

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q/A  
(Amendment No. 1)

(Mark One)

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

For the quarterly period ended November 30, 2018  
or

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

For the transition period from to  
Commission File Number: 000-55418



**KUSHCO HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

**Nevada**  
(State or other jurisdiction of  
incorporation or organization)

**46-5268202**  
(I.R.S. Employer  
Identification No.)

**11958 Monarch Street, Garden Grove, CA 92841**  
(Address of Principal Executive Offices) (Zip Code)

**(714) 243-4311**  
(Registrant's telephone number, including area code)

**N/A**

Former name, former address, and former fiscal year, if changed since last report

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, a 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 checked="" type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
Emerging growth company	<input checked="" type="checkbox"/>		

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

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 88,017,716 shares outstanding as of April 8, 2019.

#### EXPLANATORY NOTE

This Amendment No. 1 (this “Amendment”) to Form 10-Q for the fiscal quarter ended November 30, 2018, amends KushCo Holdings, Inc.’s (the “Company”) Quarterly Report on Form 10-Q for the fiscal quarter ended November 30, 2018, which was originally filed with the Securities and Exchange Commission on January 8, 2019 (the “Original Filing”).

In connection with the preparation of the Company’s condensed consolidated interim financial statements as of and for the fiscal quarter ended February 28, 2019, the Company identified inadvertent errors in the accounting for certain share-settled contingent consideration obligations relating to the Company’s acquisition of CMP Wellness in May 2017, Summit Innovations in May 2018, and Hybrid Creative in July 2018. In connection with those acquisitions, contingent equity consideration relating to certain earn-out arrangements were accounted for as equity. Upon further evaluation, the Company determined that the share-settled contingent consideration obligations should have been accounted for as liabilities and adjusted to fair value each reporting period. Respective changes in the fair value should have been recognized in the Company’s condensed consolidated statements of operations each reporting period.

This amendment is being filed solely to (i) restate the financial statements for the accounting error described above and as further described in Notes 1, 2, 3, 4, 10 and 14 to the financial statements (and make corresponding changes to Risk Factors and the Management’s Discussion and Analysis of Financial Condition and results of Operations sections in this Amendment) and (ii) amend Item 4 (Controls and Procedures).

Generally, no changes have been made to the Original Filing other than to add the information as described above. This Amendment should be read in conjunction with the Original Filing. This amendment speaks as of the date of the Original Filing and does not modify or update in any way the disclosures made in the Original Filing, except as required to reflect the revisions discussed above.

---

## FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q/A contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties and are based on the beliefs and assumptions of management and information currently available to management. In some cases, you can identify forward-looking statements by words such as “anticipate,” “believe,” “contemplate,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “predict,” “project,” “seek,” “should,” “target,” “will,” “would,” or the negative of these words or other comparable terminology.

The identification in this report of factors that may affect our future performance and the accuracy of forward-looking statements is meant to be illustrative and by no means exhaustive. All forward-looking statements should be evaluated with the understanding of their inherent uncertainty.

Factors that could cause our actual results to differ materially from those expressed or implied by forward-looking statements include, but are not limited to:

- Trends affecting our financial condition, results of operations or future prospects;
- Our business and growth strategies;
- Our financing plans and forecasts;
- The factors that we expect to contribute to our success and our ability to be successful in the future;
- Our business model and strategy for realizing positive results as sales increase;
- Competition, including our ability to respond to such competition and its expectations regarding continued competition in the market in which we compete;
- Our ability to meet our projected operating expenditures and the costs associated with development of new projects;
- Our ability to pay dividends or to pay any specific rate of dividends, if declared;
- The impact of new accounting pronouncements on our financial statements;
- That our cash flows from operating activities will be sufficient to meet our operating expenditures;
- Our market risk exposure and efforts to minimize risk;
- Development opportunities and our ability to successfully take advantage of such opportunities;
- Regulations, including anticipated taxes, tax credits or tax refunds expected;
- The outcome of various tax audits and assessments, including appeals thereof, timing of resolution of such audits, our estimates as to the amount of taxes that will ultimately be owed and the impact of these audits on our financial statements;
- Our overall outlook including all statements under *Management’s Discussion and Analysis of Financial Condition and Results of Operations*;
- That estimates and assumptions made in the preparation of financial statements in conformity with US GAAP may differ from actual results; and
- Our expectations as to future financial performance, cash and expense levels and liquidity sources.

Any forward-looking statements in this Quarterly Report on Form 10-Q/A reflect our current views with respect to future events or to our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that may cause actual results to differ materially from current expectations include, among other things, those listed under Part II, Item 1A. “Risk Factors” in this Quarterly Report on Form 10-Q/A, Part I, Item 1A. “Risk Factors” in Amendment No. 1 to our Annual Report on Form 10-K/A for the fiscal year ended August 31, 2018 and our other filings with the SEC. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Except as required by law, we assume no obligation to update or revise these forward-looking statements for any reason, even if new information becomes available in the future.

---

**KUSHCO HOLDINGS, INC.**  
**QUARTERLY REPORT ON FORM 10-Q/A**  
**FOR THE THREE MONTHS ENDED NOVEMBER 30, 2018**  
**TABLE OF CONTENTS**

	<u>Page</u>	
<b><u>Part I - FINANCIAL INFORMATION</u></b>		
<u>Item 1.</u>	<u>Financial Statements</u>	<u>4</u>
	<u>Condensed Consolidated Balance Sheets as of November 30, 2018 (unaudited) and August 31, 2018 (as restated)</u>	<u>4</u>
	<u>Condensed Consolidated Statements of Operations for the three months ended November 30, 2018 and 2017 (unaudited) (as restated)</u>	<u>5</u>
	<u>Condensed Consolidated Statements of Stockholders' Equity for the three months ended November 30, 2018 and 2017 (unaudited) (as restated)</u>	<u>6</u>
	<u>Condensed Consolidated Statements of Cash Flows for the three months ended November 30, 2018 and 2017 (unaudited) (as restated)</u>	<u>7</u>
	<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	<u>8</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>23</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosure About Market Risk</u>	<u>26</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>	<u>26</u>
<b><u>Part II - OTHER INFORMATION</u></b>		
<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>27</u>
<u>Item 1A</u>	<u>Risk Factors</u>	<u>27</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>27</u>
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	<u>27</u>
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	<u>27</u>
<u>Item 5.</u>	<u>Other Information</u>	<u>27</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>28</u>
<b><u>SIGNATURES</u></b>		<b><u>29</u></b>

---

PART I - FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

**KUSHCO HOLDINGS, INC.**  
Condensed Consolidated Balance Sheets

	<u>November 30, 2018</u> (As Restated) (Unaudited)	<u>August 31, 2018</u> (As Restated)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	\$ 3,028,436	\$ 13,466,807
Accounts receivable, net of allowance	10,339,293	8,600,959
Prepaid expenses and other current assets	20,070,569	13,623,285
Inventory, net	17,373,565	11,813,755
<b>Total Current assets</b>	<u>50,811,863</u>	<u>47,504,806</u>
Goodwill	52,267,353	52,267,353
Intangible assets, net	3,822,100	4,487,415
Equity investment	2,326,884	-
Property and equipment, net	4,995,604	4,135,090
Other assets	1,132,504	250,296
<b>Total assets</b>	<u>\$ 115,356,309</u>	<u>\$ 108,644,960</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 7,547,053	\$ 2,821,839
Accrued expenses and other current liabilities	4,590,025	3,008,385
Contingent consideration payable	5,882,675	5,488,410
Notes payable - current portion	117,192	61,685
Line of Credit	6,728,632	918,124
<b>Total current liabilities</b>	<u>24,865,577</u>	<u>12,298,443</u>
<b>Long-term liabilities</b>		
Notes payable	338,675	172,021
Warrant liability	14,646,000	14,430,000
Deferred rent	108,479	106,032
<b>Total long-term liabilities</b>	<u>15,093,154</u>	<u>14,708,053</u>
<b>Total liabilities</b>	<u>39,958,731</u>	<u>27,006,496</u>
<b>Commitments and contingencies (Note 16)</b>		
<b>Stockholders' equity</b>		
Preferred stock, \$0.001 par value, 10,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, \$0.001 par value, 265,000,000 shares authorized, 78,558,571 and 78,273,124 shares issued and outstanding, respectively	78,559	78,273
Additional paid-in capital	107,256,032	104,917,891
Accumulated deficit	(31,937,014)	(23,357,699)
<b>Total stockholders' equity</b>	<u>75,397,577</u>	<u>81,638,465</u>
<b>Total liabilities and stockholders' equity</b>	<u>\$ 115,356,309</u>	<u>\$ 108,644,960</u>

See accompanying notes to the unaudited condensed consolidated financial statements

**KUSHCO HOLDINGS, INC.**  
**Condensed Consolidated Statements of Operations**  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>November 30, 2018</b>	<b>November 30, 2017</b>
	<b>(As Restated)</b>	<b>(As Restated)</b>
Net revenue	\$ 25,319,642	\$ 8,847,115
Cost of goods sold	22,090,504	5,766,576
Gross profit	3,229,138	3,080,539
Operating expenses:		
Selling, general and administrative	12,547,638	2,929,096
Gain on disposal of assets	(1,254,414)	-
Change in contingent consideration payable	394,265	4,456,503
Total Operating Expenses	11,687,489	7,385,599
Loss from operations	(8,458,351)	(4,305,060)
Other income (expenses):		
Change in fair value of warrant liability	(216,000)	-
Change in fair value of equity investment	536,000	-
Interest expense	(440,963)	(2,413)
Total Other Income (Expenses)	(120,963)	(2,413)
Loss before income taxes	(8,579,315)	(4,307,473)
Provision for income taxes	-	54,415
Net loss	<u>\$ (8,579,315)</u>	<u>\$ (4,361,888)</u>
Basic loss per share	<u>\$ (0.11)</u>	<u>\$ (0.07)</u>
Diluted loss per share	<u>\$ (0.11)</u>	<u>\$ (0.07)</u>
Weighted average number of common shares outstanding - basic	<u>78,470,987</u>	<u>59,194,323</u>
Weighted average number of common shares outstanding - diluted	<u>78,470,987</u>	<u>59,194,323</u>

