

compensation for those services. On June 1, 2017, the agreement was amended to provide for an issuance of an aggregate of 50,000 shares of Company common stock, which were valued at \$120,000 (\$2.40 per share). The Company also issued to the consultant options to purchase 100,000 shares of Company common stock for a period of four years at an exercise price of \$2.40 per share.

- On June 1, 2017, the Company entered into a services agreement with a consultant to provide certain financial services and agree to issue 50,000 shares of common stock as part of the compensation for those services, which were valued at \$120,000 (\$2.40 per share).

The securities issued in the above-mentioned transactions were issued in connection with private placements exempt from the registration requirements of Section 5 of the Securities Act of 1933, as amended, pursuant to the terms of Section 4(2) of that Act and Rule 506 of Regulation D.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

OVERVIEW

Stem Holdings, Inc. (the "Company" or "Stem") is a Nevada corporation incorporated on June 7, 2016. The Company was formed to purchase, improve, and lease properties and finance assets which are operated by third parties and are used for the cultivation and retail sale of marijuana. During the year ended September 30, 2017, the Company was an early stage company which was only engaged in initial capital formation, initial property purchases, leasing activities and general and administrative activities related to the formation and early operation of the company. Given that the Company was only formed on June 7, 2016, the comparative results for the prior year are not relevant.

Summary of Results

	Year Ended September 30, 2017	Inception (June 7, 2016) to September 30, 2016
Revenues	\$ 326,041	\$ 0.00
Net (loss)	\$ (2,746,652)	\$ (87,699)
Basic and diluted earnings (loss) per share	\$ (0.49)	\$ (0.03)

Comparison of the results of operations for the year ended September 30, 2017 compared to the Period from Inception (June 7, 2016) through September 30, 2016

Because the 2016 period was only a short period from inception, which operations were concentrated in startup and raising funds to commence operations, we have chosen not to compare those results against the full year results for 2017 as those comparisons would not be informative. Below is our discussion of the results of operations for the year ended September 30, 2017.

The Company had revenues during the year ended September 30, 2017 of \$326,041, which primarily comprised of straight lining the rent we expect from our four leases. Under US GAAP, our rental income from the properties is earned on a straight-line basis over the entire expected life of the rent agreement, including the free rent period we have provided until each lessor ends its cannabis growing season. As of September 30, 2017, only the Willamette Property lessor had begun cash payments under the lease. We expect the remaining three lessors to commence cash payments under their three leases in May 2018.

In the year ended September 30, 2017 we incurred consulting costs of \$203,000. We expended those fees as we have yet to build up a significant employee base and currently outsource certain tasks to consultants. We expect in the upcoming year to increase our consulting fees as we continue to grow, even though we do expect to increase staffing, as we do not expect that growth will be commensurate with our growth from operations in the near term.

In the year ended September 30, 2017 we incurred professional fees of approximately \$273,000. Those fees are primarily for legal, accounting and related services in regards to our being a public company in both the United States and Canada. We expect as we grow our operations these costs will continue to grow.

In the year ended September 30, 2017, we incurred general and administrative costs of approximately \$829,000. Those costs include payroll, depreciation and amortization, insurance, rent expense and other general costs. We expect that these costs will increase as we increase our operations.

In the year ended September 30, 2017, we impaired advances totaling approximately \$297,000 to the entities we currently lease to. We made these advances to assist these entities in their start up. We impaired these advances due to the start-up nature of the entities. Should we make advances in the future prior to the entities commencing profitable operations, it's possible we may need to impair those advances.

In the year ended September 30, 2017, we incurred stock based compensation of approximately \$1.475 million, primarily the result of grants of stock and options to officers, directors and consultants. We expect that we will continue to use equity in the form of our common stock and options or warrants to compensate our employees and to reduce the cash compensation we will need to outlay to consultants in the upcoming year as we continue to grow our operations and devote our cash resources to acquiring new and improving our existing properties.

Transaction with Patch International, Inc.

On January 20, 2017, the shareholders of Patch International, Inc. voted to be acquired by the Company. As a result, the merger with Patch International, Inc. closed and the Company now has received an additional approximately

\$2.4 million which was on Patch's books at the time of the acquisition, net of the approximately \$54,000 paid to dissenting Patch International, Inc. shareholders.

