

GROWLIFE, INC.  
Form 10-Q  
November 14, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-50385  
GrowLife, Inc.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of 90-0821083  
incorporation or organization) (I.R.S. Employer Identification No.)

5400 Carillon Point  
Kirkland, WA 98033  
(Address of principal executive offices and zip code)

(866) 781-5559  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted to Rule 405 of Regulation S-T 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes No

As of November 14, 2016 there were 1,554,495,957 shares of the issuer's common stock, \$0.0001 par value per share, outstanding.



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## ITEM 1. FINANCIAL STATEMENTS

GROWLIFE, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

	September 30, 2016	December 31, 2015
ASSETS		(Audited)
CURRENT ASSETS:		
Cash and cash equivalents	\$77,229	\$60,362
Inventory, net	477,052	398,439
Deposits	16,754	16,754
Total current assets	571,035	475,555
EQUIPMENT, NET	3,562	10,327
OTHER ASSETS		
Intangible assets, net	163,693	243,604
Goodwill	739,000	739,000
TOTAL ASSETS	\$1,477,290	\$1,468,486
LIABILITIES AND STOCKHOLDERS' (DEFICIT)		
CURRENT LIABILITIES:		
Accounts payable - trade	\$1,576,736	\$1,272,572
Accounts payable - related parties	50,461	71,920
Accrued expenses	123,900	121,765
Accrued expenses - related parties	53,529	53,287
Derivative liability	880,369	1,377,175
Current portion of convertible notes payable	3,051,245	2,287,868
Deferred revenue	10,000	25,000
Total current liabilities	5,746,240	5,209,587
LONG TERM LIABILITIES:		
Convertible notes payable	-	-
COMMITMENTS AND CONTINGENCIES	-	2,000,000
MEZZANINE EQUITY:		

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Contingently redeemable common stock- 0 and 15,000,000 shares issued and outstanding at 9/30/2016 and 12/31/2015, respectively	-	300,000
<b>STOCKHOLDERS' DEFICIT</b>		
Preferred stock - \$0.0001 par value, 10,000,000 shares authorized, no shares issued and outstanding	-	-
Series B Convertible Preferred stock - \$0.0001 par value, 150,000 shares authorized, 0 and 150,000 shares issued and outstanding at 9/30/16 and 12/31/15, respectively	-	15
Series C Convertible Preferred stock - \$0.0001 par value, 51 shares authorized, 51 shares issued and outstanding at 9/30/2016 and 12/31/2015, respectively	-	-
Common stock - \$0.0001 par value, 3,000,000,000 shares authorized, 1,311, 966,477 and 891,116,496 shares issued and outstanding at 9/30/2016 and 12/31/2015, respectively	131,185	89,098
Additional paid in capital	114,054,265	110,585,434
Accumulated deficit	(118,454,400)	(116,715,648)
Total stockholders' deficit	(4,268,950)	(6,041,101)
<b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>	<b>\$1,477,290</b>	<b>\$1,468,486</b>

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





GROWLIFE, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF OPERATIONS

	Three Months Ended,		Nine Months Ended,	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
NET REVENUE	\$199,760	\$525,481	\$929,108	\$3,122,747
COST OF GOODS SOLD	179,252	604,388	893,069	2,692,578
GROSS PROFIT	20,508	(78,907)	36,039	430,169
GENERAL AND ADMINISTRATIVE EXPENSES	437,170	698,723	1,351,111	2,182,051
OPERATING LOSS	(416,662)	(777,630)	(1,315,072)	(1,751,882)
OTHER INCOME (EXPENSE):				
Change in fair value of derivative	874,985	1,746,985	496,806	1,795,879
Interest expense, net	(375,815)	(599,058)	(614,045)	(952,060)
Other (expense) income, primarily related to TCA funding	(92,025)	(468,468)	158,032	(477,018)
Loss on debt conversions	(464,473)	-	(464,473)	-
Loss on class action lawsuit settlements	-	-	-	(2,081,250)
Total other (expense)	(57,328)	679,459	(423,680)	(1,714,449)
(LOSS) BEFORE INCOME TAXES	(473,990)	(98,171)	(1,738,752)	(3,466,331)
Income taxes - current benefit	-	-	-	-
NET (LOSS)	\$(473,990)	\$(98,171)	\$(1,738,752)	\$(3,466,331)
Basic and diluted (loss) per share	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.00)
Weighted average shares of common stock outstanding- basic and diluted	1,195,368,355	899,290,409	1,082,494,008	886,492,788

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



GROWLIFE, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

Nine Months Ended,

September 30, 2016 September 30, 2015

CASH FLOWS FROM OPERATING ACTIVITIES:

Net loss	\$(1,738,752)	\$(3,466,331)
Adjustments to reconcile net loss to net cash (used in) operating activities		
Depreciation and amortization	6,765	11,212
Amortization of intangible assets	79,911	79,911
Stock based compensation	98,173	138,532
Preferred shares issued for services	-	300,000
Common stock issued for services	125,000	-
Amortization of debt discount	(99,081)	546,691
Change in fair value of derivative liability	(496,806)	(1,594,624)
Accrued interest on convertible notes payable	323,489	206,855
Loss on class action settlements	-	2,000,000
Loss on debt conversions	464,473	-
Excess and obsolete inventory	-	20,215
Write-off of patent expenses	-	3,600
Changes in operating assets and liabilities:		
Inventory	78,613	427,441
Prepaid expenses	-	41,791
Deposits	-	16,830
Accounts payable	282,705	391,494
Accrued expenses	2,377	(75,385)
Deferred revenue	(15,000)	(58,779)
CASH (USED IN) OPERATING ACTIVITIES	(888,133)	(1,010,547)

CASH FLOWS FROM INVESTING ACTIVITIES:

- -

NET CASH PROVIDED BY INVESTING ACTIVITIES:

- -

CASH FLOWS FROM FINANCING ACTIVITIES:

Cash provided from Convertible Promissory Note with Chicago Venture Partners, L.P.	905,000	-
Proceeds from the issuance of convertible debt	-	786,878
	-	-

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NET CASH PROVIDED BY FINANCING ACTIVITIES	905,000	786,878
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	16,867	(223,669)
CASH AND CASH EQUIVALENTS, beginning of period	60,362	286,238
CASH AND CASH EQUIVALENTS, end of period	\$77,229	\$62,569
Supplemental disclosures of cash flow information:		
Interest paid	\$-	\$10,500
Taxes paid	\$-	\$-
Non-cash investing and financing activities:		
Shares issued for convertible note and interest conversion	\$2,423,729	\$-
Shares issued for debt conversion	\$64,000	\$171,000
Shares issued for class action settlements	\$2,000,000	\$-
Shares issued for mezzanine equity	\$300,000	\$-
Series B Convertible Preferred Stock converted into convertible notes payable	\$(1,500,000)	\$-
Series B Convertible Preferred Stock converted into convertible notes payable debt discount	\$315,669	\$-

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



GROWLIFE, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – DESCRIPTION OF BUSINESS AND ORGANIZATION

GrowLife, Inc. (“GrowLife” or the “Company”) is incorporated under the laws of the State of Delaware and is headquartered in Seattle, Washington. The Company was founded in 2012 with the Closing of the Agreement and Plan of Merger with SGT Merger Corporation.

The Company’s goal of becoming the nation’s largest cultivation facility service provider for the production of organics, herbs and greens and plant-based medicines has not changed. The Company’s mission is to best serve more cultivators in the design, build-out, expansion and maintenance of their facilities with products of high quality, exceptional value and competitive price. Through a nationwide network of knowledgeable representatives, regional centers and its e-commerce website, GrowLife provides essential and hard-to-find goods including media (i.e., farming soil), industry-leading hydroponics equipment, organic plant nutrients, and thousands more products to specialty grow operations across the United States.

The Company primarily sells through its wholly owned subsidiary, GrowLife Hydroponics, Inc. GrowLife companies distribute and sell over 15,000 products through its e-commerce distribution channel, GrowLifeEco.com, and through our regional retail storefronts. GrowLife and its business units are organized and directed to operate strictly in accordance with all applicable state and federal laws.

On June 7, 2013, GrowLife Hydroponics completed the purchase of Rocky Mountain Hydroponics, LLC, a Colorado limited liability company (“RMC”), and Evergreen Garden Center, LLC, a Maine limited liability company (“EGC”). The effective date of the purchase was June 7, 2013. The Company purchased all of the assets and liabilities of the RMH and EGC Companies, and their retail hydroponics stores, which are located in Vail and Boulder, Colorado and Portland, Maine. The Company purchased RMC and EGC from Rob Hunt, who was appointed to the then Company’s Board of Directors and President of GrowLife Hydroponics, Inc.

On February 18, 2016, the Company’s common stock resumed unsolicited quotation on the OTC Bulletin Board after receiving clearance from the Financial Industry Regulatory Authority (“FINRA”) on our Form 15c2-11. The Company is currently taking the appropriate steps to uplist to the OTCQB Exchange and resume priced quotations with market makers as soon as it is able.

NOTE 2 – GOING CONCERN

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred net losses of \$1,738,752, \$5,688,845 and \$86,626,099 for the nine months ended September 30, 2016 and years ended December 31, 2015 and 2014, respectively. Our net cash used in operating activities was \$888,133, \$1,375,891 and \$2,122,577 for the nine months ended September 30, 2016 and the years ended December 31, 2015 and 2014, respectively.

The Company anticipates that it will record losses from operations for the foreseeable future. As of September 30, 2016, our accumulated deficit was \$118,454,400. The Company has experienced recurring operating losses and negative operating cash flows since inception, and has financed its working capital requirements during this period primarily through the recurring issuance of convertible notes payable and advances from a related party. The audit report prepared by our independent registered public accounting firm relating to our financial statements for the year ended December 31, 2015 and filed with the SEC on April 14, 2016 includes an explanatory paragraph expressing the substantial doubt about our ability to continue as a going concern.

Continuation of the Company as a going concern is dependent upon obtaining additional working capital. The financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

**NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES: ADOPTION OF ACCOUNTING STANDARDS**

**Basis of Presentation** - The accompanying unaudited consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these unaudited consolidated financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”).

**Principles of Consolidation** - The consolidated financial statements include the accounts of the Company and its wholly owned and majority-owned subsidiaries. Inter-Company items and transactions have been eliminated in consolidation.

**Cash and Cash Equivalents** - The Company classifies highly liquid temporary investments with an original maturity of three months or less when purchased as cash equivalents. The Company maintains cash balances at various financial institutions. Balances at US banks are insured by the Federal Deposit Insurance Corporation up to \$250,000. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risk for cash on deposit.





Accounts Receivable and Revenue - Revenue is recognized on the sale of a product when the product is shipped, which is when the risk of loss transfers to our customers, the fee is fixed and determinable, and collection of the sale is reasonably assured. A product is not shipped without an order from the customer and the completion of credit acceptance procedures. The majority of our sales are cash or credit card; however, we occasionally extend terms to our customers. Accounts receivable are reviewed periodically for collectability.

Inventories - Inventories are recorded on a first in first out basis. Inventory consists of raw materials, purchased finished goods and components held for resale. Inventory is valued at the lower of cost or market. The reserve for inventory was \$20,000 as of September 30, 2016 and December 31, 2015, respectively.

Property and Equipment - Property and equipment are stated at cost. Assets acquired held under capital leases are initially recorded at the lower of the present value of the minimum lease payments discounted at the implicit interest rate or the fair value of the asset. Major improvements and betterments are capitalized. Maintenance and repairs are expensed as incurred. Depreciation is computed using the straight-line method over an estimated useful life of five years. Assets acquired under capital lease are depreciated over the lesser of the useful life or the lease term. At the time of retirement or other disposition of property and equipment, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the consolidated statements of operations.

Goodwill and Intangible Assets - The Company evaluates the carrying value of goodwill, intangible assets, and long-lived assets during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. Such circumstances could include, but are not limited to (1) a significant adverse change in legal factors or in business climate, (2) unanticipated competition, (3) an adverse action or assessment by a regulator, (4) continued losses from operations, (5) continued negative cash flows from operations, and (6) the suspension of trading of the Company's securities. When evaluating whether goodwill is impaired, the Company compares the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. The fair value of the reporting unit is estimated using a combination of the income, or discounted cash flows, approach and the market approach, which utilizes comparable companies' data. If the carrying amount of a reporting unit exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss would be calculated by comparing the implied fair value of reporting unit goodwill to its carrying amount. In calculating the implied fair value of reporting unit goodwill, the fair value of the reporting unit is allocated to all of the other assets and liabilities of that unit based on their fair values. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied fair value of goodwill.

The Company amortizes the cost of other intangible assets over their estimated useful lives, which range up to ten years, unless such lives are deemed indefinite. Intangible assets with indefinite lives are tested in the fourth quarter of each fiscal year for impairment, or more often if indicators warrant.

Long Lived Assets – The Company reviews its long-lived assets for impairment annually or when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets under certain circumstances are reported at the lower of carrying amount or fair value. Assets to be disposed of and assets not expected to provide any future service potential to the Company are recorded at the lower of carrying amount or fair value (less the projected cost associated with selling the asset). To the extent carrying values exceed fair values, an impairment loss is recognized in operating results.

Fair Value Measurements and Financial Instruments - ASC Topic 820 defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 - Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The carrying value of cash, accounts receivable, investment in a related party, accounts payables, accrued expenses, due to related party, notes payable, and convertible notes approximates their fair values due to their short-term maturities.

Derivative financial instruments -The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the consolidated statements of operations. For stock-based derivative financial instruments, the Company uses a weighted average Black-Scholes-Merton option pricing model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within twelve months of the balance sheet date.



**Sales Returns** - We allow customers to return defective products when they meet certain established criteria as outlined in our sales terms and conditions. It is our practice to regularly review and revise, when deemed necessary, our estimates of sales returns, which are based primarily on actual historical return rates. We record estimated sales returns as reductions to sales, cost of goods sold, and accounts receivable and an increase to inventory. Returned products which are recorded as inventory are valued based upon the amount we expect to realize upon its subsequent disposition. As of September 30, 2016 and December 31, 2015, there was no reserve for sales returns, which are minimal based upon our historical experience.

**Stock Based Compensation** - The Company has share-based compensation plans under which employees, consultants, suppliers and directors may be granted restricted stock, as well as options and warrants to purchase shares of Company common stock at the fair market value at the time of grant. Stock-based compensation cost to employees is measured by the Company at the grant date, based on the fair value of the award, over the requisite service period under ASC 718. For options issued to employees, the Company recognizes stock compensation costs utilizing the fair value methodology over the related period of benefit. Grants of stock to non-employees and other parties are accounted for in accordance with the ASC 505.

**Net (Loss) Per Share** - Under the provisions of ASC 260, "Earnings per Share," basic loss per common share is computed by dividing net loss available to common shareholders by the weighted average number of shares of common stock outstanding for the periods presented. Diluted net loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that would then share in the income of the Company, subject to anti-dilution limitations. The common stock equivalents have not been included as they are anti-dilutive. As of September 30, 2016, there are also (i) stock option grants outstanding for the purchase of 24,010,000 common shares at a \$0.023 average strike price; (ii) warrants for the purchase of 565 million common shares at a \$0.032 average exercise price; and (iii) 286,989,167 shares related to convertible debt that can be converted at 0.0036 per share. In addition, we have an unknown number of common shares to be issued under the TCA Global Credit Master Fund LP and Chicago Venture Partners, L.P. financing agreements. As of September 30, 2015, there are also (i) stock option grants outstanding for the purchase of 40.6 million common shares at a \$0.058 average strike price; (ii) warrants for the purchase of 565.0 million common shares at a \$0.035 average exercise price; (iii) 235.6 million shares related to convertible debt that can be converted at 0.007 per share; and (iv) 6.0 million shares that may be issued to a former executive related to a severance agreement. We expect to issue \$2 million in common stock or approximately 115.1 million shares related to the settlement of the Consolidated Class Action and Derivative Action lawsuits alleging violations of federal securities laws that were filed against the Company in United States District Court, Central District of California. The shares were issued on April 6, 2016. In addition, we had an unknown number of common shares to be issued under the TCA financing agreements.

**Dividend Policy** - The Company has never paid any cash dividends and intends, for the foreseeable future, to retain any future earnings for the development of our business. Our future dividend policy will be determined by the board of directors on the basis of various factors, including our results of operations, financial condition, capital requirements and investment opportunities.

**Use of Estimates** - In preparing these unaudited interim consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates and assumptions included in our consolidated financial statements relate to the valuation of long-lived assets, estimates of sales returns, inventory reserves and accruals for potential liabilities, and valuation assumptions related to derivative liability, equity instruments and share based compensation.

Recent Accounting Pronouncements

A variety of proposed or otherwise potential accounting standards are currently under study by standard setting organizations and various regulatory agencies. Due to the tentative and preliminary nature of those proposed standards, management has not determined whether implementation of such proposed standards would be material to our consolidated financial statements.

NOTE 4 – TRANSACTIONS WITH CANX USA, LLC AND LOGIC WORKS LLC

Transactions with CANX, LLC and Logic Works LLC

On July 10, 2014, the Company closed a Waiver and Modification Agreement, Amended and Restated Joint Venture Agreement, Secured Credit Facility and Secured Convertible Note with CANX, and Logic Works, a lender and shareholder of the Company. The Agreements require the filing of a registration statement on Form S-1 within 10 days of the filing of the Company's Form 10-Q for the period ended June 30, 2014. Due to the Company's grey sheet trading status and other issues, the Company did not file the registration statement.



Previously, the Company entered into a Joint Venture Agreement with CANX, a Nevada limited liability company. Under the terms of the Joint Venture Agreement, the Company and CANX formed Organic Growth International, LLC (“OGI”), a Nevada limited liability company, for the purpose of expanding the Company’s operations in its current retail hydroponic businesses and in other synergistic business verticals and facilitating additional funding for commercially financeable transactions of up to \$40,000,000.

The Company initially owned a non-dilutive 45% share of OGI and the Company may acquire a controlling share of OGI as provided in the Joint Venture Agreement. In accordance with the Joint Venture Agreement, the Company and CANX entered into a Warrant Agreement whereby the Company delivered to CANX a warrant to purchase 140,000,000 shares of the Company common stock that is convertible at \$0.033 per share, subject to adjustment as provided in the warrant. The five year warrant expires November 18, 2018. Also in accordance with the Joint Venture Agreement, on February 7, 2014 the Company issued an additional warrant to purchase 100,000,000 shares of our common stock that is convertible at \$0.033 per share, subject to adjustment as provided in the warrant. The five year warrant expires February 6, 2019.

#### Waiver and Modification Agreement

The Company entered into a Waiver and Modification Agreement dated June 25, 2014 with Logic Works whereby the 7% Convertible Note with Logic Works dated December 20, 2013 was modified to provide for (i) a waiver of the default under the 7% Convertible Note; (ii) a conversion price which is the lesser of (A) \$0.025 or (B) twenty percent (20%) of the average of the three (3) lowest daily VWAPs occurring during the twenty (20) consecutive Trading Days immediately preceding the applicable Conversion Date on which the Holder elects to convert all or part of this Note; (iii) the filing of a registration statement on Form S-1 within 10 days of the filing of the Company’s Form 10-Q for the period ended June 30, 2014; and (iv) continuing interest of 24% per annum. Due to the Company’s grey sheet trading status and other issues, the Company did not file the registration statement. This 20% of the average should be 70% and the Parties are working to resolve this issue.

#### Amended and Restated Joint Venture Agreement

The Company entered into an Amended and Restated Joint Venture Agreement dated July 1, 2014 with CANX whereby the Joint Venture Agreement dated November 19, 2013 was modified to provide for (i) up to \$12,000,000 in conditional financing subject to review by GrowLife and approval by OGI for business growth development opportunities in the legal cannabis industry for up to nine months, subject to extension; (ii) up to \$10,000,000 in working capital loans, with each loaning requiring approval in advance by CANX; (iii) confirmed that the five year warrants, subject to adjustment, at \$0.033 per share for the purchase of 140,000,000 and 100,000,000 were fully earned and were not considered compensation for tax purposes by the Company; (iv) granted CANX five year warrants, subject to adjustment, to purchase 300,000,000 shares of common stock at the fair market price of \$0.033 per share as determined by an independent appraisal; (v) warrants as defined in the Agreement related to the achievement of OGI milestones; (vi) a four year term, subject to adjustment and (vi) the filing of a registration statement on Form S-1 within 10 days of the filing of the Company’s Form 10-Q for the period ended June 30, 2014. Due to the Company’s grey sheet trading status and other issues, the Company did not file the registration statement.

#### Secured Convertible Note and Secured Credit Facility

The Company entered into a Secured Convertible Note and Secured Credit Facility dated June 25, 2014 with Logic Works whereby Logic Works agreed to provide up to \$500,000 in funding. Each funding requires approval in advance by Logic Works, provides for interest at 6% with a default interest of 24% per annum and requires repayment by June 26, 2016. The Note is convertible into common stock of the Company at the lesser of \$0.0070 or (B) twenty percent (20%) of the average of the three (3) lowest daily VWAPs occurring during the twenty (20) consecutive Trading Days

immediately preceding the applicable conversion date on which Logic Works elects to convert all or part of this 6% Convertible Note, subject to adjustment as provided in the Note. The 6% Convertible Note is collateralized by the assets of the Company. The Company also agreed to file a registration statement on Form S-1 within 10 days of the filing of the Company's Form 10-Q for the three months ended June 30, 2014 and have the registration statement declared effective within ninety days of the filing of the Company's Form 10-Q for the three months ended June 30, 2014. Due to the Company's grey sheet trading status and other issues, the Company did not file the registration statement.

On July 10, 2014, the Company closed a Waiver and Modification Agreement, Amended and Restated Joint Venture Agreement, Secured Credit Facility and Secured Convertible Note with CANX, and Logic Works, a lender and shareholder of the Company. As of December 31, 2014, the Company has borrowed \$350,000 under the Secured Convertible Note and Secured Credit Facility dated June 25, 2014 with Logic Works.

OGI was incorporated on January 7, 2014 in the State of Nevada and had no business activities as of September 30, 2016.





## NOTE 5 – INVENTORY

Inventory as of September 30, 2016 and December 31, 2015 consists of the following:

	September 30, 2016	December 31, 2015
	(Unaudited)	(Audited)
Finished goods	\$497,052	\$418,439
Inventory reserve	(20,000)	(20,000)
Total	\$477,052	\$398,439

Finished goods inventory relates to product at the Company's retail stores, which is product purchased from distributors, and in some cases directly from the manufacturer, and resold at our stores.