See accompanying notes to the unaudited condensed consolidated financial statements

**KUSHCO HOLDINGS, INC.**  
**Condensed Consolidated Statements of Stockholders' Equity**  
(Unaudited)  
(As Restated)

	Common Shares		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Shares Issued	Amount			
<b>Balances at August 31, 2018</b>	<b>78,273,124</b>	<b>\$ 78,273</b>	<b>\$ 104,917,891</b>	<b>\$ (23,357,699)</b>	<b>\$ 81,638,465</b>
Stock option exercises	280,971	282	41,219	-	41,501
Stock-based compensation	4,476	4	2,296,922	-	2,296,926
Net loss	-	-	-	(8,579,315)	(8,579,315)
<b>Balances at November 30, 2018</b>	<b>78,558,571</b>	<b>\$ 78,559</b>	<b>\$ 107,256,032</b>	<b>\$ (31,937,014)</b>	<b>\$ 75,397,577</b>

	Common Shares		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Shares Issued	Amount			
<b>Balances at August 31, 2017</b>	<b>58,607,066</b>	<b>\$ 58,607</b>	<b>\$ 29,676,883</b>	<b>\$ 979,067</b>	<b>\$ 30,714,557</b>
Stock sold to investors	1,367,172	1,367	4,608,188	-	4,609,555
Stock option exercises	4,709	5	(5)	-	-
Stock-based compensation	27,231	27	268,081	-	268,108
Net loss	-	-	-	(4,361,888)	(4,361,888)
<b>Balances at November 30, 2017</b>	<b>60,006,178</b>	<b>\$ 60,006</b>	<b>\$ 34,553,147</b>	<b>\$ (3,382,820)</b>	<b>\$ 31,230,333</b>

See accompanying notes to the condensed consolidated financial statements

**KUSHCO HOLDINGS, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>November 30, 2018</b>	<b>November 30, 2017</b>
	<b>(As Restated)</b>	<b>(As Restated)</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Loss	\$ (8,579,315)	\$ (4,361,888)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	508,862	243,590
Gain on disposition of assets	(1,254,414)	-
Change in fair value of equity investment	(536,000)	-
Stock compensation expense	1,808,969	381,743
Change in fair value of warrant liability	216,000	-
Change in contingent consideration payable	394,265	4,456,503
Changes in operating assets and liabilities:		
Accounts receivable	(1,738,334)	(1,069,410)
Prepays	(6,663,159)	(1,545,793)
Inventory	(5,673,960)	(96,507)
Other assets	(152,777)	-
Accounts payable	4,520,681	760,577
Accrued expenses and other current liabilities	1,666,193	270,868
Net cash used in operating activities	<u>(15,482,989)</u>	<u>(960,317)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Security deposits	(25,598)	-
Acquisition of web domain	-	(44,321)
Purchase of property and equipment	(681,408)	(48,580)
Net cash used in investing activities	<u>(707,006)</u>	<u>(92,901)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayment of capital leases	(18,279)	(5,495)
Repayment of notes payable	-	(333,395)
Proceeds from stock option exercises	41,501	-
Proceeds from line of credit	30,326,556	1,500,000
Payments on line of credit	(24,516,048)	-
Proceeds from sale of stock	-	4,609,555
Payments on contingent consideration	(82,106)	(85,000)
Net cash provided by financing activities	<u>5,751,624</u>	<u>5,685,665</u>
<b>NET INCREASE IN CASH</b>	<u>(10,438,371)</u>	<u>4,632,447</u>
<b>CASH AT BEGINNING OF PERIOD</b>	<u>13,466,807</u>	<u>916,984</u>
<b>CASH AT END OF PERIOD</b>	<u>\$ 3,028,436</u>	<u>\$ 5,549,431</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
<b>CASH PAID FOR:</b>		
Interest	<u>\$ 155,069</u>	<u>\$ 2,370</u>
Income taxes	<u>\$ -</u>	<u>\$ -</u>
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
Property and equipment included in accounts payable	<u>\$ 204,533</u>	<u>\$ -</u>
Capital leases	<u>\$ 240,440</u>	<u>\$ -</u>
Services prepaid for in common stock	<u>\$ 703,832</u>	<u>\$ 34,077</u>
Equity investment	<u>\$ 1,790,884</u>	<u>\$ -</u>

See accompanying notes to the condensed consolidated financial statements

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 1 - NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES**

Nature of Business

KushCo Holdings, Inc. ("the Company") was incorporated in the state of Nevada on February 26, 2014. The Company specializes in marketing and selling packaging products, vaporizers, hydrocarbon gases, solvents, accessories and branding solutions to customers operating in the regulated medical and recreational cannabis industries. The Company provides custom branding on packaging products, and its testing standards meet the requirements set by the Consumer Product Safety Commission. The Company's packaging products primarily consists of bottles, bags, tubes and containers. The Company maintains relationships with a broad range of manufacturers and also has sophisticated in-house labeling and customization capabilities. The Company sells a wide selection of vaporizer cartridges with a variety of core materials and heating technologies, as well as a wide selection of batteries to match the cartridges. The Company provides ultra-pure hydrocarbon gases, including isobutene, n-butane, propane, ethanol, pre-mixes, custom blends and other solvents, which are essential in the extraction process. The Company's wholly-owned subsidiary, The Hybrid Creative, LLC, is a full-service creative agency that serves both cannabis and non-cannabis clients across the U.S., Canada and Europe.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and related notes include the activity of the Company and its wholly-owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information. All intercompany balances and transactions have been eliminated. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The Company's operating results for the three months period ended November 30, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ended August 31, 2019, or for any other period. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes for the fiscal year ended August 31, 2018. The condensed consolidated balance sheet as of August 31, 2018 included herein was derived from the audited financial statements as of that date, but does not include all disclosures as required by GAAP. There have been no changes to the Company's significant accounting policies, other than the adoption of ASC 606, Revenue Recognition, described in its Annual Report on Form 10-K for the fiscal year ended August 31, 2018 that have had a material impact on the Company's condensed consolidated financial statements and related notes.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reporting period.

Significant estimates relied upon in preparing these condensed consolidated financial statements include revenue recognition, accounts receivable reserves, inventory and related reserves, valuations and purchase price allocations related to business combinations, expected future cash flows used to evaluate the recoverability of long-lived assets, estimated fair values of long-lived assets used to record impairment charges related to intangible assets and goodwill, amortization periods, accrued expenses, stock-based compensation, and recoverability of the Company's net deferred tax assets and any related valuation allowance.

Although the Company regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. The Company bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results may differ from management's estimates if past experience or other assumptions do not turn out to be substantially accurate.

The Company is subject to a number of risks similar to those of other companies of similar size and having a focus of serving the cannabis industry, including, the development stage of certain products, competition, limited number of suppliers, integration of acquisitions, substantial indebtedness, government regulations, protection of proprietary rights, and dependence on key individuals.

Reclassification

Certain classifications have been made to the prior year condensed consolidated financial statements to conform to the current year presentation. The reclassification had no impact on previously reported net income (loss) or accumulated deficit.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

Accounts Receivable

Trade accounts receivable are carried at their estimated collectible amounts. Trade credit is generally extended on a short-term basis, thus trade receivables do not bear interest. Trade accounts receivables are periodically evaluated for collectability based on past credit history and their current financial condition. The Company's allowance for doubtful accounts was \$1,535,165 and \$999,752 as of November 30, 2018 and August 31, 2018, respectively.

Inventory

Inventories are stated at the lower of cost or net realizable value using the first-in first out (FIFO) method. The Company's inventory consists of finished goods of \$17,373,565 and \$11,813,755 as of November 30, 2018 and August 31, 2018, respectively. The Company also makes prepayments against the future delivery of inventory classified as prepaid inventory. The Company's prepaid inventory was \$16,680,000 and \$11,019,000 as of November 30, 2018 and August 31, 2018, respectively.

Net Loss Per Share

The Company computes earnings per share under Accounting Standards Codification subtopic 260-10, "Earnings per Share" ("ASC 260-10"). Basic net income (loss) per common share is computed by dividing net income or loss by the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common shares and common shares equivalents outstanding during the period using the treasury stock method.

Revenue Recognition

The Company markets and sells packaging products, vaporizers, hydrocarbon gases, solvents, accessories and branding solutions to customers operating in the regulated medical and recreational cannabis industries. The Company expenses fulfillment costs as incurred because the amortization period would be less than one year in accordance with the ASC 606 practical expedient.

In accordance with ASC 606, the Company applies the following steps to recognize revenue for the sale of products that reflects the consideration to which the Company expects to be entitled to receive in exchange for the promised goods:

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

1. Identify the contract with a customer

A contract with a customer exists when the Company enters into an enforceable contract with a customer. The contract is based on either the acceptance of standard terms, or the execution of terms and conditions contracts. These contracts define each party's rights, payment terms and other contractual terms and conditions of the sale. The Company applies judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience and, in some circumstances, published credit and financial information pertaining to the customer.

