2018 amounted to \$227,189 and \$224,797 respectively.

12. DEBT

Convertible Debentures

The following tables set forth the components of the Company's, convertible debentures as of March 31, 2019, and December 31, 2018:

	<u>March 31, 2019</u>	<u>December 31, 2018</u>
Redeemable unsecured convertible note -TeleMate	\$ 1,000,000	1,000,000
Principal value of secured convertible notes	6,822,708	2,822,708
Loan discounts	(641,996)	(735,871)
Less: Current portion	(2,212,125)	(676,223)
Total convertible notes, net	<u>\$ 4,968,587</u>	<u>\$ 2,410,614</u>

The Company did not issue any convertible notes or debt instruments during the three-month period ended March 31, 2019.

First Amendment of TDH Acquisition Agreement

On January 3, 2018, we entered into an amendment (the "First Amendment") to the TDH Acquisition Agreement with the individuals that sold TDH to Grom ("TDA Sellers"). Under the terms of the First Amendment:

- the maturity date of the \$4.0 Million Sellers Note extended by the TDH Sellers to Grom as part of the acquisition of TDH by Grom, was extended from July 1, 2018 until July 1, 2019 (the "First Note Extension Period");
- the interest rate on the Note was increased from 5% to 10% during the Note Extension Period;
- during the Note Extension Period, the interest will be paid quarterly in arrears, instead of annually in arrears. The first such quarterly interest payment of \$100,000 was due on September 30, 2018; and
- the Earnout Period was extended to December 31, 2019.

Also, as consideration for the First Amendment, we issued an additional 800,000 shares of our common stock to the TDA Sellers.

Second Amendment of the TDH Acquisition Agreement

On January 15, 2019, we entered into a second amendment to the TDH Acquisition Agreement (the "Second Amendment"). Under the terms of the Second Amendment:

- the maturity date of the Note was extended from July 1, 2019, to April 2, 2020.
- in the event the Note is not repaid prior to July 2, 2019: (i) no management fee shall be paid by TDA to the Company as provided in the Share Sale Agreement in which Grom acquired TDH. Management fees paid by TDA to the Company to date are approximately \$100,000 per month. Non-payment of the management fees to the Company by TDA due to the non-payment of the Note would have a material adverse impact on the Company
- the TDA Sellers shall have the right to convert the Note at a conversion price of \$0.27 per share, either in whole or in part at any time prior to the maturity, subject to the terms and conditions set forth in the Amendment

As a result of the inclusion of a \$0.27 conversion feature, under the guidelines of ASC 470-20-40-7 through 40-9, this element of the Second Amendment was considered an "extinguishment of debt" and re-issuance of the Note as a convertible note. As a result, the Company recorded a loss of \$363,468 related to the Second Amendment for the three months ended March 31, 2019.

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. net in connection with the acquisition of the NetSpective Webfiltering assets. 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, TeleMate agreed to the following terms:

TeleMate paid of the remainder of the Note in full by April 2019, therefore the TeleMate Note has been classified as a current obligation retroactive to March 31, 2019. If TeleMate converts the note, the number of shares converted thereunder will be subject to a one-year leakout agreement. If TeleMate does not convert the TeleMate Note to equity by October 1, 2019, the Company has the right to force conversion at a conversion price of \$0.48 per share.

Newbridge Offering

On November 30, 2018, the Company closed a private offering in which it sold 12% secured convertible promissory notes in an aggregate principal amount of \$552,000 and issued an aggregate of 730,974 shares of its common stock to nine accredited investors pursuant to a private placement memorandum and subscription agreement. The Notes which are due and payable two years from issuance are secured by certain assets of the Company and rank senior to all other indebtedness of the Company except for the \$4,000,000 promissory notes (the "TD Notes") issued to TD Holdings in connection with the Share Sale Agreement, dated June 30, 2016, as amended. Messrs. Marks and Leiner also pledged an aggregate of 10,000,000 shares pursuant to a pledge and security agreement to secure the timely payment of the Notes. The Notes are convertible, in whole or in part, by the note holder at a conversion rate of \$0.40 if the Company's common stock trades or is quoted at more than \$0.40 per share for 10 consecutive days. The conversion price is subject to an adjustment resulting from certain corporate actions including the subdivision or combination of stock, payment of dividends, reorganization, reclassification, consolidations, merger or sale of the Company.

