

property taxes to be paid by the Tenant and insurance costs paid by the Company. Rent payments will begin at the of the first growing season, which the Company currently estimates will occur in September 2019, and thus payments will commence in January 2020. The Company expects to treat such period as a free rental period for accounting purposes. At the time rental payments begin, the total of base rent and additional rent will not be less than \$1.00 per foot for light assisted greenhouse and \$.25 per usable square foot for un-light assisted greenhouse or outdoor grow space.

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.

7827 SE Powell, Portland, OR

In July 2017, the Company entered into a lease agreement for its acquired property located at 7827 SE Powell Blvd. in Portland, Oregon. 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 to 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 commence on the date the growing season ends, which the Company currently estimates will occur in May 2019, and thus expects payments to begin in September 2019. The Company has treated this period 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.

12. Subsequent events

From April 1, 2019 through the date of these financial statements, the Company issued shares of its common stock in satisfaction of compensation provisions within certain consulting agreements.

On March 29, 2019 the company entered into a definitive agreement to acquire Western Coast Ventures, Inc. (“WCV”). WCV has a working capital surplus of approximately \$2,000,000 and has negotiated a joint venture (the “JV”) with ILCA Holdings, Inc. (“ILCA”). ILCA has been issued a limited Conditional Use Permit for a Marijuana Production Facility (a “MPF”) by the City of San Diego, California, which will only be granting a total of 40 MPFs. The consideration for the acquisition is expected to be 2,000,000 shares of Stem’s common stock, having a value of approximately \$3,500,000 based on Stem’s closing trading price on March 29, 2019. After giving effect to the closing of the acquisition of WCV and the previously announced acquisition of South African Ventures, Inc., the former shareholders of WCV will own approximately 7.3% of the issued and outstanding shares of Stem. The acquisition of WCV is expected to be completed on or around April 12, 2019. The JV will consist of its own management team and with the personnel, expertise, and other resources necessary to construct the MPF. It is agreed that WCV will have a 51% interest in the JV, for an aggregate purchase price of \$1,500,000. ILCA will hold the remaining 49% interest in the JV. ILCA previously invested \$500,000 in the build-out and initial MPF permitting process. Stem anticipates the JV will finance the cost of construction of the MPF, estimated at \$3.5 million, with its cash on hand and other non-dilutive sources of financing. The construction of the facility has begun and is estimated to be completed during the fourth quarter of 2019. Upon issuance of the final MPF permit and the completed construction, the JV will: (1) operate an advanced cannabis facility to grow and cultivate cannabis; (2) manufacture cannabis-derived products; and (3) distribute cannabis and cannabis-derived products state-wide throughout California.

April 2019, the company entered into a definitive term sheet indicating the principle terms of an acquisitive reorganization of Consolidated Ventures of Oregon, Inc., and Opco Holdings, Inc. Pursuant to the conditions of the merger consideration, the company issued an aggregate of 12,500,000 to the selling equity owners of which will stay in escrow until the definitive agreement is executed.

In April 2019, the Company was notified by its primary bank that the banking institution would no longer allow the Company to retain its accounts and was given 30 days to move all of its cash to another financial institution. As of the date of these financial statements, the Company has transferred part of its cash holdings to a local credit union in the state of Oregon and has transferred part of its cash holdings to a related entity owned by its CEO and Chairman of the Board that is essentially a dormant corporation that does not engage in cannabis activities.

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

Forward Looking Statements

This Interim Report on Form 10-Q contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (“PLSRA”), Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) regarding Stem Holdings, Inc. (the “Company” or “Stem”, also referred to as “us”, “we” or “our”). Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Forward-looking statements involve risks and uncertainties. Forward-looking statements include statements regarding, among other things, (a) our projected sales, profitability, and cash flows, (b) our growth strategies, (c) anticipated trends in our industries, (d) our future financing plans and (e) our anticipated needs for working capital. They are generally identifiable by use of the words “may,” “will,” “should,” “anticipate,” “estimate,” “plans,” “potential,” “projects,” “continuing,” “ongoing,” “expects,” “management believes,” “we believe,” “we intend” or the negative of these words or other variations on these words or comparable terminology. These statements may be found under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Description of Business,” as well as in this Form 10-Q generally. In particular, these include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, the

outcome of contingencies such as legal proceedings, and financial results.