The Company reviews its inventory on a periodic basis to identify products that are slow moving and/or obsolete, and if such products are identified, the Company records the appropriate inventory impairment charge at such time.

## NOTE 6– INTANGIBLE ASSETS

Intangible assets as of September 30, 2016 consisted of the following:

Intangible Assets:	Estimated		Accumulated	
	Useful Lives	Cost	Amortization	Net Book Value
RMH/EGC acquisition- customer contracts	5 years	\$366,000	\$(244,000)	\$122,000
Greners acquisition- customer contracts	5 years	230,000	(188,307)	41,693
Phototron acquisition- customer contracts	5 years	215,000	(215,000)	-
Soja, Inc. (Urban Garden Supply) acquisition- customer contracts	5 years	60,000	(60,000)	-
Total intangible assets		\$871,000	\$(707,307)	\$163,693

Total amortization expense was \$79,911 for the nine months ended September 30, 2016 and 2015.

The fair value of the assets acquired detailed above, estimated by using a discounted cash flow approach based on future economic benefits associated with agreements with customers, or through expected continued business activities with its customers. In summary, the estimate was based on a projected income approach and related discounted cash flows over five years, with applicable risk factors assigned to assumptions in the forecasted results.

## NOTE 7 – CONVERTIBLE NOTES PAYABLE, NET

Convertible notes payable as of September 30, 2016 consisted of the following:

		Accrued	Debt	Balance
	Principal	Interest	Discount	As of
				September 30, 2016
6% Secured convertible note (2014)	\$350,000	\$46,405	\$-	\$396,405
7% Convertible note (\$850,000)	250,000	149,014	-	399,014
7% Convertible note (\$1,000,000)	18,573	149,324	-	167,897
Replacement debenture with TCA (\$2,830,210)	2,189,691	8,759	(863,432)	1,335,018
10% OID Convertible Promissory Note with Chicago Venture Partners, L.P.	905,000	30,916	(183,005)	752,911
	\$3,713,264	\$384,418	\$(1,046,437)	\$3,051,245



Convertible notes payable as of December 31, 2015 consisted of the following:

				Balance
	Principal	Accrued Interest	Debt Discount	As of December 31, 2015
6% Senior secured convertible notes (2012)	\$413,680	\$172,494	\$-	\$586,174
6% Secured convertible note (2014)	350,000	30,641	(83,924)	296,717
7% Convertible note (\$850,000)	250,000	104,137	-	354,137
7% Convertible note (\$1,000,000)	250,000	134,469	-	384,469
18% Senior secured redeemable convertible debenture (\$1,150,000)	1,150,000	68,510	(552,139)	666,371
	\$2,413,680	\$510,251	\$(636,063)	\$2,287,868

Several of the Company's convertible promissory notes remain outstanding beyond their respective maturity dates. This may trigger an event of default under the respective agreements. The Company is working with these noteholders to convert their notes into common stock and intends to resolve these outstanding issues as soon as practicable. As a result, the Company accrued interest on these notes at the default rates. Furthermore, as a result of being in default on these notes, the Holders could, at their sole discretion, call these notes. Although no such action has been taken by the Holders, the Company classified these notes as a current liability as of September 30, 2016 and December 31, 2015.

#### 6% Senior Secured Convertible Notes Payable (2012)

On September 28, 2012, the Company entered into an Amendment and Exchange Agreement with investors, including Sterling Scott, our then CEO. The Exchange Agreement provided for the issuance of new 6% Senior Secured Convertible Notes that replaced the 6% Senior Secured Convertible Notes that were previously issued during 2012. The 6% Notes accrued interest at the rate of 6% per annum and had a maturity date of April 15, 2015. No cash payments were required; however, accrued interest was due at maturity. In the event of a default the investors may declare the entire principal and accrued interest to be due and payable. Default interest accrued at the rate of 12% per annum. The 6% Notes were secured by substantially all of the assets of the Company and were convertible into common stock at the rate of \$0.007 per share. The Company determined that the conversion feature was a beneficial conversion feature.

As of September 10, 2014, the outstanding principal balance on Mr. Scott's 6% convertible note was \$413,680 and accrued interest were sold to two parties not related to us. On April 27, 2015, the Company entered into Amendment One of the Amended and Restated 6% Senior Secured Convertible Note, which increased the interest rate to 12% effective April 8, 2014 and extended the maturity to September 15, 2015.

On July 9, 2015, the two investors each entered into Amendment Two of the Amended and Restated 6% Senior Secured Convertible Note which provide for an increase in the interest rate from 6% to 10% and the default interest rate from 12% to 20% on the 6% Senior Secured Convertible Notes for so long as the Company remains in technical default on said notes due to its delisting from its Primary Trading Market April 2014. The Company further agreed that said 20% default interest will be applied to the date of default on April 10, 2014 and continuing through the present.

During the year ended December 31, 2015, the Company recorded interest expense of \$100,825 and \$20,486 of non-cash interest expense related to the amortization of the debt discount associated with these 6% convertible notes, respectively. As of December 31, 2015, the outstanding principal on these 6% convertible notes was \$413,680, accrued interest was \$172,494, and unamortized debt discount was \$0, which results in a net amount of \$586,174.

During the nine months ended September 30, 2016, the Company recorded interest expense of \$105,016 related to these 6% convertible notes. Two investors converted principal and interest of \$413,680 and \$67,418, respectively, into shares of the Company's common stock at a per share conversion price of \$0.007. As of September 30, 2016, the outstanding principal and interest on these 6% convertible notes was \$0.

#### 6% Secured Convertible Note and Secured Credit Facility (2014)

The Company entered into a Secured Convertible Note and Secured Credit Facility dated June 25, 2014 with Logic Works whereby Logic Works agreed to provide up to \$500,000 in funding. Each funding requires approval in advance by Logic Works, provided for interest at 6% with a default interest of 24% per annum and requires repayment by June 26, 2016. The Note is convertible into common stock of the Company at the lesser of \$0.007 or (B) twenty percent (20%) of the average of the three (3) lowest daily VWAPs occurring during the twenty (20) consecutive Trading Days immediately preceding the applicable conversion date on which Logic Works elects to convert all or part of this 6% Convertible Note, subject to adjustment as provided in the Note. The 6% Convertible Note is collateralized by the assets of the Company. The Company also agreed to file a registration statement on Form S-1 within 10 days of the filing of the Company's Form 10-Q for the three months ended June 30, 2014 and have the registration statement declared effective within ninety days of the filing of the Company's Form 10-Q for the three months ended June 30, 2014. Due to the Company's grey sheet trading status and other issues, the Company did not file the registration statement.



On July 10, 2014, the Company closed a Waiver and Modification Agreement, Amended and Restated Joint Venture Agreement, Secured Credit Facility and Secured Convertible Note with CANX, and Logic Works, a lender and shareholder of the Company.

During the year ended December 31, 2015, the Company recorded interest expense of \$21,000 and \$177,384 of non-cash interest expense related to the amortization of the debt discount associated with these 6% convertible notes, respectively. As of December 31, 2015, the Company has borrowed \$350,000 under the Secured Convertible Note and Secured Credit Facility, accrued interest was \$30,641 and the unamortized debt discount was \$83,924, which results in a net amount of \$296,717.

During the nine months September 30, 2016, the Company recorded interest expense of \$15,764 and \$83,924 of non-cash interest expense related to the amortization of the debt discount associated with this 6% convertible note, respectively. As of September 30, 2016, the Company has borrowed \$350,000 under the Secured Convertible Note and Secured Credit Facility, accrued interest was \$46,405 and the unamortized debt discount was \$0, which results in a net amount of \$396,405.

#### 7% Convertible Notes Payable

On October 11, 2013, the Company issued 7% Convertible Notes in the aggregate amount of \$850,000 to investors, including \$250,000 to Forglen LLC. The Note was due September 30, 2015. All other Notes were converted in 2014. On July 14, 2014, the Board of Directors approved a Settlement Agreement and Waiver of Default dated June 19, 2014 with Forglen related to the 7% Convertible Note. The Company cancelled the April 9, 2014 conversion as a result of the SEC suspension in the trading of the Company's securities and Forglen has \$250,000 of principal and interest outstanding on its note payable as of December 31, 2015 and September 30, 2016. The current annual rate of interest is 24% per annum. The conversion price was \$0.007 per share. The Company determined that the conversion feature was a beneficial conversion feature.

On December 20, 2013, the Company issued 7% Convertible Notes for \$1,000,000, including \$500,000 from Logic Works LLC. The principal balance due to Logic Works of \$250,000 was due September 30, 2015. The current annual rate of interest is 24% per annum. The conversion price is \$0.007 per share. The Company determined that the conversion feature was a beneficial conversion feature.

During the year ended December 31, 2015, the Company recorded interest expense of \$120,165 and \$196,032 of non-cash interest expense related to the amortization of the debt discount associated with these 7% convertible notes, respectively. As of December 31, 2015, the outstanding principal on these 7% convertible notes was \$500,000, accrued interest was \$238,606, and unamortized debt discount was \$0, which results in a net amount of \$738,606.

During the nine months ended September 30, 2016, the Company recorded interest expense of \$59,732 related to these 7% convertible notes. Logic Works converted principal of \$231,427 into shares of the Company's common stock at a per share conversion price of \$0.007. As of September 30, 2016, the outstanding principal on these 7% convertible notes was \$18,573, accrued interest was \$149,324, and unamortized debt discount was \$0, which results in a net amount of \$167,897.

#### Funding from TCA Global Credit Master Fund, LP ("TCA")

The First TCA SPA. On July 9, 2015, the Company closed a Securities Purchase Agreement and related agreements with TCA Global Credit Master Fund LP ("TCA"), an accredited investor, whereby the Company agreed to sell and TCA agreed to purchase up to \$3,000,000 of senior secured convertible, redeemable debentures, of which \$700,000 was purchased on July 9, 2015 and up to \$2,300,000 may be purchased in additional closings. The closing of the transaction (the "First TCA SPA") occurred on July 9, 2015. Effective as of May 4, 2016, the Company and TCA



entered into a First Amendment to the First TCA SPA whereby the parties agreed to amend the terms of the First TCA SPA in exchange for TCA's forbearance of existing defaults by the Company.

The Second TCA SPA. On August 6, 2015, the Company closed a second Securities Purchase Agreement and related agreements with TCA whereby the Company agreed to sell and TCA agreed to purchase a \$100,000 senior secured convertible redeemable debenture and the Company agreed to issue and sell to TCA, from time to time, and TCA agreed to purchase from the Company up to \$3,000,000 of the Company's common stock pursuant to a committed equity facility. The closing of the transaction (the "Second TCA SPA") occurred on August 6, 2015. On April 11, 2016, the Company agreed with TCA to mutually terminate the Second TCA SPA.

Amendment to the First TCA SPA. On October 27, 2015, the Company entered into an Amended and Restated Securities Purchase Agreement and related agreements with TCA whereby the Company agreed to sell, and TCA agreed to purchase \$350,000 of senior secured convertible, redeemable debentures. This was an amendment to the First TCA SPA (the "Amendment to the First TCA SPA".) As of October 27, 2015, the Company sold \$1,050,000 in Debentures to TCA and up to \$1,950,000 in Debentures remain for sale by the Company. The closing of the Amendment to the First TCA SPA occurred on October 27, 2015. In addition, TCA has advanced the Company an additional \$100,000 for a total of \$1,150,000.



Issuance of Preferred Stock to TCA. Also, on October 21, 2015 the Company issued 150,000 Series B Preferred Stock at a stated value equal to \$10.00 per share to TCA. The Series B Preferred Stock is convertible into common stock by dividing the stated value of the shares being converted by 100% of the average of the five (5) lowest closing bid prices for the common stock during the ten (10) consecutive trading days immediately preceding the conversion date as quoted by Bloomberg, LP. On October 21, 2015, we also issued 51 shares of Series C Preferred Stock at \$0.0001 par value per share to TCA. The Series C Preferred Stock is not convertible into our common stock. In the event of a default under the Amended and Restated TCA Transaction Documents, TCA can exercise voting control over our common stock with their Series C Preferred Stock voting rights.

TCA's Forbearance. Due to the Company's default on its repayment obligations under the TCA SPA's and related documents, the parties agreed to restructure the SPA's whereby TCA agreed to forbear from enforcement of our defaults and to restructure a payment schedule for repayment of debt under the SPAs. The Company defaulted because our operating results were not as expected and the Company were unable to generate sufficient revenue through its business operations to serve the TCA debt. Specifically, the First Amendment to Amended and Restated Securities Purchase Agreement made the following material modifications to the existing SPA's:

All unpaid debentures were modified as described in more detail below.

Payments on the debentures shall be made by (i) debt purchase agreement(s) to be entered into by TCA, (ii) through proceeds raised from the transaction(s) with Chicago Venture; or (iii) by the Company directly.

The due date of the debentures was extended to April 28, 2018.

TCA agreed that it shall not enforce and shall forbear from pursuing enforcement of any existing defaults by us unless and until a future Company default occurs.

In furtherance of TCA's forbearance, effective as of May 4, 2016, the Company issued Second Replacement Debenture A in the principal amount of \$150,000 and Second Replacement Debenture B in the principal amount of \$2,681,210 (collectively, the "Second Replacement Debentures").

Per the First Amendment to Amended and Restated Securities Purchase Agreement, the Second Replacement Debentures were combined, and apportioned into two separate replacement debentures. The Second Replacement Debentures were intended to act in substitution for and to supersede the debentures in their entirety. It was the intent of the Company and TCA that while the Second Replacement Debentures replace and supersede the debentures, in their entirety, they were not in payment or satisfaction of the debentures, but rather were the substitute of one evidence of debt for another without any intent to extinguish the old debt. As of September 30, 2016, the maximum number of shares subject to conversion under the Second Replacement Debentures is 19,401,389. This is an approximation. The estimation of the maximum number of shares issuable upon the conversion of the Second Replacement Debentures was calculated using an estimated average price of \$.0036 per share.

The Second Replacement Debentures contemplate TCA entering into debt purchase agreement(s) with third parties whereby TCA may, at its election, sever, split, divide or apportion the Second Replacement Debentures to accomplish the repayment of the balance owed to TCA by Company. The Second Replacement Debentures are convertible at 85% of the lowest daily volume weighted average price ("VWAP") of the Company's common stock during the five (5) business days immediately prior to a conversion date.

In connection with the above agreements, the parties acknowledged and agreed that certain advisory fees previously paid to TCA as provided in the SPAs in the amount of \$1,500,000 have been added and included within the principal balance of the Second Replacement Debentures. The advisory fees related too financial, merger and acquisition and

regulatory services provided to the Company. The conversion price discount on the Second Replacement Debentures will not apply to the advisory fees added to the Second Replacement Debentures. TCA also agreed to surrender its Series B Preferred Stock in exchange for the \$1,500,000 being added to the Second Replacement Debenture.

As more particularly described below, the Company remains in debt to TCA for the principal amount of \$1,500,000. The remaining \$1,400,000 of principal debt was assigned to Old Main Capital, LLC (see discussion immediately below.) The Company intends to use the funds generated from the Chicago Venture transaction to fuel its business operations and business plans which, in turn, will presumably generate revenues sufficient to avoid another default in the remaining TCA obligations. If the Company is unable to raise sufficient funds through the Chicago Venture transaction and/or generate sales sufficient to service the remaining TCA debt then the Company will be unable to avoid another default. Failure to operate in accordance with the various agreements with TCA could result in the cancellation of these agreements, result in foreclosure on the Company's assets in an event of default which would have a material adverse effect on our business, results of operations or financial condition.

At the date of the TCA debt restructuring the remaining unamortized discount was expensed to interest in the amount of \$482,112 and the Company recognized a loss on restructuring of \$ 279,897.



As of September 30, 2016, the Company is indebted to TCA under the First and Second Replacement Debentures in the amount of \$2,189,691, accrued interest was \$8,759 and the unamortized debt discount was \$863,432, which results in a net amount of \$1,335,018.

As discussed below, during the nine months ended September 30, 2016, Old Main Capital LLC converted principal and accrued interest of \$713,000 into 132,285,079 shares of our common stock at a per share conversion price of \$0.0054.

As discussed below during the nine months ended September 30, 2016, Chicago Venture Partners, L.P. converted principal and accrued interest of \$128,000 into 22,371,716 shares of our common stock at a per share conversion price of \$0.0057.

The Company has recorded a loss on these transactions in the amount of \$464,473.

#### TCA Assignment of Debt to Old Main Capital, LLC

On June 9, 2016, the Company closed a Debt Purchase Agreement and related agreements (the “Old Main Transaction Documents”) with TCA and Old Main Capital, LLC (“Old Main”) whereby TCA agreed to sell and Old Main agreed to purchase in multiple tranches \$1,400,000 in senior secured convertible, redeemable debentures (the “Assigned Debt”) (the “Old Main Transaction”). The Assigned Debt was our debt incurred in the TCA financing transactions that closed in 2015. We were required to execute the Old Main Transaction Documents as the Company is the “borrower” on the Assigned Debt.

Debt Purchase Agreement. As set forth above, the Company entered into the Debt Purchase Agreement on June 9, 2015 with TCA and Old Main whereby Old Main agreed to purchase, in tranches, \$1,400,000 of debt previously held by TCA. The Company executed the Debt Purchase Agreement as it was the “borrower” under the Assigned Debt and was required to make certain representations and warranties regarding the Assigned Debt. The Assigned Debt is represented by a new “10% Senior Convertible Promissory Note” entered into by and between Old Main and the Company (more particularly described below.)

Exchange Agreement. In conjunction with the Debt Purchase Agreement, on June 9, 2016, the Company entered into an Exchange Agreement whereby we agreed to exchange, in tranches, the Assigned Debt, as well as any amendments thereto, with a 10% Senior Convertible Promissory Note (the “Note”) having a principal balance of \$1,400,000. The closing dates for the exchanges, scheduled to occur in tranches, are set forth in Schedule 1 attached to the Exchange Agreement.

10% Senior Convertible Promissory Note. Pursuant to the Exchange Agreement, the Company entered into a 10% Senior Convertible Promissory Note dated June 9, 2016 with Old Main whereby the Company agreed to be indebted to Old Main for the Assigned Debt. The Company promised to pay Old Main, by no later than the maturity date of June 9, 2017 the outstanding principal of the Assigned Debt together with interest on the outstanding principal amount under the Note, at the rate of ten percent (10%) per annum simple interest.

At any time after June 9, 2016, and while the Note is still outstanding and at the sole option of Old Main, Old Main may convert all or any portion of the outstanding principal, accrued and unpaid interest redemption premium and any other sums due and payable hereunder or under any of the other Transaction Documents into shares of our Common Stock at a price equal to the lower of: (i) sixty-five percent (65%) of the lowest traded price of the Company’s Common Stock during the thirty (30) trading days prior to the Conversion Date; or (ii) sixty-five percent (65%) of the lowest traded price of the Common Stock in the thirty (30) Trading Days prior to the Closing Date.

Option Agreement. In connection with the Old Main Transaction Documents, TCA and Old Main entered into an Option Agreement dated June 8, 2016 whereby TCA agreed to grant Old Main an option to purchase the Assigned Debt, or any portion thereof, under the terms and conditions of the Debt Purchase Agreement. In consideration, Old Main agreed to pay the Option Payment as more particularly described in the Option Agreement.

On August 24, 2016, TCA terminated its Debt Purchase Agreement and related agreements with Old Main. The specific termination date is September 25, 2016, and Old Main had a right to purchase an additional \$300,000 in debt from TCA.

As discussed below, during the nine months ended September 30, 2016, Old Main converted principal and accrued interest of \$713,000 into 132,285,079 shares of our common stock at a per share conversion price of \$0.0054.





Funding from Chicago Venture Partners, L.P. (“Chicago Venture”)

Securities Purchase Agreement with Chicago Venture Partners, L.P. As of April 4, 2016, the Company entered into a Securities Purchase Agreement and Convertible Promissory Note (the “Chicago Venture Note”) with Chicago Venture, whereby we agreed to sell, and Chicago Venture agreed to purchase an unsecured convertible promissory note in the original principal amount of \$2,755,000. In connection with the transaction, the Company received \$350,000 in cash as well as a series of twelve Secured Investor Notes for a total Purchase Price of \$2,500,000. The Note carries an Original Issue Discount (“OID”) of \$250,000 and we agreed to pay \$5,000 to cover Purchaser’s legal fees, accounting costs and other transaction expenses.

The Secured Investor Notes are payable (i) \$50,000 upon filing of a Registration Statement on Form S-1; (ii) \$100,000 upon effectiveness of the Registration Statement; and (iii) up to \$200,000 per month over the 10 months following effectiveness at our sole discretion, subject to certain conditions. The Company filed the Registration Statement within forty-five (45) days of the Closing and agreed to register shares of our common stock for the benefit of Chicago Venture in exchange for the payments under the Secured Investor Notes.

Chicago Venture has the option to convert the Note at 65% of the average of the three (3) lowest volume weighted average prices in the twenty (20) Trading Days immediately preceding the applicable conversion (the “Conversion Price”). However, in no event will the Conversion Price be less than \$0.02 or greater than \$0.09. In addition, beginning on the date that is the earlier of six (6) months or five (5) days after the Registration Statement becomes effective, and on the same day of each month thereafter, the Company will re-pay the Note in monthly installments in cash, or, subject to certain Equity Conditions, in the Company’s common stock at 65% of the average of the three (3) lowest volume weighted average prices in the twenty (20) Trading Days immediately preceding the applicable conversion (the “Installment Conversion Price”).

As discussed above, once effective, the Company has the discretion to require Chicago Venture to sell to us up to \$200,000 per month over the next 10 months on the above terms. The Company would then have the option to issue shares registered under this Registration Statement to Chicago Venture. Through this prospectus, the selling stockholder may offer to the public for resale shares of the Company’s common stock that we may issue to Chicago Venture pursuant to the Chicago Venture Note.

For a period of no more than 36 months from the effective date of the Registration Statement, we may, from time to time, at the Company’s sole discretion, and subject to certain conditions that we must satisfy, draw down funds under the Chicago Venture Note.

