Share Issuances to Consultants

In the year ended September 30, 2018, the Company issued 1,055,416 shares of its common stock to consultants, employees and directors as compensation for services. From the period from October 1, 2018 through January 7, 2019 the Company issued an additional 425,000 shares to consultants. In the year ended September 30, 2018, the Company issued warrants to acquire 20,000 shares of its common stock to a consultant with an exercise price of $2.40 per share for services. In the year ended September 30, 2018, the Company issued options to acquire 2,105,000 shares of its common stock with exercise prices ranging from $2.23 to $4 per share to consultants, employees and directors for services. In the year ended September 30, 2018, options to acquire 160,000 share of stock were exercised on a cashless basis and the Company issued 65,558 shares of its common stock in satisfaction of the cash exercises.

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.

CD Special Warrants Offering

On December 27, 2018, the Company closed the first tranche of the Offering consisting of 3,121 CD Special Warrants at a price of C$1,000 per CD Special Warrant for aggregate gross proceeds of C$3,121,000 (see **CD Special Warrant Offering**, above).

ITEM 6. SELECTED FINANCIAL DATA

Pursuant to permissive authority under Regulation S-K, Rule 301, we have omitted Selected Financial Data.

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

Cautionary Note Regarding Forward-Looking Information and Factors That May Affect Future Results

This annual report on Form 10-K contains forward-looking statements regarding our business, financial condition, results of operations and prospects. The Securities and Exchange Commission (the "SEC") encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This annual report on Form 10-K and other written and oral statements that we make from time to time contain such forward-looking statements that set out anticipated results based on management's plans and assumptions regarding future events or performance. We have tried, wherever possible, to identify such statements by using words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," "will" and similar expressions in connection with any discussion of future operating or financial performance. In particular, these include statements relating to future actions, future performance or results of current and anticipated sales efforts, expenses, the outcome of contingencies, such as legal proceedings, and financial results. Factors that could cause our actual results of operations and financial condition to differ materially are set forth in the "Risk Factors" section of this annual report on Form 10-K.

We caution that these factors could cause our actual results of operations and financial condition to differ materially from those expressed in any forward-looking statements we make and that investors should not place undue reliance on any such forward-looking statements. Further, any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of anticipated or unanticipated events or circumstances. New factors emerge from time to time, and it is not possible for us to predict all such factors. Further, we cannot assess the impact of each such factor on our results of operations or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

The following discussion should be read in conjunction with our audited financial statements and the related notes that appear elsewhere in this annual report on Form 10-K.

OVERVIEW

Stem Holdings, Inc. (the "Company") is a Nevada corporation incorporated on June 7, 2016. The Company purchases, improves, and leases properties for use in the cannabis production, distribution and sales industry as well as a cultivator providing cannabis and cannabis-infused products licensed under the laws of the states of Oregon, Nevada, Oklahoma, with six current licenses for cultivation, three for production, five for processing, one for wholesale and ten dispensary licenses. In addition, the Company also procured a hemp license under the laws of Oregon. As of September 30, 2018, the Company has acquired 3 commercial properties and leased a fourth property and has entered into leases to related entities for these four properties (see Note 7). Fiscal year 2018 saw the near completion of buildout of these properties.

The Company, through its operating subsidiaries (see below), is currently in the process of finalizing the investment in and acquisition of entities that engage directly in the production and sale of cannabis, moving from a real estate focused entity with a cannabis niche to a cannabis focused entity (see Notes X,Y & Z).

As of September 30, 2018, the Company has incorporated 6 new subsidiaries –Stem Group Oklahoma, Inc., Stem Holdings Florida, Inc. Stem Holdings Oregon, Inc., Stem Holdings IP, Inc., Opco, LLC., and Stem Agri, LLC.

The Company's stock is publicly traded and is listed on the Canadian Securities Exchange under the symbol "STEM" and the OTCQB exchange under the symbol "STMH".