2. Identify the performance obligations in the contract

Performance obligations promised in a contract are identified based on the goods that will be transferred to the customer that are both capable of being distinct and are distinct in the context of the contract, whereby the transfer of the goods is separately identifiable from other promises in the contract. The Company has concluded the sale of finished goods and related shipping and handling are accounted for as a single performance obligation.

3. Determine the transaction price

The transaction price is determined based on the consideration to which the Company will be entitled to receive in exchange for transferring goods to the customer. The Company estimates the amount of potential refunds at each reporting period using a portfolio approach of historical data, adjusted for changes in expected customer experience, including seasonality and changes in economic factors.

Discounts provided to customers are accounted for as an element of the transaction price and as a reduction to revenue, and were \$312,292 and \$53,824 for the three months ended November 30, 2018 and 2017, respectively.

Revenue is presented net of taxes collected from customers and remitted to governmental authorities.

4. Allocate the transaction price to the performance obligations in the contract

The Company's products are sold at their standalone selling price.

5. Recognize revenue when the Company satisfies a performance obligation

Revenue is recognized when control of the finished goods is transferred to the customer. Control of the finished goods is transferred at a point in time, upon delivery to the customer. The period of time between the satisfaction of the performance obligation and when payment is due from the customer is not significant.

In the following table, product sales are disaggregated as follows for the three months ended November 30:

	<u>2018</u>	<u>2017</u>
Manufacturing	\$ 24,859,952	\$ 8,732,882
Services	459,690	\$ 114,233
Total Net Revenue	<u>\$ 25,319,642</u>	<u>\$ 8,847,115</u>

Advertising

The Company conducts advertising for the promotion of its products and services. In accordance with ASC subtopic 720-35-25 (Topic 720), advertising costs are charged to expense when incurred. Advertising costs were \$492,583 and \$107,924 for the three months ended November 30, 2018 and 2017, respectively.

Recently Issued Accounting Pronouncements

In August 2018, the FASB issued Accounting Standards Update ("ASU") No. 2018-13, "Fair Value Measurement (Topic 820), - Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement," which makes a number of changes meant to add, modify or remove certain disclosure requirements associated with the movement amongst or hierarchy associated with Level 1, Level 2 and Level 3 fair value measurements. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted upon issuance of the update. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

In January 2017, the FASB issued ASU No. 2017-04, *Simplifying the Test for Goodwill Impairment* ("ASU 2017-04"). ASU 2017-04 simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. ASU 2017-04 is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company adopted this standard on September 1, 2018 and the adoption of ASU 2017-04 did not have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations Clarifying the Definition of a Business* ("ASU 2017-01"), which revises the definition of a business and provides new guidance in evaluating when a set of transferred assets and activities is a business. The Company adopted this standard on September 1, 2018 and the adoption did not have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the consolidated balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the consolidated income statement. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, with early adoption permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company currently expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon our adoption of Topic 842, which will increase the total assets and the total liabilities that the Company will report relative to such amounts prior to adoption.

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

**NOTE 2 - RESTATEMENT**

In connection with the preparation of the Company's condensed consolidated interim financial statements as of and for the fiscal quarter ended February 28, 2019, the Company identified inadvertent errors in the accounting for certain shared-settled contingent consideration obligations relating to the Company's acquisition of CMP Wellness in May 2017, Summit Innovations in May 2018, and Hybrid Creative in July 2018. In connection with those acquisitions, contingent equity consideration relating to certain earn-out arrangements were accounted for as equity. Upon further evaluation, the Company determined that the share-settled contingent consideration should have been accounted for as liabilities with fair value changes recorded in the Company's consolidated statements of operations.

Accordingly, the Company is restating herein its previously issued condensed consolidated financial statements and the related disclosures for the fiscal periods ended November 30, 2018 and 2017 (the "Restated Periods").

In addition to the restatement of the financial statements, certain information within the following notes to the financial statements have been restated to reflect the corrections of misstatements discussed above as well as to add disclosure language as appropriate:

Note 1. Nature of Business and Significant Accounting Policies

Note 3. Acquisition of Summit Innovations, LLC

Note 4. Acquisition of Hybrid Creative, LLC

Note 10. Accrued Expenses and Other Current Liabilities

Note 14. Fair Value of Financial Instruments

The financial statement misstatements reflected in previously issued condensed consolidated interim financial statements did not impact cash flows from operations, investing, or financing activities in the company's condensed Consolidated Statements of Cash Flows for any period previously presented.

**Comparison of restated financial statements to financial statements as previously reported**

The following tables compare the Company's previously issued condensed Consolidated Balance Sheets and condensed Consolidated Statements of Operations as of and for the fiscal periods ended November 30, 2018 and 2017 to the corresponding restated condensed consolidated interim financial statements for those respective periods.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

Restated condensed consolidated balance sheet as of November 30, 2018 and statements of operations for the fiscal periods ended November 30, 2018 and 2017 are as follows:

	<u>November 30, 2018</u> (As Reported)	<u>Restatement</u> <u>Adjustment</u>	<u>November 30, 2018</u> (As Restated)
<b>ASSETS</b>			
<b>Current assets</b>			
Cash	\$ 3,028,436	\$ -	\$ 3,028,436
Accounts receivable, net	10,339,293	-	10,339,293
Prepaid expenses and other current assets	20,070,569	-	20,070,569
Inventory, net	17,373,565	-	17,373,565
<b>Total current assets</b>	<u>50,811,863</u>	<u>-</u>	<u>50,811,863</u>
Goodwill	49,564,325	2,703,028	52,267,353
Intangible assets, net	3,822,100	-	3,822,100
Equity investment	2,326,884	-	2,326,884
Property and equipment, net	4,995,604	-	4,995,604
Other assets	1,132,503	-	1,132,504
<b>Total assets</b>	<u>\$ 112,653,279</u>	<u>\$ 2,703,028</u>	<u>\$ 115,356,308</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Accounts payable	\$ 7,547,053	\$ -	\$ 7,547,053
Accrued expenses and other current liabilities	4,402,176	187,849	4,590,025
Contingent consideration payable	672,849	5,209,826	5,882,675
Notes payable - current portion	117,192	-	117,192
Line of credit	6,728,632	-	6,728,632
<b>Total current liabilities</b>	<u>19,467,902</u>	<u>5,397,675</u>	<u>24,865,577</u>
<b>Long-term liabilities:</b>			
Notes payable	338,675	-	338,675
Warrant liability	14,646,000	-	14,646,000
Deferred rent	108,479	-	108,479
<b>Total long-term liabilities</b>	<u>15,093,154</u>	<u>-</u>	<u>15,093,154</u>
<b>Total liabilities</b>	<u>34,561,056</u>	<u>5,397,675</u>	<u>39,958,731</u>
<b>Stockholders' equity</b>			
Preferred stock, \$0.001 par value, 10,000,000 shares authorized, no shares issued and outstanding	-	-	-
Common stock, \$0.001 par value, 265,000,000 shares authorized, 78,558,571 shares issued and outstanding	78,559	-	78,559
Additional paid-in capital	97,004,830	10,251,202	107,256,032
Accumulated deficit	(18,991,166)	(12,945,848)	(31,937,014)
<b>Total stockholders' equity</b>	<u>78,092,223</u>	<u>(2,694,647)</u>	<u>75,397,577</u>
<b>Total liabilities and stockholders' equity</b>	<u>\$ 112,653,279</u>	<u>\$ 2,703,028</u>	<u>\$ 115,356,308</u>

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

	<b>Three Months Ended November 30, 2018</b>	<b>Restatement Adjustment</b>	<b>Three Months Ended November 30, 2018</b>
	<b>(As Reported)</b>		<b>(As Restated)</b>
Net revenue	\$ 25,319,642	\$ -	\$ 25,319,642
Cost of goods sold	22,090,504	-	22,090,504
Gross profit	3,229,138	-	3,229,138
Operating expenses:			
Selling, general and administrative	12,547,638	-	12,547,638
Gain on disposal of assets	(1,254,414)	-	(1,254,414)
Change in contingent consideration payable	-	394,265	394,265
Total Operating Expenses	11,293,224	394,265	11,687,489
Loss from operations	(8,064,086)	(394,265)	(8,458,351)
Other income (expenses):			
Change in fair value of warrant liability	(216,000)	-	(216,000)
Change in fair value of equity investment	536,000	-	536,000
Interest expense	(440,964)	-	(440,964)
Total Other Income (Expenses)	(120,964)	-	(120,964)
Loss before income taxes	(8,185,050)	(394,265)	(8,579,315)
Provision for income taxes	-	-	-
Net loss	<u>\$ (8,185,050)</u>	<u>\$ (394,265)</u>	<u>\$ (8,579,315)</u>
Basic loss per share	<u>\$ (0.10)</u>		<u>\$ (0.11)</u>
Diluted loss per share	<u>\$ (0.10)</u>		<u>\$ (0.11)</u>
Weighted average number of common shares outstanding - basic	<u>78,470,987</u>		<u>78,470,987</u>
Weighted average number of common shares outstanding - diluted	<u>78,470,987</u>		<u>78,470,987</u>