Properties

In September 2016, the Company entered into a 10-year lease with respect to certain property located in Springfield, OR (the "42nd Street Property") with the landlord that commenced in November 2016. The lease requires the Company to pay a base rental fee of \$7,033 plus an additional estimated \$315 per month in real estate taxes in which the base rental fee escalates each year by approximately 2%. All taxes (including reconciling real estate taxes), maintenance and utilities are included at the end of each year as a one-time payment. In addition, the Company also remitted \$14,000 for a security deposit to the landlord. The Company has subleased this space effective July 1, 2017. The 42nd Street Property is a 16,000-sq. ft. indoor cannabis growing facility.

On November 1, 2016, the Company acquired certain property located in Eugene, OR (the "Willamette Property") for a total cash purchase price plus closing costs of approximately \$918,000. The Willamette Property is an operating cannabis dispensary.

On February 6, 2017, the Company acquired certain real property located at 7827 SE Powell Blvd, Portland, OR 97206 (the "Powell Property") for a total purchase price plus closing costs of approximately \$656,498. As part of the consideration for closing on the property, the Company issued a short term note payable to the seller in the Amount of approximately \$304,000. The Powell Property is a cannabis dispensary.

The note is non-interest bearing requires four monthly payments of \$75,000 plus a final payment for the remaining amount due immediately thereafter plus fees. Due to the short-term nature of the note, the Company has not imputed any interest as it would be immaterial to the results for the period. The Company and note holder have come to an agreement subsequent to September 30, 2017 to reduce by \$75,000 the balance due under the note, due to the Seller breaching certain sections of the Purchase and Sale Agreement dated November 15, 2016. As of September 30, 2017, the balance owed on the note was approximately \$4,000.

On April 15, 2017, the Company entered into a “Contract for Sale” for a Farm Property in Mulino OR (the “Mulino Property”), pursuant to which the seller will sell the premises to the Company upon the completion of the Company’s due diligence investigations and completion of the closing conditions precedent to each party’s obligations under the Contract for Sale. The purchase price is \$1,700,000 which will be reduced by a rental credit of approximately \$135,000, which is equivalent to nine months’ rent at \$15,000 a month. In addition, the Seller has granted the Company a credit to be reflected upon closing in the amount \$9,500 for improvements to the property made by the Company. The Company expects that the closing of the property purchase will take place in January 2018. In connection with the purchase of the property, the Company will make a cash payment in the amount of \$362,254 and will issue a promissory note in the amount of \$1,200,000 with a maturity of January 2020. The Company will pay monthly installments of principal and interest (at a rate of 2% per annum) in the amount of \$13,500, commencing in July 2018 through the maturity date (January 2020), at which time the entire unpaid principal balance and any remaining accrued interest shall be due and payable in full. In April 2017, in order for the Company to make use of the premises pending closing of the purchase of the property, the Company agreed to lease the premises from the seller for a term commencing April 5, 2017 and expiring on the earlier of: (i) the termination of the Contract for Sale by either party thereto in accordance with its terms; and (ii) October 5, 2017. The lease requires the Company to pay a base rental fee of \$15,000 for the first nine months with no lease deposit required. All taxes accruing during the lease term (including real estate taxes and personal property taxes) are the responsibility of the Company. In October 2017, both parties agreed to extend the lease through January 2018.

In addition, in the event that the Company deploys more than \$10 million in investment in real estate assets, the Company is required to acquire certain real estate properties from certain of the Company’s shareholders and their affiliated entities. Each of these properties will be leased on a double net basis to qualified tenants. The Company will not be involved in the operation of these properties or in the growing or sale of cannabis.

The leases noted above all contain provisions in which the 10-year timetable for rent payments the individual renters incur under the leases do not begin until such time as the first cannabis growing season for the renters is completed. For the Willamette Property, that period ended at the end of July 2017, and rent payments commenced in August 2017. For the other three properties, the Company currently estimates that the growing season will end at the end of April 2018 and rent payments will commence in May 2018.