Interest on the Note is payable monthly in 21 equal installments commencing four months after the issuance of the Notes. Upon the occurrence of an "event of default" as described in the Notes, the interest rate will increase to 15% and the Notes shall become immediately due and payable. The Company may prepay the Notes in full at any time by paying accrued interest and 110% of the outstanding principal balance. Newbridge Securities Corporation acted as exclusive placement agent for the offering and received (i) \$55,200, (ii) 113,586 shares of common stock; and (iii) \$11,040, representing a non-accountable expense allowance, for its services.

Secured Convertible Notes 2018

During the year ended December 31, 2018, the Company issued to accredited investors in private offerings two-year secured, convertible, original issue discount ("OID") notes for aggregate gross proceeds of \$1,238,485. The notes were issued with OID discounts of 20%, or \$247,697, have an interest rate of 10% per annum, are payable semiannually in cash, and are convertible into shares of common stock at a fixed conversion price of \$0.50 per share if converted within one year of issuance and \$0.78 per share thereafter.

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 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 a fixed conversion price of \$0.78.

In connection with the issuance of the above convertible notes, the Company also issued 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 notes.

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

2019	\$	1,676,223
2020	\$	6,145,485

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. 800,000 shares of preferred stock were issued and outstanding as of March 31, 2019. No shares of preferred stock were issued and outstanding as of December 31, 2018. On February 22, 2019, the Company designated 2,000,000 shares of its preferred stock as 10% Series A Convertible preferred stock, par value \$0.001 per share ("Series A Stock"). On each of February 27, 2019 and March 11, 2019, the Company received \$400,000 from the sale of 400,000 shares of Series A Stock to an accredited investor in private offerings pursuant to Section 4(a)(2) and/or Rule 506(b) of Regulation D, as promulgated under the Securities Act. As an inducement to purchase the Series A Stock, each investor also received 2,000,000 restricted shares of the Company's common stock.

As a result of the issuance of the Series A Stock we recorded a beneficial conversion feature and other discounts as a deemed dividend on our income statement of \$644,205.

Common stock

The Company is authorized to issue 200,000,000 shares of common stock at a par value of \$0.001 and had 144,830,713 and 138,553,655 shares of common stock issued and outstanding as of March 31, 2019, and December 31, 2018, respectively.

Common Stock Issued in Private Placements

During the three-month period ended March 31, 2019 and 2018, the Company issued -0- and 256,455 shares of common stock in private placements for proceeds of \$-0- and \$61,500, respectively.

Common Stock Issued in Connection with the Exercise of Warrants

During the three months ended March 31, 2019 no warrants were exercised.

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 \$0.24 per share.

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

During the three months ended March 31, 2019, the Company did not issue any of its shares of common stock to employees, officers, and directors. The Company issued 1,377,338 shares of common stock with a fair value of \$349,645 to consultants and other professionals in lieu of cash payments.

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 for services provided to the Company.

Each share issuance made in exchange for services was valued based upon the trading price of the Company's common stock, on the date the services were performed, 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, 2019, the Company issued 99,720 shares of common stock with a fair market value of \$26,940 to satisfy 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.

Common Stock Issued in Connection with the Issuance of Convertible Debentures

During the three months ended March 31, 2019, the Company did not issue any shares to investors as an inducement to lend in connection with the issuance of its unsecured, convertible notes.

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.

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

During each of the three months ended March 31, 2019 and March 31, 2018, we issued 800,000 shares valued at \$480,000 and \$220,000 respectively, in connection with the amendment to the \$4.0 million TDA Sellers Note -see Note 12.

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, 2019, and December 31, 2018. All stock warrants are exercisable for a period between three and five years from the date of issuance.

