

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

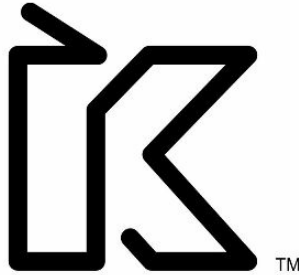
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended February 28, 2017

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



KUSH BOTTLES, INC.

(Name of small business issuer as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

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

1800 Newport Circle, Santa Ana, CA 92705
(Address of Principal Executive Offices) (Zip Code)

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

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

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:
_____ shares outstanding as of April 11, 2017.

KUSH BOTTLES, INC.

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KUSH BOTTLES, INC
Condensed Consolidated Balance Sheets
(Unaudited)

	February 28, 2017	August 31, 2016
ASSETS		
CURRENT ASSETS		
Cash	\$ 2,833,159	\$ 1,027,003
Accounts receivable, net of allowance	486,887	199,844
Prepaid expenses and other current assets	701,057	596,456
Inventory	<u>1,910,807</u>	<u>1,142,458</u>
Total Current Assets	<u>5,931,910</u>	<u>2,965,761</u>
Goodwill	2,376,589	2,376,589
Deposits	40,599	12,220
Property and equipment, net	<u>861,423</u>	<u>273,597</u>
TOTAL ASSETS	<u>\$ 9,210,521</u>	<u>\$ 5,628,167</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 755,392	\$ 369,636
Accrued expenses and other current liabilities	533,832	549,101
Notes payable - current portion	<u>28,123</u>	<u>20,247</u>
Total Current Liabilities	<u>1,317,347</u>	<u>938,984</u>
LONG-TERM DEBT		
Notes payable	<u>46,236</u>	<u>39,307</u>
TOTAL LIABILITIES	<u>1,363,583</u>	<u>978,291</u>
COMMITMENTS and CONTINGENCIES		
	-	-
STOCKHOLDERS' EQUITY		
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, 50,143,775 and 48,300,162 shares issued and outstanding, respectively	50,143	48,300
Additional paid-in capital	8,630,719	5,278,284
Accumulated deficit	<u>(833,924)</u>	<u>(676,708)</u>
Total Stockholders' Equity	<u>7,846,938</u>	<u>4,649,876</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 9,210,521</u>	<u>\$ 5,628,167</u>

See accompanying notes to the unaudited condensed consolidated financial statements

KUSH BOTTLES, INC.
Condensed Consolidated Statements of Operations
(Unaudited)

	For the Three Months Ended February 28,		For the Six Months Ended February 28,	
	2017	2016	2017	2016
REVENUE	\$ 2,970,332	\$ 1,798,539	\$ 5,442,593	\$ 3,519,029
COST OF GOODS SOLD	<u>1,913,270</u>	<u>1,200,690</u>	<u>3,549,789</u>	<u>2,351,189</u>
GROSS PROFIT	<u>1,057,062</u>	<u>597,849</u>	<u>1,892,804</u>	<u>1,167,840</u>
OPERATING EXPENSES				
Depreciation	10,174	6,057	19,478	11,948
Stock compensation expense	147,564	12,908	262,808	12,908
Selling, general and administrative	<u>894,870</u>	<u>560,344</u>	<u>1,741,921</u>	<u>1,105,977</u>
Total Operating Expenses	<u>1,052,608</u>	<u>579,309</u>	<u>2,024,207</u>	<u>1,130,833</u>
INCOME (LOSS) FROM OPERATIONS	<u>4,454</u>	<u>18,540</u>	<u>(131,403)</u>	<u>37,007</u>
OTHER INCOME (EXPENSES)				
Other expense	-	-	(23,944)	-
Interest expense	<u>(835)</u>	<u>(9,922)</u>	<u>(1,869)</u>	<u>(12,315)</u>
Total Other Income (Expenses)	<u>(835)</u>	<u>(9,922)</u>	<u>(25,813)</u>	<u>(12,315)</u>
INCOME (LOSS) BEFORE INCOME TAXES	3,619	8,618	(157,216)	24,692
PROVISION FOR INCOME TAXES	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
NET INCOME (LOSS)	<u>\$ 3,619</u>	<u>\$ 8,618</u>	<u>\$ (157,216)</u>	<u>\$ 24,692</u>
BASIC INCOME (LOSS) PER SHARE	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ (0.00)</u>	<u>\$ 0.00</u>
DILUTED INCOME (LOSS) PER SHARE	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ (0.00)</u>	<u>\$ 0.00</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC	<u>49,104,742</u>	<u>46,438,907</u>	<u>49,245,364</u>	<u>46,351,843</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - DILUTED	<u>50,540,603</u>	<u>47,412,506</u>	<u>49,245,364</u>	<u>47,325,442</u>

See accompanying notes to the unaudited condensed consolidated financial statements

KUSH BOTTLES, INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

For the Six Months Ended
February 28,

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (157,216)	\$ 24,692
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	73,096	40,832
Stock compensation expense	262,808	17,377
Changes in operating assets and liabilities		
Accounts receivable	(287,043)	(89,546)
Prepays	17,946	(314,741)
Inventory	(768,349)	(322,552)
Deposits	(28,379)	-
Accounts payable	385,756	(94,663)
Accrued expenses and other current liabilities	(15,269)	187,014
Net cash used in operating activities	<u>(516,650)</u>	<u>(551,587)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	<u>(660,922)</u>	<u>(70,407)</u>
Net cash used in investing activities	<u>(660,922)</u>	<u>(70,407)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of related party loan	-	(49,998)
Drawdown on line of credit	-	155,000
Proceeds from notes payable	24,785	-
Repayment of notes payable	(9,980)	(12,347)
Proceeds from stock option exercises	29,000	-
Proceeds from sale of stock	<u>2,939,923</u>	<u>736,010</u>
Net cash provided by financing activities	<u>2,983,728</u>	<u>828,665</u>
NET INCREASE IN CASH	1,806,156	206,671
CASH AT BEGINNING OF PERIOD	<u>1,027,003</u>	<u>201,259</u>
CASH AT END OF PERIOD	<u>\$ 2,833,159</u>	<u>\$ 407,930</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
CASH PAID FOR:		
Interest	<u>\$ 1,869</u>	<u>\$ 12,315</u>
Income taxes	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to the condensed consolidated financial statements