The Company’s ability to require Chicago Venture to fund the Chicago Venture Note is at its discretion, subject to certain limitations. Chicago Venture is obligated to fund if each of the following conditions are met; (i) the average and median daily dollar volumes of the Company’s common stock for the twenty (20) and sixty (60) trading days immediately preceding the funding date are greater than \$100,000; (ii) the Company’s market capitalization on the funding date is greater than \$17,000,000; (iii) the Company is not in default with respect to share delivery obligations under the note as of the funding date; and (iv) the Company is current in its reporting obligations. Chicago Venture’s obligations under the equity line are not transferable.

The issuance of the Company’s common stock under the Chicago Venture Note will have no effect on the rights or privileges of existing holders of common stock except that the economic and voting interests of each stockholder will be diluted as a result of any such issuance. Although the number of shares of common stock that stockholders presently own will not decrease, these shares will represent a smaller percentage of the Company’s total shares that will be outstanding after any issuances of shares of common stock to Chicago Venture. If the Company’s draw down amounts under the Chicago Venture Note when the Company’s share price is decreasing, the Company will need to

issue more shares to repay the same amount than if the Company's stock price was higher. Such issuances will have a dilutive effect and may further decrease our stock price.

There is no guarantee that the Company will be able to meet the foregoing conditions or any other conditions under the Securities Purchase Agreement and/or Chicago Venture Note or that the Company will be able to draw down any portion of the amounts available under the Securities Purchase Agreement and/or Chicago Venture Note. However, the Company does believe there is a strong likelihood, as long as we can meet the various conditions to funding, that the Company will receive the full amount of funding under the equity line of credit. Given the Company's financial challenges and the competitive nature of our business, the Company also believes it will need the full amount of funding under the equity line of credit in order to fully realize the business plans.

A portion of the funds received from Chicago Venture will be used to pay off TCA, a previous equity financing partner and a portion will be invested in our business. Specifically, the Company anticipates that approximately \$1,400,000 is expected to be used to pay TCA and the remaining funds, if any, will be used for general business purposes such as marketing, product development, expansion and administrative costs. The Company is not aware of any relationship between TCA and Chicago Venture. The Company has had no previous transactions with Chicago Venture or any of Chicago Venture's affiliates. The Company cannot predict whether the Chicago Venture transaction will have either a positive or negative impact on our stock price. However, in addition to the fact that each Chicago Venture conversion, when and if it occurs, has a dilutive effect on the Company's stock price, that should Chicago Venture convert large portions of the debt into registered shares and then sells those shares on the market, that the Company's stock price could be depressed.



As of September 30, 2016, the outstanding balance due to Chicago Venture is \$905,000, accrued interest was \$30,916, net of the OID of \$183,005, which results in a net amount of \$752,911. The OID has been recorded as a discount to debt and will be amortized over the life of the loan.

As discussed below during the nine months ended September 30, 2016, Chicago Venture converted principal and accrued interest of \$128,000 into 22,371,716 shares of our common stock at a per share conversion price of \$0.0057.

Debt Purchase Agreement and First Amendment to Debt Purchase Agreement and Note Assignment Agreement On August 24, 2016, the Company closed a Debt Purchase Agreement and a First Amendment to Debt Purchase Agreement and related agreements with Chicago Venture and TCA.

On August 24, 2016, TCA closed an Assignment of Note Agreement and related agreements with Chicago Venture. The referenced agreements relate to the assignment of Company debt, in the form of debentures, by TCA to Chicago Venture. The Company was a party to the agreements between TCA and Chicago Venture because the Company is the “borrower” under the TCA held debentures.

Exchange Agreement, Convertible Promissory Note and related Agreements with Chicago Venture On August 17, 2016, the Company closed an Exchange Agreement and a Convertible Promissory Note and related agreements with Chicago Venture whereby the Company agreed to the assignment of debentures representing debt between the Company, on the one hand, and with TCA, on the other hand. Specifically, the Company agreed that TCA could assign a portion of the Company’s debt held by TCA to Chicago Venture.

According to the Exchange Agreement, the debt is to be assigned in tranches, with the first tranche of debt assigned from TCA to Chicago Venture being \$128,000 which is represented by an Initial Exchange Note as defined in the Exchange Agreement.

#### NOTE 8 – DERIVATIVE LIABILITY

In April 2008, the FASB issued a pronouncement that provides guidance on determining what types of instruments or embedded features in an instrument held by a reporting entity can be considered indexed to its own stock for the purpose of evaluating the first criteria of the scope exception in the pronouncement on accounting for derivatives. This pronouncement was effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of these requirements can affect the accounting for warrants and many convertible instruments with provisions that protect holders from a decline in the stock price (or “down-round” provisions). For example, warrants or conversion features with such provisions are no longer recorded in equity. Down-round provisions reduce the exercise price of a warrant or convertible instrument if a company either issues equity shares for a price that is lower than the exercise price of those instruments or issues new warrants or convertible instruments that have a lower exercise price.

Derivative liability as of September 30, 2016 is as follows:

				Carrying
Fair Value Measurements				Amount at
Using Inputs				
Financial Instruments	Level 1	Level 2	Level 3	September 30, 2016

Liabilities:

Derivative Instruments	\$-	\$880,369	\$-	\$880,369
Total	\$-	\$880,369	\$-	\$880,369

For the nine months ended September 30, 2016, the Company recorded non-cash income of \$496,806 related to the “change in fair value of derivative” expense related to its 6%, 7% and 18% convertible notes.



Derivative liability as of December 31, 2015 is as follows:

Financial Instruments	Carrying			December 31, 2015
	Level 1	Level 2	Level 3	
	Fair Value Measurements Using			Amount at
	Inputs			
<b>Liabilities:</b>				
Derivative Instruments	\$-	\$1,377,175	\$-	\$1,377,175
Total	\$-	\$1,377,175	\$-	\$1,377,175

For the year ended December 31, 2015, the Company recorded non-cash income of \$723,740 related to the “change in fair value of derivative” expense related to its 6%, 7% and 18% convertible notes.

The risk-free rate of return reflects the interest rate for the United States Treasury Note with similar time-to-maturity to that of the warrants.

#### 7% Convertible Notes

As of December 31, 2015, the Company had outstanding 7% convertible notes for \$500,000 that the Company determined had an embedded derivative liability due to the “reset” clause associated with the note’s conversion price. The Company valued the derivative liability of these notes at \$105,515 using the Black-Scholes-Merton option pricing model, which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 133.2%; (iii) risk free rate of .001%, (iv) stock price of \$.005, (v) per share conversion price of \$0.007, and (vi) expected term of .25 years, as the Company estimated that these notes will be converted by March 31, 2016.

As of September 30, 2016, the Company had outstanding 7% convertible notes with a remaining balance of \$268,573 that the Company determined had an embedded derivative liability due to the “reset” clause associated with the note’s conversion price. The Company valued the derivative liability of these notes at \$472,426 using the Black-Scholes-Merton option pricing model, which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 145.8%; (iii) risk free rate of .002%, (iv) stock price of \$.0057, (v) per share conversion price of \$0.0036, and (vi) expected term of .25 years, as the Company estimates that these notes will be converted by December 31, 2016.

#### 6% Convertible Notes

As of December 31, 2015, the Company had outstanding unsecured 6% convertible notes for \$350,000 that the Company determined were a derivative liability due to the “reset” clause associated with the note’s conversion price. The Company valued the derivative liability of these notes at \$54,377 using the Black-Scholes-Merton option pricing model. which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 133.2%; (iii) risk free rate of 0.34%, (iv) stock price of

\$.005, (v) per share conversion price of \$0.007, and (vi) expected term of .56 years.

As of September 30, 2016, the Company had outstanding unsecured 6% convertible notes for \$350,000 that the Company determined had an embedded derivative liability due to the “reset” clause associated with the note’s conversion price. The Company valued the derivative liability of these notes at \$330,338 using the Black-Scholes-Merton option pricing model, which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 145.8%; (iii) risk free rate of .002%, (iv) stock price of \$.0057, (v) per share conversion price of \$0.0036, and (vi) expected term of .25 years, as the Company estimates that these notes will be converted by December 31, 2016.

Funding from TCA Global Credit Master Fund, LP (“TCA”).

The First TCA SPA. On July 9, 2015, the Company closed a Securities Purchase Agreement and related agreements with TCA Global Credit Master Fund LP (“TCA”), an accredited investor, whereby the Company agreed to sell and TCA agreed to purchase up to \$3,000,000 of senior secured convertible, redeemable debentures, of which \$700,000 was purchased on July 9, 2015 and up to \$2,300,000 may be purchased in additional closings. The closing of the transaction (the “First TCA SPA”) occurred on July 9, 2015. Effective as of May 4, 2016, the Company and TCA entered into a First Amendment to the First TCA SPA whereby the parties agreed to amend the terms of the First TCA SPA in exchange for TCA’s forbearance of existing defaults by the Company.





The Second TCA SPA. On August 6, 2015, the Company closed a second Securities Purchase Agreement and related agreements with TCA whereby the Company agreed to sell and TCA agreed to purchase a \$100,000 senior secured convertible redeemable debenture and the Company agreed to issue and sell to TCA, from time to time, and TCA agreed to purchase from the Company up to \$3,000,000 of the Company's common stock pursuant to a committed equity facility. The closing of the transaction (the "Second TCA SPA") occurred on August 6, 2015. On April 11, 2016, the Company agreed with TCA to mutually terminate the Second TCA SPA.

Amendment to the First TCA SPA. On October 27, 2015, the Company entered into an Amended and Restated Securities Purchase Agreement and related agreements with TCA whereby the Company agreed to sell, and TCA agreed to purchase \$350,000 of senior secured convertible, redeemable debentures. This was an amendment to the First TCA SPA (the "Amendment to the First TCA SPA".) As of October 27, 2015, the Company sold \$1,050,000 in Debentures to TCA and up to \$1,950,000 in Debentures remain for sale by the Company. The closing of the Amendment to the First TCA SPA occurred on October 27, 2015. In addition, TCA has advanced the Company an additional \$100,000 for a total of \$1,150,000.

Issuance of Preferred Stock to TCA. Also, on October 21, 2015 the Company issued 150,000 Series B Preferred Stock at a stated value equal to \$10.00 per share to TCA. The Series B Preferred Stock is convertible into common stock by dividing the stated value of the shares being converted by 100% of the average of the five (5) lowest closing bid prices for the common stock during the ten (10) consecutive trading days immediately preceding the conversion date as quoted by Bloomberg, LP. On October 21, 2015, we also issued 51 shares of Series C Preferred Stock at \$0.0001 par value per share to TCA. The Series C Preferred Stock is not convertible into our common stock. In the event of a default under the Amended and Restated TCA Transaction Documents, TCA can exercise voting control over our common stock with their Series C Preferred Stock voting rights.

TCA's Forbearance. Due to the Company's default on its repayment obligations under the TCA SPA's and related documents, the parties agreed to restructure the SPA's whereby TCA agreed to forbear from enforcement of our defaults and to restructure a payment schedule for repayment of debt under the SPAs. The Company defaulted because our operating results were not as expected and the Company were unable to generate sufficient revenue through its business operations to serve the TCA debt. Specifically, the First Amendment to Amended and Restated Securities Purchase Agreement made the following material modifications to the existing SPA's:

All unpaid debentures were modified as described in more detail below.

Payments on the debentures shall be made by (i) debt purchase agreement(s) to be entered into by TCA, (ii) through proceeds raised from the transaction(s) with Chicago Venture; or (iii) by the Company directly.

The due date of the debentures was extended to April 28, 2018.

TCA agreed that it shall not enforce and shall forbear from pursuing enforcement of any existing defaults by us unless and until a future Company default occurs.

In furtherance of TCA's forbearance, effective as of May 4, 2016, the Company issued Second Replacement Debenture A in the principal amount of \$150,000 and Second Replacement Debenture B in the principal amount of \$2,681,210 (collectively, the "Second Replacement Debentures").

Per the First Amendment to Amended and Restated Securities Purchase Agreement, the Second Replacement Debentures were combined, and apportioned into two separate replacement debentures. The Second Replacement Debentures were intended to act in substitution for and to supersede the debentures in their entirety. It was the intent of the Company and TCA that while the Second Replacement Debentures replace and supersede the debentures, in

their entirety, they were not in payment or satisfaction of the debentures, but rather were the substitute of one evidence of debt for another without any intent to extinguish the old debt. As of September 30, 2016, the maximum number of shares subject to conversion under the Second Replacement Debentures is 19,401,389. This is an approximation. The estimation of the maximum number of shares issuable upon the conversion of the Second Replacement Debentures was calculated using an estimated average price of \$.0036 per share.

The Second Replacement Debentures contemplate TCA entering into debt purchase agreement(s) with third parties whereby TCA may, at its election, sever, split, divide or apportion the Second Replacement Debentures to accomplish the repayment of the balance owed to TCA by Company. The Second Replacement Debentures are convertible at 85% of the lowest daily volume weighted average price ("VWAP") of the Company's common stock during the five (5) business days immediately prior to a conversion date.

In connection with the above agreements, the parties acknowledged and agreed that certain advisory fees previously paid to TCA as provided in the SPAs in the amount of \$1,500,000 have been added and included within the principal balance of the Second Replacement Debentures. The advisory fees related too financial, merger and acquisition and regulatory services provided to the Company. The conversion price discount on the Second Replacement Debentures will not apply to the advisory fees added to the Second Replacement Debentures. TCA also agreed to surrender its Series B Preferred Stock in exchange for the \$1,500,000 being added to the Second Replacement Debenture.



As more particularly described below, the Company's remain in debt to TCA for the principal amount of \$1,500,000. The remaining \$1,400,000 of principal debt was assigned to Old Main Capital, LLC (see discussion immediately below.) The Company intends to use the funds generated from the Chicago Venture transaction to fuel its business operations and business plans which, in turn, will presumably generate revenues sufficient to avoid another default in the remaining TCA obligations. If the Company is unable to raise sufficient funds through the Chicago Venture transaction and/or generate sales sufficient to service the remaining TCA debt then the Company will be unable to avoid another default. Failure to operate in accordance with the various agreements with TCA could result in the cancellation of these agreements, result in foreclosure on the Company's assets in an event of default which would have a material adverse effect on our business, results of operations or financial condition.

On July 9, 2015, the Company valued the conversion feature as a derivative liability of this senior secured convertible redeemable debenture at \$888,134 and discounted debt by \$700,000 and recorded interest expense of \$188,134. The Company valued the derivative liability of this debenture at \$888,134 using the Black-Scholes-Merton option pricing model, which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 160.0%; (iii) risk free rate of 0.25%, (iv) stock price of \$0.02, (v) per share conversion price of \$0.011, and (vi) expected term of 1.0 years.

At the inception of the Replacement Debentures, the embedded derivative liability was remeasured at fair value and the Company recorded a net gain of \$420,822, using the Black-Scholes-Merton option pricing model which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 150.0%; (iii) risk free rate of 0.001%, (iv) stock price of \$0.015, (v) per share conversion price of \$0.013, and (vi) expected term of 1.0 year.

At inception, the Company valued the conversion feature of the Replacement Debentures as a derivative liability in the amount of \$979,716 using the Black-Scholes-Merton option pricing model, which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 150.0%; (iii) risk free rate of .52%, (iv) stock price of \$.015, (v) per share conversion price of \$0.013, and (vi) expected term of 1.0 years, as the Company estimated that the Replacement Debentures will be converted by September 30, 2017. The amount was recorded as a discount to debt and will be amortized over the life of the debentures. As of June 30, 2016, the Company amortized \$5,698 to interest expense.

As of September 30, 2016, the Company revalued the embedded derivative liability of the Replacement Debentures at \$77,608 using the Black-Scholes-Merton option pricing model, which approximates the Monte Carlo and other binomial valuation techniques, with the following assumptions (i) dividend yield of 0%; (ii) expected volatility of 150.5%; (iii) risk free rate of .002%, (iv) stock price of \$.0057 (v) per share conversion price of \$0.0036, and (vi) expected term of 1.0 year, as the Company estimates that these notes will be converted or assigned in total to Chicago Venture by September 30, 2017.

#### NOTE 9 – RELATED PARTY TRANSACTIONS

Since January 1, 2015, we have engaged in the following reportable transactions with our directors, executive officers, holders of more than 5% of our voting securities, and affiliates or immediately family members of our directors, executive officers and holders of more than 5% of our voting securities.

##### Certain Relationships

Please see the transactions with CANX, LLC and Logic Works in Note 5, TCA Global Credit Master Fund LP and Chicago Venture Partners, L.P. discussed in Note 7, 8 10 and 13.

Transactions with an Entity Controlled by Marco Hegyi

An entity controlled by Mr. Hegyi received a warrant to purchase up to twenty five million shares of our common stock at an exercise price of \$0.08 per share was reduced to \$0.01 per share on December 18, 2015.

On April 15, 2016, the Company issued 1,000,000 shares of its common stock to an entity affiliated with Marco Hegyi, our Chief Executive Officer, pursuant to a conversion of debt for \$20,000. The shares were valued at the fair market price of \$0.02 per share.

Transactions with an Entity Controlled by Mark E. Scott

An entity controlled by Mr. Scott received an option to purchase sixteen million shares of our common stock at an exercise price of \$0.07 per share was reduced to \$0.01 per share on December 18, 2015. Two million shares vested on August 17, 2015 with the Company's resolution of the class action lawsuits. An additional two million share stock option vest on April 18, 2016 upon the Company securing a market maker with an approved 15c2-11 resulting in the Company's relisting on OTCBB.



On January 4, 2016, the Company issued 3,000,000 shares of its common stock to an entity affiliated with Mark E. Scott, Chief Financial Officer, pursuant to a conversion of debt for \$30,000. The shares were valued at the fair market price of \$0.01 per share.

#### Transactions with Michael Fasci

On January 27, 2016, the Company issued 1,500,000 shares of its common stock to Michael Fasci, a member of the Board of Directors, for director services. The shares were valued at the fair market price of \$0.01 per share.

On May 25, 2016, the Company issued 2,500,000 shares of its common stock to Michael Fasci, a member of the Board of Directors, for director services. The shares were valued at the fair market price of \$0.02 per share.

#### NOTE 10– EQUITY

##### Authorized Capital Stock

The Company has authorized 3,010,000,000 shares of capital stock, of which 3,000,000,000 are shares of voting common stock, par value \$0.0001 per share, and 10,000,000 are shares of preferred stock, par value \$0.0001 per share.

##### Non-Voting Preferred Stock

Under the terms of our articles of incorporation, the Company's board of directors is authorized to issue shares of non-voting preferred stock in one or more series without stockholder approval. The Company's board of directors has the discretion to determine the rights, preferences, privileges and restrictions, dividend rights, conversion rights, redemption privileges and liquidation preferences, of each series of non-voting preferred stock.

The purpose of authorizing the Company's board of directors to issue non-voting preferred stock and determine the Company's rights and preferences is to eliminate delays associated with a stockholder vote on specific issuances. The issuance of non-voting preferred stock, while providing flexibility in connection with possible acquisitions, future financings and other corporate purposes, could have the effect of making it more difficult for a third party to acquire, or could discourage a third party from seeking to acquire, a majority of our outstanding voting stock. Other than the Series B and C Preferred Stock discussed below, there are no shares of non-voting preferred stock presently outstanding and we have no present plans to issue any shares of preferred stock.

##### Series B Preferred Stock Designation

In connection with the Amended and Restated Securities Purchase Agreement, the Board of Directors, on October 21, 2015, approved the authorization of a Series B Preferred Stock as provided in our Certificate of Incorporation, as amended.

The Series B Preferred Stock has authorized 150,000 shares with a stated value equal to \$10.00 per share. Dividends payable to other classes of stock are restricted until repayment of the aggregate value of Series B Preferred Stock. Upon the Company's liquidation or dissolution, Series B Preferred Stock has no priority or preference with respect to distributions of any assets by the Company. The Series B Preferred Stock is convertible into common stock by dividing the stated value of the shares being converted by 100% of the average of the five lowest closing bid prices for the common stock during the ten consecutive trading days immediately preceding the conversion date as quoted by Bloomberg, LP.

TCA was issued 150,000 shares of Series B Preferred Stock. However, in no event will Purchaser be entitled to hold in excess of 4.99% of the outstanding shares of common stock of the Company.

In connection with the First Amendment to Amended and Restated Securities Purchase Agreement, TCA is surrendering the Series B Preferred Stock.

##### Series C Preferred Stock Designation



In connection with the Amended and Restated Securities Purchase Agreement, the Board of Directors, on October 21, 2015, approved the authorization of a Series C Preferred Stock as provided in the Company's Certificate of Incorporation, as amended, and the issuance of 51 shares of Series C Preferred Stock. These shares only have voting rights in the event of a default by us under the Amended and Restated Transaction Documents. The Series C Preferred Stock is cancelled with the repayment of the TCA debt.



The Series C Preferred Stock Designation authorizes 51 shares of Series C Preferred Stock. Series C Preferred Stock is not entitled to dividend or liquidation rights and is not convertible into our common stock.

In the event of a default under the Amended and Restated Transaction Documents, each share of Series C Preferred Stock shall have voting votes equal to 0.019607 multiplied by the total issued and outstanding common stock and preferred stock eligible to vote divided by .49 minus the numerator. For example, if the total issued and outstanding common stock eligible to vote is 5,000,000, the voting rights of one share of Series C Preferred Stock shall be equal to 102,036 (e.g.  $((0.019607 \times 5,000,000)/0.49) - (0.019607 \times 5,000,000) = 102,036$ ). In the event of a default under the Amended and Restated TCA Transaction Documents, TCA can exercise voting control over our common stock.

#### Common Stock

Unless otherwise indicated, all of the following sales or issuances of Company securities were conducted under the exemption from registration as provided under Section 4(2) of the Securities Act of 1933 (and also qualified for exemption under 4(5), formerly 4(6) of the Securities Act of 1933, except as noted below). All of the shares issued were issued in transactions not involving a public offering, are considered to be restricted stock as defined in Rule 144 promulgated under the Securities Act of 1933 and stock certificates issued with respect thereto bear legends to that effect.

The Company has compensated consultants and service providers with restricted common stock during the development of our business and when our capital resources were not adequate to provide payment in cash.