Any or all of our forward-looking statements in this report may turn out to be inaccurate. They can be affected by inaccurate assumptions we might make or by known or unknown risks or uncertainties. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially as a result of various factors, including, without limitation, the risks outlined under “Risk Factors” detailed in the Company’s Form 10 registration statement and matters described in this Form 10-Q generally. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur. You should not place undue reliance on these forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to publicly update any forward-looking statements, whether as the result of new information, future events, or otherwise. We intend that all forward-looking statements be subject to the safe harbor provisions of the PSLRA.

For the year ended September 30, 2018, the financial statements have been prepared by management in accordance with the standards of the Public Company Accounting Oversight Board (United States). For the three and six months ended March 31, 2018 and 2019, the unaudited interim financial statements have been prepared by management in accordance with the condensing rules of the United States Securities and Exchange Commission.

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 an investment in a cultivator providing cannabis and cannabis-infused products licensed under the laws of the state of Nevada. As of March 31, 2019, the Company has acquired 3 commercial properties and leased a fourth property and has entered into leases to related entities for these four properties.

The Company is also currently working towards acquiring additional entities and assisting certain joint ventures with obtaining licenses and permits for cannabis production, distribution and sale in additional US states and foreign countries. Should it be successful in these endeavors, the Company will transform into a multi-state and worldwide, vertically integrated, cannabis company that purchases, improves, leases, operates and invests in properties for use in the production, distribution and sales of cannabis and cannabis-infused products licensed under the laws of the states of Oregon, Nevada, California and Oklahoma. As of March 31, 2019, these potential partners had ownership interests in 26 state issued cannabis licenses including six (6) licenses for cannabis cultivation, three (3) licenses for cannabis production, five (5) licenses for cannabis processing, one (1) license for cannabis wholesale distribution, one (1) license for hemp production and ten (10) cannabis dispensary licenses.

Stem’s potential partner consumer brands are award-winning and nationally known, and include cultivators, TJ’s Gardens and Yerba Buena; retail brands, Stem and TJ’s; infused product manufacturers, Cannavore and Supernatural Honey; and a CBD company, Dose-ology.

The Company has incorporated 6 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.

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”.

Recent Developments

Cannabis is currently a Schedule I controlled substance under the Controlled Substances Act (CSA) and is, therefore, illegal under federal law. Even in those states in which the use of cannabis has been legalized pursuant to state law, its use, possession or cultivation remains a violation of federal law. A Schedule I controlled substance is defined as one that has no currently accepted medical use in the United States, a lack of safety for use under medical supervision and a high potential for abuse. The U.S. Department of Justice (the “DOJ”) defines Schedule I controlled substances as “the most dangerous drugs of all the drug schedules with potentially severe psychological or physical dependence.” If the federal government decides to enforce the CSA, persons that are charged with distributing, possessing with intent to distribute or growing cannabis could be subject to fines and/or terms of imprisonment, the maximum being life imprisonment and a \$50 million fine, even though these persons are in compliance with state law.

In light of such conflict between federal laws and state laws regarding cannabis, the previous administration under President Obama had effectively stated that it was not an efficient use of resources to direct federal law enforcement agencies to prosecute those lawfully abiding by state-designated laws allowing the use and distribution of medical cannabis. The new administration under President Trump could decide to strongly enforce the federal laws applicable to cannabis. *See Justice Department Memo on Marijuana Enforcement discussed below.* Any such change in the federal government’s enforcement of current federal laws could cause significant financial damage to us. While we do not currently harvest, distribute or sell cannabis, we may be irreparably harmed by a change in enforcement policies of the federal government.

The Company and our licensed products will also be subject to a number of other federal, state and local laws, rules and regulations. We anticipate that our licensees and vendors will be required to manufacture our products in accordance with the Good Manufacturing Practices guidelines and will be subject to regulations relating to employee safety, working conditions, protection of the environment, and other items. The current administration has indicated that it will closely scrutinize the cannabis industry, in particular, recreational marijuana. Changes in laws, rules and regulations or the recall of any product by a regulatory authority, could have a material adverse effect on our business and financial condition.

Justice Department Memo on Marijuana Enforcement

Because of the inconsistencies in federal and state law, on January 4, 2018, the Department of Justice (DOJ) issued a memo on federal marijuana enforcement policy announcing what it deemed to be a return to the rule of law and the rescission of previous guidance documents which would include the so called Cole Memorandum. Since the passage of the Controlled Substances Act in 1970, Congress has generally prohibited the cultivation, distribution, and possession of marijuana. In the memorandum, Attorney General Jeff Sessions directs all U.S. Attorneys to enforce the laws enacted by Congress and to follow well-established principles when pursuing prosecutions related to marijuana activities. The DOJ asserts this return to the rule of law is also a return of trust and local control to federal prosecutors who know where and how to deploy Justice Department resources most effectively to reduce violent crime, stem the tide of the drug crisis, and dismantle criminal gangs.