KUSH BOTTLES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 – NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Kush Bottles, Inc. ("the Company") was incorporated in the state of Nevada on February 26, 2014. The Company specializes in the wholesale distribution of packaging supplies for the cannabis industry. The Company's wholly owned subsidiary Kim International Corporation (KIM), a California corporation, was originally incorporated as Hy Gro Economics Corporation ("Hy Gro") on December 2, 2010. On October 30, 2012, Hy Gro amended its articles of incorporation to reflect a name change to KIM International Corporation (KIM).

Recapitalization

On March 4, 2014, the shareholders of KIM exchanged all 10,000 of their common shares for 32,400,000 common shares of Kush Bottles, Inc. The operations of KIM became the operations of Kush after the share exchange and accordingly the transaction is accounted for as a recapitalization of KIM whereby the historical financial statements of KIM were presented as the historical financial statements of the combined entity.

Subsequent to the share exchange, the members of KIM owned 32,400,000 of shares of Company's common stock, effectively obtaining operational and management control of Kush. Kush had no operations prior to the share exchange. As a result of the recapitalization, KIM was the acquiring entity in accordance with ASC 805, Business Combinations. The accumulated losses of KIM were carried forward after the completion of the share exchange. Operations prior to the share exchange were those of KIM.

All reference to common stock shares and per share amounts were restated to effect the recapitalization which occurred on March 4, 2014.

Acquisition of Dank Bottles, LLC

On April 10, 2015, the Company entered into an equity purchase agreement to acquire all of the issued and outstanding membership interests in Dank Bottles, LLC ("Dank"), a Colorado limited liability company, effectively making Dank a wholly owned subsidiary of the Company. In exchange for the purchased interests, the Company paid cash consideration of \$373,725 and issued 3,500,000 shares of common stock to the sellers of Dank.

The acquisition was accounted for using the purchase method of accounting in accordance with ASC 805, Business Combinations. As of April 10, 2015, the assets acquired, including the identifiable intangible assets, and liabilities assumed from Dank were recorded at their respective fair values. Any excess of the purchase price for the acquisition over the net fair value of Dank identified tangible and intangible assets acquired and liabilities assumed were recorded as goodwill. The fair value measurements utilize estimates based on key assumptions of the Acquisition, and historical and current market data.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and related notes include the activity of the Company and its wholly owned subsidiaries KIM and Dank have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information. 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. Our operating results for the three and six month periods ended February 28, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ended August 31, 2017, 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, 2016.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers cash and cash equivalents to consist of cash on hand and investments having an original maturity of 90 days or less that are readily convertible into cash. As of February 28, 2017 and August 31, 2016, the Company had \$2,833,159 and \$1,027,003, respectively.

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 \$2,000 as of February 28, 2017 and August 31, 2016, 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 \$1,910,807 and \$1,142,458 as of February 28, 2017 and August 31, 2016, respectively.

Property and Equipment

Property and equipment is recorded at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, after the asset is placed in service. Asset lives range from 3 to 7 years. Gains and losses from the retirement or disposition of property and equipment are included in operations in the period incurred. Maintenance and repairs are expensed as incurred.

Fair Value of Financial Instruments

The fair value of certain of our financial instruments, including cash and cash equivalents, receivables, other current assets, accounts payable, accrued compensation and employee benefits, other accrued liabilities and notes payable, approximate their carrying amounts because of the short-term maturity of these instruments.

Concentration of Risk

Financial instruments that potentially expose us to concentrations of risk consist primarily of cash and cash equivalents and accounts receivable, which are generally not collateralized. Our policy is to place our cash and cash equivalents with high quality financial institutions, in order to limit the amount of credit exposure. The Company generally does not require collateral from its customers, but its credit extension and collection policies include analyzing the financial condition of potential customers, establishing credit limits, monitoring payments, and aggressively pursuing delinquent accounts. The Company maintains allowances for potential credit losses. A significant portion of the Company's revenues are derived from the sales of products to the purveyors of cannabis products and services.

Goodwill and Other Long-Lived Assets

Goodwill represents the excess of cost over the fair value of identifiable assets acquired and liabilities assumed in business combinations. The Company's management assess goodwill for impairment on an annual basis during the fourth quarter using an August 1 measurement date unless circumstances require a more frequent measurement. When evaluating goodwill for impairment, the Company may first perform an assessment qualitatively whether it is more likely than not that a reporting unit's carrying amount exceeds its fair value, referred to as a "step zero" approach. If, based on the review of the qualitative factors, the Company determines it is not more likely than not that the fair value of goodwill is less than its carrying value, it would bypass the two-step impairment test. Events and circumstances the Company considers in performing the "step zero" qualitative assessment include macro-economic conditions, market and industry conditions, internal cost factors, share price fluctuations, and the operational stability and the overall financial performance of the reporting units. If the Company concludes that it is more likely than not that a reporting unit's fair value is less than its carrying amount, it would perform the first step ("step one") of the two-step impairment test and calculate the estimated fair value of the goodwill by using discounted cash flow valuation model. These methods require estimates of future revenues, profits, capital expenditures, working capital, and other relevant factors. The Company estimates these amounts by evaluating historical trends, current budgets, operating plans, industry data, and other relevant factors.