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

	<b>Three Months Ended November 30, 2017 (As Reported)</b>	<b>Restatement Adjustment</b>	<b>Three Months Ended November 30, 2017 (As Restated)</b>
Net revenue	\$ 8,847,115	\$ -	\$ 8,847,115
Cost of goods sold	5,766,576	-	5,766,576
Gross profit	3,080,539	-	3,080,539
Operating expenses			
Selling, general and administrative	2,929,096	-	2,929,096
Change in fair value of contingent consideration payable	-	4,456,503	4,456,503
Total Operating Expenses	2,533,552	4,456,503	7,385,599
Income from operations	151,443	(4,456,503)	(4,305,060)
Other income (expenses)			
Interest expense	(2,413)	-	(2,413)
Total Other Income (Expenses)	(2,413)	-	(2,413)
Income (loss) before income taxes	149,030	(4,456,503)	(4,307,473)
Provision for income taxes	54,415	-	54,415
Net income (loss)	\$ 94,615	\$ (4,456,503)	\$ (4,361,888)
Basic income (loss) per share	\$ 0.00		\$ (0.07)
Diluted income (loss) per share	\$ 0.00		\$ (0.07)
Weighted average number of common shares outstanding - basic	59,194,323		59,194,323
Weighted average number of common shares outstanding - diluted	65,908,368		59,194,323

**NOTE 3 - ACQUISITION OF SUMMIT INNOVATIONS, LLC**

On May 2, 2018, the Company completed its acquisition of Summit Innovations, LLC (“Summit”), a leading distributor of hydrocarbon gases to the legal cannabis industry. Pursuant to the terms of the merger agreement with Summit, Summit merged with and into KCH Energy, LLC, a wholly-owned subsidiary of the Company, with KCH Energy, LLC as the surviving entity.

The acquisition was accounted for using the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. Total Fixed purchase consideration at closing consisted of 1,280,000 shares of common stock and cash consideration of \$905,231, net of cash received. Cash consideration of \$187,849 and approximately 640,000 shares of common stock were held back by the Company for a period of 15 months for potential post-closing working capital and/or indemnification claims relating to, among other things, breaches of representations, warranties and covenants contained in the merger agreement. The former members of Summit may become entitled to receive earn-out consideration of up to an additional 1,280,000 shares of the Company’s common stock, in the aggregate, based on the net revenue performance of the Summit business during a one-year period following the closing.

As discussed in Note 2, in connection with the Company’s initial purchase accounting, the Company inadvertently classified the contingent equity consideration as equity. Given that the earnout arrangements allow for a variable number of shares to be issued depending on how the Summit business performs against the revenue target, the Company should have classified the contingent equity consideration as a liability until the contingency is resolved. Accordingly, the Company has recorded the changes in the fair value of its contingent consideration within its statements of operations.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 4 - ACQUISITION OF THE HYBRID CREATIVE, LLC**

On July 11, 2018, the Company completed its acquisition of Zack Darling Creative Associates (“ZDCA”), and its wholly-owned subsidiary The Hybrid Creative, LLC (“Hybrid”), which together operated as a specialist design agency. Pursuant to the terms of the purchase agreement with the members of ZDCA, the Company purchased the entire issued member interest of ZDCA. Following the acquisition, ZDCA operates as a wholly-owned subsidiary of the Company, with Hybrid continuing to operate as wholly-owned subsidiary of ZDCA.

The acquisition was accounted for using the acquisition method of accounting in accordance with ASC 805, Business Combinations. The consideration paid to the members of Hybrid at the closing included cash consideration consisting of an aggregate of \$847,187 in cash, net of cash received, \$82,106 in cash held back and share consideration consisting of an aggregate of 360,000 shares of the Company’s common stock. The former members of ZDCA may become entitled to receive cash contingent consideration of up to \$485,000 and up to 212,858 common shares of equity consideration, based on the net revenue performance of Hybrid during the period September 1, 2018 through August 31, 2019.

As discussed in Note 2, in connection with the Company’s initial purchase accounting, the Company inadvertently classified the contingent equity consideration as equity. Given that the earnout arrangements allow for a variable number of shares to be issued depending on how the Hybrid business performs against the revenue target, the Company should have classified the contingent equity consideration as a liability until the contingency is resolved. Accordingly, the Company has recorded the changes in the fair value of its contingent consideration within its statements of operations.

**NOTE 5 - CONCENTRATIONS OF RISK**

Supplier Concentrations

The Company purchases inventory from various suppliers and manufacturers. For the three months ended November 30, 2018, one vendor accounted for approximately 56% of total inventory purchases. For the three months ended November 30, 2017, two vendors accounted for approximately 30% and 13%, respectively, of total inventory purchases.

Customer Concentrations

During the three months ended November 30, 2018 and 2017, there was one customer which represented over 10% of the Company’s revenues. As of November 30, 2018, there was one customer who represented 16% of accounts receivable. As of November 30, 2017, there were two customers who represented 26% of accounts receivable.

**NOTE 6 - RELATED-PARTY TRANSACTIONS**

The Company sub-leased its former corporate headquarters from 3 Kings Ventures, LLC, a related party owned by Dallas Imbimbo, Director, Nicholas Kovacevich, Chairman and Chief Executive Officer, and Jeffrey Meng, formerly a greater than 5% stockholder. During the three months ended November 30, 2018 and 2017, the Company made rent payments of \$0 and \$53,660, respectively, to these related parties.

**NOTE 7 - SALE OF RUB**

On September 21, 2018, Smoke Cartel, Inc. (“Smoke Cartel”) and the Company entered into an agreement to sell a web domain and inventory related to the Company’s Roll-uh-Bowl (“RUB”) product line. The Company received 1,410,145 shares of Smoke Cartel common stock as part of the consideration for this transaction. The fair value of its equity investment as of September 21, 2018 was based upon the closing stock price of Smoke Cartel.

The following sets forth the calculation of the gain on disposition of assets upon completion of the sale:

Fair value of Smoke Cartel as of September 21, 2018	\$	1,790,884
RUB web domain and inventory sold		(536,470)
Gain on disposition of assets	\$	<u>1,254,414</u>

The sale of the RUB assets did not qualify as a discontinued operation as the sale is not a strategic shift that has (or will have) a major effect on the Company’s operations and financial results.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 8 - PROPERTY AND EQUIPMENT**

The major classes of fixed assets consist of the following as of November 30, 2018 and August 31, 2018:

	November 30, 2018	August 31, 2018
Machinery and equipment	\$ 3,138,820	\$ 2,937,784
Vehicles	621,350	380,893
Office Equipment	575,819	385,627
Leasehold improvements	1,483,386	1,318,805
	5,819,375	5,023,109
Accumulated Depreciation	(1,153,886)	(888,019)
	<u>\$ 4,665,489</u>	<u>\$ 4,135,090</u>

Of the \$621,350 of vehicles as of November 30, 2018, \$240,440 consists of capital leased assets.

Depreciation and amortization expense was \$265,867 and \$55,472, for the three months ended November 30, 2018 and 2017, respectively. Of the \$265,867 of depreciation and amortization expense related to tangible assets for the three months ended November 30, 2018, \$162,959 is included in selling, general and administrative expense and \$102,908 is included in cost of goods sold on the condensed consolidated statements of operations. Of the \$55,472 of depreciation and amortization expense for the three months ended November 30, 2017, \$13,696 is included in selling, general and administrative expense and \$41,776 is included in cost of goods sold on the condensed consolidated statements of operations.

The Company's construction-in-progress assets equaled \$330,115 and \$0, as of November 30, 2018 and August 31, 2018, respectively.

**NOTE 9 - INTANGIBLE ASSETS**

Intangible assets consist of the following as of November 30, 2018 and August 31, 2018:

Description	Weighted Average Estimated Useful Life	As of November 30, 2018			As of August 31, 2018		
		Gross Carrying Value	Accumulated Amortization	Net Amount	Gross Carrying Value	Accumulated Amortization	Net Amount
Domain name	5 years	\$ 9,321	\$ (943)	\$ 8,378	\$ 598,605	\$ (166,530)	\$ 432,075
Trade name	6 years	2,600,000	(686,111)	1,913,889	2,600,000	(577,778)	2,022,222
Non-compete agreement	4 years	2,370,000	(470,167)	1,899,833	2,370,000	(336,882)	2,033,118
		<u>\$ 4,979,321</u>	<u>\$ (1,157,221)</u>	<u>\$ 3,822,100</u>	<u>\$ 5,568,605</u>	<u>\$ (1,081,190)</u>	<u>\$ 4,487,415</u>

Amortization expense was \$242,995 and \$188,118, for the three months ended November 30, 2018 and 2017, respectively.