“It is the mission of the Department of Justice to enforce the laws of the United States, and the previous issuance of guidance undermines the rule of law and the ability of our local, state, tribal, and federal law enforcement partners to carry out this mission,” said Attorney General Jeff Sessions. “Therefore, today’s memo on federal marijuana enforcement simply directs all U.S. Attorneys to use previously established prosecutorial principles that provide them all the necessary tools to disrupt criminal organizations, tackle the growing drug crisis, and thwart violent crime across our country.”

We intend to conduct rigorous due diligence to verify the legality of all activities that we engage in and ensure that our activities do not interfere with any of the enforcement priorities of the Department of Justice.

Industrial Hemp

Industrial hemp is now legal in the U.S., which advocates hope could eventually loosen laws around the popular marijuana extract CBD. The 2018 farm bill which legalized hemp including a variety of cannabis that does not produce the psychoactive component of marijuana. CBD, a non-psychoactive compound that has started to turn up in beverages, health products and pet snacks, among other products. Notwithstanding, the Food and Drug Administration has issued a statement that despite the new status of hemp, CBD is still considered a drug ingredient and remains illegal to add to food or health products without the agency’s approval. The FDA has ruled that some hemp ingredients, such as hulled hemp seeds, hemp seed protein and hemp seed oil, are safe in food and won’t require additional approvals.

The Farm Bill sets U.S. Government agricultural and food policy. The current version of the bill places industrial hemp, which is defined as a cannabis plant with under 0.3% of tetrahydrocannabinol (“THC”) under the supervision of the Agriculture Department and removes CBD from the purview of the Controlled Substances Act, which regulates marijuana. The law also “explicitly” preserved the Food and Drug Administration’s authority to regulate products containing cannabis, or cannabis-derived compounds.

Summary of Results

	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Revenues	\$ 353,851	\$ 309,960
Net (loss)	\$ (2,667,459)	\$ (908,238)
Basic and diluted earnings (loss) per share	\$ (0.17)	\$ (0.11)

	Six Months Ended March 31, 2019	Six Months Ended March 31, 2018
Revenues	\$ 691,803	\$ 619,789
Net (loss)	\$ (6,687,058)	\$ (1,596,081)
Basic and diluted earnings (loss) per share	\$ (0.46)	\$ (0.22)

Comparison of the results of operations for the three months ended March 31, 2019 compared to the three months ended March 31, 2018

The Company had revenues during the three months ended March 31, 2019 of \$353,851 compared with \$309,960 for the comparable period of 2018, which primarily comprised 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 March 31, 2019, 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 2019.

In the three months ended March 31, 2019, we incurred consulting costs of \$106,556 compared to \$40,600 in the comparable period of the prior year. 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 three months ended March 31, 2019, we incurred professional fees of approximately \$408,696 compared to \$256,645 in the comparable period of the prior year. Those fees are primarily for legal, accounting and related services relating 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 three months ended March 31, 2019, we incurred general and administrative costs of approximately \$943,795 compared to \$445,870, which included an increase in 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 three months ended March 31, 2019, we incurred stock-based compensation of approximately \$1,162,729 compared to \$338,454 in the comparable period of the prior year, 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.

Comparison of the results of operations for the six months ended March 31, 2019 compared to the six months ended March 31, 2018

The Company had revenues during the six months ended March 31, 2019 of \$691,803 compared with \$619,789 for the comparable period of 2018, which primarily comprised 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 March 31, 2019, 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 2019.

In the six months ended March 31, 2019, we incurred consulting costs of \$180,906 compared to \$96,050 in the comparable period of the prior year. 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 six months ended March 31, 2019, we incurred professional fees of approximately \$850,568 compared to \$397,243 in the comparable period of the prior year. Those fees are primarily for legal, accounting and related services relating 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 six months ended March 31, 2019, we incurred general and administrative costs of approximately \$1,802,577 compared to \$878,238. These 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 six months ended March 31, 2019, we incurred stock-based compensation of approximately \$2,763,306 compared to \$698,000 in the comparable period of the prior year, 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.