Going Concern

These audited financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. While the recreational use of cannabis is legal under the laws of certain States, where the Company is currently finalizing the acquisition of entities or investment in entities that directly produce or sell cannabis, the use and possession of cannabis is illegal under United States Federal law for any purpose, by way of Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970, otherwise known as the Controlled Substances Act of 1970 (the "ACT"). Cannabis is currently included under Schedule 1 of the Act, making it illegal to cultivate, sell or otherwise possess in the United States.

On January 4, 2018 the office of the Attorney General published a memo regarding cannabis enforcement that rescinds directives promulgated under former President Obama that eased federal enforcement. In a January 8, 2018 memo, Jefferson B. Sessions, then Attorney General of the United States, indicated enforcement decisions will be left up to the U.S. Attorney's in their respective states clearly indicating that the burden is with "federal prosecutors deciding which cases to prosecute by weighing all relevant considerations, including federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of federal prosecution, and the cumulative impact of particular crimes on the community." Subsequently, in April 2018, President Trump promised to support congressional efforts to protect states that have legalized the cultivation, sale and possession of cannabis, however, a bill has not yet been finalized in order to implement legislation that would, in effect, make clear the federal government cannot interfere with states that have voted to legalize cannabis. Further in December 2018, the US Congress passed legislation, which the President signed on December 20, 2018, removing hemp from being included with Cannabis in Schedule I of the Act.

These conditions raise substantial doubt as to the Company's ability to continue as a going concern should it complete its acquisitions and investments, which it considers likely as of the date of these financial statements. Should the United States Federal Government choose to begin enforcement of the provisions under the Act, the Company through its wholly owned subsidiaries could be prosecuted under the Act and the Company may have to immediately cease operations and/or be liquidated upon their closing of the acquisition or investment in entities that engage directly in the production and or sale of cannabis.

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amount and classification of liabilities that might result from this uncertainty.

Recent Developments

Under the Obama Administration, the DOJ previously issued memoranda, including the so-called "Cole Memo" on August 29, 2013, providing internal guidance to federal prosecutors concerning enforcement of federal cannabis prohibitions under the CSA. This guidance essentially characterized use of federal law enforcement resources to prosecute those complying with state laws allowing the use, manufacture and distribution of cannabis as an inefficient use of such federal resources when state laws and enforcement efforts are effective with respect to specific federal enforcement priorities under the CSA.

On January 4, 2018, U.S. Attorney General Jeff Sessions issued the Sessions Memo, which rescinded the Cole Memo and related internal guidance issued by the DOJ regarding federal law enforcement priorities involving marijuana. The Sessions Memo instructs federal prosecutors that when determining which marijuana-related activities to prosecute under federal law with the DOJ's finite resources, prosecutors should follow the well-established principles set forth in the U.S. Attorneys' Manual governing all federal prosecutions. The Sessions Memo states that "these principles require federal prosecutors deciding which cases to prosecute to weigh all relevant considerations, including federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community." The Sessions Memo went on to state that given the DOJ's well-established general principles, "previous nationwide guidance specific to marijuana is unnecessary and is rescinded, effective immediately."

It is unclear at this time what impact the Sessions Memo will have on the medical-use marijuana industry. In addition, pursuant to the current omnibus spending bill previously approved by Congress, the DOJ is prohibited from using funds appropriated by Congress to prevent states from implementing their medical-use cannabis laws. This provision, however, is currently set to expire on March 23, 2018, and there is no assurance that Congress will approve inclusion of a similar prohibition on DOJ spending in the appropriations bill for 2018. Although, as of September 30, 2018, we are not engaged in the purchase, sale, growth, cultivation, harvesting, or processing of marijuana products, we lease our properties to tenants who engage in such activities, and therefore strict enforcement of federal prohibitions regarding marijuana could irreparably harm our business, subject us to criminal prosecution and/or adversely affect the trading price of our securities.

Results of Operations

The following comparative analysis on results of operations was based primarily on the comparative consolidated financial statements, footnotes and related information for the periods identified below and should be read in conjunction with the audited consolidated financial statements and the notes to those statements for the years ended September 30, 2018 and 2017, which are included elsewhere in this annual report on Form 10-K. The results discussed below are for the years ended September 30, 2018 and 2017.