The following table shows the remaining amortization expense associated with finite lived intangible assets as of November 30, 2018:

	Intangible Assets
2019 (Remaining nine months)	\$ 710,966
2020	947,954
2021	881,288
2022	747,955
2023	528,511
Thereafter	5,426
	<u>\$ 3,822,100</u>

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 10 - ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following as of November 30, 2018 and August 31, 2018:

	<b>November 30, 2018</b>	<b>August 31, 2018</b>
	<b>(Restated)</b>	<b>(Restated)</b>
Customer deposits	\$ 1,795,874	\$ 768,908
Accrued compensation	1,391,855	992,747
Sales tax payable	415,928	432,491
Other accrued expenses	986,368	814,239
	<u>\$ 4,590,025</u>	<u>\$ 3,008,385</u>

**NOTE 11 - NOTES PAYABLE**

Automobile Contracts Payable

The Company has entered into purchase contracts for its vehicles. The loans and automobile contracts are secured by the vehicles and bear interest at an average interest rate of approximately 4% per annum. Future principal payments on these automobile contracts payable is summarized in the table below:

	<b>Principal Due (Unaudited)</b>
2019 (Remaining nine months)	\$ 88,971
2020	116,297
2021	110,728
2022	112,767
2023	27,104
	<u>\$ 455,867</u>

**NOTE 12 - LOAN AGREEMENT**

On November 16, 2017, the Company and its wholly-owned subsidiary KIM International Corporation (“KIM”) as borrowers, and all of the Company’s other subsidiaries, as credit parties, entered into a Loan and Security Agreement (the “Loan Agreement”) with Gerber Finance Inc., as lender (“Gerber”), effective as of November 6, 2017. The Loan Agreement originally provided a secured revolving credit facility (the “Revolving Line”) in an aggregate principal amount of up to \$2.0 million at any time outstanding. Under the original terms of the Loan Agreement, the principal amount of loans, plus the face amount of any outstanding letters of credit, at any time outstanding cannot exceed up to 85% of the Company’s eligible receivables minus reserves. Under the terms of the Loan Agreement, the Company may also request letters of credit from Gerber. The proceeds of the loans under the Loan Agreement will be used for working capital and general corporate purposes. The Revolving Line has a maturity date of November 6, 2019. Borrowings under the Revolving Line accrues interest at a rate based on the prime rate as customarily defined, plus a margin of 3.0%. On March 8, 2018, the Company and KIM entered into a first amendment to the Loan Agreement with Gerber. Pursuant to the first amendment, the aggregate principal amount of the Revolving Line at any time outstanding was increased to \$4.0 million and the principal amount of loans, plus the face amount of any outstanding letters of credit, at any time outstanding could not exceed the lesser of (i) 40% of the value of certain inventory and (ii) 50% of certain accounts receivable. In April 2019, the Company obtained a waiver of non-compliance with certain corporate violations associated with the restatements noted in Note 2.

On November 9, 2018, the Company and KIM entered into a second amendment to the Loan Agreement with Gerber. Pursuant to the second amendment, the aggregate principal amount of the Revolving Line at any time outstanding was increased to \$8.0 million. Additionally, subject to certain exceptions, the face amount of any outstanding letters of credit, at any time outstanding cannot exceed the lesser of (i) 25% of the value of certain inventory (increasing to 40% upon receipt of certain landlord waivers) and (ii) 50% of certain accounts receivable.

During the three months ended November 30, 2018, the Company drew down \$30,326,556 from its line of credit and repaid \$24,516,048. As of November 30, 2018, the amount outstanding on the Revolving Line was \$6,728,632.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 13 - WARRANT LIABILITY**

In June of 2018, the Company issued warrants to purchase 3,750,000 shares of its common stock to investors in a registered direct offering. The warrants have a term of five years from the date of issuance. The exercise price of the warrants is protected in the event the Company issues securities with a variable conversion or exercise price during the three-year period following the warrants' issuance, and the Company is contractually prohibited from making such issuances during the three-year period. Pursuant to ASC Topic 815, the fair value of the warrants of \$15,350,000 was recorded as a derivative liability on the issuance dates. The estimated fair values of the warrants were computed at issuance using an option pricing model.

The estimated fair value of the outstanding warrant liabilities was \$14,646,000 and \$14,430,000 as of November 30, 2018 and August 31, 2018, respectively.

Increases or decreases in the fair value of the derivative liability are included as a component of other income (expense) in the accompanying condensed consolidated statements of operations for the respective period. The changes to the derivative liability for warrants resulted in an increase of \$216,000 in warrant liability and a corresponding loss for the three months ended November 30, 2018.

The estimated fair value of the warrants was computed as of November 30, 2018 and August 31, 2018 using the following assumptions:

	<b>November 30, 2018</b>	<b>August 31, 2018</b>
Stock price volatility	86.3%	78.1% - 81.1%
Risk-free interest rates	2.83%	2.72% - 2.74%
Annual dividend yield	0%	0%
Term	4.5	3.8 - 4.0

In addition, management assessed the probabilities of future financing assumptions in the valuation models.

**NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS - RESTATED**

Fair value measurements are performed in accordance with the guidance provided by ASC Topic 820, "Fair Value Measurements and Disclosures." ASC Topic 820 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or parameters are not available, valuation models are applied.

ASC Topic 820 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Assets and liabilities recorded at fair value in the financial statements are categorized based upon the hierarchy of levels of judgment associated with the inputs used to measure their fair value. Hierarchical levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities that an entity has the ability to access.

Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Unobservable inputs that are supportable by little or no market activity and that are significant to the fair value of the asset or liability.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, capital lease obligations and deferred revenue approximate their fair values based on their short-term nature. The carrying amount of the Company's long-term notes payable approximates its fair value based on interest rates available to the Company for similar debt instruments and similar remaining maturities.

The estimated fair value of the contingent consideration related to the Company's business combinations is recorded using significant unobservable measures and other fair value inputs and is therefore classified as a Level 3 financial instrument.

The Company accounts for its investment in Smoke Cartel at fair value. On September 21, 2018, Smoke Cartel and the Company entered into an agreement to sell the RUB web domain and inventory related to this product line and in exchange, received 1,410,145 shares of Smoke Cartel common stock (see Note 6 above.) The fair value of its investment as of September 21, 2018 and November 30, 2018 was based upon the closing stock price of Smoke Cartel. The investment was classified as a Level 2 financial instrument.

In connection with the Company's registered direct offering in June 2018, the Company issued warrants to purchase shares of its common stock and recorded embedded conversion features which are accounted for as derivative liabilities (see Note 13 above.) The estimated fair value of the derivatives is recorded using significant unobservable measures and other fair value inputs and is therefore classified as a Level 3 financial instrument.

The following table details the fair value measurements within the fair value hierarchy of the Company's financial instruments, which includes the Level 2 assets and the Level 3 liabilities:

	<b>Fair Value at November 30, 2018 (Restated)</b>			
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets:</b>				
Equity investment	\$ 2,326,884	\$ -	\$ 2,326,884	\$ -
<b>Liabilities:</b>				
Contingent consideration payable	\$ 5,882,675	\$ -	\$ -	\$ 5,882,675
Warrant liability	14,646,000	-	-	14,646,000
Total liabilities	<u>\$ 20,528,675</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,528,675</u>

  

	<b>Fair Value at August 31, 2018 (Restated)</b>			
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Liabilities:</b>				
Contingent consideration payable	\$ 5,488,410	\$ -	\$ -	\$ 5,488,410
Warrant liability	14,430,000	-	-	14,430,000
Total liabilities	<u>\$ 19,918,410</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 19,918,410</u>

The following table reflects the activity for the Company's investment in Smoke Cartel measured at fair value using Level 2 inputs:

	<b>Investment in Smoke Cartel</b>
Balance at August 31, 2018	\$ -
Acquisition of equity investment	1,790,884
Adjustment to fair value	536,000
Balance at November 30, 2018	<u>\$ 2,326,884</u>

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

The following table reflects the activity for the Company's warrant derivative liability measured at fair value using Level 3 inputs:

	<b>Warrant Liability</b>
As of August 31, 2018	\$ 14,430,000
Change in fair value	216,000
As of November 30, 2018	<u>\$ 14,646,000</u>

The following table reflects the restated activity for the Company's contingent acquisition liabilities measured at fair value using Level 3 inputs:

	<b>Contingent Consideration</b>
As of Aug 31, 2018 balance	\$ 5,488,410
Change in fair value	394,265
As of November 30, 2018 balance	<u>\$ 5,882,675</u>

The fair value of contingent consideration is evaluated each reporting period using projected revenues, discount rates, and projected timing of revenues. Projected contingent payment amounts are discounted back to the current period using a discount rate. Projected revenues are based on the Company's most recent internal operational budgets and projections. Increases in projected revenues may result in higher fair value measurements. Increases in discount rates and the time to payment may result in lower fair value measurements. Increases (decreases) in any of those inputs in isolation may result in a significantly lower (higher) fair value measurement. During the three months ended November 30, 2018 and 2017, the net adjustment to the fair value of the Company's contingent consideration was \$0.

**NOTE 15 - STOCKHOLDERS' EQUITY**

Preferred Stock

The authorized preferred stock is 10,000,000 shares with a par value of \$0.001. As of November 30, 2018, and August 31, 2018, the Company has no shares of preferred stock issued or outstanding.

Common Stock

The authorized common stock is 265,000,000 shares with a par value of \$0.001. As of November 30, 2018, and August 31, 2018, 78,558,571 and 78,273,124 shares were issued and outstanding, respectively.

During the three months ended November 30, 2017, the Company sold 1,367,172 shares of its common stock to investors in exchange for cash of \$2,045,505. For the same period ended November 30, 2017, the Company collected \$2,564,050 of cash in advance of issuing the related 1,709,366 shares in the subsequent period.

Share-based Compensation

The Company recorded stock compensation expense of \$1,808,969 and \$381,743 for the three-month periods ended November 30, 2018 and 2017, respectively, in connection with the issuance of shares of common stock and options to purchase common stock.

During the three months period ended November 30, 2018, the Company authorized to issue shares of common stock to consultants in exchange for \$124,098 of services rendered and \$703,832 of prepaid services, for a total of \$827,930. The \$703,832 of prepaid services is included in prepaid expenses on the condensed consolidated balance sheet as of November 30, 2018. The total fair value of shares vested during the three-month period November 30, 2018 is \$1,468,996. This amount is included in stock compensation expense on the condensed consolidated statements of operations.