LIQUIDITY AND FINANCIAL CONDITION

Liquidity and Capital Resources

The Company had cash of \$391,389 as of September 30, 2017. Our primary uses of cash have been for salaries, fees paid to third parties for professional services, property operating expenses, general and administrative expenses, and the acquisition and development of rental properties. All funds received have been expended in the furtherance of growing the business. We have received funds from financing activities such as from the sale of our common stock. The following trends are reasonably likely to result in changes in our liquidity over the near to long term:

- An increase in working capital requirements to finance our current business,
- Acquisition and buildout of rental properties;
- Addition of administrative and sales personnel as the business grows and
- The cost of being a public company.

Subsequent to September 30, 2017, we have raised an additional approximately \$2.5 million in our private placements and have also raised \$200,000 in short term notes. Our efforts to raise additional capital are ongoing.

We currently have committed that we would need to spend approximately \$2.2 million on capital expenditures for the expansion and buildout of our Powell and Springfield properties, and in addition, approximately \$1.525 million to purchase the Mulino Property. These capital expenditures are contingent upon several factors including the Company obtaining financing for the development of the properties and the construction of the tenant improvements in such amount and on such terms and provisions as are acceptable to the Company.

We have used our available funds to fund our operating expenses, pay our obligations, acquire and develop rental properties, and grow our company. We need to raise significant additional capital or debt financing to acquire new properties, to develop existing properties, and to assure we have sufficient working capital for our ongoing operations and debt obligations. There is no guarantee that such funding will be available to the Company at a viable cost, if at all.

CRITICAL ACCOUNTING POLICIES

Revenue Recognition

The Company recognizes rental revenue from tenants, including rental abatements, lease incentives and contractual fixed increases attributable to operating leases, on a straight-line basis over the term of the related leases when collectability is reasonably assured.

The Company makes estimates of the collectability of its tenant receivables related to base rents, straight-line rent and other revenues. In the current fiscal year, the Company began significant rental operations. The Company expects its analysis of any accounts receivable and evaluates the adequacy of the allowance for doubtful accounts, it considers such things as historical bad debts, tenant creditworthiness, current economic trends, facility operating performance, lease structure, developments relevant to a tenant's business, and changes in tenants' payment patterns. Specifically, for straight-line rent receivables, the Company's assessment includes an estimation of a tenant's ability to fulfill its rental obligations over the remaining lease term.

Use of estimates

The preparation of our financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and judgments used are based on management's experience and the assumptions used are believed to be reasonable given the circumstances that exist at the time the financial statements are prepared. Actual results may differ from these estimates.

Capitalization of Project Costs

The Company's policy is to capitalize all costs that are directly identifiable with a specific property, would be capitalized if the Company had already acquired the property, and when the property, or an option to acquire the property, is being actively sought after, and either funds are available or will likely become available. All amounts shown capitalized prior to acquisition of a property are included under the caption of Project Costs in the balance sheet.

Emerging Growth Company

The Company has elected to be an emerging growth company as defined under the Jumpstart Our Business Startups Act of 2012 ("Jobs Act"). Included with this election, the Company has also elected to use the provisions within the Jobs Act that allow companies that go public to continue to use the private company adoption date rules for new accounting policies. Should the Company obtain revenues in excess of \$1 billion on an annual basis, have its non-affiliated market capitalization increase to over \$700 million as of the last day of its second quarter, or raise in excess of \$1 billion in public offerings of its equity or instruments directly convertible into its equity, it will forfeit its status under the Jobs Act as an emerging growth company.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In July 2016, the Company entered into a 10-year lease for a commercial building from an unrelated third party in Springfield, Oregon. At the time, the original lease was entered into, the Company had expected to close on significant subscriptions from its private placement. However, when those did not immediately materialize, the Company entered into an agreement with the landlord to cancel the lease and in addition, paid the landlord \$15,000 not to rent out the property until such time the Company could enter into a new lease. In September 2016, the Company entered into a new 10-year lease with the landlord that commenced in November 2016. The lease requires the Company to pay a base rental fee of \$7,033 plus an additional estimated \$315 per month in real estate taxes in which the base rental fee escalates each year by approximately 2%. All taxes (including reconciling real estate taxes), maintenance and utilities are included at the end of each year as a one-time payment. In addition, the Company also remitted \$14,000 for a security deposit to the landlord.