Comparison of the results of operations for the year ended September 30, 2018 compared to the Year Ended September 30, 2017

Revenues

For the years ended September 30, 2018 and 2017, revenue was as follows:

	Year Ended September 30, 2018	Year Ended September 30, 2017
Revenues	$ 1,295,694	$ 326,041
Net (loss)	$ (7,860,395)	$ (2,746,652)
Basic and diluted earnings (loss) per share	$ (0.95)	$ (0.49)

For the year ended September 30, 2018, total revenues amounted to $1,295,694 as compared to $326,041 for the year ended September 30, 2017, an increase of $969,653 or 75%. This increase in revenues was primarily comprised of straight lining the rent we expect from our other three 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 we have completed the buildout of the respective properties. As of September 30, 2018, 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 early 2019.

Operating expenses

	Year Ended September 30, 2018	Year Ended September 30, 2017
Consulting fees	$ 215,849	$ 203,000
Professional fees	$ 778,992	$ 273,399
General and administrative expenses	$ 3,020,915	$ 827,907
Impairment of advance-related party	$ -	$ 297,085
Stock based compensation	$ 4,839,504	$ 1,475,545
Total	$ 8,855,260	$ 3,076,936

- For the year ended September 30, 2018, consulting fees increased by $12,849, or 6.3%, as compared to the year ended September 30, 2017 due to an increase in the execution of additional consulting contracts in the area of investor relations.

- For the year ended September 30, 2018, professional fees increased by $505,593, or 184.9%, as compared to the year ended September 30, 2017. The increase was primarily attributable to both legal and accounting fees relative to compliance, acquisition and audit work. We expect these costs to increase as we continue to grow our operations.

- General and administrative expenses consist of expenses such as depreciation and amortization, rent expense, directors' and officers' liability insurance, travel expenses, office expenses, telephone and internet expenses and other general operating expenses. For the year ended September 30, 2018, general and administrative expenses increased by $1,833,008 or 221% as compared to the year ended September 30, 2017. These increases were primarily attributable to an increase in insurance, depreciation and impairment, and salary expense. We expect these costs, excluding future impairments, to increase as we continue to grow our operations.

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- During the year ended September 30, 2018, we recorded stock-based compensation of $4,839,504 as compared to $1,475,545 for the comparable 2017 period, an increase of $3,363,959, or 227.9%. This increase is due to our practice in our growth phase to use our cash resources to acquire new properties and improve existing properties and to rely more on equity based instruments for compensation to directors, officers, employees and consultants.

Operating loss

As a result of the factors described above, for the years ended September 30, 2018 and 2017, operating loss amounted to $6,775,566, as compared to an operating loss of $2,750,895, an increase of $4,024,671 or 146.3%.

Other income (expenses)

Other income (expenses) primarily includes interest expense incurred on debt with third parties and related parties, and, also includes other income (expenses). For the year ended September 30, 2018, total other income (expense) amounted to a net expense of $300,829, as compared to total other income of $4,243, representing a change of $305,072 or 7190.0%. The primary driver of the increase in interest expense was the greater utilization of debt in the fiscal 2018 year over 2017 and warrants and conversion features attached to certain debt instruments. We expect a substantial increase in our interest expense in our first quarter of the fiscal year ended September 30, 2019 as we issued an inducement offer to the holders of our convertible notes and all holders agreed to convert based on that inducement. This will result in the remaining discount on the convertible notes being amortized to interest expense in the quarter ending December 31, 2018.

Net income (loss)

As a result of the foregoing, for the years ended September 30, 2018 and 2017, net loss amounted to $7,860,395, or $(0.95) per basic and diluted common share, and a net loss of $2,746,652, or $(0.49) per basic and diluted common share, respectively.

LIQUIDITY AND FINANCIAL CONDITION

Liquidity and Capital Resources

The Company had cash of $761,351 and $391,389 as of September 30, 2018 and 2017 respectively. 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, 2018, we have raised an additional approximately $2.2 million in our private placement with Cannacord. Our efforts to raise additional capital are ongoing and we expect to receive the remainder of the offering of approximately CAD $7 million (approximately $4.8 million USD after fees and expenses) in the upcoming quarters in the fiscal year ended September 30, 2019.