During the three months period ended November 30, 2018, the Company issued 4,476 shares of common stock to a consultant in exchange for services rendered.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

During the three months period ended November 30, 2017, the Company issued 27,231 shares of common stock to consultants in exchange for \$20,000 of services rendered and \$34,077 of prepaid services, for a total of \$54,077. The total fair value of options vested during the three-month period November 30, 2017 is \$214,031. This amount is included in stock compensation expense on the condensed consolidated statements of operations.

Stock Options

The Company's 2016 Stock Incentive Plan (the "Plan") was adopted on February 9, 2016. The Plan, as amended, permits the grant of share options and shares to its employees and directors for up to 15,000,000 shares of common stock. The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant; those option awards generally vest based on three years of continuous service and have 10-year contractual terms.

The Company estimates the fair value of share-based compensation utilizing the Black-Scholes option pricing model, which is dependent upon several variables such as the expected option term, expected volatility of our stock price over the expected option term, expected risk-free interest rate over the expected option term, expected dividend yield rate over the expected option term, and an estimate of expected forfeiture rates. The Company believes this valuation methodology is appropriate for estimating the fair value of stock options granted to employees and directors which are subject to ASC Topic 718 requirements. These amounts are estimates and thus may not be reflective of actual future results, nor amounts ultimately realized by recipients of these grants. The Company recognizes compensation on a straight-line basis over the requisite service period for each award. The following table summarizes the assumptions the Company utilized to record compensation expense for stock options granted during the three months ended November 30, 2018 and 2017:

	November 30, 2018	November 30, 2017
Expected term in years	3	1-4
Expected volatility	82% - 87%	60%
Risk-free interest rate	2.70% - 3.01%	1.14% - 1.97%
Expected dividend yield	0%	0%

The expected life is computed using the simplified method, which is the average of the vesting term and the contractual term. The expected volatility is based on management's analysis of historical volatility for comparable companies. The risk-free interest rate is based on the U.S. Treasury yields with terms equivalent to the expected term of the related option at the time of the grant. While the Company believes these estimates are reasonable, the compensation expense recorded would increase if the expected life was increased, a higher expected volatility was used, or if the expected dividend yield increased.

During the three months ended November 30, 2018 and 2017, the Company issued 2,494,500 and 960,500 stock options, respectively, pursuant to the Company's 2016 Stock Incentive Plan. A summary of the Company's stock option activity during the three-month period ended November 30, 2018 is presented below:

	Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balance Outstanding, August 31, 2018	9,367,693	\$ 3.85	9.1	\$ 14,463,235
Granted	2,494,500	\$ 5.61	9.8	664,750
Exercised	(287,499)	\$ 0.29	-	-
Forfeited	(736,947)	\$ 3.85	-	-
Balance Outstanding, November 30, 2018	<u>10,837,747</u>	\$ 4.35	9.3	\$ 15,671,112
Exercisable, November 30, 2018	<u>2,814,806</u>	\$ 2.78	8.0	\$ 7,212,336

The weighted-average grant-date fair value of options granted during the three months ended November 30, 2018 and 2017, was \$3.10 and \$2.25, respectively. The weighted-average grant-date fair value of options forfeited during the three months ended November 30, 2018 was \$2.01.

**KUSHCO HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

During the three months ended November 30, 2018, the Company issued 266,667 shares of common stock in exchange for \$41,501, pursuant to stock option exercises and issued 18,748 shares of common stock pursuant to a cashless exercise of 20,831 stock options. During the three months ended November 30, 2017, the Company issued 4,709 shares of common stock pursuant to cashless exercises of 10,000 stock options.

As of November 30, 2018, there was \$17,836,723 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.3 years.

**NOTE 16 - COMMITMENTS AND CONTINGENCIES**

Other Commitments

In the ordinary course of business, the Company may enter into contractual purchase obligations and other agreements that are legally binding and specify certain minimum payment terms.

Litigation

The Company may be subject to legal proceedings and claims which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity.

**NOTE 17 - SUBSEQUENT EVENTS**

Subsequent to November 30, 2018 and through January 4, 2019, the Company sold 2,307,141 shares of its common stock to investors in exchange for aggregate gross proceeds of \$9,468,394 in a private placement.

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

### Restatement of Previously Issued Consolidated Financial Statements

As discussed further in Note 2 in the Notes to condensed Consolidated Financial Statements, we have restated our condensed consolidated financial statements as of and for the three months ended November 30, 2018 and 2017. Refer to the Explanatory Note preceding Part 1, Item 1 and Note 2 to the Condensed Consolidated Financial Statements for additional details regarding the aforementioned restatement adjustments.

### Cautionary Statement Concerning Forward-Looking Statements

The following discussion and analysis should be read in conjunction with our audited consolidated financial statements and related notes included in this report. This report contains "forward-looking statements." The statements contained in this report that are not historic in nature, particularly those that utilize terminology such as "may," "will," "should," "expects," "anticipates," "estimates," "believes," or "plans" or comparable terminology are forward-looking statements based on current expectations and assumptions.

Various risks and uncertainties could cause actual results to differ materially from those expressed in forward-looking statements. The forward-looking events discussed in this report, the documents to which we refer you and other statements made from time to time by us or our representatives, may not occur, and actual events and results may differ materially and are subject to risks, uncertainties, and assumptions about us. For these statements, we claim the protection of the "bespeaks caution" doctrine. All forward-looking statements in this document are based on information currently available to us as of the date of this report, and we assume no obligation to update any forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results, performance, or achievements expressed or implied by such forward-looking statements.

### Overview

We provide customizable packaging products, vaporizers, hydrocarbon gases, solvents, accessories and branding solutions primarily for the cannabis industry. Representative examples of our products include pop-top bottles, vaporizer cartridges and accessories, bags, tubes, and other containers. We sell our solutions predominantly to businesses operating in jurisdictions that have some form of cannabis legalization. These businesses include medical and recreational dispensaries, large and small scale processors, and packaging re-distributors.

We believe that we have created one of the largest product libraries in the cannabis industry, allowing us to be a comprehensive solutions provider to our customers. Our extensive knowledge of the regulatory environment applicable to the cannabis industry allows us to quickly adapt to our customers' packaging requirements. We maintain the flexibility to enter the markets of decriminalized regions by establishing re-distributor partnerships or opening new facilities. We also have the flexibility to introduce new products and services to our vast customer network. We have no supplier "take or pay" arrangements. In addition to these factors, we believe that we offer competitive pricing, prompt deliveries, and excellent customer service. We expect continued growth as we take measures to expand into new markets, invest in our systems and personnel, forge strategic alliances and invest in our own molds and intellectual property.

### Acquisitions

On May 1, 2017 ("Merger Date"), we and our wholly-owned subsidiary, KBCMP, Inc. ("Merger Sub"), entered into an Agreement of Merger (the "Merger Agreement") with Lancer West Enterprises, Inc. and Walnut Ventures, pursuant to which each of Lancer West Enterprises, Inc. and Walnut Ventures were merged with and into Merger Sub, with Merger Sub as the surviving corporation, resulting in our indirect acquisition of CMP Wellness, LLC ("CMP"). Prior to the merger, CMP was owned 100% by Lancer West Enterprises, Inc. and Walnut Ventures. Membership interest in CMP was the sole asset of Lancer West Enterprises, Inc. and Walnut Ventures. As a result, CMP became our wholly-owned subsidiary. CMP is a distributor of vaporizers, cartridges and accessories.

The purchase price for CMP consisted of an aggregate of \$1,500,000 in cash, unsecured promissory notes in the aggregate principal amount of approximately \$770,820 having a one-year maturity, and an aggregate of 7,800,000 restricted shares of the Company's common stock. The purchase price is subject to customary post-closing adjustments with respect to confirmation of the levels of working capital and cash held by CMP as of the closing. During the one-year period following the closing, the former owners of CMP may become entitled to receive up to an additional approximately \$1,905,000 in cash, in the aggregate, and approximately 4,740,960 shares of our common stock, in the aggregate, based on the future performance of CMP.

On May 2, 2018, we completed our acquisition of Summit Innovations, LLC ("Summit"), a leading distributor of hydrocarbon gases to the legal cannabis industry. Pursuant to the terms of the merger agreement, Summit merged with and into our wholly-owned subsidiary, KCH Energy, LLC ("KCH"), with KCH as the surviving entity. The consideration paid to the members of Summit at the closing included cash consideration, consisting of an aggregate of \$905,231 in cash, net of cash received, and an aggregate of 1,280,000 shares of our common stock. Cash consideration of \$187,849 and approximately 640,000 shares of common stock from the share consideration were held back by us for a period of 15 months for potential post-closing working capital and/or indemnification claims relating to, among other things, breaches of representations, warranties and covenants contained in the merger agreement. The former members of Summit may become entitled to receive earn-out consideration of up to an additional 1,280,000 shares of common stock, in the aggregate, based on the net revenue performance of the Summit business during a one-year period following the closing.

We estimated the fair value of contingent consideration and recorded the earn-out consideration of the additional 1,280,000 shares of common stock as a liability within our consolidated balance sheets. Changes in the estimated contingent consideration to be paid and in the fair value of the contingent consideration liability from period to period are recorded within operating expenses of our consolidated statements of operations.