In August 2016, the Company and certain shareholders of the Company entered into a "Multi Party" Agreement, in which the Company became obligated to lease or acquire three separate real estate assets, and separately, if certain events occur (see below), additional real estate assets held by entities related to those shareholders. In September 2016, the Company entered into the lease as more fully described above, and in November 2016, acquired a property after the shareholder that owned the purchase agreement transferred that purchase agreement to the Company, in accordance with the Multi Party agreement.

On April 15, 2017, the Company entered into a "Contract for Sale" for a Farm Property in Mulino OR (the "Mulino Property"), pursuant to which the seller will sell the premises to the Company upon the completion of the Company's due diligence investigations and completion of the closing conditions precedent to each party's obligations under the Contract for Sale. The purchase price is \$1,700,000 which will be reduced by a rental credit of approximately \$135,000, which is equivalent to nine months' rent at \$15,000 a month. In addition, the Seller has granted the Company a credit to be reflected upon closing in the amount \$9,500 for improvements made by the Company to the property. The Company expects that the closing of the property purchase will take place in January 2018. In connection with the purchase of the property, the Company will make a cash payment in the amount of \$362,254 and will issue a promissory note in the amount of \$1,200,000 with a maturity of January 2020. The Company will pay monthly installments of principal and interest (at a rate of 2% per annum) in the amount of \$13,500, commencing in July 2018 through the maturity date (January 2020), at which time the entire unpaid principal balance and any remaining accrued interest shall be due and payable in full. In April 2017, in order for the Company to make use of the premises pending closing of the purchase of the property, the Company agreed to lease the premises from the seller for a term commencing April 5, 2017 and expiring on the earlier of: (i) the termination of the Contract for Sale by either party thereto in accordance with its terms; and (ii) October 5, 2017. The lease

requires the Company to pay a base rental fee of \$15,000 for the first nine months with no lease deposit required. All taxes accruing during the lease term (including real estate taxes and personal property taxes) are the responsibility of the Company. In October 2017, both parties agreed to extend the lease through January 2018.

In addition, in the event that the Company deploys more than \$10 million in investment in real estate assets, the Company is required to acquire certain real estate properties from certain of the Company's shareholders and their affiliated entities.

Should the Company obtain in excess of \$10,000,000 through a combination of its private placements and its merger with Patch Holdings, Inc. (see Note 5), it is required to purchase certain real estate properties owned by entities affiliated with certain of its shareholders.

In addition, certain shareholders of the Company have begun organizing entities that will operate directly in the cannabis industry, and the Company intends to offer leases of its properties to these entities in the near future. The Multi Party Agreement also requires that in the event that the US Government amends Title 21 of the United States Code, otherwise known as the Controlled Substances Act, to remove cannabis as a Schedule I drug, and the Company raises more than \$10 million in equity and merger funding, the Company is required to enter into agreements to acquire those related entities and issue such equity that the shareholders of the related entities obtain 75% of the then issued and outstanding equity of the Company, regardless of the profitability or financial condition of the related entities at the time of their acquisition.

In February 2017, the Company entered into a 1-year lease for the occupancy of the Company's corporate office located in Boca Raton, Florida. The lease requires the Company to pay a base rental fee of \$785.00 per month. All taxes, maintenance and utilities are included. In addition, the Company also remitted \$785 for a security deposit to the landlord.

In February 2017, the Company entered into an advisory agreement with an unrelated third party with a term of 12 months. As part of that agreement, the third party agreed to provide assistance for the Company with respect to eligibility for becoming quoted on the OTCQB/OTCQX and advising and assisting the Company in complying with its ongoing OTCQB/OTCQX disclosure obligation under current federal and state securities laws. These services to the Company are exchanged for a \$10,000 upfront payment, and \$5,000 payment upon the acceptance on OTCQB/OTCQX.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The financial information required by Item 8 begins on the following page.