We currently have committed that we would need to spend approximately $200,000 on capital expenditures for the expansion and buildout of our Mulino, Powell and Springfield properties. 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.

In October 2018, we issued an inducement offer to the holders of $2.575 million of our convertible notes, such that if they agreed to convert their notes into shares of our common stock, we would reduce the conversion rate from the range of $2.40 to $2.50 per share, depending on the convertible note, to $1.80 per share for all holders. In October and November 2018, all holders of our convertible notes accepted our offer and agreed to convert their notes into shares of our common stock at the inducement rate. This resulted in a reduction in our outstanding liabilities of approximately $2.575 million.

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 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.

On February 28, 2018, the Company executed a $550,000 mortgage payable on the Willamette property to acquire additional funds. The mortgage bears interest at 15% per annum. Monthly interest only payments began March 1, 2018 and continue each month thereafter until paid. The entire unpaid balance is due on March 1, 2020, the maturity date of the mortgage, and is secured by the underlying property. The Company paid costs of approximately $28,000 to close on the mortgage. The mortgage terms do not allow participations by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project. The note has been cross guaranteed by the CEO and Director of the Company.

On April 4, 2018, the Company executed a $314,000 mortgage payable on the Powell property to acquire additional funds. At closing $75,000 of the proceeds was put into escrow. The mortgage bears interest at 15% per annum. Monthly interest only payments began May 1, 2018 and continue each month thereafter until paid. The entire unpaid balance is due on April 1, 2020, the maturity date of the mortgage, and is secured by the underlying property. The Company paid costs of approximately $19,000 to close on the mortgage. The mortgage terms do not allow participations by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project. The note has been cross guaranteed by the CEO and Director of the Company.

On January 16, 2018 the Company consummated a "Contract for Sale" for a Farm Property in Mulino OR (the "Mulino Property"). The purchase price was $1,700,000 which was reduced by a rental credit of approximately $135,000 which is equivalent to nine months' rent at $15,000 a month and an additional credit of $9,500 for additional work done on the property. In connection with the purchase of the property, the Company made a cash payment as down payment plus payment of closing costs in the amount of $370,637 and issued 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. The note is secured by a deed of trust on the property.

In July 2018, the Company entered into a Membership Interest Purchase Agreement with a Florida company to acquire a 25% membership interest in the entity. The entity has the ability to obtain a license to cultivate and sell cannabis for medical purposes under newly enacted laws in Florida. As part of the purchase agreement, we funded $500,000 up front to allow the entity, along with a promissory note for $1 million, subject to closing which will occur on the entity obtaining the necessary licenses. As of September 30, 2018 and the date of filing of this Form 10-K, the entity had not yet been granted the necessary licenses to commence operations. In the event that the investee fails to obtain the necessary licenses, the purchase agreement is voided, the Company will return the membership interest and all monies not spent on the license process will be returned to the Company and the promissory note will be cancelled.

In September 2018, the Company entered into a separate Membership Interest Purchase Agreement with a Nevada entity to acquire a 50% interest in that entity. As part of the purchase agreement, the Company deposited into escrow with an attorney $375,000 and will pay a further $375,000 at closing. The entity is seeking licenses to cultivate and sell cannabis in the state of Nevada. As of September 30, 2018 and the date of filing of this Form 10-K, the entity had not yet been granted the necessary licenses to commence operations. In the event that the investee fails to obtain the necessary licenses, the purchase agreement is voided, all monies not spent on the license process will be returned to the Company and amounts held in escrow will be returned to the Company.

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. In July 2017, the Company entered into a lease agreement for the 42^{nd} Street Property. The lease agreement is for a term of ten years and a monthly rent obligation of $64,640, subject to annual increases of 3% per year plus an amount for additional rent based on final buildout costs incurred by the Company. The lease is a double net lease with maintenance and real property taxes to be paid by the Tenant and insurance costs paid by the Company. Rent payments have not commenced. The Company has treated tenancy for the period prior to rent commencement as a free rental period for accounting purposes.