During the nine months ended September 30, 2016, the Company had had the following sales of unregistered of equity securities to accredited investors unless otherwise indicated:

On January 4, 2016, the Company issued 3,000,000 shares of its common stock to an entity affiliated with Mark E. Scott, our Chief Financial Officer, pursuant to a conversion of debt for \$30,000. The shares were valued at the fair market price of \$0.01 per share.

On January 16, 2016, the Company issued 1,400,000 shares of its common stock to an unaccredited former consultant pursuant a conversion of debt for \$14,000. The shares were valued at the fair market price of \$0.01 per share.

On January 27, 2016, the Company issued 1,500,000 shares of its common stock to Michael E. Fasci, a Board Director, pursuant to a service award for \$15,000. The shares were valued at the fair market price of \$0.01 per share.

In consideration for advisory services provided by TCA to the Company, the Company issued 15,000,000 shares of Common Stock during the year ending December 31, 2015. As the common stock was conditionally redeemable, the Company recorded the common stock as mezzanine equity in the accompanying consolidated balance sheet as of December 31, 2015. As of September 30, 2016, the shares are no longer conditionally redeemable and were recorded as issued and outstanding common stock.

The Company issued \$2 million in common stock or 115,141,048 shares of our common stock on April 6, 2016 pursuant to the settlement of the Consolidated Class Action and Derivative Action lawsuits alleging violations of federal securities laws that were filed against the Company in United States District Court, Central District of California. The Company accrued \$2,000,000 as loss on class action lawsuits and contingent liabilities during the year ending December 31, 2015.

On April 15, 2016, the Company issued 1,000,000 shares of its common stock to an entity affiliated with Marco Hegyi, our Chief Executive Officer, pursuant to a conversion of debt for \$20,000. The shares were valued at the fair market price of \$0.02 per share.

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On May 25, 2016, the Company issued 2,500,000 shares of its common stock to Michael E. Fasci, a Board Director, pursuant to a service award for \$50,000. The shares were valued at the fair market price of \$0.02 per share.

On July 13, 2016, the Company issued 6,000,000 shares of common stock pursuant to Settlement Agreement and Release with Mr. Robert Hunt, a former executive. While the conditions had not been met, the Company issued 6,000,000 shares of common stock on July 13, 2016 which were valued at \$0.010 per share.

During the nine months ended September 30, 2016, Holders of the Company's Convertible Notes Payables, converted principal and accrued interest of \$844,565 into 120,652,138 shares of the Company's common stock at a per share conversion price of \$0.007.

During the nine months ended September 30, 2016, Old Main converted principal and accrued interest of \$713,000 into 132,285,079 shares of our common stock at a per share conversion price of \$0.0054.

During the nine months ended September 30, 2016, Chicago Venture converted principal and accrued interest of \$128,000 into 22,371,716 shares of our common stock at a per share conversion price of \$0.0057.



Warrants

The Company did not issue any warrants during the nine months ended September 30, 2016.

A summary of the warrants issued as of September 30, 2016 is as follows:

September 30, 2016

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	565,000,000	\$0.032
Issued	-	-
Exercised	-	-
Forfeited	-	-
Expired	-	-
Outstanding at end of period	565,000,000	\$0.032
Exerciseable at end of period	565,000,000	

A summary of the status of the warrants outstanding as of September 30, 2016 is presented below:

September 30, 2016

	Weighted Average	Weighted Average	Shares	Weighted Average Exercise Price
Number of Warrants	Remaining Life	Exercise Price	Exerciseable	Exercise Price
540,000,000	2.56	\$0.033	540,000,000	\$0.033
25,000,000	2.94	0.010	25,000,000	0.010

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565,000,000 2.55 \$0.032 565,000,000 \$0.032

Warrants totaling 565,000,000 shares of common stock have no intrinsic value as of September 30, 2016.





## NOTE 11 – STOCK OPTIONS

### Description of Stock Option Plan

In fiscal year 2011, the Company authorized a Stock Incentive Plan whereby a maximum of 18,870,184 shares of the Company's common stock could be granted in the form of Non-Qualified Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, and Other Stock-Based Awards. On April 18, 2013, the Company's Board of Directors voted to increase to 35,000,000 the maximum allowable shares of the Company's common stock allocated to the 2011 Stock Incentive Plan. The Company has outstanding unexercised stock option grants totaling 24,010,000 shares as of September 30, 2016. All grants are non-qualified as the plan was not approved by the shareholders within one year of its adoption.

### Determining Fair Value under ASC 505

The Company records compensation expense associated with stock options and other equity-based compensation using the Black-Scholes-Merton option valuation model for estimating fair value of stock options granted under our plan. The Company amortizes the fair value of stock options on a ratable basis over the requisite service periods, which are generally the vesting periods. The expected life of awards granted represents the period of time that they are expected to be outstanding. The Company estimates the volatility of our common stock based on the historical volatility of its own common stock over the most recent period corresponding with the estimated expected life of the award. The Company bases the risk-free interest rate used in the Black Scholes-Merton option valuation model on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term equal to the expected life of the award. The Company has not paid any cash dividends on our common stock and does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes-Merton option valuation model and adjusts share-based compensation for changes to the estimate of expected equity award forfeitures based on actual forfeiture experience. The effect of adjusting the forfeiture rate is recognized in the period the forfeiture estimate is changed.

### Stock Option Activity

During the nine months ended September 30, 2016, the Company had the following stock option activity:

An entity controlled by Mr. Scott had a two million share stock option that was previously issued vest on April 18, 2016 upon the Company securing a market maker with an approved 15c2-11 resulting in the Company's relisting on OTCBB.

Mr. Belmont resigned January 13, 2016 and an option to purchase five million shares of the Company's common stock under the Company's 2011 Stock Incentive Plan expired on April 13, 2016.

An employee forfeited a stock grant for 10,000 shares of the Company's common stock during the nine months ended September 30, 2016.

As of September 30 2016, there are 24,010,000 options to purchase common stock at an average exercise price of \$0.023 per share outstanding under the 2011 Stock Incentive Plan. The Company recorded \$98,173 and \$138,532 of compensation expense, net of related tax effects, relative to stock options for the nine months ended September 30, 2016 and 2015, respectively, in accordance with ASC 505. Net loss per share (basic and diluted) associated with this expense was approximately (\$0.00). As of September 30, 2016, there is \$114,379 of total unrecognized costs related to employee granted stock options that are not vested. These costs are expected to be recognized over a period of approximately 3.08 years.

Stock option activity for the nine months ended September 30, 2016 and the years ended December 31, 2015 and 2014 is as follows:

		Weighted Average	
	Options	Exercise Price	\$
Granted	49,720,000	\$0.075	\$3,706,000
Exercised	(5,126,187)	(0.133)	(682,922)
Forfeitures	(44,725,000)	(0.092)	(4,132,751)
Outstanding as of December 31, 2014	40,720,000	0.058	2,356,000
Granted	-	-	(960,000)
Exercised	-	-	-
Forfeitures	(11,700,000)	(0.050)	(585,000)
Outstanding as of December 31, 2015	29,020,000	0.028	811,000
Granted	-	-	-
Exercised	-	-	-
Forfeitures	(5,010,000)	-	(250,500)
Outstanding as of September 30, 2016	24,010,000	\$0.023	\$560,500



The following table summarizes information about stock options outstanding and exercisable as of September 30, 2016:

Range of Exercise Prices	Number Outstanding	Weighted	Weighted	Number Exercisable	Weighted
		Average Remaining Life In Years	Average Exercise Price		Average Exercise Price
\$0.05	8,010,000	4.00	\$0.050	6,017,500	\$0.050
0.01	16,000,000	3.02	0.010	12,055,556	0.010
	24,010,000	3.08	\$0.023	18,073,056	\$0.039

Stock option grants totaling 24,010,000 shares of common stock have no intrinsic value as of September 30, 2016.

#### NOTE 12 – COMMITMENTS, CONTINGENCIES AND LEGAL PROCEEDINGS

##### Legal Proceedings

The Company is involved in the disputes and legal proceedings described below. In addition, as a public company, the Company is also potentially susceptible to litigation, such as claims asserting violations of securities laws. Any such claims, with or without merit, if not resolved, could be time-consuming and result in costly litigation. The Company accrues any contingent liabilities that are likely.

##### Class Actions Alleging Violations of Federal Securities Laws

Beginning on April 18, 2014, three class action lawsuits alleging violations of federal securities laws were filed against the Company in United States District Court, Central District of California (the “Court”). At a hearing held on July 21, 2014, the three class action lawsuits were consolidated into one case with Lawrence Rosen as the lead plaintiff (the “Consolidated Class Action,” styled Romero et al. vs. GrowLife et al.). On May 15, 2014 and August 4, 2014, respectively two shareholder derivative lawsuits were filed against the Company with the Court (the “Derivative Actions”). On October 20, 2014, AmTrust North America, the Company’s insurer, filed a lawsuit contesting insurance coverage on the above legal proceedings. The Company made a general appearance in this action. On January 20, 2015, the Court ordered all of the above actions stayed pending completion of mediation of the dispute. On April 27, 2015, the Court preliminarily approved the proposed settlement of the Consolidated Class Action. On June 1, 2015, the Court preliminarily approved the proposed settlement of the Derivative Actions pursuant to a proposed stipulated settlement agreement. On August 3, 2015, the Court entered a Final Order and Judgment resolving the Consolidated Class Action litigation in its entirety. The Consolidated Class Action was thereby dismissed in its entirety with prejudice and without costs. On August 10, 2015, pursuant to a settlement by and between the Company and AmTrust North America, AmTrust’s lawsuit contesting insurance coverage of the Consolidated Class Action and Derivative Actions was dismissed in its entirety with prejudice pursuant to a Stipulation for Dismissal of Entire Action with Prejudice executed by and between AmTrust and the Company. On August 17, 2015, the Court entered a Final Order and Judgment resolving the Derivative Actions in their entirety. The Derivative Actions were thereby dismissed in

their entirety with prejudice.

As a result of the foregoing, all litigation discussed herein is resolved in full at this time. The Company issued \$2 million in common stock or 115,141,048 shares of the Company's common stock on April 6, 2016 pursuant to the settlement of the Consolidated Class Action and Derivative Action lawsuits alleging violations of federal securities laws that were filed against the Company in United States District Court, Central District of California. The Company accrued \$2,000,000 as loss on class action lawsuits and contingent liabilities during the year ending December 31, 2015.

#### Sales, Payroll and Other Tax Liabilities

As of September 30, 2016, the Company owes approximately \$118,900 in sales tax and \$59,892 in payroll and other taxes.



### Potential Convertible Note Defaults

Several of the Company's convertible promissory notes remain outstanding beyond their respective maturity dates. This may trigger an event of default under the respective agreements. The Company is working with these noteholders to convert their notes into common stock and intends to resolve these outstanding issues as soon as practicable.

### Other Legal Proceedings

The Company is in default on its Portland, Maine store lease and the Company is negotiating with the landlord. The Company has been sued for non-payment of lease payments at closed stores in Boulder, Colorado and Plaistow, New Hampshire. The Company is currently subject to legal actions with various vendors and a former officer.

It is possible that additional lawsuits may be filed and served on the Company.

### Operating Leases

Upon the Company's acquisition of Rocky Mountain Hydroponics, LLC and Evergreen Garden Center, LLC, the Company assumed the lease for the RMH/EGC retail hydroponics store located in Portland, Maine. The lease commencement date was May 1, 2013 with an expiration date of April 30, 2016. The monthly rent for year one of the lease was \$4,917, with monthly rent of \$5,065 in year two, and monthly rent of \$5,217 in year three of the lease. The Company has an option to extend the lease for two three year terms as long it is not in default under the lease. The Company is currently operating its store under this lease.

On October 21, 2013, the Company entered into a lease agreement for retail space for its hydroponics store in Avon (Vail), Colorado. The lease expires on September 30, 2018. Monthly rent for year one of the lease is \$2,606 and increases 3.5% per year thereafter through the end of the lease. The Company does not have an option to extend the lease.

On May 31, 2016, the Company rented space at 5400 Carillon Point, Kirkland, Washington 98033 for \$1,539 per month for its corporate office. The Company's agreement expires May 31, 2017 and can be extended.

The aggregate future minimum lease payments under operating leases, to the extent the leases have early cancellation options and excluding escalation charges, are as follows:

#### Years Ended September 30, Total

2017	\$97,635
2018	32,330
2019	0
2020	0
2021	-
Beyond	-
Total	\$129,965

### Employment and Consulting Agreements

Employment Agreement with Marco Hegyi

On December 4, 2013, the Company entered into an Employment Agreement with Marco Hegyi pursuant to which the Company engaged Mr. Hegyi as its President from December 4, 2013 through December 4, 2016 to provide consulting and management services. Per the terms of the Hegyi Agreement, Mr. Hegyi established an office in Seattle, Washington while also maintaining operations in the Southern California area. Mr. Hegyi's annual compensation is \$150,000 for the first year of the Hegyi Agreement; \$250,000 for the second year; and \$250,000 for the third year. Mr. Hegyi is also entitled to receive an annual bonus equal to four percent (4%) of the Company's EBITDA for that year. The annual bonus shall be paid no later than 31 days (i.e., by January 31st) following the end of each calendar year. Mr. Hegyi's first annual bonus will be calculated based on the Company's EBITDA for calendar year 2014, with such bonus payable on or before January 31, 2015. If Mr. Hegyi's employment is terminated for any reason prior to the expiration of the Term, as applicable, his annual bonus will be prorated for that year based on the number of days worked in that year. At the commencement of Mr. Hegyi's employment, an entity affiliated with Mr. Hegyi received a Warrant to purchase up to 25,000,000 shares of common stock of the Company at an exercise price of \$0.08 per share. The Hegyi Warrant is exercisable for five years. On June 20, 2014, the Company and Mr. Hegyi reduced the warrant life from ten to five years. On January 25, 2016, the Company reduced the warrant exercise price to \$0.01 per share effective December 18, 2015.





Mr. Hegyi was entitled to participate in all group employment benefits that are offered by the Company to the Company's senior executives and management employees from time to time, subject to the terms and conditions of such benefit plans, including any eligibility requirements. In addition, the Company is required to purchase and maintain during the Term a "key manager" insurance policy on Mr. Hegyi's life in the amount of \$4,000,000, paid as \$2,000,000 payable to Mr. Hegyi's named heirs or estate as the beneficiary, and \$2,000,000 payable to the Company. The Company and Mr. Hegyi waived this \$2,000,000 key manager insurance. If, prior to the expiration of the Term, the Company terminates Mr. Hegyi's employment for "Cause", or if Mr. Hegyi voluntarily terminates his employment without "Good Reason", or if Mr. Hegyi's employment is terminated by reason of his death, then all of the Company's obligations hereunder shall cease immediately, and Mr. Hegyi will not be entitled to any further compensation beyond any pro-rated base salary due and bonus amounts earned through the effective date of termination. Mr. Hegyi will also be reimbursed for any expenses incurred prior to the date of termination for which he was not previously reimbursed.

If the Company terminates Mr. Hegyi's employment at any time prior to the expiration of the Term without Cause, or if Mr. Hegyi terminates his employment at any time for "Good Reason" or due to a "Disability", Mr. Hegyi will be entitled to receive (i) his base salary amount through the end of the Term; and (ii) his annual bonus amount for each year during the remainder of the Term, which bonus amount shall be equal to the greater of (A) the annual bonus amount for the immediately preceding year, or (B) the bonus amount that would have been earned for the year of termination, absent such termination. If there has been a "Change in Control" and the Company (or its successor or the surviving entity) terminates Mr. Hegyi's employment without Cause as part of or in connection with such Change in Control (including any such termination occurring within one (1) month prior to the effective date of such Change in Control), then in addition to the benefits set forth above, Mr. Hegyi will be entitled to (i) an increase of \$300,000 in his annual base salary amount (or an additional \$25,000 per month) through the end of the Term; plus (ii) a gross-up in the annual base salary amount each year to account for and to offset any tax that may be due by Mr. Hegyi on any payments received or to be received by Mr. Hegyi under this Agreement that would result in a "parachute payment" as described in Section 280G of the Internal Revenue Code of 1986, as amended. If the Company (or its successor or the surviving entity) terminates Mr. Hegyi's employment without Cause within twelve (12) months after the effective date of any Change in Control, or if Mr. Hegyi terminates his employment for Good Reason within twelve (12) months after the effective date of any Change in Control, then in addition to the benefits set forth above, Mr. Hegyi will be entitled to (i) an increase of \$300,000 in his annual base salary amount (or an additional \$25,000 per month), which increased annual base salary amount shall be paid for the remainder of the Term or for two (2) years following the Change in Control, whichever is longer; (ii) a gross-up in the annual base salary amount each year to account for and to offset any tax that may be due by Mr. Hegyi on any payments received or to be received by Mr. Hegyi under this Letter Agreement that would result in a "parachute payment" as described in Section 280G of the Internal Revenue Code of 1986, as amended; (iii) payment of Mr. Hegyi's annual bonus amount as set forth above for each year during the remainder of the Term or for two (2) years following the Change in Control, whichever is longer; and (iv) health insurance coverage provided for and paid by the Company for the remainder of the Term or for two (2) years following the Change in Control, whichever is longer.

#### Consulting Chief Financial Officer Agreement with an Entity Controlled by Mark E. Scott

On July 31, 2014, the Company entered into a Consulting Chief Financial Officer Letter with an entity controlled by Mark E. Scott pursuant to which the Company engaged Mr. Scott as its Consulting CFO from July 1, 2014 through September 30, 2014, and continuing thereafter until either party provides sixty day notice to terminate the Letter or Mr. Scott enters into a full-time employment agreement.

Per the terms of the Scott Agreement, Mr. Scott's compensation is \$150,000 on an annual basis for the first year of the Scott Agreement. Mr. Scott is also entitled to receive an annual bonus equal to two percent of the Company's EBITDA for that year. The Company's Board of Directors granted Mr. Scott an option to purchase sixteen million shares of the Company's Common Stock under the Company's 2011 Stock Incentive Plan at an exercise price of \$0.07 per share, the

fair market price on July 31, 2014. On December 18, 2015, the Company reduced the exercise price to \$0.01 per share. The shares vest (i) two million shares vest immediately upon securing a market maker with an approved 15c2-11 resulting in the Company's relisting on OTCBB (earned as of February 18, 2016); (ii) two million shares vest immediately upon the successful approval and effectiveness of the Company's S-1 (not earned as of September 30, 2016); (iii) two million shares vest immediately upon the Company's resolution of the class action lawsuits (earned as of August 17, 2015); and (iv) ten million shares will vest on a monthly basis over a period of three years beginning on the July 1, 2014.

All options will have a five-year life and allow for a cashless exercise. The stock option grant is subject to the terms and conditions of the Company's Stock Incentive Plan, including vesting requirements. In the event that Mr. Scott's continuous status as consultant to the Company is terminated by the Company without Cause or Mr. Scott terminates his employment with the Company for Good Reason as defined in the Scott Agreement, in either case upon or within twelve months after a Change in Control as defined in the Company's Stock Incentive Plan except for CANX USA, LLC, then 100% of the total number of shares shall immediately become vested.

Mr. Scott will be entitled to participate in all group employment benefits that are offered by the Company to the Company's senior executives and management employees from time to time, subject to the terms and conditions of such benefit plans, including any eligibility requirements. In addition, the Company is required to purchase and maintain an insurance policy on Mr. Scott's life in the amount of \$2,000,000 payable to Mr. Scott's named heirs or estate as the beneficiary. Finally, Mr. Scott is entitled to twenty days of vacation annually and also has certain insurance and travel employment benefits.

If, prior to the expiration of the Term, the Company terminates Mr. Scott's employment for Cause, or if Mr. Scott voluntarily terminates his employment without Good Reason, or if Mr. Scott's employment is terminated by reason of his death, then all of the Company's obligations hereunder shall cease immediately, and Mr. Scott will not be entitled to any further compensation beyond any pro-rated base salary due and bonus amounts earned through the effective date of termination. Mr. Scott will also be reimbursed for any expenses incurred prior to the date of termination for which he was not previously reimbursed. Mr. Scott may receive severance benefits and the Company's obligation under a termination by the Company without Cause or Mr. Scott terminates his employment for Good Reason are discussed above.



#### Promotion Letter with Joseph Barnes

On October 10, 2014, the Company entered into a Promotion Letter with Joseph Barnes which was effective October 1, 2014 pursuant to which the Company engaged Mr. Barnes as its Senior Vice-President of Business Development from October 1, 2014 on an at will basis.

Per the terms of the Barnes Agreement, Mr. Barnes's compensation is \$90,000 on an annual basis. Mr. Barnes received a bonus of \$6,500 and is also entitled to receive a quarterly bonus based on growth of the Company's growth margin dollars. No quarterly bonuses were earned under this Promotion Letter. Mr. Barnes was granted an option to purchase eight million shares of the Company's common stock under the Company's 2011 Stock Incentive Plan at an exercise price on the date of grant. The shares vest (i) two million shares vested immediately; and (ii) six million shares vest on a monthly basis over a period of three years beginning on the date of grants.

All options will have a five-year life and allow for a cashless exercise. The stock option grant is subject to the terms and conditions of the Company's Stock Incentive Plan, including vesting requirements. In the event that Mr. Barnes's continuous status as employee to the Company is terminated by the Company without Cause or Mr. Barnes terminates his employment with the Company for Good Reason as defined in the Barnes Agreement, in either case upon or within twelve months after a Change in Control as defined in the Company's Stock Incentive, then 100% of the total number of shares shall immediately become vested.

Mr. Barnes was entitled to participate in all group employment benefits that are offered by the Company to the Company's senior executives and management employees from time to time, subject to the terms and conditions of such benefit plans, including any eligibility requirements. Finally, Mr. Barnes is entitled to fifteen days of vacation annually and also has certain insurance and travel employment benefits.

Mr. Barnes may receive severance benefits and the Company's obligation under a termination by the Company without Cause or Mr. Barnes terminates his employment for Good Reason are discussed above.

#### Agreements with Robert Hunt

On June 7, 2013, the Company entered into an Executive Services Agreement with Robert Hunt, pursuant to which the Company engaged Mr. Hunt, from June 8, 2013 through June 7, 2015 to provide consulting and management services as the President of GrowLife Hydroponics, Inc.