For fiscal 2016, the Company began its assessment with the step zero qualitative analysis because the fair value substantially exceeded the carrying value goodwill. After evaluating and weighing all relevant events and circumstances, the Company concluded that it is not more likely than not that the fair value of goodwill was less its carrying amounts. Consequently, the Company did not perform a step one quantitative analysis in fiscal 2016.

Earnings (Loss) Per Share

The Company computes net loss 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 loss by the weighted average number of shares of common stock. Diluted net loss per share is computed using the weighted average number of common and common stock equivalent shares outstanding during the period.

Basic earnings per share are computed by dividing net earnings by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share are computed by dividing net earnings by the sum of (a) the weighted average number of shares of common stock outstanding during the period and (b) the potentially dilutive securities outstanding during the period. Stock options are the only potentially dilutive securities; and the number of dilutive options is computed using the treasury stock method.

The following table sets forth the calculation of basic and diluted earnings per share:

	Three months ended		Six months ended	
	February 28, 2017	February 29, 2016	February 28, 2017	February 29, 2016
Net income (loss)	\$ 3,619	\$ 8,618	\$ (157,216)	\$ 24,692
Weighted average common shares outstanding for basic EPS	49,104,742	46,438,907	49,245,364	46,351,843
Net effect of dilutive options	1,435,861	973,599	-	973,599
Weighted average common shares outstanding for diluted EPS	50,540,603	47,412,506	49,245,364	47,325,442
Basic earnings (loss) per share	\$ 0.00	\$ 0.00	\$ (0.00)	\$ 0.00
Diluted earnings (loss) per share	\$ 0.00	\$ 0.00	\$ (0.00)	\$ 0.00

Comprehensive Income (loss)

Comprehensive income (loss) is the change in the Company's equity (net assets) during each period from transactions and other events and circumstances from non-owner sources. During the quarters ended February 28, 2017 and 2016, the Company had no elements of comprehensive income or loss.

Revenue Recognition

It is the Company's policy that revenues from product sales is recognized in accordance with ASC 605 "Revenue Recognition". Four basic criteria must be met before revenue can be recognized; (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectability is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding fixed nature in selling prices of the products delivered and the collectability of those amounts. The Company has not implemented any specific rebate programs. Provisions for discounts to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. During the quarters ended February 28, 2017 and 2016, we had provisions for sales discounts of \$19,457 and \$19,034, respectively. The Company has not established a formal customer incentive program, but considers and accomodates discounts to certain customers on a case by case basis, including by way of example, for volume shipping or for certain new customers with orders over a specific discretionary dollar threshold.

As of February 28, 2017 and August 31, 2016, the Company had a refund allowance of \$0. Consistent with ASC 605-15-25-1, the Company considers factors such as historical return of products, estimated remaining shelf life, price changes from competitors, and introductions of competing products in establishing a refund allowance. The Company recognizes revenues as risk and title to products transfers to the customer (which generally occurs at the time shipment is made), the sales price is fixed or determinable, and collectability is reasonably assured. The Company defers any revenue for which the product was not delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required.

Warranty Costs

The Company has not had any historical warranty related expenditures from the sales of its products, which if incurred would result in the return of any defective products by customers.

Business Combinations

Accounting for our acquisitions requires the Company to recognize, separately from goodwill, the assets acquired and the liabilities assumed at their acquisition-date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition-date fair values of the assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date, its estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the consolidated statements of operations and comprehensive income (loss).

Accounting for business combinations requires the Company's management to make significant estimates and assumptions, especially at the acquisition date including its estimates for intangible assets, contractual obligations assumed, pre-acquisition contingencies and contingent consideration, where applicable. If management cannot reasonably determine the fair value of a pre-acquisition contingency (non-income tax related) by the end of the measurement period, the Company will recognize an asset or a liability for such pre-acquisition contingency if: (i) it is probable that an asset existed or a liability had been incurred at the acquisition date and (ii) the amount of the asset or liability can be reasonably estimated. Although the Company believes the assumptions and estimates it has made in the past have been reasonable and appropriate, they are based in part on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Subsequent to the measurement period, changes in the estimates of such contingencies will affect earnings and could have a material effect on the Company's results of operations and financial position.

Examples of critical estimates in valuing certain of the intangible assets we have acquired include but are not limited to: (i) future expected cash flows from product sales; (ii) the acquired company's brand and competitive position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company's product portfolio. Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results.

In addition, any uncertain tax positions and tax related valuation allowances assumed in connection with a business combination are initially estimated as of the acquisition date. If applicable, the Company would reevaluate these items quarterly based upon facts and circumstances that existed as of the acquisition date with any adjustments to its preliminary estimates being recorded to goodwill provided that we are within the measurement period. Subsequent to the measurement period or the final determination of the tax allowance's or contingency's estimated value, whichever comes first, changes to these uncertain tax positions and tax related valuation allowances will affect the Company's provision for income taxes in our consolidated statements of income and comprehensive income and could have a material impact on our results of operations and financial position.

Share-based Compensation

The Company account for its stock based award in accordance with Accounting Standards Codification subtopic 718-10, "Compensation", which requires fair value measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including restricted stock awards. The Company estimates the fair value of stock using the stock price on the date of the approval of the award. The fair value is then expensed over the requisite service periods of the awards, which is generally the performance period and the related amount is recognized in the consolidated statements of operations.

Advertising

The Company conducts advertising for the promotion of its services. In accordance with ASC Topic 720-35-25, advertising costs are charged to operations when incurred.

Income Taxes

The Company accounts for income taxes in accordance with accounting guidance now codified as FASB ASC 740, "Income Taxes," which requires that the Company recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized.