	<u>Number of Warrants Outstanding</u>	<u>Weighted Avg. Exercise Price</u>	<u>Weighted Avg. Contractual Life (Yrs.)</u>
Balance January 1, 2017	7,608,154	\$ 0.26	0.75
Warrants issued	567,166	\$ 1.50	2.00
Less: Warrants exercised	(7,107,765)	\$ 0.24	
Warrants forfeited	(29,190)	\$ 0.24	
December 31, 2017	<u>1,038,365</u>	<u>\$ 1.36</u>	<u>2.38</u>
Warrants issued	—	—	
Warrants exercised	<u>(256,455)</u>	<u>—</u>	
Balance 31, 2018	<u>781,910</u>	<u>\$ 1.36</u>	<u>1.38</u>
Warrants issued	—	—	
Warrants forfeited	—	—	
Warrants exercised	—	—	
Balance March 31, 2019	<u>781,910</u>	<u>\$ 1.36</u>	<u>1.13</u>

Stock Options

The following table represents all outstanding and exercisable stock options as of March 31, 2019.

	<u>Options issued</u>	<u>Options forfeited</u>	<u>Options outstanding</u>	<u>Vested options</u>	<u>Strike Price</u>	<u>Weighted Average Remaining Life In Years</u>
	7,735,350	–	7,735,350	7,735,350	\$ 0.24	4.02
	9,695,250	417,000	9,278,250	9,278,250	\$ 0.36	0.20
	938,250	938,250	–	–	\$ 0.48	–
	13,135,500	3,544,500	9,591,000	9,591,000	\$ 0.72	1.00
	<u>5,481,000</u>	<u>1,042,500</u>	<u>4,438,500</u>	<u>4,438,500</u>	\$ 0.78	1.96
Total	<u>36,985,350</u>	<u>5,942,250</u>	<u>31,043,100</u>	<u>31,043,100</u>	\$ 0.50	1.65

The Company did not issue any stock options during the three months ended March 31, 2019 or for the three months ended March 31, 2018.

For the three months ended March 31, 2019, and 2018, the Company recorded \$16,200 and \$76,193, respectively in stock-based compensation expense related to these stock options.

14. COMMITMENTS AND CONTINGENCIES

In the United States, we lease approximately 1550 square feet of office space in Boca Raton, Florida for \$4,227 per month pursuant to a three-year lease expiring on September 30, 2021. Our Florida office houses our corporate headquarters and administrative staff.

Our animation business leases portions of 3 floors comprising in the aggregate of approximately 28,800 square feet in the West Tower of the Philippine Stock Exchange Centre in Pasig City, Manila for administration and production purposes. 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 1,400 square foot office in Norcross, Georgia on January 1, 2018, to house our NetSpective division. The monthly rent for 2018 was \$2,055 which increases by approximately 3% annually, pursuant to a five-year lease which expires in December 2023.

We believe our leased space for the present time is adequate and additional space at comparable prices is available at all locations.

15. SUBSEQUENT EVENTS

On May 1, 2019, the Company filed a consent solicitation on Schedule 14A with the SEC to obtain the approval of the majority of stockholders entitled to vote on an amendment to the Company's Articles of Incorporation to increase the authorized common stock of the Company from 200,000,000 shares to 500,000,000 shares. The Company's Board of Directors fixed April 5, 2019, as the record date for holders of its common stock and Series A preferred stock who will be entitled to participate in the consent solicitation. A Notice of Consent Solicitation was mailed on May 1, 2019 to all holders of its common stock and Series A preferred stock as of the record date. In order to approve the proposed amendment, consents must be received by May 31, 2019.

On April 2, 2019, we sold 125,000 shares of Series A Stock to an accredited investor and received proceeds of \$125,000. In connection with this purchase, the investor received 625,000 restricted shares of the Company's common stock.

The Series A Stock is convertible, at any time, into five shares of common stock of the Company.

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

We operate our business through the following five wholly-owned subsidiaries:

- Grom Social, Inc. ("Grom Social") was incorporated in the State of Florida on March 5, 2012 and operates our social media network designed for children.
- TD Holdings Limited ("TD Holdings"), which was acquired in July 2016, was incorporated in Hong Kong on September 15, 2005. 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 are the production of animated films based in Manila, the Philippines.
- Grom Educational Services, Inc. ("GES"), was incorporated in the State of Florida on January 17, 2017, and operates our NetSpective Webfiltering services to schools and libraries.
- Grom Nutritional Services, Inc. ("GNS") was incorporated in the State of Florida on April 19, 2017. We intend to market and distribute four flavors of a nutritional supplement to children through GNS. GNS did not record any revenue in 2018.
- Illumination America Lighting, Inc. ("IAL"), was incorporated in the State of Florida on August 21, 2017. IAL operates our LED lighting business that was our principal business prior to the Share Exchange. IAL did not record any revenue in 2018.