On May 30, 2014, the Company announced the resignation of Robert Hunt effective May 23, 2014 as Executive Vice President of GrowLife, Inc., President of GrowLife Hydroponics. On June 3, 2014, the Board of Directors accepted the resignation of Robert Hunt effective June 2, 2014 as a Director of the Company. On October 17, 2014, the Company entered into a Settlement Agreement and Release with Mr. Robert Hunt, whereby the Parties cancelled the Executive Services Agreement ("ESA") dated June 7, 2013 and his stock option grant for 12,000,000 shares. The Company agreed to issue 6,000,000 shares of common stock under certain conditions that have not been met (issuance not considered triggered by the Company as of September 30, 2016). While the conditions had not been met, the Company issued 6,000,000 shares of common stock on July 13, 2016 where were valued at \$0.010 per share.

#### Promotion Letter with Jeremy Belmont

On October 10, 2014, the Company entered into a Promotion Letter with Jeremy Belmont which was effective October 1, 2014 pursuant to which the Company engaged Mr. Belmont as Vice President of Sales from October 1, 2014 on an at will basis. This Promotion Letter superseded and canceled the Manager Services Agreement with Mr. Belmont dated October 1, 2013.

Per the terms of the Belmont Agreement, Mr. Belmont's compensation was \$72,000 on an annual basis. Mr. Belmont received a bonus of \$6,500 and is also entitled to receive a quarterly bonus based on growth of the Company's growth margin dollars. No quarterly bonuses were earned under this Promotion Letter. Mr. Belmont was granted an option to purchase five million shares of the Company's common stock under the Company's 2011 Stock Incentive Plan. Mr. Belmont resigned January 13, 2016 and the option to purchase five million shares of the Company's common stock expired on April 13, 2016.



#### NOTE 13 – SUBSEQUENT EVENTS

The Company evaluates subsequent events, for the purpose of adjustment or disclosure, up through the date the financial statements are available.

The following material transactions occurred subsequent to September 30, 2016:

##### Equity Issuances

Old Main converted principal and interest of \$40,150 into 12,365,872 shares of our common stock at a per share conversion price of \$.0036.

Chicago Venture converted principal and interest of \$681,668 into 145,676,481 shares of our common stock at a per share conversion price of \$0.0047.

Logic Works converted principal and interest of \$235,682 into 65,467,127 shares of our common stock at a per share conversion price of \$0.036.

During October 2016, the Company issued 5,020,000 shares of our common stock to former directors and service providers at \$0.01 per share. The price per share was based on the thirty day trailing average.

On October 12, 2016, the Company amended the exercise price of the stock option grants for Joseph Barnes to \$0.010 per share.

On October 12, 2016, Marco Hegyi converted \$40,000 in deferred compensation into 4,000,000 shares of the Company's common stock at \$0.01 per share.

On October 21, 2016, Mark Scott cancelled stock option grants totaling 12,000,000 shares of the Company's common stock at \$0.01 per share. Mr. Scott has an additional 2,000,000 share stock option grant which continues to vest monthly over 36 months and a 2,000,000 share stock option grant which vests upon the achievement of certain performance goals related to acquisitions.

Also on October 20, 2016, Mark Scott, converted \$40,000 in deferred compensation into 4,000,000 shares of the Company's common stock at \$0.01 per share. The price per share was based on the thirty day trailing average.

In addition, on October 20, 2016, Mark Scott was granted 6,000,000 shares of the Company's common stock at \$0.01 per share. The price per share was based on the thirty day trailing average.

##### Dissolution of Certain Non-Operating Subsidiaries

The Company determined that certain wholly-owned subsidiaries were unnecessary for the ongoing operations of the Company's business and elected to dissolve these entities and/or surrender their foreign status in certain jurisdictions for the purpose of reducing unnecessary compliance costs.

The Company is dissolving SG Technologies Corp., a Nevada corporation, and is surrendering its qualification to do business in California due to the fact that the Company no longer operates any business under this wholly-owned subsidiary.



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The Company is dissolving Phototron, Inc. and GrowLife Productions, Inc., all California corporations, due to the fact that the Company no longer operates any business under these wholly-owned subsidiaries.

The Company is dissolving Business Bloom, Inc., a California corporation, and is withdrawing its foreign entity status in Colorado due to the fact that the Company no longer operates any business under this wholly-owned subsidiary.

The Company is surrendering its qualification to do business in California due to the fact that the Company has moved its headquarters to Kirkland, Washington and will no longer required to register as a foreign entity in California.



#### Potential Convertible Note Defaults

Several of the Company's convertible promissory notes remain outstanding beyond their respective maturity dates. This may trigger an event of default under the respective agreements. The Company is working with these noteholders to convert their notes into common stock and intends to resolve these outstanding issues as soon as practicable.

#### Employment Agreement

On October 21, 2016, the Company entered into an Employment Agreement with Marco Hegyi pursuant to which the Company engaged Mr. Hegyi as its Chief Executive Officer through October 20, 2018. Mr. Hegyi's previous Employment Agreement was dated December 4, 2013 and which is set to expire on December 4, 2016.

Mr. Hegyi's annual compensation is \$250,000. Mr. Hegyi is also entitled to receive an annual bonus equal to four percent (4%) of the Company's EBITDA for that year. The annual bonus shall be paid no later than 31 days following the end of each calendar year.

Mr. Hegyi received a Warrant to purchase up to 10,000,000 shares of common stock of the Company at an exercise price of \$0.01 per share. In addition, Mr. Hegyi received Warrants to purchase up to 10,000,000 shares of common stock of the Company at an exercise price of \$0.01 per share which vest on October 21, 2017 and 2018. The Warrants are exercisable for 5 years.

Mr. Hegyi will be entitled to participate in all group employment benefits that are offered by the Company to the Company's senior executives and management employees from time to time, subject to the terms and conditions of such benefit plans, including any eligibility requirements. In addition, the Company will purchase and maintain during the Term an insurance policy on Mr. Hegyi's life in the amount of \$2,000,000 payable to Mr. Hegyi's named heirs or estate as the beneficiary.

If the Company terminates Mr. Hegyi's employment at any time prior to the expiration of the Term without Cause, as defined in the Employment Agreement, or if Mr. Hegyi terminates his employment at any time for "Good Reason" or due to a "Disability", Mr. Hegyi will be entitled to receive (i) his Base Salary amount through the end of the Term; and (ii) his Annual Bonus amount for each year during the remainder of the Term.

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

Forward-looking statements in this report reflect the good-faith judgment of our management and the statements are based on facts and factors as we currently know them. Forward-looking statements are subject to risks and uncertainties and actual results and outcomes may differ materially from the results and outcomes discussed in the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, but are not limited to, those discussed below as well as those discussed elsewhere in this report (including in Part II, Item 1A (Risk Factors)). Readers are urged not to place undue reliance on these forward-looking statements because they speak only as of the date of this report. We undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this report.

### THE COMPANY AND OUR BUSINESS

GrowLife, Inc. ("GrowLife" or the "Company") is incorporated under the laws of the State of Delaware and is headquartered in Kirkland, Washington. We were founded in 2012 with the Closing of the Agreement and Plan of Merger with SGT Merger Corporation.

Our goal of becoming the nation's largest cultivation facility service provider for the production of organics, herbs and greens and plant-based medicines continues to guide our decisions. Our mission is to best serve more cultivators in the design, build-out, expansion and maintenance of their facilities with products of high quality, exceptional value and competitive price. Through knowledgeable representatives, regional centers and its e-commerce website, GrowLife provides essential and hard-to-find goods including growing media, industry-leading hydroponics equipment, organic plant nutrients, and thousands more products to specialty grow operations across the United States.

We primarily sell through our wholly owned subsidiary, GrowLife Hydroponics, Inc. GrowLife companies distribute and sell over 15,000 products through its e-commerce distribution channel, GrowLifeEco.com, and through our regional retail storefronts. GrowLife and its business units are organized and directed to operate strictly in accordance with all applicable state and federal laws.



We are focusing on future success. In that regard, we believe that the hydroponics supply industry will experience significant growth and, as a result, operating in this industry has become highly competitive, cash intensive and customer centric. However, we have plans to address these challenges.

First, the opportunity to sell both infrastructure equipment and recurring supplies to the indoor cultivation industry is constantly increasing as demand for indoor cultivation grows across the United States. We believe the demand will continue to grow and more and more states and municipalities enact rules and regulations allowing for more indoor cultivation activities. We plan to continue with our multi-faceted distribution strategy, which we believe serves customers in the following manner: Direct sales to large commercial customers, retail in some markets for local convenience, and e-commerce via GrowLifeEco.com to fulfill orders across the nation from customers of all sizes. Second, serving what we see as an increasing number of cultivators has become cash intensive because of the need for large inventory levels at retail, extensive e-commerce online marketing, and supporting payment terms to large accounts. We need to arrange for financing support to be competitive. We have learned that retail success is about having the right products on hand, knowledgeable and experienced talent, accessible advisory services and superior turn-over ratios. Currently, GrowLifeEco.com offers over 15,000 products, far beyond the 3,000 found in Greener.com, its former online store.

Third, our customers come in different stages from caregiver cultivators to 80,000 square foot commercial operations. With the use of e-commerce, we endeavor to reach as many customers as possible in areas where we do not have stores or a direct sales presence. Earlier this year GrowLife built GrowLifeEco.com, our new e-commerce website, that is optimized for mobile devices. Our next step is to put web marketing in place to increase awareness, traffic and conversions.

Also, we recognize demand is increasing from small, aspiring cultivation consumers across the country seeking to learn and use a complete indoor growing solution. To address this demand, we packaged GrowLife Cube, a development-stage annual subscription service, for consumers to get hands-on experience with indoor growing. Although many still buy the components separately, we are working on developing videos and supplier tools to attract them to this one-stop shop subscription program. Given the election results in California the GrowLife Cube subscription service will evolve with greater value and specialty services to be announced in the fourth quarter.

#### Resumed Trading of our Common Stock

On February 18, 2016, our common stock resumed unsolicited quotation on the OTC Bulletin Board after receiving clearance from the Financial Industry Regulatory Authority (“FINRA”) on our Form 15c2-11. We are currently taking the appropriate steps to uplist to the OTCQB Exchange and resume priced quotations with market makers as soon as it is able.

#### Market Size and Growth

Governing.com reports that due to the recent elections, 28 states plus Washington, DC have legalized cannabis for medical use and seven states plus Washington, DC have passed recreational use into law. California’s approved Prop. 64 Measure allows adults 21 and older to now to grow up to six plants in their homes. This creates a sizable consumer indoor cultivation market that was not available before. Governing.com’s map shows current state laws and recently approved ballot measures legalizing marijuana for medical or recreational purposes. Medical marijuana laws recently passing in Arkansas, Florida and North Dakota have yet to become effective. Laws permitting recreational use in Massachusetts and Nevada have also not yet been implemented after receiving voter approval. This Information is current as of November 9, 2016.



As the states across the country approve medicinal cannabis usage, with different THC and CBD compositions, and similar indoor growing supply companies. Therefore, as the cannabis market grows so does the revenue growth opportunity for us. Researchers from The ArcView Group, report the legal marijuana market totaled \$5.4 billion in sales in 2015, and on pace to grow to \$6.7 billion in 2016. ArcView also believes the legal marijuana industry could grow at a compound annual rate of 30% through 2020.

More important, GrowLife serves a new, yet sophisticated community of commercial and urban cultivators growing specialty crops including organics, greens and plant-based medicines. Unlike the traditional agricultural industry, these cultivators use innovative indoor growing techniques to produce specialty crops in highly controlled environments. This enables them to produce crops at higher yields without having to compromise quality - regardless of the season or weather and drought conditions.

Indoor growing is commonly used for plant-based medicines because they often require high-degree of regulation and controls including government compliance, security, and crop consistency. This makes indoor growing a preferred method. Cultivators of plant-based medicines often make a significant investment to design and build-out their facilities. They look to work with companies such as GrowLife who understand their specific needs, and can help mitigate risks that could jeopardize their crops.

Indoor growing techniques, however, are not limited to plant-based medicines. Vertical farms producing organic fruits and vegetables are beginning to emerge in the market due to a rising shortage of farmland, and environmental vulnerabilities including drought, other severe weather conditions and insect pests. Indoor growing techniques enables cultivators to grow crops all-year-round in urban areas, and take up less ground while minimizing environmental risks. Indoor growing techniques typically require a more significant upfront investment to design and build-out these facilities, than traditional farmlands. If new innovations lower the costs for indoor growing, and the costs to operate traditional farmlands continue to rise, then indoor growing techniques may be a compelling alternative for the broader agricultural industry.

#### Strategy

Our goal is to become the nation's largest cultivation facility service provider for the production of organics, herbs and greens and plant-based medicines. We intend to achieve our goal by (i) expanding our nationwide, multi-channel sales network presence, (ii) offering the best terms for the full range of build-out equipment and consumable supplies, and (iii) deliver superior, innovative products exclusively.

First, we provide distribution through retail, e-commerce and direct sales to have national coverage and serve cultivators of all sizes. Each channel offers varying pricing for differing benefits. Retail sells at list price by offering inventory convenience, e-commerce provides the lowest price without requiring local inventory, and direct sales delivers the best bid price for high-volume purchasers. Additional points of service may be added through existing distribution locations and services. This may be done in several manners and programs that may incorporate cultivator-centric locations with other retailers.

Second, we serve the needs of all size cultivators and each one's unique formulation, or 'recipe'. We provide thousands of varieties of supplies from dozens of vendors and distributors. More importantly is our experience of knowing which products to recommend under each customer's circumstance. Growing operations seeking expansion may also qualify for leasing terms by one of our financing partner.

And third, our experience with hundreds of customers allows us to determine specific product needs and sources to test new designs. Lights, pesticides, nutrients, extraction and growing systems are some examples of products that GrowLife has obtained exclusive access to purchase and distribute. Popular name branded products are seeking to be part of the GrowLife company in many forms. In exchange, we can market their products in a unique manner over generic products.

Our company can expand with these strategies until it serves all the indoor cultivators throughout the country. Once a customer is engaged, we will gradually expand their purchasing market share by providing greater economic benefit to the customers who buy more products from GrowLife than from other suppliers.

#### Key Market Priorities

Demand for indoor growing equipment is increasing due to legalization of plant-based medicines, primarily cannabis, which is mainly due to equipment purchases for build-out and repeated consumables. This demand is projected to



continue to grow as a result of the supporting state laws in 28 states and the District of Columbia. Continued innovation in more efficient build-out technologies along with larger and consolidated cultivation facilities will further expand market demand for our products and services.

We expect for the market to continue to segment into urban farmers serving groups of individuals, community cultivators, and large-scale cultivation facilities across the states. Each segment will be optimized to different distribution channels that we currently provide. Our volume purchasing will allow us to obtain the best prices and maximize both our revenues and gross margins.

The nature of the cannabis industry's inefficiencies due to the lack of interstate commerce imposed by the Federal government has segmented the market opportunities by State laws, population and demand. Currently, Colorado laws and population demand make it the most progressive and top market in the industry. We have elected to have a major retail presence in Colorado with our direct sales team and centralized our national e-commerce operations. California is expected to surpass Colorado and GrowLife expects to establish a major presence in the state. We are currently reaching most of the legal states using both direct sales and seek to introduce GrowLife eco products to other hydroponic and gardening retailers.



### Employees

As of September 30, 2016, we had one full-time employee and one consultant at our Seattle, Washington office. Marco Hegyi, our Chief Executive Officer, is based in Kirkland, Washington. Mark E. Scott, our consulting CFO, is based out of in Seattle, Washington. In addition, we have 7 employees located throughout the United States who operate our e-commerce, direct sales and retail businesses. None of our employees is subject to a collective bargaining agreement or represented by a trade or labor union. We believe that we have a good relationship with our employees.

### Key Partners

Our key customers varying by state and are expected to be more defined as the company moves from its retail walk-in purchasing sales strategy to serving cultivation facilities directly and under predictable purchasing contracts.

Our key suppliers include distributors such as HydroFarm, Urban Horticultural Supply and Sunlight Supply to product-specific suppliers. All the products purchased and resold are applicable to indoor growing for organics, greens, and plant-based medicines.

### Competition

Certain large commercial cultivators have found themselves willing to assume their own equipment support by buying large volume purchased directly from certain suppliers and distributors such as Sunlight Supplies, HydroFarm, and UHS. Other key competitors on the retail side consist of local and regional hydroponic resellers of indoor growing equipment. On the e-commerce business, GrowersHouse.com, Hydrobuilder.com, HorticultureSource.com and smaller online resellers using Amazon and eBay e-commerce market systems.

### Intellectual Property and Proprietary Rights

Our intellectual property consists of brands and their related trademarks and websites, customer lists and affiliations, product know-how and technology, and marketing intangibles.

Our other intellectual property is primarily in the form of trademarks and domain names. We also hold rights to more than a dozen website addresses related to our business including websites that are actively used in our day-to-day business such as [www.growlifeinc.com](http://www.growlifeinc.com), [www.growlifeco.com](http://www.growlifeco.com) and [www.grener.com](http://www.grener.com).

We have a policy of entering into confidentiality and non-disclosure agreements with our employees and some of our vendors and customers as necessary.

### Government Regulation

Currently, there are twenty-eight states plus the District of Columbia that have laws and/or regulation that recognize in one form or another legitimate medical uses for cannabis and consumer use of cannabis in connection with medical treatment. There are currently seven states that allow recreational use of cannabis. As of the date of this writing, the policy and regulations of the Federal government and its agencies is that cannabis has no medical benefit and a range of activities including cultivation and use of cannabis for personal use is prohibited on the basis of federal law and may or may not be permitted on the basis of state law. Active enforcement of the current federal regulatory position on cannabis on a regional or national basis may directly and adversely affect the willingness of customers of GrowLife to invest in or buy products from GrowLife. Active enforcement of the current federal regulatory position on cannabis may thus indirectly and adversely affect revenues and profits of the GrowLife companies.

All this being said, many reports show that the majority of the American public is in favor of making medical cannabis available as a controlled substance to those patients who need it. The need and consumption will then require cultivators to continue to provide safe and compliant crops to consumers. The cultivators will then need to build facilities and use consumable products, which GrowLife provides.

### THE COMPANY'S COMMON STOCK

Our common stock traded on the grey market under the symbol "PHOT" through February 17, 2016. While the company was without a market maker, its stock does trade directly between buyers and sellers on the grey sheets. The quotations reflect inter-dealer prices, without retail markup, markdown or commission, and may not represent actual transactions. Consequently, the information provided below was not be indicative of our common stock price under different conditions.

On February 18, 2016, our common stock resumed unsolicited quotation on the OTC Bulletin Board after receiving clearance from the Financial Industry Regulatory Authority ("FINRA") on our Form 15c2-11. We are currently taking

the appropriate steps to uplist to the OTCQB Exchange and resume priced quotations with market makers as soon as it is able.

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## PRIMARY RISKS AND UNCERTAINTIES

We are exposed to various risks related to legal proceedings, our need for additional financing, the sale of significant numbers of our shares, the potential adjustment in the exercise price of our convertible debentures and a volatile market price for our common stock. These risks and uncertainties are discussed in more detail below in Part II, Item 1A.

## RESULTS OF OPERATIONS

The following table presents certain consolidated statement of operations information and presentation of that data as a percentage of change from period-to-period.

(dollars in thousands)

	Three Months September 30,			
	2016	2015	\$ Variance	% Variance
Net revenue	\$200	\$525	\$(325)	-61.9%
Cost of goods sold	179	604	(425)	70.4%
Gross profit	21	(79)	100	-126.6%
General and administrative expenses	438	699	(261)	37.3%
Operating loss	(417)	(778)	361	46.4%
Other income (expense):				
Change in fair value of derivative	875	1,747	(872)	-49.9%
Interest expense, net	(376)	(599)	223	37.2%
Other expense, primarily related to TCA funding	(92)	(468)	376	80.3%
Loss on debt conversions	(464)	-	(464)	-100.0%
Total other (expense) income	(57)	680	(737)	-108.4%
(Loss) before income taxes	(474)	(98)	(376)	-383.7%
Income taxes - current benefit	-	-	-	0.0%
Net (loss)	\$(474)	\$(98)	\$(376)	-383.7%

## THREE MONTHS ENDED SEPTEMBER 30, 2016 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2015

## Revenue

Net revenue for the three months ended September 30, 2016 decreased \$325,000 to \$200,000 as compared to \$525,000 for the nine months ended September 30, 2015. The decrease was due to (i) lower revenue from the retail stores acquired by GrowLife Hydroponics' acquisition of Rocky Mountain Hydroponics and Evergreen Garden Center on September 7, 2013; (ii) closure of the unprofitable Peabody, Massachusetts, Woodland Hills, California and Plaistow, New Hampshire stores; and (iii) lack of liquidity. During the three months ended September 30, 2016, we transitioned funding from TCA funding to Chicago Venture. During the transition, we experienced difficulties in purchasing product and lost or canceled sales.

## Cost of Goods Sold

Cost of sales for the three months ended September 30, 2016 decreased \$425,000 to \$179,000 as compared to \$604,000 for the three months ended September 30, 2015. The decrease was due to (i) lower revenue from the retail stores acquired by GrowLife Hydroponics' acquisition of Rocky Mountain Hydroponics and Evergreen Garden Center on September 7, 2013; (ii) closure of the unprofitable Peabody, Massachusetts, Woodland Hills, California and Plaistow, New Hampshire stores; and (iii) lack of liquidity. During the three months ended September 30, 2016, we transitioned funding from TCA funding to Chicago Venture. During the transition, we experienced difficulties in purchasing product and ordered product at higher costs and lost or canceled sales.

Gross profit was \$21,000 for the three months ended September 30, 2016 as compared to (\$79,000) for the three months ended September 30, 2015. The gross margin was 10.3% for the three months ended September 30, 2016 as compared to (15.0)% for the three months ended September 30, 2015. During the three months ended September 30, 2016, we transitioned funding from TCA funding to Chicago Venture. During the transition, we experienced difficulties in purchasing product and ordered product at higher costs and lost or canceled sales.





### General and Administrative Expenses

General and administrative expenses for the three months ended September 30, 2016 decreased \$261,000 to \$438,000 as compared to \$699,000 for the three months ended September 30, 2015. The decrease was due to (i) reduced insurance expense of \$76,000; (ii) reduced payroll of \$65,000; (iii) reduced auditing expenses of \$57,000; (iv) reduced consulting expenses of \$49,000; (v) reduced legal expenses of \$36,000; and offset by (vi) increased other general expenses of \$22,000. As part of the general and administrative expenses for the three months ended September 30, 2016, we did not record any public relation, investor relation or business development expenses.