The Company applies the provisions of ASC 740, "Accounting for Uncertainty in Income Taxes". The ASC clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The ASC provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company did not identify any material uncertain tax positions on returns that have been filed or that will be filed. The Company did not recognize any interest or penalties for unrecognized tax benefits during the six months ended February 28, 2017 and the fiscal year ended August 31, 2016, nor were any interest or penalties accrued as of February 28, 2017 and August 31, 2016.

Fair Value of Financial Instruments

The Company adopted ASC 820 which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The standard outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures. Under this standard certain assets and liabilities must be measured at fair value, and disclosures are required for items measured at fair value.

The Company currently does not have non-financial assets or non-financial liabilities that are required to be measured at fair value on a recurring basis. The Company's financial assets and liabilities are measured using inputs from the three levels of the fair value hierarchy. The three levels are as follows:

Level 1 - Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. The fair value of the Company's cash is based on quoted prices and therefore classified as Level 1.

Level 2 - Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3 - Unobservable inputs that reflect management's assumptions about the assumptions that market participants would use in pricing the asset or liability.

Application of Valuation Hierarchy

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following is a description of the valuation methodology used to measure fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Note Payable – Vehicle Loan. The Company assesses the fair value of this liability to approximate its carrying value based on the effective yields of similar obligations.

The Company had no financial assets or liabilities that are measured at fair value on a recurring basis as of February 28, 2017 and August 31, 2016.

Segment Information

The Company is organized as a single operating segment, whereby its chief operating decision maker assesses the performance of and allocates resources to the business as a whole.

Recently Issued Accounting Pronouncements

In January 2017, the FASB issued Accounting Standards Update 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 does not anticipate the adoption of ASU 2017-04 will have a material impact on its consolidated financial statements.

In August, 2016, the FASB issued Accounting Standards Update No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)* ("ASU 2016-15"). The amendments in ASU 2016-15 address eight specific cash flow issues and apply to all entities that are required to present a statement of cash flows under ASC Topic 230, *Statement of Cash Flows*. The amendments in ASU 2016-15 are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption during an interim period. The Company has not yet completed the analysis of how adopting this guidance will affect its consolidated financial statements.

In May 2016, accounting guidance was issued to clarify the not yet effective revenue recognition guidance issued in May 2014. This additional guidance does not change the core principle of the revenue recognition guidance issued in May 2014, rather, it provides clarification of accounting for collections of sales taxes as well as recognition of revenue (i) associated with contract modifications, (ii) for noncash consideration, and (iii) based on the collectability of the consideration from the customer. The guidance also specifies when a contract should be considered “completed” for purposes of applying the transition guidance. The effective date and transition requirements for this guidance are the same as the effective date and transition requirements for the guidance previously issued in 2014, which is effective for interim and annual periods beginning on or after December 15, 2017. The Company not yet determined the impact that this new guidance will have on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The amendments in this update change existing guidance related to accounting for employee share-based payments affecting the income tax consequences of awards, classification of awards as equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual periods, with early adoption permitted. The Company is currently evaluating the potential impact of the adoption of this standard.

In February 2016, the FASB issued ASU 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 is currently evaluating the potential impact of the adoption of this standard.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this update revise the accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The amendments are effective for annual reporting periods after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the potential impact of the adoption of this standard.

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 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 – CONCENTRATIONS OF RISK

Supplier Concentrations

The Company purchases inventory from various suppliers and manufacturers. For the six months ended February 28, 2017 and 2016, three vendors accounted for approximately 39% and 50%, respectively, of total inventory purchases.

Customer Concentrations

During the six months ended February 28, 2017 and 2016, one customer represented 9% and 11% of the Company's revenues, respectively.

NOTE 3 – RELATED-PARTY TRANSACTIONS

The Company leases its California and Colorado facilities from related parties. During the six months ended February 28, 2017 and 2016, the Company made rent payments of \$101,400 and \$84,600, respectively, to these related parties.

NOTE 4 – PROPERTY AND EQUIPMENT

The major classes of fixed assets consist of the following as of February 28, 2017 and August 31, 2016:

	February 28, 2017	August 31, 2016
Machinery and equipment	\$ 737,825	\$ 147,577
Vehicles	165,806	116,592
Office Equipment	90,112	71,507
Leasehold improvements	65,953	63,323
	1,059,696	398,999
Accumulated Depreciation	(198,273)	(125,402)
	\$ 861,423	\$ 273,597

Depreciation expense was \$73,096 and \$40,832, for the three months ended February 28, 2017 and 2016, respectively.

NOTE 5 – ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	February 28, 2017	August 31, 2016
Customer deposits	\$ 287,628	\$ 260,409
Accrued compensation	104,785	178,769
Credit card liabilities	89,512	67,813
Deferred rent	28,021	18,810
Sales tax payable	23,884	23,300
	\$ 533,830	\$ 549,101

NOTE 6 – STOCKHOLDERS' EQUITY

Preferred Stock

The authorized preferred stock is 10,000,000 shares with a par value of \$0.001. As of February 28, 2017 and August 31, 2016, 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 February 28, 2017 and August 31, 2016, 50,143,775 and 48,300,162 shares were issued and outstanding, respectively.

During the six months ended February 28, 2017, the Company sold 1,726,266 shares of its common stock to investors in exchange for cash of \$2,939,923.

Share-based Compensation

The Company recorded compensation expense of \$262,808 and \$12,908 for the six month periods ended February 28, 2017 and 2016, respectively, in connection with the issuance of shares of common stock and options to purchase common stock.

During the six month period ended February 28, 2017, the Company issued 81,790 shares of common stock to consultants in exchange for \$93,623 of services rendered and \$122,547 of prepaid services, for a total of \$216,170. The \$122,547 of prepaid services is included in prepaid expenses and other current assets on the condensed consolidated balance sheet as of February 28, 2017.