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. In July 2017, the Company entered into an operating lease agreement with a marijuana dispensary to move into the Willamette Property. The lease agreement is for a base term of ten years (see note below) and a monthly rent obligation of $13,800, subject to annual increases of 3% per year, plus an amount for additional rent based on final buildout costs incurred by the Company. The lease is a double net lease with maintenance and real property taxes to be paid by the Tenant and insurance costs paid by the Company. The Company provided the tenant with one month of free rent. Upon the expiration of the term of ten years, the Lessee has the option to renew the lease agreement for one five-year term, on the same terms as provided in the lease agreement. On February 28, 2018, the Company executed a $550,000 mortgage payable on the Willamette property to acquire additional funds. The mortgage bears interest at 15% per annum. Monthly interest only payments began March 1, 2018 and continue each month thereafter until paid. The entire unpaid balance is due on March 1, 2020, the maturity date of the mortgage, and is secured by the underlying property. The mortgage terms do not allow participations by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project. For the nine months ended June 30, 2018, interest expense related to this mortgage amounted to $27,500. The note has been cross guaranteed by the CEO and Director of the Company.

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. In July 2017, the Company entered into a lease agreement for the Powell Property. The lease agreement is for a term of ten years and a monthly rent obligation of $6,523, subject to annual increases of 3% per year. Maintenance and real property taxes shall be paid by the Tenant and insurance paid by the Company. Additional rents will be added to pay landlord back for tenant improvements by the end of the first term of the lease, payments will include annual interest at 12% compounded monthly. Rent payments have not commenced. The Company has treated tenancy for the period prior to rent commencement as a free rental period for accounting purposes. Upon the expiration of the term of ten years, the Lessee has the option to renew the lease agreement for five-year term, on the same terms as provided in the lease agreement. On April 4, 2018, the Company executed a $314,000 mortgage payable on the Powell property to acquire additional funds. The mortgage bears interest at 15% per annum. Monthly interest only payments began May 1, 2018 and continue each month thereafter until paid. The entire unpaid balance is due on April 1, 2020, the maturity date of the mortgage, and is secured by the underlying property. The mortgage terms do not allow participations by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project. The note has been cross guaranteed by the CEO and Director of the Company.

In January 2018 the Company consummated a "Contract for Sale" for a Farm Property in Mulino OR (the "Mulino Property"). The purchase price was $1,700,000 which was reduced by a rental credit of approximately $135,000 which is equivalent to nine months' rent at $15,000 a month and an additional credit of $9,500 for additional work done on the property. In connection with the purchase of the property, the Company made a cash payment as down payment plus payment of closing costs in the amount of $370,637 and issued 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. The note is secured by a deed of trust on the property.

The Company has committed to improve the aforementioned properties which are leased to third parties. These commitments will require an additional cash outlay in the amount of approximately $200,000.

Our future operation is dependent on our ability to manage our current cash balances and on the collection of rental revenues. Our real estate properties are leased to related party tenants under double-net leases for which terms and expirations vary. We monitor the credit of all tenants to stay abreast of any material changes in credit quality. We monitor tenant credit by (1) reviewing the credit ratings of tenants (or their parent companies or lease guarantors) that are rated by national recognized rating agencies; (2) reviewing financial statements and related metrics and information that are publicly available or that are provided to us upon request, and (3) monitoring the timeliness of rent collections.

We intend on securing additional financing to acquire and develop additional and existing properties. Financing transactions may include the issuance of equity or debt securities, obtaining credit facilities, or other financing mechanisms. Even if we are able to raise the funds required, it is possible that we could incur unexpected costs and expenses or experience unexpected cash requirements that would force us to seek alternative financing. Furthermore, if we issue additional equity or debt securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. The inability to obtain additional capital may restrict our ability to grow our business operations.

Cash Flow

For the Years Ended September 30, 2018 and 2017

Net cash flows used in operating activities was $1,859,603 for the year ended September 30, 2018 as compared net cash flow used in operating activities to $947,894 for the year ended September 30, 2017, a change of $911,709.