Non-cash general and administrative expenses for the three months ended September 30, 2016 was \$123,000, with (i) depreciation and amortization of \$30,000; (ii) stock based compensation of \$33,000 related to stock option grants; (iii) common stock issued for services of \$60,000.

Non-cash general and administrative expenses for the three months ended September 30, 2015 was \$64,000, with (i) depreciation and amortization of \$26,000; and (ii) stock based compensation of \$38,000 related to stock option grants.

### Other Income/ Expense

Other expense for the three months ended September 30, 2016 was \$57,000 as compared to other income of \$680,000 for the three months ended September 30, 2015. The other expense for the three months ended September 30, 2016 included other expense of \$92,000, interest expense of \$376,000, and loss on debt conversions of \$464,000, offset change in derivative liability of \$875,000. The change in derivative liability is the non-cash change in the fair value and relates to our derivative instruments. The non-cash interest related to the amortization of the debt discount associated with our convertible notes and accrued interest expense related to our notes payable. The loss on debt conversions related to the conversion of our notes payable at prices below the market price.

Other income for the three months ended September 30, 2015 was \$680,000 as compared to other expense of \$35,644,000 for the three months ended September 30, 2014. The other income for the three months ended September 30, 2015 included change in derivative liability of \$1,747,000, offset by interest expense of \$599,000 and other expense of \$468,000. The change in derivative liability is the non-cash change in the fair value and relates to our derivative instruments. The non-cash interest related to the amortization of the debt discount associated with our convertible notes, accrued interest expense related to our notes payable. The other expense is primarily related to the TCA funding.

### Net (Loss)

Net loss for the three months ended September 30, 2016 was \$474,000 as compared to a net loss of \$98,000 for the three months ended September 30, 2015 for the reasons discussed above.

Net loss for the nine months ended September 30, 2016 included non-cash expense of \$59,000 including (i) depreciation and amortization of \$30,000; (ii) stock based compensation of \$33,000 related to stock option grants; (iii) common stock issued for services of \$60,000; (iv) accrued interest and amortization of debt discount on convertible notes payable of \$222,000; (v) loss on debt conversions of \$464,000; offset by (vi) change in derivative liability of \$875,000.

Net loss for the three months ended September 30, 2015 included non-cash income of \$859,000, including (i) change in derivative liability of \$1,546,000 and other of \$77,000, offset by (ii) depreciation and amortization of \$26,000; (iii) stock based compensation of \$38,000 related to stock option grants; (iv) interest expense of \$400,000; (v) preferred shares issues for services of \$300,000.

We expect losses to continue as we implement our business plan.



The following table presents certain consolidated statement of operations information and presentation of that data as a percentage of change from period-to-period.

(dollars in thousands)

Nine Months Ended September 30,

	2016	2015	\$ Variance	% Variance
Net revenue	\$929	\$3,123	\$(2,194)	-70.3%
Cost of goods sold	893	2,693	(1,800)	66.8%
Gross profit	36	430	(394)	-91.6%
General and administrative expenses	1,351	2,182	(831)	38.1%
Operating loss	(1,315)	(1,752)	437	24.9%
Other income (expense):				
Change in fair value of derivative	497	1,796	(1,299)	-72.3%
Interest expense, net	(614)	(952)	338	35.5%
Other income (expense), primarily related to TCA funding	157	(477)	634	132.9%
Loss on debt conversions	(464)	-	(464)	-100.0%
Loss on class action lawsuit settlements	-	(2,081)	2,081	100.0%
Total other (expense)	(424)	(1,714)	1,290	75.3%
(Loss) before income taxes	(1,739)	(3,466)	1,727	49.8%
Income taxes - current benefit	-	-	-	0.0%
Net (loss)	\$(1,739)	\$(3,466)	\$1,727	49.8%

#### NINE MONTHS ENDED SEPTEMBER 30, 2016 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2015

##### Revenue

Net revenue for the nine months ended September 30, 2016 decreased \$2,194,000 to \$929,000 as compared to \$3,123,000 for the nine months ended September 30, 2015. The decrease was due to (i) lower revenue from the retail stores acquired by GrowLife Hydroponics' acquisition of Rocky Mountain Hydroponics and Evergreen Garden Center on September 7, 2013; (ii) closure of the unprofitable Peabody, Massachusetts, Woodland Hills, California and Plaistow, New Hampshire stores; and (iii) lack of liquidity. During the nine months ended September 30, 2016, we transitioned funding from TCA funding to Chicago Venture. During the transition, we experienced difficulties in purchasing product and lost or canceled sales.

##### Cost of Goods Sold

Cost of sales for the nine months ended September 30, 2016 decreased \$1,800,000 to \$893,000 as compared to \$2,693,000 for the nine months ended September 30, 2015. The decrease was due to (i) lower revenue from the retail stores acquired by GrowLife Hydroponics' acquisition of Rocky Mountain Hydroponics and Evergreen Garden Center on September 7, 2013; (ii) closure of the unprofitable Peabody, Massachusetts, Woodland Hills, California and Plaistow, New Hampshire stores; and (iii) lack of liquidity. During the nine months ended September 30, 2016, we transitioned funding from TCA funding to Chicago Venture. During the transition, we experienced difficulties in purchasing product and ordered product at higher costs and lost or canceled sales.

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Gross profit was \$36,000 for the nine months ended September 30, 2016 as compared to \$430,000 for the nine months ended September 30, 2015. The gross margin was 3.9% for the nine months ended September 30, 2016 as compared to 14.8% for the nine months ended September 30, 2015. During the nine months ended September 30, 2016, we transitioned funding from TCA funding to Chicago Venture. During the transition, we experienced difficulties in purchasing product and ordered product at higher costs and lost or canceled sales.



### General and Administrative Expenses

General and administrative expenses for the nine months ended September 30, 2016 decreased \$831,000 to \$1,351,000 as compared to \$2,182,000 for the nine months ended September 30, 2015. The decrease was due to (i) reduced legal expense of \$78,000; (ii) reduced wages of \$308,000; (iii) reduced insurance expense of \$175,000; (iv) reduced consulting expenses of \$112,000; (v) reduced auditing of \$57,000 and (vi) reduced other general expenses of \$101,000. As part of the general and administrative expenses for the nine months ended September 30, 2016, we did not record any public relation, investor relation or business development expenses.

Non-cash general and administrative expenses for the nine months ended September 30, 2016 was \$310,000 including (i) depreciation and amortization of \$87,000; (ii) stock based compensation of \$98,000 related to stock option grants; (iii) common stock issued for services of \$125,000.

Non-cash general and administrative expenses for the nine months ended September 30, 2015 was \$230,000, with (i) depreciation and amortization of \$91,000; and (ii) stock based compensation of \$139,000 related to stock option grants.

### Other Income/ Expense

Other expense for the nine months ended September 30, 2016 was \$424,000 as compared to other expense of \$1,714,000 for the nine months ended September 30, 2015. The other expense for the nine months ended September 30, 2016 included interest expense of \$614,000 and loss on debt conversions of \$464,000, offset by change in derivative liability of \$497,000 and other income of \$157,000. The change in derivative liability is the non-cash change in the fair value and relates to our derivative instruments. The non-cash interest related to the amortization of the debt discount associated with our convertible notes and accrued interest expense related to our notes payable. The loss on debt conversions related to the conversion of our notes payable at prices below the market price.

The other expense for the nine months ended September 30, 2015 included change in derivative liability of \$1,796,000, offset by interest expense of \$952,000, other expense of \$477,000 and loss on class action lawsuit settlements of \$2,081,000. The change in derivative liability is the non-cash change in the fair value and relates to our derivative instruments. The non-cash interest related to the amortization of the debt discount associated with our convertible notes, accrued interest expense related to our notes payable. We accrued \$2,081,000 as loss on class action lawsuits and contingent liabilities as of September 30, 2015. The other expense is primarily related to the TCA funding.

### Net (Loss)

Net loss for the nine months ended September 30, 2016 was \$1,739,000 as compared to a net loss of \$3,466,000 for the nine months ended September 30, 2015 for the reasons discussed above.

Net loss for the nine months ended September 30, 2016 included non-cash expense of \$502,000 including (i) depreciation and amortization of \$87,000; (ii) stock based compensation of \$98,000 related to stock option grants; (iii) common stock issued for services of \$125,000; (iv) accrued interest and amortization of debt discount on convertible notes payable of \$223,000; (v) loss on debt conversions of \$464,000; and (vi) change in derivative liability of \$497,000.

Net loss for the nine months ended September 30, 2015 included non-cash expense of \$1,712,000, including (i) depreciation and amortization of \$91,000; (ii) stock based compensation of \$139,000 related to stock option grants; (iii) interest expense of \$754,000, (iv) loss on class action lawsuit settlements of \$2,000,000; (v) preferred shares

issued for services of \$300,000; and (v) other of \$23,000, offset by (iv) change in derivative liability of \$1,595,000.

We expect losses to continue as we implement our business plan.

#### LIQUIDITY AND CAPITAL RESOURCES

We had cash of \$77,000 and a net working capital deficit of approximately \$4,294,000 (excluding the derivative liability- warrants of \$880,000 as of September 30, 2016. We expect losses to continue as we grow our business. Our cash used in operations for the nine months ended September 30, 2016 and the years ended December 31, 2015 and 2014 was \$888,000, \$1,376,000 and \$2,123,000, respectively.





Shortly after the SEC suspended trading of our securities on April 10, 2014, some of our primary suppliers rescinded our credit terms and required us to pay cash for our product purchases and pay down our outstanding balance with these suppliers.

We will need to obtain additional financing in the future. There can be no assurance that we will be able to secure funding, or that if such funding is available, the terms or conditions would be acceptable to us. If we are unable to obtain additional financing, we may need to restructure our operations, divest all or a portion of our business or file for bankruptcy.

We have financed our operations through the issuance of convertible debentures and the sale of common stock.

Funding from Chicago Venture Partners, L.P.

Entry into Securities Purchase Agreement with Chicago Venture Partners, L.P. As of April 4, 2016, we entered into a Securities Purchase Agreement and Convertible Promissory Note (the “Chicago Venture Note”) with Chicago Venture, whereby we agreed to sell, and Chicago Venture agreed to purchase an unsecured convertible promissory note in the original principal amount of \$2,755,000. In connection with the transaction, we received \$350,000 in cash as well as a series of twelve Secured Investor Notes for a total Purchase Price of \$2,500,000. The Note carries an Original Issue Discount (“OID”) of \$250,000 and we agreed to pay \$5,000 to cover Purchaser’s legal fees, accounting costs and other transaction expenses.

The Secured Investor Notes are payable (i) \$50,000 upon filing of a Registration Statement on Form S-1; (ii) \$100,000 upon effectiveness of the Registration Statement; and (iii) up to \$200,000 per month over the 10 months following effectiveness at our sole discretion, subject to certain conditions. We agreed to file the Registration Statement within forty-five (45) days of the Closing and agreed to register shares of our common stock for the benefit of Chicago Venture in exchange for the payments under the Secured Investor Notes.

Chicago Venture has the option to convert the Note at 65% of the average of the three (3) lowest volume weighted average prices in the twenty (20) Trading Days immediately preceding the applicable conversion (the “Conversion Price”). However, in no event will the Conversion Price be less than \$0.02 or greater than \$0.09. In addition, beginning on the date that is the earlier of six (6) months or five (5) days after the Registration Statement becomes effective, and on the same day of each month thereafter, the Company will re-pay the Note in monthly installments in cash, or, subject to certain Equity Conditions, in our common stock at 65% of the average of the three (3) lowest volume weighted average prices in the twenty (20) Trading Days immediately preceding the applicable conversion (the “Installment Conversion Price”).

As discussed above, once effective, we have the discretion to require Chicago Venture to sell to us up to \$200,000 per month over the next 10 months on the above terms. We would then have the option to issue shares registered under this Registration Statement to Chicago Venture. Through this prospectus, the selling stockholder may offer to the public for resale shares of our common stock that we may issue to Chicago Venture pursuant to the Chicago Venture Note.

For a period of no more than 36 months from the effective date of the Registration Statement, we may, from time to time, at our sole discretion, and subject to certain conditions that we must satisfy, draw down funds under the Chicago Venture Note.

Our ability to require Chicago Venture to fund the Chicago Venture Note is at our discretion, subject to certain limitations. Chicago Venture is obligated to fund if each of the following conditions are met; (i) the average and median daily dollar volumes of our common stock for the twenty (20) and sixty (60) trading days immediately

preceding the funding date are greater than \$100,000; (ii) our market capitalization on the funding date is greater than \$17,000,000; (iii) we are not in default with respect to share delivery obligations under the note as of the funding date; and (iv) we are current in its reporting obligations. Chicago Venture' obligations under the equity line are not transferable.

The issuance of our common stock under the Chicago Venture Note will have no effect on the rights or privileges of existing holders of common stock except that the economic and voting interests of each stockholder will be diluted as a result of any such issuance. Although the number of shares of common stock that stockholders presently own will not decrease, these shares will represent a smaller percentage of our total shares that will be outstanding after any issuances of shares of common stock to Chicago Venture. If we draw down amounts under the Chicago Venture Note when our share price is decreasing, we will need to issue more shares to repay the same amount than if our stock price was higher. Such issuances will have a dilutive effect and may further decrease our stock price.

There is no guarantee that we will be able to meet the foregoing conditions or any other conditions under the Securities Purchase Agreement and/or Chicago Venture Note or that we will be able to draw down any portion of the amounts available under the Securities Purchase Agreement and/or Chicago Venture Note. However, we do believe there is a strong likelihood, as long as we can meet the various conditions to funding, that we will receive the full amount of funding under the equity line of credit. Given our financial challenges and the competitive nature of our business, we also believe we will need the full amount of funding under the equity line of credit in order to fully realize our business plans.



A portion of the funds received from Chicago Venture will be used to pay off TCA Global Credit Master Fund, LP (“TCA”), a previous equity financing partner and a portion will be invested in our business. Specifically, we anticipate that approximately \$1,400,000 is expected to be used to pay TCA and the remaining funds, if any, will be used for general business purposes such as marketing, product development, expansion and administrative costs. We are not aware of any relationship between TCA and Chicago Venture. We have had no previous transactions with Chicago Venture or any of Chicago Venture’s affiliates. We cannot predict whether the Chicago Venture transaction will have either a positive or negative impact on our stock price. However, in addition to the fact that each Chicago Venture conversion, when and if it occurs, has a dilutive effect on our stock, that should Chicago Venture convert large portions of the debt into registered shares and then sells those shares on the market, that our stock price could be depressed.

Debt Purchase Agreement and First Amendment to Debt Purchase Agreement and Note Assignment Agreement. On August 24, 2016, we closed a Debt Purchase Agreement and a First Amendment to Debt Purchase Agreement and related agreements with Chicago Venture and TCA.

On August 24, 2016, TCA closed an Assignment of Note Agreement and related agreements with Chicago Venture. The referenced agreements relate to the assignment of Company debt, in the form of debentures, by TCA to Chicago Venture. The Company was a party to the agreements between TCA and Chicago Venture because the Company is the “borrower” under the TCA held debentures.

Exchange Agreement, Convertible Promissory Note and related Agreements with Chicago Venture. On August 17, 2016, we closed an Exchange Agreement and a Convertible Promissory Note and related agreements with Chicago Venture whereby we agreed to the assignment of debentures representing debt between the Company, on the one hand, and with TCA, on the other hand. Specifically, we agreed that TCA could assign a portion of the Company’s debt held by TCA to Chicago Venture.

According to the Exchange Agreement, the debt is to be assigned in tranches, with the first tranche of debt assigned from TCA to Chicago Venture being \$128,000 which is represented by an Initial Exchange Note as defined in the Exchange Agreement.

Funding from TCA Global Credit Master Fund, LP (“TCA”).

The First TCA SPA. On July 9, 2015, we closed a Securities Purchase Agreement and related agreements with TCA Global Credit Master Fund LP (“TCA”), an accredited investor, whereby we agreed to sell and TCA agreed to purchase up to \$3,000,000 of senior secured convertible, redeemable debentures, of which \$700,000 was purchased on July 9, 2015 and up to \$2,300,000 may be purchased in additional closings. The closing of the transaction (the “First TCA SPA”) occurred on July 9, 2015. Effective as of May 4, 2016, the Company and TCA entered into a First Amendment to the First TCA SPA whereby the parties agreed to amend the terms of the First TCA SPA in exchange for TCA’s forbearance of existing defaults by the Company.

The Second TCA SPA. On August 6, 2015, we closed a second Securities Purchase Agreement and related agreements with TCA whereby we agreed to sell and TCA agreed to purchase a \$100,000 senior secured convertible redeemable debenture and we agreed to issue and sell to TCA, from time to time, and TCA agreed to purchase from us up to \$3,000,000 of the Company’s common stock pursuant to a committed equity facility. The closing of the transaction (the “Second TCA SPA”) occurred on August 6, 2015. On April 11, 2016, we agreed with TCA to mutually terminate the Second TCA SPA.

Amendment to the First TCA SPA. On October 27, 2015, we entered into an Amended and Restated Securities Purchase Agreement and related agreements with TCA whereby we agreed to sell, and TCA agreed to purchase

\$350,000 of senior secured convertible, redeemable debentures. This was an amendment to the First TCA SPA (the "Amendment to the First TCA SPA".) As of October 27, 2015, we sold \$1,050,000 in Debentures to TCA and up to \$1,950,000 in Debentures remain for sale by us. The closing of the Amendment to the First TCA SPA occurred on October 27, 2015. In addition, TCA has advanced us an additional \$100,000 for a total of \$1,150,000.

Issuance of Preferred Stock to TCA. Also, on October 21, 2015 we issued 150,000 Series B Preferred Stock at a stated value equal to \$10.00 per share to TCA. The Series B Preferred Stock is convertible into common stock by dividing the stated value of the shares being converted by 100% of the average of the five (5) lowest closing bid prices for the common stock during the ten (10) consecutive trading days immediately preceding the conversion date as quoted by Bloomberg, LP. On October 21, 2015, we also issued 51 shares of Series C Preferred Stock at \$0.0001 par value per share to TCA. The Series C Preferred Stock is not convertible into our common stock. In the event of a default under the Amended and Restated TCA Transaction Documents, TCA can exercise voting control over our common stock with their Series C Preferred Stock voting rights.



TCA's Forbearance. Due to our default on its repayment obligations under the TCA SPA's and related documents, the parties agreed to restructure the SPA's whereby TCA agreed to forbear from enforcement of our defaults and to restructure a payment schedule for repayment of debt under the SPAs. We defaulted because our operating results were not as expected and we were unable to generate sufficient revenue through its business operations to serve the TCA debt. Specifically, the First Amendment to Amended and Restated Securities Purchase Agreement made the following material modifications to the existing SPA's:

All unpaid debentures were modified as described in more detail below.

Payments on the debentures shall be made by (i) debt purchase agreement(s) to be entered into by TCA, (ii) through proceeds raised from the transaction(s) with Chicago Venture; or (iii) by the Company directly.

The due date of the debentures was extended to April 28, 2018.

TCA agreed that it shall not enforce and shall forbear from pursuing enforcement of any existing defaults by us unless and until a future Company default occurs.

In furtherance of TCA's forbearance, effective as of May 4, 2016, we issued Second Replacement Debenture A in the principal amount of \$150,000 and Second Replacement Debenture B in the principal amount of \$2,681,209.82 (collectively, the "Second Replacement Debentures").

Per the First Amendment to Amended and Restated Securities Purchase Agreement, the Second Replacement Debentures were combined, and apportioned into two separate replacement debentures. The Second Replacement Debentures were intended to act in substitution for and to supersede the debentures in their entirety. It was the intent of the Company and TCA that while the Second Replacement Debentures replace and supersede the debentures, in their entirety, they were not in payment or satisfaction of the debentures, but rather were the substitute of one evidence of debt for another without any intent to extinguish the old debt. The maximum number of shares subject to conversion under the Second Replacement Debentures is 383,028,714. This is an approximation. The estimation of the maximum number of shares issuable upon the conversion of the Second Replacement Debentures was calculated using an estimated average price of \$.013 per share.

The Second Replacement Debentures contemplate TCA entering into debt purchase agreement(s) with third parties whereby TCA may, at its election, sever, split, divide or apportion the Second Replacement Debentures to accomplish the repayment of the balance owed to TCA by Company. The Second Replacement Debentures are convertible at 85% of the lowest daily volume weighted average price ("VWAP") of our common stock during the five (5) business days immediately prior to a conversion date.

In connection with the above agreements, the parties acknowledged and agreed that certain advisory fees previously paid to TCA as provided in the SPAs in the amount of \$1,500,000 have been added and included within the principal balance of the Second Replacement Debentures. The advisory fees related too financial, merger and acquisition and regulatory services provided to us. The conversion price discount on the Second Replacement Debentures will not apply to the advisory fees added to the Second Replacement Debentures. TCA also agreed to surrender its Series B Preferred Stock in exchange for the \$1,500,000 being added to the Second Replacement Debenture.

As more particularly described below, we remain in debt to TCA for the principal amount of \$1,500,000. The remaining \$1,400,000 of principal debt was assigned to Old Main Capital, LLC (see discussion immediately below.) We intend to use the funds generated from the Chicago Venture transaction to fuel its business operations and business plans which, in turn, will presumably generate revenues sufficient to avoid another default in the remaining TCA obligations. If we are unable to raise sufficient funds through the Chicago Venture transaction and/or generate



sales sufficient to service the remaining TCA debt then we will be unable to avoid another default. Failure to operate in accordance with the various agreements with TCA could result in the cancellation of these agreements, result in foreclosure on our assets in an event of default which would have a material adverse effect on our business, results of operations or financial condition.

#### TCA Assignment of Debt to Old Main Capital, LLC

On September 9, 2016, we closed a Debt Purchase Agreement and related agreements (the “Old Main Transaction Documents”) with TCA and Old Main Capital, LLC (“Old Main”) whereby TCA agreed to sell and Old Main agreed to purchase in multiple tranches \$1,400,000 in senior secured convertible, redeemable debentures (the “Assigned Debt”) (the “Old Main Transaction”). The Assigned Debt was our debt incurred in the TCA financing transactions that closed in 2015. We were required to execute the Old Main Transaction Documents as we are the “borrower” on the Assigned Debt.