Stock Options

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 six months ended February 28, 2017 and 2016:

	February 28, 2017	February 29, 2016
Expected term (years)	1-4	N/A
Expected volatility	60%	N/A
Weighted-average volatility	60%	N/A
Risk-free interest rate	0.85%-1.57%	N/A
Dividend yield	0%	N/A
Expected forfeiture rate	33%	N/A

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 six months ended February 28, 2017 and 2016, the Company issued 865,000 and 0 stock options, respectively, pursuant to the Company's 2016 Stock Incentive Plan, which was adopted on February 9, 2016. A summary of the Company's stock option activity during the six month period ended February 28, 2017 is presented below:

	No. of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance Outstanding, August 31, 2016	2,039,000	\$ 0.57	5.67 years	\$2,283,680
Granted	865,000	\$ 2.08	9.74 years	-
Exercised	(42,500)	\$ 1.09	-	-
Forfeited	(140,000)	\$ 1.01	-	-
Balance Outstanding, February 28, 2017	2,721,500	\$ 1.02	6.72 years	\$ -
Exercisable, February 28, 2017	1,300,625	\$ 0.33	3.65 years	\$ -

The weighted-average grant-date fair value of options granted during the six months ended February 28, 2017 and 2016, was \$0.81 and \$0, respectively. The weighted-average grant-date fair value of options forfeited during the six months ended February 28, 2017 was \$0.46. The weighted-average grant-date fair value of options forfeited during the six months ended February 28, 2017 was \$0.42.

During the six months ended February 28, 2017, the Company issued 25,000 shares of common stock in exchange for \$29,000, pursuant to a stock option exercise. In addition, the Company issued 10,557 shares of common stock pursuant to a cashless exercise of 17,500 stock options.

A summary of the status of the Company's non-vested options as of August 31, 2016, and changes during the six month period ended February 28, 2017, is presented below:

	No. of Options	Weighted Average Grant-Date Fair Value
Nonvested at August 31, 2016	909,000	\$ 221,227
Granted	865,000	468,845
Vested	(213,125)	(169,185)
Forfeited	(140,000)	(70,469)
Nonvested at February 28, 2017	<u>1,420,875</u>	<u>\$ 450,418</u>

As of February 28, 2017, there was \$450,418 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 1.6 years. The total fair value of shares vested during the six month period February 28, 2017 was \$169,185. This amount is included in stock compensation expense on the consolidated statements of operations.

NOTE 7 – COMMITMENTS AND CONTINGENCIES

Lease

The Company's corporate head-quarters and primary distribution center is located in Santa Ana, California. Effective July 1, 2017, the Company's Santa Ana lease will be terminated and the Company will move its corporate headquarters from Santa Ana, California to Garden Grove, California. The new California facility lease expires on August 1, 2022 and requires escalating monthly payments that range between \$24,480 and \$28,379. On April 1, 2016, the Company entered into a new sublease agreement for a facility located in Woodinville, Washington. The lease commenced on July 15, 2016 and expires on January 31, 2020, and requires escalating monthly payments that range between \$14,985 and \$16,022. Effective April 10, 2015, the Company assumed the facility lease in Denver, Colorado, which is the headquarters of operations for its wholly-owned subsidiary, Dank. On September 1, 2016, the Colorado facility lease was amended to include additional office space. The lease runs through March 31, 2020 and requires escalating monthly payments, ranging between \$4,800 and \$7,300. During the six months ended February 28, 2017 and 2016, the Company recognized \$189,338 and \$101,203, respectively, of rental expense, related to its office, retail and warehouse space.

Minimum future commitments under non-cancelable operating leases and other obligations were as follows at February 28, 2017:

2017	\$ 452,180
2018	572,706
2019	570,285
2020	324,405
Thereafter	<u>521,132</u>
	<u>\$ 2,440,708</u>

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. The Company had no such agreements as of February 28, 2017.

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. The Company had no pending legal proceedings or claims as of February 28, 2017.

NOTE 8 – SUBSEQUENT EVENTS

Subsequent issuance of Common Stock

Subsequent to February 28, 2017 and through the date of this filing, the Company sold 39,985 shares of its common stock to investors in exchange for cash consideration of \$69,974.

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

Cautionary Statement Concerning Forward-Looking Statements

This report 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. The use of words such as "believes", "expects", "anticipates", "intends", "plans", "estimates", "should", "likely" or similar expressions, indicates a forward-looking statement.

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 the Company's financial condition, results of operations or future prospects;
- The Company's business and growth strategies;
- The Company's financing plans and forecasts;
- The factors that we expect to contribute to our success and the Company's ability to be successful in the future;
- The Company's business model and strategy for realizing positive results as sales increase;
- Competition, including the Company's ability to respond to such competition and its expectations regarding continued competition in the market in which the Company competes;
- Expenses;
- The Company's ability to meet its projected operating expenditures and the costs associated with development of new projects;
- The Company's ability to pay dividends or to pay any specific rate of dividends, if declared;
- The impact of new accounting pronouncements on its financial statements;
- That the Company's cash flows from operating activities will be sufficient to meet its projected operating expenditures for the next twelve months;
- The Company's market risk exposure and efforts to minimize risk;
- Development opportunities and its 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, the Company's estimates as to the amount of taxes that will ultimately be owed and the impact of these audits on the Company's financial statements;
- The Company's overall outlook including all statements under *Management's Discussion and Analysis or Plan of Operation*;
- That estimates and assumptions made in the preparation of financial statements in conformity with US GAAP may differ from actual results; and
- Expectations, plans, beliefs, hopes or intentions regarding the future.

The following discussion and analysis was prepared to supplement information contained in the accompanying consolidated financial statements and is intended to provide certain details regarding the Company's financial condition as of February 28, 2017, and the results of operations for the three and six months ended February 28, 2017. It should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto contained in this report as well as the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal years ended August 31, 2016 and August 31, 2015.