LIQUIDITY AND FINANCIAL CONDITION

Liquidity and Capital Resources

The Company had cash of \$8,658,292 as of March 31, 2019. Our primary uses of cash have been for salaries, fees paid to third parties for professional services, insurance, general and administrative expenses, and the acquisitions and development of rental properties and their improvement. All funds received have been expended in the furtherance of growing the business. We have received funds from financing activities such as from equity offerings and debt financing as well as the proceeds from advances to be contributed to new ventures. 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 entry into the cultivation, production and sale of cannabis;
- 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 March 31, 2019, we have not raised any additional funds in our private placements. Our efforts to raise additional capital are ongoing and we expect to continue our efforts in the following quarters.

With respect to the company's investments in the projects pertaining to the equity method investee's and affiliates, we have committed that we need to spend \$4,600,000 in expansion, buildout and improvements. 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.

Equipment financing

In November 2017, the Company entered into a promissory note in the amount of \$21,749 from a vendor of the Company to finance the acquisition of a security electronics system in one of its properties. The promissory note bears an interest rate of 18% per annum and also contains a 10% servicing fee. The note matures 24 months after issuance and is secured by certain security electronics purchased with proceeds of the note. This vendor is currently in a restructuring and is likely to go out of business. As of March 31, 2019, the Company has been notified that the vendor holding the note is in bankruptcy and during the quarter ended March 31, 2019, the Company withheld payment under the note. The obligation remains outstanding at \$14,950 as of March 31, 2019. This is included in current portion of long-term debt and long-term debt line items in the balance sheet.

Effective April 29, 2018, the Company entered into a 36-month premium finance agreement in consideration for a John Deere Gator Tractor in the principal amount of \$15,710. The note bears no annual interest rate and requires the Company to make thirty-six monthly payments of \$442 over the term of the note. As of March 31, 2019, the obligation outstanding is \$11,062. No amount was recorded for the premium for the non-interest-bearing feature of the note as it was immaterial. The note is secured by the equipment financed. This is included in current portion of long-term debt and long-term debt line items in the balance sheet.

Effective May 29, 2018, the Company entered into a 24-month premium finance agreement in consideration for a MT85 wide track loader in the principal amount of \$27,844. The note bears no annual interest rate and requires the Company to make 24 monthly payments of \$1,160 over the term of the note. As of March 31, 2019, the obligation outstanding is \$17,403. No amount was recorded for the premium for the non-interest-bearing feature of the note as it was immaterial. The note is secured by the equipment financed. This is included in current portion of long-term debt and long-term debt line items in the balance sheet.

Due to related parties

As of March 31, 2019, related parties had advanced cash and equipment, on a due on demand, unsecured and undocumented basis, to the Company in the amount of \$33,600.

Insurance financing

In February 2019, the Company entered into a 10-month premium finance agreement in partial consideration for an insurance policy in the principal amount of \$259,916. The note bears an annual interest rate of 5.75% and requires the Company to make ten monthly payments of \$22,205 over the term of the note. As of March 31, 2019, the obligation outstanding is \$199,845. This is included in the short-term notes and advances line item in the balance sheet.

Effective March 8, 2019, the Company entered into a 10-month premium finance agreement in partial consideration for an insurance policy in the principal amount of \$5,975. The note bears an annual interest rate of 5.75% and requires the Company to make ten monthly payments of \$513 over the term of the note. As of March 31, 2019, the obligation outstanding is \$4,617. This is included in the short-term notes and advances line item in the balance sheet.

Effective July 31, 2018, the Company entered into a 9-month premium finance agreement in partial consideration for an insurance policy in the principal amount of \$54,701.55. The note bears an annual interest rate of 7.99% and requires the Company to make nine monthly payments of \$4,435 over the term of the note. As of March 31, 2019, the obligation outstanding is \$4,435. This is included in the short-term notes and advances line item in the balance sheet.

Short-term notes and advances

In September 2018, an investor interested in the then ongoing private placement of convertible notes (see below) advanced the Company \$168,000 on an unsecured basis and then entered discussions with Company regarding the form of the note. As of March 31, 2019, the Company and the investor had come to terms and the investor agreed to the terms of the notes which has an interest rate of 8% payable quarterly and matures in one year.

As disclosed in Note 6, the Company entered into a promissory note in the principal amount of \$1 million payable to ECP as part of its investment in the LLC. The promissory is payable in five installments commencing upon the effective date (the date of grant of license to engage in cannabis operations issuable by the government of the State of Florida), over the course of 1 year, with an interest rate of 1% per annum for the first six months, then increasing to 5.5% per annum for the remainder of the note period through maturity. In the event the LLC is denied the licenses necessary to operate, the note is cancelled in full.