Debt Purchase Agreement. As set forth above, we entered into the Debt Purchase Agreement on September 9, 2015 with TCA and Old Main whereby Old Main agreed to purchase, in tranches, \$1,400,000 of debt previously held by TCA. We executed the Debt Purchase Agreement as it was the “borrower” under the Assigned Debt and was required to make certain representations and warranties regarding the Assigned Debt. The Assigned Debt is represented by a new “10% Senior Convertible Promissory Note” entered into by and between Old Main and the Company (more particularly described below.)



Exchange Agreement. In conjunction with the Debt Purchase Agreement, on September 9, 2016, we entered into an Exchange Agreement whereby we agreed to exchange, in tranches, the Assigned Debt, as well as any amendments thereto, with a 10% Senior Convertible Promissory Note (the “Note”) having a principal balance of \$1,400,000. The closing dates for the exchanges, scheduled to occur in tranches, are set forth in Schedule 1 attached to the Exchange Agreement.

10% Senior Convertible Promissory Note. Pursuant to the Exchange Agreement, we entered into a 10% Senior Convertible Promissory Note dated September 9, 2016 with Old Main whereby the Company agreed to be indebted to Old Main for the Assigned Debt. We promised to pay Old Main, by no later than the maturity date of September 9, 2017 the outstanding principal of the Assigned Debt together with interest on the outstanding principal amount under the Note, at the rate of ten percent (10%) per annum simple interest.

At any time after September 9, 2016, and while the Note is still outstanding and at the sole option of Old Main, Old Main may convert all or any portion of the outstanding principal, accrued and unpaid interest redemption premium and any other sums due and payable hereunder or under any of the other Transaction Documents into shares of our Common Stock at a price equal to the lower of: (i) sixty-five percent (65%) of the lowest traded price of the Company’s Common Stock during the thirty (30) trading days prior to the Conversion Date; or (ii) sixty-five percent (65%) of the lowest traded price of the Common Stock in the thirty (30) Trading Days prior to the Closing Date.

Option Agreement. In connection with the Old Main Transaction Documents, TCA and Old Main entered into an Option Agreement dated September 8, 2016 whereby TCA agreed to grant Old Main an option to purchase the Assigned Debt, or any portion thereof, under the terms and conditions of the Debt Purchase Agreement. In consideration, Old Main agreed to pay the Option Payment as more particularly described in the Option Agreement.

On August 24, 2016, TCA terminated its Debt Purchase Agreement and related agreements with Old Main. The specific termination date is September 25, 2016, and Old Main had a right to purchase an additional \$300,000 in debt from TCA.

#### Operating Activities

Net cash used in operating activities for the nine months ended September 30, 2016 was \$888,000. This amount was primarily related to a net loss of \$1,739,000, offset by an increase in inventory of \$79,000 an increase in accounts payable and accrued expenses of \$271,000 and non-cash expenses of \$502,000 including (i) depreciation and amortization of \$87,000; (ii) stock based compensation of \$98,000 related to stock option grants; (iii) common stock issued for services of \$125,000; (iv) accrued interest and amortization of debt discount on convertible notes payable of \$223,000; (v) loss on debt conversions of \$464,000; and (vi) change in derivative liability of \$497,000.

#### Financing Activities

Net cash provided by financing activities for the nine months ended September 30, 2016 was \$905,000. The amount related to funding provided by Chicago Venture.

Our contractual cash obligations as of September 30, 2016 are summarized in the table below:

	Less Than			Greater Than	
Contractual Cash Obligations	Total	1 Year	1-3 Years	3-5 Years	5 Years

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Operating leases	\$129,965	\$97,635	\$32,330	\$-	\$-
Note payable	3,161,766	3,161,766	-	-	-
Capital expenditures	25,000	25,000	-	-	-
	\$3,316,731	\$3,284,401	\$32,330	\$-	\$-

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## OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements (as that term is defined in Item 303 of Regulation S-K) that are reasonably likely to have a current or future material effect on our financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

This item is not applicable.

## ITEM 4. CONTROLS AND PROCEDURES

### a) Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, of the effectiveness of the design and operation of our disclosure controls and procedures. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (“Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures also include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our principal executive and principal financial officers concluded as of September 30, 2016 that our disclosure controls and procedures were not effective at the reasonable assurance level due to the material weaknesses in our internal controls over financial reporting discussed immediately below.

### Identified Material Weakness

A material weakness in our internal control over financial reporting is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

Management identified the following material weakness during its assessment of internal controls over financial reporting:

#### Audit Committee:

On September 3, 2014, we formed an Audit Committee and appointed an audit committee financial expert as defined by SEC and as adopted under the Sarbanes-Oxley Act of 2002. Prior to this, we did not have an Audit Committee to oversee financial reporting and used external service providers to ensure compliance with the SEC requirements. The current Audit Committee has one management director. Subsequent to the year ended December 31, 2015, Mr. Fasci was appointed as Secretary of the Company and is no longer deemed independent under this standard.

#### Other Weaknesses:

Our information systems lack sufficient controls limiting access to key applications and data.

Our inventory system lacked standardized product descriptions and effective controls to ensure the accuracy, valuation, and timeliness of the financial accounting process around inventory, including a lack of accuracy and basis for valuation resulting in adjustments to the amount of cost of revenues and the carrying amount of inventory.

b) Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2016, there were no changes in our internal controls over financial reporting during this fiscal quarter that materially affected, or is reasonably likely to have a materially affect, on our internal control over financial reporting.





## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings.

We are involved in the disputes and legal proceedings described below. In addition, as a public company, we are also potentially susceptible to litigation, such as claims asserting violations of securities laws. Any such claims, with or without merit, if not resolved, could be time-consuming and result in costly litigation. We accrue any contingent liabilities that are likely.

#### Class Actions Alleging Violations of Federal Securities Laws

Beginning on April 18, 2014, three class action lawsuits alleging violations of federal securities laws were filed against the Company in United States District Court, Central District of California (the “Court”). At a hearing held on July 21, 2014, the three class action lawsuits were consolidated into one case with Lawrence Rosen as the lead plaintiff (the “Consolidated Class Action,” styled *Romero et al. vs. GrowLife et al.*). On May 15, 2014 and August 4, 2014, respectively two shareholder derivative lawsuits were filed against the Company with the Court (the “Derivative Actions”). On October 20, 2014, AmTrust North America, our insurer, filed a lawsuit contesting insurance coverage on the above legal proceedings. We made a general appearance in this action. On September 1, 2015, the Court preliminarily approved the proposed settlement of the Derivative Actions pursuant to a proposed stipulated settlement agreement. On August 3, 2015, the Court entered a Final Order and Judgment resolving the Consolidated Class Action litigation in its entirety. The Consolidated Class Action was thereby dismissed in its entirety with prejudice and without costs. On August 10, 2015, pursuant to a settlement by and between the Company and AmTrust North America, AmTrust’s lawsuit contesting insurance coverage of the Consolidated Class Action and Derivative Actions was dismissed in its entirety with prejudice pursuant to a Stipulation for Dismissal of Entire Action with Prejudice executed by and between AmTrust and the Company. On August 17, 2015, the Court entered a Final Order and Judgment resolving the Derivative Actions in their entirety. The Derivative Actions were thereby dismissed in their entirety with prejudice. We issued \$2 million in common stock or 115,141,048 shares of the Company’s common stock on April 6, 2016 pursuant to the settlement of the Consolidated Class Action and Derivative Action lawsuits alleging violations of federal securities laws that were filed against the Company in United States District Court, Central District of California. We accrued \$2,000,000 as loss on class action lawsuits and contingent liabilities during the year ending December 31, 2015.

#### Sales, Payroll and Other Tax Liabilities

As of September 30, 2016, we owe approximately \$118,900 in sales tax and \$59,892 in payroll and other taxes.

#### Potential Convertible Note Defaults

Several of our convertible promissory notes remain outstanding beyond their respective maturity dates. This may trigger an event of default under the respective agreements. We are working with these noteholders to convert their notes into common stock and intends to resolve these outstanding issues as soon as practicable.

#### Other Legal Proceedings

We are in default on our Portland, Maine store lease and we are negotiating with the landlord. We have been sued for non-payment of lease payments at closed stores in Boulder, Colorado and Plaistow, New Hampshire. We are currently subject to legal actions with various vendors and a former officer.

It is possible that additional lawsuits may be filed and served on the Company.

## Risks Related to Our Business

### Suspension of trading of the Company's securities.

On April 10, 2014, we received notice from the SEC that trading of our common stock on the OTCBB was to be suspended from April 10, 2014 through April 24, 2014. The SEC issued its order pursuant to Section 12(k) of the Securities Exchange Act of 1934. According to the notice received by us from the SEC: "It appears to the Securities and Exchange Commission that the public interest and the protection of investors require a suspension of trading in the securities of GrowLife, Inc. because of concerns regarding the accuracy and adequacy of information in the marketplace and potentially manipulative transactions in GrowLife's common stock." To date, we have not received notice from the SEC that it is being formally investigated.



On February 18, 2016, our common stock resumed unsolicited quotation on the OTC Bulletin Board after receiving clearance from the Financial Industry Regulatory Authority (“FINRA”) on our Form 15c2-11. We are currently taking the appropriate steps to uplist to the OTCQB Exchange and resume priced quotations with market makers as soon as it is able.

The suspension of trading eliminated our market makers, resulted in our trading on the grey sheets, resulted in legal proceedings and restricted our access to capital. This action had a material adverse effect on our business, financial condition and results of operations. If we are unable to obtain additional financing when it is needed, we will need to restructure our operations, and divest all or a portion of our business.

SEC charges outsiders with manipulating our securities.

On August 5, 2014, the SEC charged four promoters with ties to the Pacific Northwest for manipulating our securities. The SEC alleged that the four promoters bought inexpensive shares of thinly traded penny stock companies on the open market and conducted pre-arranged, manipulative matched orders and wash trades to create the illusion of an active market in these stocks. They then sold their shares in coordination with aggressive third party promotional campaigns that urged investors to buy the stocks because the prices were on the verge of rising substantially. This action has had a material adverse effect on our business, financial condition and results of operations. If we are unable to obtain additional financing when it is needed, we will need to restructure our operations, and divest all or a portion of our business.

On July 9, 2015, the SEC entered into settlements with two of the promoters. In connection with the settlement of their SEC action, the two men are liable for disgorgement of approximately \$2.1 million and \$306,000 in illicit profits, respectively. Earlier this year the two men were also sentenced to five and three years in prison, respectively, for their participation in the scheme.

We are involved in Legal Proceedings.

We are involved in the disputes and legal proceedings as discussed in this prospectus. In addition, as a public company, we are also potentially susceptible to litigation, such as claims asserting violations of securities laws. Any such claims, with or without merit, if not resolved, could be time-consuming and result in costly litigation. There can be no assurance that an adverse result in any future proceeding would not have a potentially material adverse on our business, results of operations or financial condition.

Our Joint Venture Agreement with CANX USA, LLC is important to our operations.

On July 10, 2014, we closed a Waiver and Modification Agreement, Amended and Restated Joint Venture Agreement, Secured Credit Facility and Secured Convertible Note with CANX, and Logic Works LLC, a lender and shareholder of the Company. The Agreements require the filing of a registration statement on Form S-1 within 10 days of the filing of our Form 10-Q for the period ended September 30, 2014. Due to our grey sheet trading status and other issues, we did not file the registration statement.

Previously, we entered into a Joint Venture Agreement with CANX USA LLC, a Nevada limited liability company. Under the terms of the Joint Venture Agreement, the Company and CANX formed Organic Growth International, LLC (“OGI”), a Nevada limited liability company, for the purpose of expanding the Company’s operations in its current retail hydroponic businesses and in other synergistic business verticals and facilitating additional funding for commercially financeable transactions of up to \$40,000,000. In connection with the closing of the Agreement, CANX agreed to provide a commitment for funding in the amount of \$1,300,000 for a GrowLife Infrastructure Funding Technology program transaction and provided additional funding under a 7% Convertible Note instrument for \$1,000,000, including \$500,000 each from Logic Works and China West III Investments LLC, entities that are

unaffiliated with CANX and operate as separate legal entities. We initially owned a non-dilutive 45% share of OGI and we may acquire a controlling share of OGI as provided in the Joint Venture Agreement. In accordance with the Joint Venture Agreement, the Company and CANX entered into a Warrant Agreement whereby the Company delivered to CANX a warrant to purchase 140,000,000 shares of the Company common stock at a maximum strike price of \$0.033 per share. Also in accordance with the Joint Venture Agreement, we issued an additional warrant to purchase 100,000,000 shares of our common stock at a maximum strike price of \$0.033 per share on February 7, 2014.

On April 10, 2014, as a result of the suspension in the trading of our securities, we went into default on our 7% Convertible Notes Payable for \$500,000 each from Logic Works and China West III. As a result, we accrued interest on these notes at the default rate of 24% per annum. Furthermore, as a result of being in default on these notes, the Holders could have, at their sole discretion, called these notes.

#### Waiver and Modification Agreement

We entered into a Waiver and Modification Agreement dated September 25, 2014 with Logic Works LLC whereby the 7% Convertible Note with Logic Works dated December 20, 2013 was modified to provide for (i) a waiver of the default under the 7% Convertible Note; (ii) a conversion price which is the lesser of (A) \$0.025 or (B) twenty percent (20%) of the average of the three (3) lowest daily VWAPs occurring during the twenty (20) consecutive Trading Days immediately preceding the applicable Conversion Date on which the Holder elects to convert all or part of this Note; (iii) the filing of a registration statement on Form S-1 within 10 days of the filing of the Company's Form 10-Q for the period ended September 30, 2014; and (iv) continuing interest of 24% per annum. China West III converted its Note into common stock on September 4, 2014. Due to our grey sheet trading status and other issues, we did not file the registration statement.



#### Amended and Restated Joint Venture Agreement

We entered into an Amended and Restated Joint Venture Agreement dated July 1, 2014 with CANX whereby the Joint Venture Agreement dated November 19, 2013 was modified to provide for (i) up to \$12,000,000 in conditional financing subject to review by GrowLife and approval by OGI for business growth development opportunities in the legal cannabis industry for up to six months, subject to extension; (ii) up to \$10,000,000 in working capital loans, with each loaning requiring approval in advance by CANX; (iii) confirmed that the five year warrants, subject to extension, at \$0.033 per share for the purchase of 140,000,000 and 100,000,000 were fully earned and were not considered compensation for tax purposes by the Company; (iv) granted CANX five year warrants, subject to extension, to purchase 300,000,000 shares of common stock at the fair market price of \$0.033 per share as determined by an independent appraisal; (v) warrants as defined in the Agreement related to the achievement of OGI milestones; (vi) a four year term, subject to adjustment and (vi) the filing of a registration statement on Form S-1 within 10 days of the filing of our Form 10-Q for the period ended September 30, 2014. Due to our grey sheet trading status and other issues, we did not file the registration statement.

#### Secured Convertible Note and Secured Credit Facility

We entered into a Secured Convertible Note and Secured Credit Facility dated September 25, 2014 with Logic Works whereby Logic Works agreed to provide up to \$500,000 in funding. Each funding requires approval in advance by Logic Works, provides for interest at 6% with a default interest of 24% per annum and requires repayment by September 26, 2016. The Note is convertible into our common stock at the lesser of \$0.007 or (B) 20% of the average of the three (3) lowest daily VWAPs occurring during the 20 consecutive Trading Days immediately preceding the applicable conversion date on which Logic Works elects to convert all or part of this 6% Convertible Note, subject to adjustment as provided in the Note. The 6% Convertible Note is collateralized by our assets. We also agreed to file a registration statement on Form S-1 within 10 days of the filing of our Form 10-Q for the three months ended September 30, 2014 and have the registration statement declared effective within ninety days of the filing of our Form 10-Q for the three months ended September 30, 2014. Due to our grey sheet trading status and other issues, we did not file the registration statement.

On July 10, 2014, we closed a Waiver and Modification Agreement, Amended and Restated Joint Venture Agreement, Secured Credit Facility and Secured Convertible Note with CANX, and Logic Works LLC, a lender and shareholder of the Company. As of December 31, 2015, we have borrowed \$350,000 under the Secured Convertible Note and Secured Credit Facility dated September 25, 2014 with Logic Works.

Failure to operate in accordance with the Agreements with CANX could result in the cancellation of these agreements, result in foreclosure on our assets in event of default and would have a material adverse effect on our business, results of operations or financial condition.

Our proposed business is dependent on laws pertaining to the marijuana industry.

Continued development of the marijuana industry is dependent upon continued legislative authorization of the use and cultivation of marijuana at the state level. Any number of factors could slow or halt progress in this area. Further, progress, while encouraging, is not assured. While there may be ample public support for legislative action, numerous factors impact the legislative process. Any one of these factors could slow or halt use of marijuana, which would negatively impact our proposed business.

As of September 30, 2016, 23 states and the District of Columbia allow its citizens to use medical marijuana. Additionally, 4 states have legalized cannabis for adult use. The state laws are in conflict with the federal Controlled Substances Act, which makes marijuana use and possession illegal on a national level. The Obama

administration has effectively stated that it is not an efficient use of resources to direct law federal law enforcement agencies to prosecute those lawfully abiding by state-designated laws allowing the use and distribution of medical marijuana. However, there is no guarantee that the administration will not change its stated policy regarding the low-priority enforcement of federal laws. Additionally, any new administration that follows could change this policy and decide to enforce the federal laws strongly. Any such change in the federal government's enforcement of current federal laws could cause significant financial damage to us and its shareholders.

Further, while we do not harvest, distribute or sell marijuana, by supplying products to growers of marijuana, we could be deemed to be participating in marijuana cultivation, which remains illegal under federal law, and exposes us to potential criminal liability, with the additional risk that our business could be subject to civil forfeiture proceedings.

The marijuana industry faces strong opposition.

It is believed by many that large, well-funded businesses may have a strong economic opposition to the marijuana industry. We believe that the pharmaceutical industry clearly does not want to cede control of any product that could generate significant revenue. For example, medical marijuana will likely adversely impact the existing market for the current "marijuana pill" sold by mainstream pharmaceutical companies. Further, the medical marijuana industry could face a material threat from the pharmaceutical industry, should marijuana displace other drugs or encroach upon the pharmaceutical industry's products. The pharmaceutical industry is well funded with a strong and experienced lobby that eclipses the funding of the medical marijuana movement. Any inroads the pharmaceutical industry could make in halting or impeding the marijuana industry harm our business, prospects, results of operation and financial condition.





Marijuana remains illegal under Federal law.

Marijuana is a Schedule-I controlled substance and is illegal under federal law. Even in those states in which the use of marijuana has been legalized, its use remains a violation of federal law. Since federal law criminalizing the use of marijuana preempts state laws that legalize its use, strict enforcement of federal law regarding marijuana would harm our business, prospects, results of operation and financial condition.

Raising additional capital to implement our business plan and pay our debts will cause dilution to our existing stockholders, require us to restructure our operations, and divest all or a portion of our business.

We need additional financing to implement our business plan and to service our ongoing operations and pay our current debts. There can be no assurance that we will be able to secure any needed funding, or that if such funding is available, the terms or conditions would be acceptable to us.

If we raise additional capital through borrowing or other debt financing, we may incur substantial interest expense. Sales of additional equity securities will dilute on a pro rata basis the percentage ownership of all holders of common stock. When we raise more equity capital in the future, it will result in substantial dilution to our current stockholders.

If we are unable to obtain additional financing when it is needed, we will need to restructure our operations, and divest all or a portion of our business.

#### Potential Convertible Note Defaults

Several of the Company's convertible promissory notes remain outstanding beyond their respective maturity dates. This may trigger an event of default under the respective agreements. The Company is working with these noteholders to convert their notes into common stock and intends to resolve these outstanding issues as soon as practicable. Any default could have a significant adverse effect on our cash flows and should we be unsuccessful in negotiating an extension or other modification, we may have to restructure our operations, divest all or a portion of its business, or file for bankruptcy.

Closing of bank accounts could have a material adverse effect on our business, financial condition and/or results of operations.

As a result of the regulatory environment, we have experienced the closing of several of our bank accounts since March 2014. We have been able to open other bank accounts. However, we may have other banking accounts closed. These factors impact management and could have a material adverse effect on our business, financial condition and/or results of operations.

Federal regulation and enforcement may adversely affect the implementation of medical marijuana laws and regulations may negatively impact our revenues and profits.

Currently, there are twenty three states plus the District of Columbia that have laws and/or regulation that recognize in one form or another legitimate medical uses for cannabis and consumer use of cannabis in connection with medical treatment. Many other states are considering legislation to similar effect. As of the date of this writing, the policy and regulations of the Federal government and its agencies is that cannabis has no medical benefit and a range of activities including cultivation and use of cannabis for personal use is prohibited on the basis of federal law and may or may not be permitted on the basis of state law. Active enforcement of the current federal regulatory position on cannabis on a regional or national basis may directly and adversely affect the willingness of customers of GrowLife to invest in or buy products from GrowLife that may be used in connection with cannabis. Active enforcement of the current federal

regulatory position on cannabis may thus indirectly and adversely affect revenues and profits of the GrowLife companies.

Our history of net losses has raised substantial doubt regarding our ability to continue as a going concern. If we do not continue as a going concern, investors could lose their entire investment.

Our history of net losses has raised substantial doubt about our ability to continue as a going concern, and as a result, our independent registered public accounting firm included an explanatory paragraph in its report on our financial statements as of and for the year ended December 31, 2015 and 2014 with respect to this uncertainty. Accordingly, our ability to continue as a going concern will require us to seek alternative financing to fund our operations. This going concern opinion could materially limit our ability to raise additional funds through the issuance of new debt or equity securities or otherwise. Future reports on our financial statements may include an explanatory paragraph with respect to our ability to continue as a going concern.

We have a history of operating losses and there can be no assurance that we can again achieve or maintain profitability.

We have experienced net losses since inception. As of September 30, 2016, we had an accumulated deficit of \$118.5 million. There can be no assurance that we will achieve or maintain profitability.



We are subject to corporate governance and internal control reporting requirements, and our costs related to compliance with, or our failure to comply with existing and future requirements, could adversely affect our business.