Overview

Kush Bottles, Inc. ("Kush" or the "Company") provides customizable packaging products, materials and supplies for the cannabis industry. Representative examples of our products include pop-top bottles, exit/barrier bags, tubes, and other small-sized 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 purchase commitments and no 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 invest in our own molds and intellectual property.

Results of Operations – Comparison for the three month periods ended February 28, 2017 and 2016

Total revenues increased from \$1,798,539 during the three month period ended February 29, 2016 to \$2,970,332 during the three month period ended February 28, 2017, which represents an increase of \$1,171,793 or 65%. The increase is primarily attributed to overall growth in the number of customers, average order size, and order volume in all markets. Sales growth was not significantly impacted by inflation or changes in pricing. Cost of goods sold increased from \$1,200,690 during the three month period ended February 29, 2016 to \$1,913,270 during the three month period ended February 28, 2017, an increase of \$712,580 or 59%. The primary components of cost of goods sold include direct purchases, direct labor and freight. Gross profits for the three month period ended February 28, 2017 amounted to \$1,057,062 for a 35.6% gross margin. Gross profits for the three month period ended February 29, 2016 amounted to \$597,849 for a 33.2% gross margin. Gross Profits increased by \$459,213 or 77% during the three month period ended February 28, 2017 compared to the three month period ended February 29, 2016.

Operating expenses for the three month period ended February 28, 2017 amounted to \$1,052,608 compared to \$579,309 for the three month period ended February 29, 2016, an increase of \$473,299 or 82%. The increase in operating expenses stems from increases in stock compensation, payroll, insurance, professional fees, and rent. Stock compensation expense increased from \$12,908 during the three month period ended February 29, 2016 to \$147,564 during the three month period ended February 28, 2017 due to the amortization of stock options and stock payments issued in exchange for services. Payroll and payroll related costs increased by \$170,212 or 54% during the three month period ended February 28, 2017 due to an increase in salary levels and a head-count increase of 16. Insurance costs increased by \$50,011 due to the Company expanding its insurance coverage across all facets of the business. Professional fees increased \$41,514 during the three month period ended February 28, 2017 as a result of continued utilization of attorneys and auditors. Rent expense increased by \$42,233 or 80%, which can be primarily attributed to the Company moving into a larger facility in Woodinville, Washington in July 2016.

The net result for the three month period ended February 28, 2017 was a profit of \$3,619 or \$0.00 income per share compared to a profit of \$8,618 or \$0.00 income per share for the three month period ended February 29, 2016.

Results of Operations – Comparison for the six month periods ended February 28, 2017 and 2016

Total revenues increased from \$3,519,029 during the six month period ended February 29, 2016 to \$5,442,593 during the six month period ended February 28, 2017, which represents an increase of \$1,923,564 or 55%. The increase is primarily attributed to overall growth in the number of customers, average order size, and order volume in all markets. Sales growth was not significantly impacted by inflation or changes in pricing. Cost of goods sold increased from \$2,351,189 during the six month period ended February 29, 2016 to \$3,549,789 during the six month period ended February 28, 2017, an increase of \$1,198,600 or 51%. The primary components of cost of goods sold include direct purchases, direct labor and freight. Gross profits for the six month period ended February 28, 2017 amounted to \$1,892,804 for a 34.8% gross margin. Gross profits for the six month period ended February 29, 2016 amounted to \$1,167,840 for a 33.2% gross margin. Gross Profits increased by \$724,964 or 62% during the six month period ended February 28, 2017 compared to the six month period ended February 29, 2016.

Operating expenses for the six month period ended February 28, 2017 amounted to \$2,024,207 compared to \$1,130,833 for the six month period ended February 29, 2016, an increase of \$893,374 or 79%. The increase in operating expenses stems from increases in stock compensation, payroll, insurance, professional fees, and rent. Stock compensation expense increased from \$12,908 during the six month period ended February 29, 2016 to \$262,808 during the six month period ended February 28, 2017 due to the amortization of stock options and stock payments issued in exchange for services. Payroll and payroll related costs increased by \$316,726 or 50% during the six month period ended February 28, 2017 due to an increase in salary levels and a head-count increase of 16. Insurance costs increased \$83,750 due to the Company expanding its insurance coverage across all facets of the business. Professional fees increased \$69,887 during the six month period ended February 28, 2017 as a result of continued utilization of attorneys and auditors. Rent expense increased by \$88,135 or 87%, which can be primarily attributed to the Company moving into a larger facility in Woodinville, Washington in July 2016.

The net result for the six month period ended February 28, 2017 was a loss of \$157,216 or \$(0.00) loss per share compared to a profit of \$24,692 or \$0.00 income per share for the six month period ended February 29, 2016.

Liquidity and Capital Resources

At February 28, 2017, we had cash of \$2,833,159 and a working capital surplus of \$4,614,563.

Cash Flows from Operating Activities

For the six month period ended February 28, 2017, net cash used in operating activities was \$516,650 compared to \$551,587 in net cash used in operating activities for the six month period ended February 29, 2016. The change is primarily attributed to an increase in accounts payable during the six month period ended February 28, 2017.

Cash Flows from Investing Activities

Net cash used in investing activities increased from \$70,407 to \$660,922 for the six month period ended February 28, 2017, which can be primarily attributed to the Company's investment in production molds.

Cash Flows from Financing Activities

Net cash provided by financing activities increased from \$828,665 to \$2,983,723 for the six month period ended February 29, 2016 and February 28, 2017, respectively. The increase is primarily attributed to the sale of shares of the Company's common stock in private placement offerings in exchange for cash of \$2,939,923 during the six month period ended February 28, 2017 compared to \$736,010 in offerings during the six month period ended February 29, 2016.

The Company manages its liquidity and financial position in the context of its overall business strategy. The Company continually forecasts and manages its cash, working capital balances, and capital structure to meet the short-term and long-term obligations of its business while seeking to maintain liquidity and financial flexibility.