Results of Operations

Comparison of Results of Operations for the quarter ended March 31, 2019 and 2018

Revenue

During the three months ended March 31, 2019, we generated revenues of \$1,966,860 compared to revenues of \$2,032,672 during the three months ended March 31, 2018, representing a decrease of \$65,812, or approximately 3.2%. The decrease is primarily attributable to a decrease of approximately \$61,000 in revenues at Netspective webfiltering. Revenues at our TDA animation division were approximately equal to the prior year at \$1,800,000. Revenues generated by our animation business and our webfiltering business are based on contracts which change from period to period. Until we can generate larger levels of revenue, the amount of revenue recorded from quarter to quarter may change based upon the timing of the completion of contracts.

Subscription and advertising revenue generated by our gromsocial.com website and from our “MamaBear” mobile software safety application for the three months ended March 31, 2019, was nominal. We currently hope to start generating revenue from these sources in the second half of 2019 due to the launch of our new Grom mobile app. On April 4, 2019, we submitted our new mobile app to the Apple Store and the Google Play Store for approval. We have received approval from the Google Play Store into the “the Designed for Families program”. We expect approval shortly, from the Apple Store. This is a standard process for the development of any new app. Before an app can be offered to the public for a free download or for a charge, it is subject to a review process. The Apple store covers IOS or programs that can only be download on an Apple phone. The Google Play Store addresses apps that can only be downloaded on Android devices.

We have received approval from the Google Play Store for its “ Designed for Families” program. We hope to receive approval shortly from the Apple Store. Before anew app can be offered to the public for a free download or for a charge, it is subject to a review process. The Apple Store covers IOS or programs that can only be download on an Apple phone. The Google Play Store addresses apps that can only be downloaded on Android devices.

We also hope to generate revenues from our new nutritional product supplement for children that we currently expect to launch in the third quarter of 2019. However, there can be no assurances we will be successful in generating revenue from these sources.

Gross margin

Gross margin is calculated by subtracting the 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 45-57%, margins for our NetSpective web filtering revenues are typically in the 75-78% range. 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. Current gross margins percentages may not be indicative of future gross margin performance.

Gross margin for the periods ended March 31, 2019, and 2018 were 58.6% and 61.7%, respectively. The increase in gross margin for the year ended 2019 compared to 2018, is primarily attributable to improved margins at both our animation and webfiltering divisions.

Operating expenses

Operating expenses were \$2,077,217 for the three months ended March 31, 2019, compared to \$2,083,307 for the three months ended March 31, 2018 a decrease of approximately \$90,000 in professional fees and a \$60,000 decrease in stock-based compensation. For the three months ended March 31, 2019, general and administrative expenses were \$1,519,720 compared to general and administrative expenses of 1,368,546 for the three months ended March 31, 2018, representing an increase of approximately \$151,000 primarily attributable to increase across numerous expense categories with the largest increases in investor relations expenses of approximately \$20,000, and outside services of approximately \$22,000. Professional fees were \$290,769 for the three months ended March 31, 2019 as compared to \$382,555 for the three months ended March 31, 2018. During the three months ended March 31, 2019 depreciation and amortization was \$222,428 compared to \$200,101 for the three months ended March 31, 2018 due to higher levels of property subject to depreciation in the three months ended March 31, 2019. Selling and marketing was \$28,099 during the three months ended March 31, 2019 compared to \$55,912 in the three months ended March 31, 2018.

Other Income (Expense)

Other expense for the period ended March 31, 2019, was \$718,781 compared to other expense of \$262,748 for the period ended March 31, 2018 representing an increase in other expense of \$456,033. The increase in net expense is primarily attributable to two factors. During the three months ended March 31, 2019; we recorded a one-time charge of \$363,468 related to the amendment of our \$4,000,000 Promissory Note issued to the TDA Sellers. Additionally, our interest expense increased by approximately \$113,000 due to higher debt levels during the three months ended March 31, 2019 compared to three months ended March 31, 2018.

Net loss

Net loss for the three months ended March 31, 2019, was \$1,643,639 compared to a net loss of \$1,091,122 for the three months ended March 31, 2018, or an increase in a net loss of \$552,517. Such increase is primarily attributable to a reduced gross margin of approximately \$102,000 and an increase in other expense of \$456,033 during the three months ended March 31, 2019.