- Net cash flow used in operating activities for the year ended September 30, 2018 primarily reflected a net loss of $7,076,395 adjusted for the add-back of non-cash items consisting of depreciation, amortization and impairment of $1,363,460, stock-based compensation expense of $4,839,504, non-cash interest $197,203, offset by a settlement gain from a note payable of $44,388, and changed operating assets and liabilities consisting of an increase in deferred revenue of $1,143,894, a decrease in prepaid expenses of $379,277 and net changes in other operating liabilities of $409,630.

- Net cash flow used in operating activities for the year ended September 30, 2017 primarily reflected a net loss of $2,746,652 adjusted for the add-back of non-cash items consisting of depreciation and amortization of $129,217, stock-based compensation expense of $1,475,545, impairment of advance-related party of $297,085, and changed in operating assets and liabilities consisting of an decrease in the deposits of $113,034 and an increase in deferred revenue of $298,441 and an increase of $82,318 in accounts payable and accrued expenses.

- Net cash flow used in investing activities for the year ended September 30, 2018 amounted to $7,345,484 and consisted of 4,898,309 used in the development of leased properties including the expansion of rentable space, upgrading irrigation, ventilation, plumbing and electrical systems, and the purchase of property and equipment. Additionally, $1,301,166 was invested in a new equity method investee and a further $1,059,019 was invested in two new potential equity method investees, upon their obtaining the necessary licenses. For the year ended September 30, 2017, net cash flow used in investing activities in the amount of $3,500,547 primarily reflects the development of owned and leased properties and acquisition of other property and equipment.

- Net cash provided by financing activities was $9,575,049 for the year ended September 30, 2018 as compared to $4,041,632 for the year ended September 30, 2017. During the year ended September 30, 2018, we received proceeds from the issuance of common shares of $6,570,873, compared to $4,528,742 in 2017, note payable proceeds of $368,000, and convertible debt proceeds of $2,325,000, mortgage proceeds of $738,936, and an offset of $427,760 of payment on notes payable as compared to $468,860 in 2017.

CRITICAL ACCOUNTING POLICIES

Principals of Consolidation

The accompanying consolidated financial statements include the accounts of Stem Holdings, Inc. and its wholly-owned subsidiaries, Stem Group Oklahoma, Inc., Stem Holdings Florida, Inc., Stem Holdings Oregon, Inc., Stem Holdings IP, Inc., Opco, LLC., and Stem Agri, LLC. All material intercompany accounts, transactions, and profits have been eliminated in consolidation. Our wholly owned subsidiaries had no operations, assets or liabilities as of September 30, 2018.

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 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 in its analysis of accounts receivable and its evaluation of the adequacy of the allowance for doubtful accounts. 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.

Real Estate Acquisition Valuation

All assets acquired and liabilities, assumed in an acquisition of real estate are measured at their acquisition date fair values. The acquisition value of land, building and improvements are included in real estate investments on the accompanying consolidated balance sheets. Acquisition pursuit costs associated with asset acquisitions are capitalized. The Company has early adopted ASU 2017-01, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as businesses acquisitions. As a result of early adopting ASU 2017-01, real estate acquisitions did not meet the definition of a business combination and were deemed asset acquisitions, and the Company therefore capitalized its acquisition pursuit costs associated with these acquisitions.

Reclassifications

Certain amounts in the Company's consolidated financial statements for prior periods have been reclassified to conform to the current period presentation. These reclassifications have not changed the results of operations of prior periods.

Use of estimates

The preparation of these 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. The significant estimates included in these financial statements are those associated with the assumptions used to value equity instruments, valuation of its properties for impairment testing and the deferral of rents. Actual results may differ from these estimates.

Instruments to Purchase Common Stock and Other Derivative Financial Instruments

We classify as equity any contracts that require physical settlement or net-share settlement or provide us a choice of net-cash settlement or settlement in our own shares (physical settlement or net-share settlement) provided that such contracts are indexed to our own stock. We classify as assets or liabilities any contracts that require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside our control) or give the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement). We assess the classification of instruments issued to purchase our common stock and any other financial instrument at each reporting date to determine whether a change in classification between assets and liabilities is required.