As of August 31, 2015, the Company has historically funded its operations primarily through the issuance of equity. For the fiscal year ended August 31, 2016, the Company had net income of \$71,739, and an accumulated deficit of \$676,708 as of August 31, 2016. The Company's net accounts receivables have averaged below 10 days of average sales for the past two fiscal years including during the six month period ended February 28, 2017. The Company expects days sales outstanding to remain in the below 10-day range.

The Company believes that income generated from operations are adequate to fund existing obligations and introduce new products for at least the next twelve months. The Company may elect to raise additional funds, through debt or equity financings, for the purposes of expanding current operations, making capital acquisitions, or consummating strategic transactions. Additional equity or debt financing may not be available when needed, on terms favorable to the Company or at all.

Critical Accounting Policies and Estimates

We believe that the following critical policies affect our more significant judgments and estimates used in preparation of the our financial statements.

We disclose those accounting policies that we consider to be significant in determining the amounts to be utilized for communicating our consolidated financial position, results of operations and cash flows in the first note to our consolidated financial statements included elsewhere herein. Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in conformity with these principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results are likely to differ from these estimates, but management does not believe such differences will materially affect our financial position or results of operations.

We issue restricted stock to consultants and suppliers for various services for compensation. Cost for these transactions are measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is measurable more reliably measurable. The value of the Common Stock is measured at the earlier of: (i) the date at which a firm commitment for performance by the counterparty to earn the equity instruments is reached or (ii) the date at which the counterparty's performance is complete.

The Company issues options and warrants to consultants, directors, and officers as compensation for services. These options and warrants are valued using the Black-Scholes model, which focuses on the current stock price and the volatility of moves to predict the likelihood of future stock moves. This method of valuation is typically used to price stock options and warrants based on the price of the underlying stock.

Intangibles, specifically goodwill, are reviewed for impairment whenever facts and circumstances indicate that the carrying value may not be recoverable. When required impairment losses on assets to be held and used are recognized based on the fair value of the asset. The fair value is determined based on generally on estimates of future cash flows or independent appraisals, if required. If the carrying amount of the intangible asset is not recoverable from its undiscounted cash flows, an impairment loss is recognized for the difference between the carrying amount and fair value of the asset. We estimate fair value using the expected future cash flows discounted at a rate commensurate with the risk associated with the recovery of the assets. We did not recognize any impairment losses for any periods presented.

Fair value estimates used in preparation of the financial statements are based upon certain market assumptions and pertinent information available to our management. The respective carrying value of certain on-balance-sheet financial instruments approximated their fair values. These financial instruments include cash, accounts payable, accrued liabilities. Fair values were assumed to approximate carrying values for these financial instruments since they are short-term in nature and their carrying amounts approximate fair values or they are receivable or payable on demand.

We believe that the following accounting policies are the most critical because they have the greatest impact on the presentation of our financial condition and results of operations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 and assumptions made by management include, but are not limited to, the determination of the provision for income taxes, the fair value of stock-based compensation, and valuation of intangible assets. The Company bases the estimates on historical experience and on various other assumptions that are believed to be reasonable. Actual results could differ from those estimates.

Accounts Receivable and Allowance for Bad Debts

Trade accounts receivable are stated at the amount the Company expects to collect, and are derived from sales to customers. Management reviews accounts receivable on a periodic basis to determine if any receivables will potentially be uncollectible. A reserve for uncollectible trade receivables is established when collection of amounts due from clients is deemed improbable. Indicators of improbable collection include client bankruptcy, client litigation, client cash flow difficulties, or ongoing service or billing disputes. Historically, the Company has experienced a de minimis amount of bad debts. Trade credit is generally extended on a short-term basis, thus trade receivables do not bear interest.

Inventory

Inventories, comprised solely of finished goods, are stated at the lower of cost or net realizable value using the first-in first out (FIFO) method.

Revenue Recognition

It is the Company's policy that revenues from product sales is recognized in accordance with ASC 605 "Revenue Recognition". Four basic criteria must be met before revenue can be recognized; (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectability is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding fixed nature in selling prices of the products delivered and the collectability of those amounts. The Company has not implemented any specific rebate programs. Provisions for discounts to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company has not established a formal customer incentive program, but considers and accommodates discounts to certain customers on a case by case basis, including by way of example, for volume shipping or for certain new customers with orders over a specific discretionary dollar threshold. Consistent with ASC 605-15-25-1, the Company considers factors such as historical return of products, estimated remaining shelf life, price changes from competitors, and introductions of competing products in establishing a refund allowance. The Company recognizes revenues as risk and title to products transfers to the customer (which generally occurs at the time shipment is made), the sales price is fixed or determinable, and collectability is reasonably assured. The Company defers any revenue for which the product was not delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required.

Share-based Compensation

The Company accounts for its stock based awards in accordance with Accounting Standards Codification subtopic 718-10, "Compensation", which requires fair value measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including restricted stock awards. The Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors based on estimated fair value on the date of grant. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Statement of Operations.

The Company estimates the fair value of share-based payment awards on the date of grant using the Black-Scholes model.

The Company's determination of fair value of share-based payment awards on the date of grant is affected by a number of highly complex and subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, stock price, exercise price, dividends paid, expected term and risk free discount rate. Although the fair value of stock options is determined in accordance with an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

The fair value is then expensed over the requisite service periods of the awards, which is generally the performance period and the related amount is recognized in the consolidated statements of operations.

Income Taxes

The Company accounts for income taxes in accordance with accounting guidance now codified as FASB ASC 740, "Income Taxes," which requires that the Company recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized.

The Company applies the provisions of ASC 740, "Accounting for Uncertainty in Income Taxes". The ASC clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The ASC provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company did not identify any material uncertain tax positions on returns that have been filed or that will be filed.