Mortgages payable

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 participation 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. This is included in the long-term debt line item in the balance sheet.

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. No amount was recorded for the premium for the below market rate feature of the note as it was immaterial. The note is secured by a deed of trust on the property. The Company performed an analysis and determined that the rate obtained was below market, however, no premium was recorded as the Company determined it was immaterial.

Cash Flow

For the six months ended March 31, 2019 and 2018

Net cash flows used in operating activities was \$2,706,968 for the six months ended March 31, 2019 as compared net cash flow used in operating activities to \$974,353 for the quarter ended March 31, 2018, a change of \$1,732,615.

- Net cash flow used in operating activities for the six months ended March 31, 2019 primarily reflected a net loss of \$6,687,058 adjusted for the add-back of non-cash items consisting of depreciation and amortization of \$456,728, stock-based compensation expense of \$2,763,306, non-cash interest \$590,918 and convertible notes inducement expense of \$823,900 offset by a change operating assets and liabilities consisting of an increase in deferred revenue of \$648,303, an increase in prepaid expenses of \$106,276 and net changes in other operating liabilities of \$99,817.
- Net cash flow used in operating activities for the six months ended March 31, 2019 primarily reflected a net loss of \$1,596,081 adjusted for the add-back of non-cash items consisting of depreciation and amortization of \$193,338, stock-based compensation expense of \$698,000, non-cash interest \$92,499 offset by a change operating assets and liabilities consisting of an increase in deferred revenue of \$564,589, a decrease in prepaid expenses of \$84,943 and net changes in other operating liabilities of \$117,537.
- Net cash flow used in investing activities for the six months ended March 31, 2019 amounted to \$2,643,035 and consisted of \$754,879 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, \$970,001 and \$361,677 consisted of both equity method and advances in investments in affiliates, and the procurement of cash through an acquisition for stock.
- Net cash provided by financing activities was \$7,960,874 for the six months ended March 31, 2019 as compared to \$5,430,152 for the six months ended March 31, 2018. During the six months ended March 31, 2019, we received proceeds from an advance from NVDRE of \$300,000 and proceeds of \$3,493,055 related to Stem Venture Funds and \$1,999,000 related to West Coast Ventures. Additionally, convertible debt proceeds of \$2,357,125, note payable proceeds of \$150,000, and offsets of \$235,684 of payment on notes payable and \$102,622 incurred for loan fees.

CRITICAL ACCOUNTING POLICIES

Basis of preparation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The condensed financial statements included herein are unaudited. Such financial statements, in the opinion of management, contain all adjustments necessary to present fairly the financial position and results of operations as of and for the periods indicated. All such adjustments are of a normal recurring nature. These interim results are not necessarily indicative of the results to be expected for the year ending September 30, 2019 or for any other period. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, and because of this, for further information, readers should refer to the financial statements and footnotes included in our Form 10K for the fiscal year ended September 30, 2018 filed with the Securities and Exchange Commission on January 14, 2019. The Company believes that the disclosures are adequate to make the interim information presented not misleading.

Principals of Consolidation

The accompanying condensed consolidated financial statements include the accounts of Stem Holdings, Inc. and its wholly-owned or controlled operating subsidiaries, Stem Holdings Oregon, Inc., Stem Holdings IP, Inc., Opco, LLC, Stem Agri, LLC., Stem Group Oklahoma, Inc. and Stem

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.

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.

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.

Beneficial Conversion Feature

The Company issued convertible notes that have conversion prices that create an embedded beneficial conversion feature on the issuance date. A beneficial conversion feature exists on the date a convertible note is issued when the fair value of the underlying common stock to which the note is convertible into is in excess of the remaining unallocated proceeds of the note after first considering the allocation of a portion of the note proceeds to the fair value of any attached equity instruments, if any related equity instruments were granted with the debt, on a relative fair market basis. The Company estimates the fair value of its common stock using the most recent selling price available. The intrinsic value of the beneficial conversion feature is recorded as a debt discount with a corresponding amount to additional paid-in capital. The debt discount is amortized to interest expense over the life of the note using the effective interest method.