On July 11, 2018, we completed its acquisition of Zack Darling Creative Associates (“ZDCA”), and its wholly owned subsidiary The Hybrid Creative, LLC (“Hybrid”), which together operated as a specialist creative marketing agency. Pursuant to the terms of the membership interest purchase agreement with the members of ZDCA, we purchased the entire issued membership interest of ZDCA for an aggregate of \$847,187 in cash, net of cash received, and an aggregate of 360,000 shares of our common stock. Cash consideration of \$82,106 and approximately 162,000 shares of common stock from the share consideration were held back by us issuable on January 1, 2019. The former members of ZDCA may become entitled to receive earn-out payments of up to \$1.4 million, through a combination of cash and stock payments, based on the net revenue performance of the Hybrid business during the period September 1, 2018 through August 31, 2019. Following the acquisition, ZDCA operates as our wholly-owned subsidiary, with Hybrid continuing to operate as wholly-owned subsidiary of ZDCA.

#### **Line of Credit**

On November 16, 2017, we and KIM International Corporation (“KIM”), our wholly-owned subsidiary, as borrowers, and all of our other subsidiaries, as credit parties, entered into a Loan and Security Agreement (the “Loan Agreement”) with Gerber Finance Inc., as lender (“Gerber”), effective as of November 6, 2017. The Loan Agreement originally provided a secured revolving credit facility (the “Revolving Line”) in an aggregate principal amount of up to \$2.0 million at any time outstanding. Under the terms of the original Loan Agreement, the principal amount of loans, plus the face amount of any outstanding letters of credit, at any time outstanding cannot exceed up to 85% of our eligible receivables minus reserves. Under the terms of the Loan Agreement, we may also request letters of credit from Gerber. The proceeds of the loans under the Loan Agreement will be used for working capital and general corporate purposes. The Revolving Line has a maturity date of November 6, 2019. Borrowings under the Revolving Line accrues interest at a rate based on the prime rate as customarily defined, plus a margin of 3.0%. On March 8, 2018, we and KIM entered into a first amendment to the Loan Agreement with Gerber. Pursuant to the first amendment, the aggregate principal amount of the Revolving Line at any time outstanding was increased to \$4.0 million and the principal amount of loans, plus the face amount of any outstanding letters of credit, at any time outstanding could not exceed the lesser of (i) 40% of the value of certain inventory and (ii) 50% of certain accounts receivable.

On November 9, 2018, we and KIM entered into a second amendment to the Loan Agreement with Gerber. Pursuant to the second amendment, the aggregate principal amount of the revolving credit facility at any time outstanding was increased to \$8.0 million. Additionally, subject to certain exceptions, the face amount of any outstanding letters of credit, at any time outstanding cannot exceed the lesser of (i) 25% of the value of certain inventory (increasing to 40% upon receipt of certain landlord waivers) and (ii) 50% of certain accounts receivable. As of November 30, 2018, the amount outstanding on the Revolving Line was \$6,728,632.

#### **Results of Operations - Comparison for the three month periods ended November 30, 2018 and 2017**

##### **Revenue**

For the three months ended November 30, 2018, our revenue increased to \$25,319,642, compared to \$8,847,115 for the three months ended November 30, 2017, which represents an increase of \$16,472,527 or 186%. We experienced solid organic growth across all markets, namely in California following the adoption of adult use cannabis sales from January 1st, 2018. In addition, vaping product related sales remained strong as this sector of the cannabis industry continues to perform well. In addition, we achieved strong growth for custom branded products as customers seek differentiated brand building solutions in line with regulatory requirements. Non-organic revenue related to acquisitions represented 7% of total revenue during the three months ended November 30, 2018.

##### **Gross Profit**

Gross profit for the three months ended November 30, 2018 was \$3,229,138, or 13% of revenue, compared to \$3,080,539, or 35% of revenue, for the three months ended November 30, 2017. The decrease in gross profit percentage is primarily attributable an increase in freight costs as a result of air freighting inventory versus ocean freight to rapidly meet customer demand to compensate for vendor capacity issues. Supply chain inefficiencies are currently being addressed to reduce the need to air freight product, which we expect will significantly reduce freight costs in the future which will favorably impact gross profits. Overhead costs also increased as a % of revenue, which is contributing to a decrease in gross profits in preparation to scale the business for expected growth. Also contributing the gross profit decrease is the mix of products sold, driven by vaporizers and cartridges sales that carry lower margins than the rest of the product portfolio.

## Operating Expenses

Our operating expenses for the three months ended November 30, 2018 increased to \$11,687,489, or 46% of total revenue, from \$7,385,598, or 83% of total revenue, for the three months ended November 30, 2017. The increase is due to the expansion of the business, primarily attributed to increased personnel cost, insurance, professional and facility expenses, partially offset by a \$4,062,237 decrease in the change in contingent consideration payable. We will continue to make significant investments in infrastructure and supply chain to scale effectively.

## Income (Loss) from Operations

Loss from operations for the three months ended November 30, 2018 was \$8,458,351 compared to a loss from operations of \$4,305,060 for the three months ended November 30, 2017. The decrease is primarily attributable to investment in infrastructure and personnel to scale the expanding business offset partially by the gain on disposition of RUB assets and a \$4,062,237 decrease in the change in contingent consideration payable.

## Other Income (Expense), Net

Other Income (expense), net, during the three months ended November 30, 2018 was net expense of \$120,963, as compared to an expense of \$2,413 for the three months ended November 30, 2017. The increase is attributed interest expense related to the increased credit line capacity and warrant liability loss offset by a gain from the change in fair value of our equity investment.

## Income Tax Expense

The provision for income taxes was \$0 and \$54,415, for both the three-month periods ended November 30, 2018 and 2017, respectively.

## Net Income (Loss)

Our net result for the three months ended November 30, 2018 was a net loss of \$8,579,315 or \$0.11 per share, compared to net loss of \$4,361,888 or \$0.07 per share, for the three months ended November 30, 2017.

## Liquidity and Capital Resources

As of November 30, 2018, we had cash of \$3,028,436 and a working capital surplus of \$25,946,286 compared to cash of \$5,549,431 and working capital deficit of \$4,899,430 as of November 30, 2017. Working capital increased by \$30,845,716. The increase in working capital is primarily due to an increase in net revenue for the three month period ended November 30, 2018, as compared to the same period a year ago, increased purchases of inventory to meet increased customer demand and decreased contingent consideration payable.

### *Cash Flows from Operating Activities*

For the three month period ended November 30, 2018, net cash used in operating activities was \$15,482,989 compared to \$960,317 in net cash used in operating activities for the three month period ended November 30, 2017. The change is primarily attributed to an increase in inventory, including related prepayments, and accounts receivable during the three month period ended November 30, 2018.

### *Cash Flows from Investing Activities*

Net cash used in investing activities increased from \$92,901 for the three month period ended November 30, 2017 to \$707,006 for the three month period ended November 30, 2018, which can be primarily attributed to higher levels of equipment purchases during the current period.

### *Cash Flows from Financing Activities*

Net cash provided by financing activities increased from \$5,685,665 for the three month period ended November 30, 2017 to \$5,751,624 for the three month period ended November 30, 2018. The increase is primarily attributed to the net drawdown on line of credit.

We manage our liquidity and financial position in the context of our overall business strategy. We continually forecast and manage our cash, working capital balances, and capital structure to meet the short-term and long-term obligations of our business while seeking to maintain liquidity and financial flexibility. We have historically funded our operations primarily through the cash flows generated from our operations, borrowings available under our credit facility and from proceeds from the issuance of equity.

We believe that cash generated from our operations, along with the funds available through debt or equity financings, primarily for the purposes of expanding current operations, making capital acquisitions, or consummating strategic transactions are adequate to fund our financial obligations for at least the next twelve months.

### *Off-Balance Sheet Arrangements*

We do not currently have, and did not have during the periods presented, any off-balance sheet arrangements, as defined under SEC rules.

### **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of the condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, accounts receivable reserves, inventory and related reserves, valuations and purchase price allocations related to business combinations, expected cash flows used to evaluate the recoverability of long-lived assets, estimated fair values of long-lived assets used to record impairment charges related to intangible assets and goodwill, amortization periods, accrued expenses, stock-based compensation, contingent liabilities, and recoverability of our net deferred tax assets and any related valuation allowance. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates, other than the adoption of ASC 606, Revenue Recognition, described in Amendment No. 1 to our Annual Report on Form 10-K/A for the fiscal year ended August 31, 2018.

### **Item 3. Quantitative and Qualitative Disclosure About Market Risk**

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash and cash equivalents. We consider investments that, when purchased, have a remaining maturity of ninety (90) days or less to be cash equivalents. We do not believe that a notional or hypothetical 10% change in interest rate percentages would have a material impact on the fair value of our investment portfolio or our interest income.

### **Item 4. Controls and Procedures**

#### **Management's Evaluation of our Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and the Chief Financial Officer, we are responsible for conducting an evaluation of the effectiveness of the design and operation of our internal controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the fiscal quarter covered by this report. Disclosure controls and procedures means that the material information required to be included in our SEC reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to our company, including any consolidating subsidiaries, and was made known to us by others within those entities, particularly during the period when this report was being prepared. Based on this evaluation, our principal executive officer and principal financial officer concluded as of the evaluation date that our disclosure controls and procedures were not effective as of November 30, 2018.