Foreign Currency Transactions

None.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

As a "smaller reporting company" as defined by Item 10 of Regulation S-K, the Company is not required to provide this information

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We maintain "disclosure controls and procedures", as that term is defined in Rule 13a-15(e), promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in our company's reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

As required by paragraph (b) of Rules 13a-15 under the Securities Exchange Act of 1934, our management, with the participation of our principal executive officer and our principal financial officer, evaluated our company's disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q. Based on this evaluation, our management concluded that as of the end of the period covered by this quarterly report on Form 10-Q, our disclosure controls and procedures were not effective.

Management Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002. Our management, with the participation of our principal executive officer and principal financial officer have conducted an assessment, including testing, using the criteria in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("*COSO*") (2013). Our system of internal control over financial reporting is designed 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. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. This assessment included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion on this evaluation. Based on this evaluation, management concluded that our internal control over financial reporting was not effective as of February 28, 2017. The ineffectiveness of the Company's internal control over financial reporting was due to the following material weaknesses, which are indicative of many small companies with small staff:

- (i) inadequate segregation of duties consistent with control objectives;
- (ii) lack of a code of ethics;
- (iii) lack of a whistleblower policy;
- (iv) lack of an independent board of directors or board committees related to financial reporting; and
- (iv) lack of multiple levels of supervision and review.

We believe that the weaknesses identified above have not had any material effect on our financial results. While not being legally obligated to have an audit committee, it is our management's view that such a committee, including an independent financial expert member, is an utmost important entity level control over the Company's financial statements. Currently, the board of directors acts in the capacity of the audit committee. However, we are currently reviewing our disclosure controls and procedures related to these material weaknesses and expect to implement changes in the current fiscal year, including identifying specific areas within our governance, accounting and financial reporting processes to add adequate resources to potentially mitigate these material weaknesses.

Our management will continue to monitor and evaluate the effectiveness of our internal 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, as necessary and as funds allow.

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management's Remediation Plan

The weaknesses and their related risks are not uncommon in a company of our size because of the limitations in the size and number of staff. Due to our size and nature, segregation of all conflicting duties has not always been possible and may not be economically feasible.

However, we plan to take steps to enhance and improve the design of our internal control over financial reporting. During the period covered by this quarterly report on Form 10-Q, we have not been able to remediate the material weaknesses identified above. To remediate such weaknesses, we plan to implement the following changes in the current fiscal year as resources allow:

- (i) appoint additional qualified personnel to address inadequate segregation of duties and implement modifications to our financial controls to address such inadequacies; and
- (ii) adopt a written whistleblower policy and code of ethics; and
- (iii) appoint an independent board of directors, including board committees related to financial controls and reporting.

The remediation efforts set out herein will be implemented in the current 2017 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.

Management believes that despite our material weaknesses set forth above, our financial statements for the three month period ended February 28, 2017 are fairly stated, in all material respects, in accordance with U.S. GAAP.

Changes in Internal Control Over Financial Reporting

During the six months ended February 28, 2017, we implemented a new accounting software system which allows for greater security and restricted access to computer systems. This change had a material effect on our internal control over financial reporting as it establishes another level of formal controls.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

We are not required to provide this information as we are a Smaller Reporting Company.

Item 2. Unregistered Sales of Equity Securities.

The authorized common stock is 265,000,000 shares with a par value of \$0.001. As of February 28, 2017 and August 31, 2016, 50,143,775 and 48,300,162 shares were issued and outstanding, respectively.

During the six months ended February 28, 2017, the Company sold 1,726,266 shares of its common stock to investors in exchange for cash of \$2,939,923.

Subsequent to February 28, 2017 and through the date of this filing, the Company sold 39,985 shares of its common stock to investors in exchange for cash consideration of \$69,974.

Item 3. Default Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable to our Company.

Item 5. Other Information.

None.

Item 6. Exhibits

- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Nicholas Kovacevich.
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Chris Martin
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Nicholas Kovacevich.
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Chris Martin.

101.INS* XBRL Instance Document

101.SCH* XBRL Taxonomy Schema

101.CAL* XBRL Taxonomy Calculation Linkbase

101.DEF* XBRL Taxonomy Definition Linkbase

101.LAB* XBRL Taxonomy Label Linkbase

101.PRE* XBRL Taxonomy Presentation Linkbase

* Furnished herewith. XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereto duly authorized.

KUSH BOTTLES, INC.

Date: April 12, 2017 By: /s/ Nicholas Kovacevich
Chief Executive Officer and Secretary

Date: April 12, 2017 By: /s/ Chris Martin
Chief Financial Officer

**CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Nicholas Kovacevich, certify that:

- 1) I have reviewed this Quarterly report of Kush Bottles, Inc. on Form 10-Q;
- 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) I am 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 the 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.
 - (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 a Quarterly report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) 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 controls over financial reporting.

Date: April 12, 2017

/s/ Nicholas Kovacevich

Nicholas Kovacevich
Chief Executive Officer

**CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Chris Martin, certify that:

- 1) I have reviewed this Quarterly report of Kush Bottles, Inc. on Form 10-Q;
- 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) I am 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 the 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.
 - (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 Quarterly report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) 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 controls over financial reporting.

Date: April 12, 2017

/s/ Chris Martin

Chris Martin
Chief Financial Officer

**CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Kush Bottles, Inc. (the Company") on Form 10-Q for the period ended herein as filed with the Securities and Exchange Commission (the "Report"), I, Nicholas Kovacevich, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss.1350, as adopted pursuant to ss.906 of the Sarbanes-Oxley Act of 2002, that:

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

Kush Bottles, Inc.

Date: April 12, 2017

By: /s/ Nicholas Kovacevich
Nicholas Kovacevich
Chief Executive Officer