Cash and cash equivalents

Cash and cash equivalents include short-term investments with original maturities of three months or less and are recorded at cost, which approximates fair market value given the short-term nature.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and our deferred rents. As of September 30, 2018, the Company had deposits in a major financial institution in excess of the FDIC insurance limit. The Company believes the risk of loss to be minimal as it maintains its cash balances at well capitalized financial institutions. As of September 30, 2018, the Company had deferrals of rent due to free rent periods of approximately $1.4 million as it completes the buildout of three of its properties. The Company is currently in the process of acquiring the entities that it currently rents to and believes as of the date of these financial statements that it will acquire those entities, and because of this, no impairment testing was performed due to the likelihood of success of that acquisition (see Note X). Should the Company be successful in its acquisition of the renters, the deferred rental asset will eliminate against the liability held by the affiliates and therefore no impairment would be necessary. Should the Company fail to acquire its renters in the upcoming fiscal year, then impairment of the deferred rents could be likely.

Geographical Concentrations

As of September 30, 2018, the Company primarily rents to entities engaged in the production and sale of cannabis, which is only legal for recreational use in 10 states, with lesser legalization, such as for medical use in an additional 21 states, as of the time of these financial statements.

Carrying value, recoverability and impairment of long-lived assets

The Company follows Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC') 360 to evaluate its long-lived assets with determinate lives. The Company's long-lived assets, which include property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company does not test for impairment in the year of acquisition of properties so long as those properties are acquired from unrelated third parties.

The Company assesses the recoverability of its long-lived assets by comparing the projected undiscounted net cash flows associated with the related long-lived asset or group of long-lived assets over their remaining estimated useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets. Fair value is generally determined using the assets expected future discounted cash flows or market value, if readily determinable. If long- lived assets are determined to be recoverable, but the newly determined remaining estimated useful lives are shorter than originally estimated, the net book values of the long-lived assets are depreciated and amortized over the newly determined remaining estimated useful lives.

The Company considers the following to be some examples of important indicators that may trigger an impairment review: (i) significant under-performance or losses of assets relative to expected historical or projected future operating results; (ii) significant changes in the manner or use of assets or in the Company's overall strategy with respect to the manner or use of the acquired assets or changes in the Company's overall business strategy; (iii) significant negative industry or economic trends; (iv) increased competitive pressures; (v) a significant decline in the Company's stock price for a sustained period of time; and (vi) regulatory changes. The Company evaluates assets for potential impairment indicators at least annually and more frequently upon the occurrence of such events.

As of September 30, 2018, the Company performed its impairment analysis of its properties and determined that based on its valuation performed for the Mulino Farm project, an impairment in the value of its building and improvements was required, due to the nature of the property, its location and the specialized improvements the Company added to the property over the course of the fiscal year ended September 30, 2018. Based on its valuation, the Company has recorded an impairment of $784,000 as of September 30, 2018 (see Note 3) for the Mulino Farm property which is included in general and administrative expenses line item on the Statement of Operations.

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 in order to exercise their option. All amounts shown capitalized prior to acquisition of a property are included under the caption of Project Costs in the balance sheet.

Income Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of currently due plus deferred taxes. Deferred tax assets and liabilities are determined based on differences between financial reporting carrying amounts and the respective tax bases of assets and liabilities and are measured using tax rates and laws that are expected to be in effect when the differences are expected to be recovered or settled. Valuation allowances are provided against deferred tax assets if it is more likely than not that the deferred tax assets will not be realized.

The Company follows the guidance of FASB ASC 740-10 which relates to the Accounting for Uncertainty in Income Taxes, which seeks to reduce the diversity in practice associated with the accounting and reporting for uncertainty in income tax positions. This interpretation prescribes a comprehensive model for financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns.

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (the "Act"), a tax reform bill which, among other items, reduces the current federal income tax rate to 21% from 34%. The rate reduction is effective January 1, 2018 and is permanent. The Act has caused the Company's deferred income taxes to be revalued. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through income tax expense. Pursuant to the guidance within SEC Staff Accounting Bulletin No. 118 ("SAB 118"), as of December 31, 2017, the Company recognized the provisional effects of the enactment of the Act for which measurement could be reasonably estimated. Since the Company has provided a full valuation allowance against its deferred tax assets, the revaluation of the deferred tax assets did not have a material impact on any period presented. The ultimate impact of the Act may differ from these estimates due to the Company's continued analysis or further regulatory guidance that may be issued as a result of the Act.