We must comply with corporate governance requirements under the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as well as additional rules and regulations currently in place and that may be subsequently adopted by the SEC and the Public Company Accounting Oversight Board. These laws, rules, and regulations continue to evolve and may become increasingly stringent in the future. We are required to include management's report on internal controls as part of our annual report pursuant to Section 404 of the Sarbanes-Oxley Act. We strive to continuously evaluate and improve our control structure to help ensure that we comply with Section 404 of the Sarbanes-Oxley Act. The financial cost of compliance with these laws, rules, and regulations is expected to remain substantial.

We cannot assure you that we will be able to fully comply with these laws, rules, and regulations that address corporate governance, internal control reporting, and similar matters. Failure to comply with these laws, rules and regulations could materially adversely affect our reputation, financial condition, and the value of our securities.

Our management has concluded that we have material weaknesses in our internal controls over financial reporting and that our disclosure controls and procedures are not effective.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting. During the review of our financial statements for the year ended December 31, 2015, our management identified material weaknesses in our internal control over financial reporting. If these weaknesses continue, investors could lose confidence in the accuracy and completeness of our financial reports and other disclosures.

Our inability to effectively manage our growth could harm our business and materially and adversely affect our operating results and financial condition.

Our strategy envisions growing our business. We plan to expand our product, sales, administrative and marketing organizations. Any growth in or expansion of our business is likely to continue to place a strain on our management and administrative resources, infrastructure and systems. As with other growing businesses, we expect that we will need to further refine and expand our business development capabilities, our systems and processes and our access to financing sources. We also will need to hire, train, supervise and manage new and retain contributing employees. These processes are time consuming and expensive, will increase management responsibilities and will divert management attention. We cannot assure you that we will be able to:

expand our products effectively or efficiently or in a timely manner;

allocate our human resources optimally;

meet our capital needs;

identify and hire qualified employees or retain valued employees; or

incorporate effectively the components of any business or product line that we may acquire in our effort to achieve growth.

Our inability or failure to manage our growth and expansion effectively could harm our business and materially and adversely affect our operating results and financial condition.

Our operating results may fluctuate significantly based on customer acceptance of our products. As a result, period-to-period comparisons of our results of operations are unlikely to provide a good indication of our future performance. Management expects that we will experience substantial variations in our net sales and operating results from quarter to quarter due to customer acceptance of our products. If customers don't accept our products, our sales and revenues will decline, resulting in a reduction in our operating income.

Customer interest for our products could also be impacted by the timing of our introduction of new products. If our competitors introduce new products around the same time that we issue new products, and if such competing products are superior to our own, customers' desire for our products could decrease, resulting in a decrease in our sales and revenues. To the extent that we introduce new products and customers decide not to migrate to our new products from our older products, our revenues could be negatively impacted due to the loss of revenue from those customers. In the event that our newer products do not sell as well as our older products, we could also experience a reduction in our revenues and operating income.



As a result of fluctuations in our revenue and operating expenses that may occur, management believes that period-to-period comparisons of our results of operations are unlikely to provide a good indication of our future performance.

If we do not successfully generate additional products and services, or if such products and services are developed but not successfully commercialized, we could lose revenue opportunities.

Our future success depends, in part, on our ability to expand our product and service offerings. To that end we have engaged in the process of identifying new product opportunities to provide additional products and related services to our customers. The process of identifying and commercializing new products is complex and uncertain, and if we fail to accurately predict customers' changing needs and emerging technological trends our business could be harmed. We may have to commit significant resources to commercializing new products before knowing whether our investments will result in products the market will accept. Furthermore, we may not execute successfully on commercializing those products because of errors in product planning or timing, technical hurdles that we fail to overcome in a timely fashion, or a lack of appropriate resources. This could result in competitors providing those solutions before we do and a reduction in net sales and earnings.

The success of new products depends on several factors, including proper new product definition, timely completion and introduction of these products, differentiation of new products from those of our competitors, and market acceptance of these products. There can be no assurance that we will successfully identify new product opportunities, develop and bring new products to market in a timely manner, or achieve market acceptance of our products or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive.

Our future success depends on our ability to grow and expand our customer base. Our failure to achieve such growth or expansion could materially harm our business.

To date, our revenue growth has been derived primarily from the sale of our products and through the purchase of existing businesses. Our success and the planned growth and expansion of our business depend on us achieving greater and broader acceptance of our products and expanding our customer base. There can be no assurance that customers will purchase our products or that we will continue to expand our customer base. If we are unable to effectively market or expand our product offerings, we will be unable to grow and expand our business or implement our business strategy. This could materially impair our ability to increase sales and revenue and materially and adversely affect our margins, which could harm our business and cause our stock price to decline.

If we incur substantial liability from litigation, complaints, or enforcement actions resulting from misconduct by our distributors, our financial condition could suffer. We will require that our distributors comply with applicable law and with our policies and procedures. Although we will use various means to address misconduct by our distributors, including maintaining these policies and procedures to govern the conduct of our distributors and conducting training seminars, it will still be difficult to detect and correct all instances of misconduct. Violations of applicable law or our policies and procedures by our distributors could lead to litigation, formal or informal complaints, enforcement actions, and inquiries by various federal, state, or foreign regulatory authorities against us and/or our distributors. Litigation, complaints, and enforcement actions involving us and our distributors could consume considerable amounts of financial and other corporate resources, which could have a negative impact on our sales, revenue, profitability and growth prospects. As we are currently in the process of implementing our direct sales distributor program, we have not been, and are not currently, subject to any material litigation, complaint or enforcement action regarding distributor misconduct by any federal, state or foreign regulatory authority.



Our future manufacturers could fail to fulfill our orders for products, which would disrupt our business, increase our costs, harm our reputation and potentially cause us to lose our market.

We may depend on contract manufacturers in the future to produce our products. These manufacturers could fail to produce products to our specifications or in a workmanlike manner and may not deliver the units on a timely basis. Our manufacturers may also have to obtain inventories of the necessary parts and tools for production. Any change in manufacturers to resolve production issues could disrupt our ability to fulfill orders. Any change in manufacturers to resolve production issues could also disrupt our business due to delays in finding new manufacturers, providing specifications and testing initial production. Such disruptions in our business and/or delays in fulfilling orders would harm our reputation and would potentially cause us to lose our market.

Our inability to effectively protect our intellectual property would adversely affect our ability to compete effectively, our revenue, our financial condition and our results of operations.

We may be unable to obtain intellectual property rights to effectively protect our business. Our ability to compete effectively may be affected by the nature and breadth of our intellectual property rights. While we intend to defend against any threats to our intellectual property rights, there can be no assurance that any such actions will adequately protect our interests. If we are unable to secure intellectual property rights to effectively protect our technology, our revenue and earnings, financial condition, and/or results of operations would be adversely affected.



We may also rely on nondisclosure and non-competition agreements to protect portions of our technology. There can be no assurance that these agreements will not be breached, that we will have adequate remedies for any breach, that third parties will not otherwise gain access to our trade secrets or proprietary knowledge, or that third parties will not independently develop the technology.

We do not warrant any opinion as to non-infringement of any patent, trademark, or copyright by us or any of our affiliates, providers, or distributors. Nor do we warrant any opinion as to invalidity of any third-party patent or unpatentability of any third-party pending patent application.

Our industry is highly competitive and we have less capital and resources than many of our competitors, which may give them an advantage in developing and marketing products similar to ours or make our products obsolete.

We are involved in a highly competitive industry where we may compete with numerous other companies who offer alternative methods or approaches, may have far greater resources, more experience, and personnel perhaps more qualified than we do. Such resources may give our competitors an advantage in developing and marketing products similar to ours or products that make our products obsolete. There can be no assurance that we will be able to successfully compete against these other entities.

Transfers of our securities may be restricted by virtue of state securities "blue sky" laws, which prohibit trading absent compliance with individual state laws. These restrictions may make it difficult or impossible to sell shares in those states.

Transfers of our common stock may be restricted under the securities or securities regulations laws promulgated by various states and foreign jurisdictions, commonly referred to as "blue sky" laws. Absent compliance with such individual state laws, our common stock may not be traded in such jurisdictions. Because the securities held by many of our stockholders have not been registered for resale under the blue sky laws of any state, the holders of such shares and persons who desire to purchase them should be aware that there may be significant state blue sky law restrictions upon the ability of investors to sell the securities and of purchasers to purchase the securities. These restrictions may prohibit the secondary trading of our common stock. Investors should consider the secondary market for our securities to be a limited one.

We are dependent on key personnel and we are default under Employment and Consulting Agreements

Our success depends to a significant degree upon the continued contributions of key management and other personnel, some of whom could be difficult to replace. We do not maintain key man life insurance covering our officers. Our success will depend on the performance of our officers and key management and other personnel, our ability to retain and motivate our officers, our ability to integrate new officers and key management and other personnel into our operations, and the ability of all personnel to work together effectively as a team. Our failure to retain and recruit officers and other key personnel could have a material adverse effect on our business, financial condition and results of operations.

We have limited insurance.

We have no directors' and officers' liability insurance and limited commercial liability insurance policies. Any significant claims would have a material adverse effect on our business, financial condition and results of operations.

Risks Related to our Common Stock

CANX and Logic Works and TCA could have significant influence over matters submitted to stockholders for approval.

#### CANX and Logic Works

As of September 30, 2016, CANX and Logic Works in the aggregate hold shares representing approximately 39.8% of our common stock on a fully-converted basis and could be considered a control group for purposes of SEC rules. However, their agreements limit their ownership to 4.99% individually and each of the parties disclaims its status as a control group or a beneficial owner due to the fact that their beneficial ownership is limited to 4.99% per their agreements. Beneficial ownership includes shares over which an individual or entity has investment or voting power and includes shares that could be issued upon the exercise of options and warrants within 60 days after the date of determination.



## TCA

As a result of funding from TCA as previously detailed, they exercise significant control over us.

If these persons were to choose to act together, they would be able to significantly influence all matters submitted to our stockholders for approval, as well as our officers, directors, management and affairs. For example, these persons, if they choose to act together, could significantly influence the election of directors and approval of any merger, consolidation or sale of all or substantially all of our assets. This concentration of voting power could delay or prevent an acquisition of us on terms that other stockholders may desire.

Trading in our stock is limited by the lack of market makers and the SEC's penny stock regulations.

On April 10, 2014, as a result of the SEC suspension in the trading of our securities, we lost all market makers and traded on the grey market of OTCBB. Until we complied with FINRA Rule 15c2-11, we traded on the grey market, which has limited quotations and marketability of securities. Holders of our common stock found it more difficult to dispose of, or to obtain accurate quotations as to the market value of, our common stock, and the market value of our common stock declined.

On February 18, 2016, our common stock resumed unsolicited quotation on the OTC Bulletin Board after receiving clearance from the Financial Industry Regulatory Authority ("FINRA") on our Form 15c2-11. We are currently taking the appropriate steps to uplist to the OTCQB Exchange and resume priced quotations with market makers as soon as it is able.

Our stock is categorized as a penny stock. The SEC has adopted Rule 15g-9 which generally defines "penny stock" to be any equity security that has a market price (as defined) less than US\$ 5.00 per share or an exercise price of less than US\$ 5.00 per share, subject to certain exclusions (e.g., net tangible assets in excess of \$2,000,000 or average revenue of at least \$6,000,000 for the last three years). The penny stock rules impose additional sales practice requirements on broker-dealers who sell to persons other than established customers and accredited investors. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document in a form prepared by the SEC, which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker-dealer and salesperson compensation information, must be given to the customer orally or in writing prior to effecting the transaction and must be given to the customer in writing before or with the customer's confirmation. In addition, the penny stock rules require that prior to a transaction in a penny stock not otherwise exempt from these rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. Finally, broker-dealers may not handle penny stocks under \$0.10 per share.

These disclosure requirements reduce the level of trading activity in the secondary market for the stock that is subject to these penny stock rules. Consequently, these penny stock rules would affect the ability of broker-dealers to trade our securities if we become subject to them in the future. The penny stock rules also could discourage investor interest in and limit the marketability of our common stock to future investors, resulting in limited ability for investors to sell their shares.

FINRA sales practice requirements may also limit a shareholder's ability to buy and sell our stock.

In addition to the "penny stock" rules described above, FINRA has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable

for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. The FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

The market price of our common stock may be volatile.

The market price of our common stock has been and is likely in the future to be volatile. Our common stock price may fluctuate in response to factors such as:

Halting of trading by the SEC or FINRA.

Announcements by us regarding liquidity, legal proceedings, significant acquisitions, equity investments and divestitures, strategic relationships, addition or loss of significant customers and contracts, capital expenditure commitments, loan, note payable and agreement defaults, loss of our subsidiaries and impairment of assets,

Issuance of convertible or equity securities for general or merger and acquisition purposes,

Issuance or repayment of debt, accounts payable or convertible debt for general or merger and acquisition purposes,

Sale of a significant number of shares of our common stock by shareholders,

General market and economic conditions,





Quarterly variations in our operating results,  
Investor relation activities,  
Announcements of technological innovations,  
New product introductions by us or our competitors,  
Competitive activities, and  
Additions or departures of key personnel.

These broad market and industry factors may have a material adverse effect on the market price of our common stock, regardless of our actual operating performance. These factors could have a material adverse effect on our business, financial condition, and/or results of operations.

The sale of a significant number of our shares of common stock could depress the price of our common stock.

Sales or issuances of a large number of shares of common stock in the public market or the perception that sales may occur could cause the market price of our common stock to decline. As of September 30, 2016, there were approximately 1.312 billion shares of our common stock issued and outstanding. In addition, as of September 30, 2016, there are also (i) stock option grants outstanding for the purchase of 24 million common shares at a \$0.023 average strike price; (ii) warrants for the purchase of 565 million common shares at a \$0.032 average exercise price; and (iii) 267.6 million shares related to convertible debt that can be converted at 0.0036 per share. In addition, we have an unknown number of common shares to be issued under the TCA and Chicago Venture financing agreements because the number of shares ultimately issued to TCA depends on the price at which TCA converts its debt to shares. The lower the conversion price, the more shares that will be issued to TCA or Chicago Venture upon the conversion of debt to shares. We won't know the exact number of shares of stock issued to TCA or Chicago Venture until the debt is actually converted to equity. If all stock option grant, warrant and contingent shares are issued, approximately 2.168 billion of our currently authorized 3 billion shares of common stock will be issued and outstanding. For purposes of estimating the number of shares issuable upon the exercise/conversion of all stock options, warrants and contingent shares, we assumed the number of shares and average share prices detailed above.

These stock option grant, warrant and contingent shares could result in further dilution to common stock holders and may affect the market price of the common stock.

Significant shares of common stock are held by our principal shareholders, other Company insiders and other large shareholders. As affiliates as defined under Rule 144 of the Securities Act or Rule 144 of the Company, our principal shareholders, other Company insiders and other large shareholders may only sell their shares of common stock in the public market pursuant to an effective registration statement or in compliance with Rule 144.

Some of the present shareholders have acquired shares at prices as low as \$0.007 per share, whereas other shareholders have purchased their shares at prices ranging from \$0.0036 to \$0.78 per share.

These stock option grant, warrant and contingent shares could result in further dilution to common stock holders and may affect the market price of the common stock.

Some of our convertible debentures may require adjustment in the conversion price.

Our 7% Convertible Notes Payable and our 6% Convertible Secured Convertible Note and Secured Credit Facility dated September 25, 2014 with Logic Works may require an adjustment in the current conversion price of \$0.0036 per share if we issue common stock, warrants or equity below the price that is reflected in the convertible notes payable. The conversion price of the convertible notes will have an impact on the market price of our common stock. Specifically, if under the terms of the convertible notes the conversion price goes down, then the market price, and ultimately the trading price, of our common stock will go down. If under the terms of the convertible notes the conversion price goes up, then the market price, and ultimately the trading price, of our common stock will likely go up. In other words, as the conversion price goes down, so does the market price of our stock. As the conversion price goes up, so presumably does the market price of our stock. The more the conversion price goes down, the more shares are issued upon conversion of the debt which ultimately means the more stock that might flood into the market, potentially causing a further depression of our stock.



We do not anticipate paying any cash dividends on our capital stock in the foreseeable future.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all of our future earnings, if any, to finance the growth and development of our business, and we do not anticipate paying any cash dividends on our capital stock in the foreseeable future. In addition, the terms of any future debt agreements may preclude us from paying dividends. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future.

Anti-takeover provisions may limit the ability of another party to acquire our company, which could cause our stock price to decline.

Our certificate of incorporation, as amended, our bylaws and Delaware law contain provisions that could discourage, delay or prevent a third party from acquiring our company, even if doing so may be beneficial to our stockholders. In addition, these provisions could limit the price investors would be willing to pay in the future for shares of our common stock.

We may issue preferred stock that could have rights that are preferential to the rights of common stock that could discourage potentially beneficial transactions to our common shareholders.

An issuance of additional shares of preferred stock could result in a class of outstanding securities that would have preferences with respect to voting rights and dividends and in liquidation over our common stock and could, upon conversion or otherwise, have all of the rights of our common stock. Our Board of Directors' authority to issue preferred stock could discourage potential takeover attempts or could delay or prevent a change in control through merger, tender offer, proxy contest or otherwise by making these attempts more difficult or costly to achieve. The issuance of preferred stock could impair the voting, dividend and liquidation rights of common stockholders without their approval.

If the company were to dissolve or wind-up, holders of our common stock may not receive a liquidation preference.

If we were to wind-up or dissolve the Company and liquidate and distribute our assets, our shareholders would share ratably in our assets only after we satisfy any amounts we owe to our creditors. If our liquidation or dissolution were attributable to our inability to profitably operate our business, then it is likely that we would have material liabilities at the time of liquidation or dissolution. Accordingly, we cannot give you any assurance that sufficient assets will remain available after the payment of our creditors to enable you to receive any liquidation distribution with respect to any shares you may hold.

#### Risks Associated with Securities Purchase Agreement with Chicago Venture

The Securities Purchase Agreement with Chicago Venture will terminate if we file protection from its creditors, a Registration Statement on Form S-1 is not effective, and our market capitalization or the trading volume of our common stock does not reach certain levels. If terminated, we will be unable to draw down all or substantially all of our \$2,500,000 Chicago Venture Note.

Our ability to require Chicago Venture to fund the Chicago Venture Note is at our discretion, subject to certain limitations. Chicago Venture is obligated to fund if each of the following conditions are met; (i) the average and median daily dollar volumes of our common stock for the twenty (20) and sixty (60) trading days immediately preceding the funding date are greater than \$100,000; (ii) our market capitalization on the funding date is greater than \$17,000,000; (iii) we are not in default with respect to share delivery obligations under the note as of the funding date; and (iv) we are current in its reporting obligations.

There is no guarantee that we will be able to meet the foregoing conditions or any other conditions under the Securities Purchase Agreement and/or Chicago Venture Note or that we will be able to draw down any portion of the amounts available under the Securities Purchase Agreement and/or Chicago Venture Note.

If we not able to draw down all \$2,500,000 available under the Securities Purchase Agreement or if the Securities Purchase Agreement is terminated, we may be forced to curtail the scope of our operations or alter our business plan if other financing is not available to us.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Unless otherwise indicated, all of the following sales or issuances of Company securities were conducted under the exemption from registration as provided under Section 4(2) of the Securities Act of 1933 (and also qualified for exemption under 4(5), formerly 4(6) of the Securities Act of 1933, except as noted below). All of the shares issued were issued in transactions not involving a public offering, are considered to be restricted stock as defined in Rule 144 promulgated under the Securities Act of 1933 and stock certificates issued with respect thereto bear legends to that effect.



We have compensated consultants and service providers with restricted common stock during the development of our business and when our capital resources were not adequate to provide payment in cash.

During the three months ended September 30, 2016, we had the following sales of unregistered of equity securities to accredited investors unless otherwise indicated:

On July 13, 2016, we issued 6,000,000 shares of common stock pursuant to Settlement Agreement and Release with Mr. Robert Hunt, a former executive While the conditions had not been met, we issued 6,000,000 shares of common stock on July 13, 2016 which were valued at \$0.010 per share.

During the three months ended September 30, 2016, a Holder of the Company's Convertible Notes Payables, converted principal and accrued interest of \$235,660 into 33,665,701 shares of the Company's common stock at a per share conversion price of \$0.007.

During the three months ended September 30, 2016, Old Main converted principal and accrued interest of \$638,000 into 120,746,617 shares of our common stock at a per share conversion price of \$0.0053.

During the three months ended September 30, 2016, Chicago Venture converted principal and accrued interest of \$128,000 into 22,371,716 shares of our common stock at a per share conversion price of \$0.0057.

#### ITEM 5. OTHER INFORMATION

This item is not applicable.

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

The exhibits required to be filed herewith by Item 601 of Regulation S-K, as described in the following index of exhibits, are attached hereto unless otherwise indicated as being incorporated by reference, as follows:

(a)  
Exhibits

Exhibit No.	Description
10.1	Exchange Agreement dated August 17, 2016, entered into by and between GrowLife, Inc. and Chicago Venture Partners, L.P. Filed as an exhibit to the Company's Form 8-K and filed with the SEC on August 30, 2016, and hereby incorporated by reference.
10.2	Debt Purchase Agreement dated August 15, 2016, entered into by and between GrowLife, Inc., TCA Global Credit Master Fund, LP and Chicago Venture Partners, L.P. Filed as an exhibit to the Company's Form 8-K and filed with the SEC on August 30, 2016, and hereby incorporated by reference.
10.3	First Amendment to Debt Purchase Agreement dated August 15, 2016, entered into by and between GrowLife, Inc., TCA Global Credit Master Fund, LP and Old Main Capital, LLC. Filed as an exhibit to the Company's Form 8-K and filed with the SEC on August 30, 2016, and hereby incorporated by reference.
16.1	Letter dated July 14, 2016 from PMB Helin Donovan LLP. Filed as an exhibit to the Company's Form 8-K and filed with the SEC on July 14, 2016, and hereby incorporated by reference.

31.1 Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer.

32.1 Section 906 Certifications.

32.2 Section 906 Certifications.

101 Interactive data files pursuant to Rule 405 of Regulation S-T. Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GROWLIFE, INC.

(Registrant)

Date: November 14, 2016 By: /s/ Marco Hegyi  
Marco Hegyi  
Chief Executive Officer and Chairman of the Board  
(Principal Executive Officer)

Date: November 14, 2016 By: /s/ Mark Scott  
Mark Scott  
Consulting Chief Financial Officer  
(Principal Financial and Accounting Officer)