In connection with the restatement discussed in the Explanatory Note to this Form 10-Q/A and Note 2 titled "Restatement" to the Company's condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q/A, management, including our Chief Executive Officer and Chief Financial Officer, reassessed the effectiveness of our disclosure controls and procedures as of November 30, 2018. Based on this reassessment, management has concluded that we did not maintain effective disclosure controls and procedures as of November 30, 2018 because (1) a material weakness related to the accounting, presentation, and disclosure of share-settled contingent consideration, (2) we had inadequate segregation of duties consistent with control objectives and (3) we had a lack of multiple levels of supervision and review. Management concluded that these deficiencies were material weaknesses as defined in the Securities and Exchange Commission regulations. These material weaknesses resulted in the misstatement of our financial statements and disclosures for the fiscal years ended August 31, 2018 and 2017, and for each of the interim periods ended May 31, 2017, November 30, 2017, February 28, 2018, May 31, 2018 and November 30, 2018, as more fully discussed in Note 2 titled "Restatement" to the Company's consolidated financial statements included in Part I, Item 1 of this Form 10-Q/A.

We have taken steps to enhance our internal controls over financial reporting and plan to take additional steps to remediate the material weaknesses. Specifically:

- We appointed additional independent members with public company board experience to our board of directors, such that our board of directors is now composed of a majority of independent directors;
- On March 9, 2018, our board of directors formed an Audit Committee composed entirely of independent directors that, among other things, assists the board of directors in its oversight of the integrity of our financial statements and our financing reporting processes and systems of internal control;
- The Company announced the hiring of our new Chief Financial Officer, Christopher Tedford, with significant sales and distribution experience who will focus on the development of the finance and accounting function;
- We added staff to our finance team, and outsourced to third party the assessment of certain complex transactions under US GAAP;

- In January 2018, we hired a controller with public company experience; and
- We have adopted a Code of Business Conduct and Ethics and a whistleblower policy.
- In February 2019, we engaged a national accounting advisory firm to assist with the design and implementation of our internal control over financial reporting based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Our management will continue to monitor and evaluate the effectiveness of our disclosure controls and procedures and our internal controls over financial reporting on an ongoing basis and is committed to taking further action and implementing additional enhancements or improvements.

During the period covered by this amended Quarterly Report on Form 10-Q/A, we have not been able to remediate the material weaknesses described above. To remediate such weaknesses, we plan to appoint additional qualified personnel to address inadequate segregation of duties and implement modifications to our financial controls to address such inadequacies.

The remediation efforts set out herein will continue to be implemented in our 2019 fiscal year. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake.

### **Changes in Internal Control over Financial Reporting**

There has been no change in our internal control over financial reporting identified in connection with our evaluation we conducted of the effectiveness of our internal control over financial reporting as of November 30, 2018, that occurred during our first fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

To the best of the Company's knowledge and belief, no material legal proceedings are currently pending or threatened.

### **Item 1A. Risk Factors.**

Item 1A of Part I of Amendment No. 1 to our Annual Report on Form 10-K/A for the year ended August 31, 2018, filed with the SEC on April 11, 2019 contains risk factors identified by the Company. Our operations could also be affected by additional factors that are not presently known to us or by factors that we currently consider immaterial to our business. To our knowledge and except to the extent additional factual information disclosed in this Amendment No. 1 to our Quarterly Report on Form 10-Q/A relates to such risk factors, there have been no material changes in the risk factors described in "Item 1A. Risk Factors" in Amendment No. 1 to our Annual Report on Form 10-K/A for the fiscal year ended August 31, 2018.

### **Item 2. Unregistered Sales of Equity Securities.**

During the three months ended November 30, 2018, we granted 457,627 unregistered shares of our common stock for services pursuant to contracts, with an aggregate fair market value of \$2,754,915.

Subsequent to November 30, 2018 and through the date of this filing, we sold 2,307,141 shares of our common stock to investors in exchange for aggregate gross proceeds of \$9,468,394.

These securities were issued without registration under the Securities Act in reliance on registration exemptions contained in Section 4(a)(2) of the Securities Act and Regulation D as transactions by an issuer not involving any public offering. The recipients of securities in each such transaction represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and appropriate legends were affixed to the share certificates and other instruments issued in such transactions. The sales of these securities were made without general solicitation or advertising.

### **Item 3. Default Upon Senior Securities.**

None.

### **Item 4. Mine Safety Disclosures.**

Not applicable.

### **Item 5. Other Information.**

None.

**Item 6. Exhibits**

The following exhibits are filed as part of this Current Report on Form 10-Q. Where such filing is made by incorporation by reference to a previously filed document, such document is identified.

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
<a href="#"><u>3.1<sup>(1)</sup></u></a>	<a href="#"><u>Amended and Restated Articles of Incorporation of KushCo Holdings, Inc.</u></a>
<a href="#"><u>10.1<sup>(2)</sup></u></a>	<a href="#"><u>Asset Purchase Agreement, dated September 21, 2018, by and between KushCo Holdings, Inc. and Smoke Cartel, Inc.</u></a>
<a href="#"><u>10.2<sup>(3)</sup></u></a>	<a href="#"><u>Second Amendment to Loan and Security Agreement, dated November 9, 2019, by and among Gerber Finance, Inc., KushCo Holdings, Inc. and KIM International Corporation.</u></a>
<a href="#"><u>10.3<sup>(4)</sup></u></a>	<a href="#"><u>Offer Letter, dated November 8, 2018, by and between KushCo Holdings, Inc. and Christopher Tedford.</u></a>
<a href="#"><u>10.4<sup>(5)</sup></u></a>	<a href="#"><u>Amended and Restated Offer Letter, dated November 21, 2018, by and between KushCo Holdings, Inc. and Jason Vegotsky</u></a>
<a href="#"><u>31.1*</u></a>	<a href="#"><u>Certification of principal executive officer pursuant to Rules 13a-15(e) and 15d-15(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
<a href="#"><u>31.2*</u></a>	<a href="#"><u>Certification of principal financial and accounting officer pursuant to Rules 13a-15(e) and 15d-15(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
<a href="#"><u>32.1**</u></a>	<a href="#"><u>Certification of principal executive officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></a>
<a href="#"><u>32.2**</u></a>	<a href="#"><u>Certification of principal financial and accounting officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></a>
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.

- (1) Previously filed as an exhibit to the Company's Current Report on Form 8-K (filed September 4, 2018) and incorporated by reference thereto.
- (2) Previously filed as an exhibit to the Company's Current Report on Form 8-K (filed September 26, 2018) and incorporated by reference thereto.
- (3) Previously filed as an exhibit to the Company's Current Report on Form 8-K (filed November 14, 2018) and incorporated by reference thereto.
- (4) Previously filed as an exhibit to the Company's Current Report on Form 8-K (filed November 21, 2018) and incorporated by reference thereto.
- (5) Previously filed as an exhibit to the Company's Annual Report on Form 10-K (filed November 29, 2018) and incorporated by reference thereto.

\* Filed herewith.

\*\*This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

# Management contract or compensatory plan or arrangement.

**SIGNATURES**

Pursuant to the requirements 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.

**KUSHCO HOLDINGS, INC.**

Date: April 11, 2019

By: /s/ Nicholas Kovacevich  
Nicholas Kovacevich  
Chairman and Chief Executive Officer  
(Principal executive officer)

Date: April 11, 2019

By: /s/ Christopher Tedford  
Christopher Tedford  
Chief Financial Officer  
(Principal financial and accounting officer)

**Certification**

I, Nicholas Kovacevich, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q/A of KushCo Holdings, 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 to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 11, 2019

/s/ Nicholas Kovacevich

---

Nicholas Kovacevich  
Chairman and Chief Executive Officer  
(principal executive officer)

---

**Certification**

I, Christopher Tedford, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q/A of KushCo Holdings, 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 to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 11, 2019

/s/ Christopher Tedford

Christopher Tedford

Chief Financial Officer

(principal accounting and financial officer)

---

**CERTIFICATION OF PERIODIC FINANCIAL REPORT  
PURSUANT TO 18 U.S.C. SECTION 1350**

The undersigned officer of KushCo Holdings, Inc. (the "Company") hereby certifies to his knowledge that the Company's Quarterly Report on Form 10-Q/A for the three months ended November 30, 2018 (the "Report") to which this certification is being furnished as an exhibit, as filed with the Securities and Exchange Commission on the date hereof, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company. This certification is provided solely pursuant to 18 U.S.C. Section 1350 and Item 601(b)(32) of Regulation S-K ("Item 601(b)(32)") promulgated under the Securities Act of 1933, as amended (the "Securities Act"), and the Exchange Act. In accordance with clause (ii) of Item 601(b)(32), this certification (A) shall not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and (B) shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

Date: April 11, 2019

/s/ Nicholas Kovacevich

\_\_\_\_\_  
Nicholas Kovacevich  
Chairman and Chief Executive Officer  
(principal executive officer)

---

**CERTIFICATION OF PERIODIC FINANCIAL REPORT  
PURSUANT TO 18 U.S.C. SECTION 1350**

The undersigned officer of KushCo Holdings, Inc. (the "Company") hereby certifies to his knowledge that the Company's Quarterly Report on Form 10-Q/A for the three months ended November 30, 2018 (the "Report") to which this certification is being furnished as an exhibit, as filed with the Securities and Exchange Commission on the date hereof, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company. This certification is provided solely pursuant to 18 U.S.C. Section 1350 and Item 601(b)(32) of Regulation S-K ("Item 601(b)(32)") promulgated under the Securities Act of 1933, as amended (the "Securities Act"), and the Exchange Act. In accordance with clause (ii) of Item 601(b)(32), this certification (A) shall not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and (B) shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

Date: April 11, 2019

/s/ Christopher Tedford

Christopher Tedford

Chief Financial Officer

(principal financial and accounting officer)

---