The Company follows the provisions of FASB ASC 740-10 "Uncertainty in Income Taxes". Certain recognition thresholds must be met before a tax position is recognized in the financial statements. An entity may only recognize or continue to recognize tax positions that meet a "more-likely-than-not" threshold.

The Company does not believe it has any uncertain tax positions as of September 30, 2018 and 2017 that would require either recognition or disclosure in the accompanying consolidated financial statements.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "*Leases (Topic 842).*" ASU 2016-02 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to recognize a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The pronouncement requires a modified retrospective method of adoption and is effective on January 1, 2019, with early adoption permitted. We will continue to evaluate the effect the adoption of ASU 2016-02 will have on the consolidated financial statements of the Company. However, we currently believe that the adoption of ASU 2016-02 will not have a material impact for operating leases where we are a lessor and will continue to record revenues from rental properties for our operating leases on a straight-line basis. However, for leases where we are a lessee, primarily for our administrative office lease, we will be required to record a lease liability and a right of use asset on our consolidated balance sheets at fair value upon adoption. In addition, direct internal leasing overhead costs will continue to be capitalized, however, indirect internal leasing overhead costs previously capitalized will be expensed under ASU 2016-02.

In August 2016, the FASB issued ASU 2016-15 which addresses eight cash flow classification issues, eliminating the diversity in practice. This ASU is effective for annual and interim reporting periods beginning after December 15, 2017, with early adoption permitted. The retrospective transition method, requiring adjustment to all comparative periods presented, is required unless it is impracticable for some of the amendments, in which case those amendments would be prospectively applied as of the earliest date practicable. The adoption of ASU 2016-15 is not expected to have any impact on our consolidated financial statements.

In May 2014, FASB issued an update ("ASU 2014-09") establishing Accounting Standards Codification ("ASC") Topic 606, *Revenue from Contracts with Customers* ("ASC 606"). ASU 2014-09, as amended by subsequent ASUs on the topic, establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most of the existing revenue recognition guidance. This standard, which is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2017, requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services and also requires certain additional disclosures. We adopted this standard effective January 1, 2018 using the modified retrospective approach, which requires applying the new standard to all existing contracts not yet completed as of the effective date and recording a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. Based on an evaluation of the impact ASU 2014-09 will have on our sources of revenue, we have concluded that ASU 2014-09 will not have a material impact on the process for, timing of, and presentation and disclosure of revenue recognition from contracts with tenants.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective, including industry-specific revenue guidance. The standard specifically excludes lease contracts. The ASU allows for the use of either the full or modified retrospective transition method and will be effective for the Company on October 1, 2019, at which time the Company expects to adopt the updated standard using the modified retrospective approach. However, as the majority of the Company's revenue is from rental income related to leases, the ASU will not have a material impact on the consolidated financial statements. Related disclosures will be provided and/or updated pursuant to the requirements of the ASU.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The standard amends the existing lease accounting guidance and requires lessees to recognize a lease liability and a right-of-use asset for all leases (except for short-term leases that have a duration of one year or less) on their balance sheets. Lessees will continue to recognize lease expense in a manner similar to current accounting. For lessors, accounting for leases under the new guidance is substantially the same as in prior periods, but eliminates current real estate-specific provisions and changes the treatment of initial direct costs. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparable period presented, with an option to elect certain transition relief. Full retrospective application is prohibited. The standard will be effective for the Company on October 1, 2020; however, early adoption of the ASU is permitted. While the Company is currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures, we expect to adopt the guidance on its effective date, at which time we anticipate recognizing right-of-use assets and related lease liabilities on our consolidated balance sheets related to ground leases for any communities where we are the lessee.

Management does not believe that any other recently issued, but not yet effective accounting pronouncements, if adopted, would have a material effect on the accompanying consolidated financial statements.

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.