Net loss attributable to common stockholders was \$2,287,844 for the three months ended March 31, 2019 due to the deemed dividend of \$644,205 paid the preferred stockholders. There was no net loss attributable to common stockholders in the three months ended March 31, 2018.

Liquidity and Capital Resources

At March 31, 2019, we had \$762,500 in cash on hand compared to \$633,593 in cash on hand as of December 31, 2018.

Cash Used in Operating Activities

During the three months ended March 31, 2019, net cash used in operating activities was \$550,770 compared to net cash of \$500,763 used in operating activities during the three months ended March 31, 2018. The increase of \$50,007 in net cash used in operating activities is primarily attributable to a significant increase in the Company’s net loss from \$1,091,122 in the three months ended March 31, 2018 to \$1,643,639 in the three months ended March 31, 2019, offset by an increase in operating assets of approximately \$80,000 and an increase in loss on extinguishment of debt of \$363,468.

Cash Used in Investing Activities

Net cash used in investing activities during the period ended March 31, 2019, decreased approximately \$66,000 from approximately \$171,000 during the three months ended March 31, 2018 compared to the same period in 2018. This decrease is attributable to a reduction of \$66,000 in the amount of fixed assets purchased during the three-month period ended March 31, 2019.

Cash Provided by Financing Activities

Net cash provided by financing activities was \$773,714 for the three months ended March 31, 2019 compared to \$683,260 for the three months ended 2018. The increase in net cash provided by financing activities is attributable to \$800,000 in proceeds from the sale of equity in private placement offering in the three months ended in 2019 compared to approximately \$683,000 in proceeds from the sale of convertible notes in the three month period ended March 31 2018, net of repayments.

Our consolidated financial statements for the three months ended March 31, 2019 have been prepared assuming we will continue as a going concern, which contemplates the 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, 2019, 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 \$3,235,230.

We currently have a monthly consolidated cash operating loss of approximately \$150,000, or approximately \$1,800,000 per year. In order to fund our operations for the next twelve months, we believe we will be required to raise approximately \$2,000,000. As of the date of this Report, we have no firm 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.

Historically we have funded our operations through equity issuances, debt issuances and officer loans. We hope to be able to continue to fund our operating losses in a similar manner but there can be no assurances that we will be able to do so. Additionally, if we choose to future equity issuances may result in dilution to current shareholders and debt may have negative covenants

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of March 31, 2019, and December 31, 2018.

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, 2018, 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.

We are a smaller reporting company and are not required to provide this information.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, as of March 31, 2019, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were effective as of March 31, 2019 to ensure that information required to be disclosed by us in reports filed or submitted under the Securities Exchange Act were recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Act Commission's rules and forms and that our disclosure controls are effectively designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is accumulated and communicated to management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

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 has materially affected or is reasonably likely to affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. *Legal Proceedings.*

There are no pending legal proceedings to which the Company is a party or in which any director, officer or affiliate of the Company, any owner of record or beneficially of more than 5% of any class of voting securities of the Company, or security holder is a party adverse to the Company or has a material interest adverse to the Company. The Company's property is not the subject of any pending legal proceedings

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, 2018, filed with the SEC on April 16, 2019.

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

Except as set forth below, there were no sales of equity securities sold during the period covered by this Report that were not registered under the Securities Act and were not previously reported in a Current Report on Form 8-K filed by the Company.

On each of February 27, 2019 and March 11, 2019, the Company sold 400,000 shares of its Series A convertible preferred stock to an accredited investor in a private offering for \$400,000. As an inducement to purchase the Series A Stock, each investor also received 2,000,000 restricted shares of the Company's common stock.

The above issuances did not involve any underwriters, underwriting discounts or commissions, or any public offering and we believe is exempt from the registration requirements of the Securities Act of 1933 by virtue of Section 4(2) thereof and/or Regulation D promulgated thereunder.

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 20, 2019

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

Date: May 20, 2019

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 20, 2019

/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 20, 2019

/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, 2019, as filed with the Securities and Exchange Commission on May 20, 2019 (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 20, 2019

/s/ Darren Marks

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

Dated: May 20, 2019

/s/ Melvin Leiner

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