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. No amounts have been recorded for deferred rent in these financial statements as the amount was deemed immaterial by the Company. The Company has subleased this space pursuant to a 10-year lease. On February 22, 2018, both parties executed a lease addendum that adds contiguous property for 12,322 square feet. The term commences November 1, 2017 and continues through November 31, 2026 at a rate of \$3,525 a month that escalates 3% per year.

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, additional real estate assets held by entities related to those shareholders. The Agreement also gives the Company the right of first refusal in regard to certain properties owned by the persons and entities affiliated with the parties of the Agreement so long as certain targets are met.

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, if the Company obtains in excess of \$13 million through a combination of private placements and its merger with Patch Holdings, Inc., the cannabis affiliates become obligated to purchase preferred stock of the Company in an amount equivalent to 50% of their post-tax net operating income.

Certain shareholders of the Company have begun organizing entities that will operate directly in the cannabis industry, and the Company leases its properties to these entities. 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 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. Parties have verbally agreed. In November 2017, the Company entered into a consulting 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 business affairs relating to business consolidations and financing. As consideration for these services, the Company has agreed to issue to the consultant options to acquire up to 100,000 shares of common stock of the Company.

In March 2018, the Company entered into a 3-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 \$3,024 per month. All taxes, maintenance and utilities are billed separately. In addition, the Company also remitted \$6,048 or a security deposit to the landlord. The landlord provided the Company with 2 free months.

January 16, 2018 the Company consummated a “Contract for Sale” for a Farm Property in Mulino, OR (the “Mulino Property”). The purchase price is \$1,700,000 which is 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 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.

Property Rental Agreements

1027 Willamette, Eugene, OR

In July 2017, the Company entered into an operating lease agreement with a marijuana dispensary (the “Lessee”) to move into the Company’s acquired property located at 1027 Willamette Street in Eugene, Oregon. 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.

Springfield Suites, Springfield, OR

In July 2017, the Company entered into a lease agreement for its property and warehouse building located at 800 N 42nd street in Springfield, Oregon. The lease agreement is for a term of ten years (see note below) 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 commence on the date the growing season ends, which the Company currently estimates will occur in August 2019, and thus expects payments to begin in September 2019. The Company has treated this period as a free rental period for accounting purposes. At the time rental payments begin, the total of base rent and additional rent will not be less than \$1.00 per foot for light assisted greenhouse and \$.25 per usable square foot for un-light assisted greenhouse or outdoor grow space.

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.

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14336 S. Union Hall Road, Mulino, OR

In July 2017, the Company entered into a lease agreement for its property located at 14336 South Union Hall Road in Mulino, Oregon. The lease agreement is for a term of ten years (see note below) and a monthly rent obligation of \$18,750, 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 shall be paid by the Tenant and insurance costs paid by the Company. Rent payments will begin at the of the first growing season, which the Company currently estimates will occur in August 2019, and thus payments will commence in September 2019. The Company expects to treat such period as a free rental period for accounting purposes. At the time rental payments begin, the total of base rent and additional rent will not be less than \$1.00 per foot for light assisted greenhouse and \$.25 per usable square foot for un-light assisted greenhouse or outdoor grow space.

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.

7827 SE Powell, Portland, OR

In July 2017, the Company entered into a lease agreement for its acquired property located at 7827 SE Powell Blvd. in Portland, Oregon. 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 commence on the date the growing season ends, which the Company currently estimates will occur in June 2019, and thus expects payments to begin in September 2019. The Company has treated this period 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.

During the six months ended March 31, 2019, the Company incurred total rent expense of \$145,074. As of March 31, 2019, the Company has recorded a long-term asset for the straight lining of rent under the rental leases to the cannabis operators of approximately \$2,090,638.

OFF-BALANCE SHEET ARRANGEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)) as of the end of the quarterly period covered by this report, have concluded that our disclosure controls and procedures are not effective to reasonably ensure that material information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's Rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) under the Exchange Act) during the fiscal period to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

Smaller reporting companies are not required to provide the information required by this item.

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

The following table sets forth all securities issued by Stem since between January 1, 2019 and May 13, 2019:

	<u>Security</u>	<u>No. Shares</u>
Services	Common Stock	200,000
Compensation	Common Stock	47,343
Debt Conversion	Common Stock	255,556
Acquisitions	Common Stock	15,060,475
Total		15,563,374

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

<u>Exhibit No.</u>	<u>Description</u>
31.1/31.2	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1/32.2	Certification of Principal Executive Officer and Principal Financial Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

STEM HOLDINGS, INC.

May 16, 2019

By: /s/ Adam Berk
Adam Berk, President and Chief

