

## 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 and S-1 registration statements 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 three and nine months ended June 30, 2023, the financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States. For the three and nine months ended June 30, 2023, the unaudited interim financial statements have been prepared by management in accordance with the condensing rules of the United States Securities and Exchange Commission.

## Results of Operations

(\$ in thousands)	For the Three Months Ended June 30,		Change	
	2023	2022	\$	%
Gross Revenue	\$ 5,389	\$ 4,823	566	12%
Discounts and returns	(1,559)	(652)	907	139%
Cost of goods sold	2,787	3,500	(713)	(20%)
Consulting fees	123	104	19	18%
Professional fees	258	551	(293)	(53%)
General and administration	2,094	2,555	(461)	(18%)
Impairment expense	471	-	471	100%
Other income, net	826	3,011	(2,185)	73%
<b>Net loss</b>	<b>\$ (1,077)</b>	<b>\$ 472</b>		

### Comparison of the results of operations for the three months ended June 30, 2023, compared to the three months ended June 30, 2022

The Company had net revenues during the three months ended June 30, 2023, of \$ 3,830 compared with \$4,171 for the comparable period of 2022, the decrease in revenue was primarily related to a decrease in flower sales related to general market conditions.

Cost of goods for the three months ended June 30, 2023, amounted to approximately \$2,787 compared to \$3,500 in the comparable period of the prior year. These costs include both the cost of finished product purchased for retail and the cost of cultivation and processing for the grow facilities and sold at the wholesale level.

In the three months ended June 30, 2023, we incurred consulting costs of approximately \$123 compared to approximately \$104 in the comparable period of the prior year. The increase in consulting fees was attributed to an increase in stock-based consulting expenses.

In the three months ended June 30, 2023, we incurred professional fees of approximately \$258 compared to approximately \$551 in the comparable period of the prior year. The fees are primarily for legal, accounting, and related services that pertains to our being a public company in both the United States and Canada.

In the three months ended June 30, 2023, we incurred general and administrative costs of approximately \$2,094 compared to approximately \$2,555 in the comparable period of the prior year. The decrease relates primarily to a decrease in costs related to insurance, office expenses, and salaries.

The Company recognized other income of \$826 during the three months ended June 30, 2023, compared to other income during the three months ended June 30, 2022, of \$3,011. The other income was primarily related to the sale of a subsidiary.

(\$ in thousands)	For the Nine Months Ended June 30,		Change	
	2023	2022	\$	%
Gross Revenue	\$ 14,117	\$ 14,578	(461)	(3%)
Discounts and returns	(2,334)	(2,061)	273	13%
Cost of goods sold	10,103	10,691	(588)	(6%)
Consulting fees	231	633	(402)	(64%)
Professional fees	743	2,543	(1,800)	(71%)
General and administration	6,602	8,744	(2,142)	(24%)
Impairment of intangibles	471	795	(324)	(41%)
Other income (expenses), net	(1,022)	5,457	(6,479)	119%
Loss from discontinued operations	-	(1,745)	1,745	100%
<b>Net loss</b>	<b>\$ (7,389)</b>	<b>\$ (7,177)</b>		

The Company had net revenues during the nine months ended June 30, 2023, of \$11,783 compared with \$12,517 for the comparable period of 2022, the decrease in revenue was primarily related to a decrease in flower sales related to general market conditions.

Cost of goods for the nine months ended June 30, 2023, amounted to \$10,103 compared to \$10,691 in the comparable period of the prior year. These costs include both the cost of finished product purchased for retail and the cost of cultivation and processing for the grow facilities and sold at the wholesale level.

In the nine months ended June 30, 2023, we incurred consulting costs of \$231 compared to \$633 in the comparable period of the prior year. We mitigated our consulting expenses which were stock based the prior year.

In the nine months ended June 30, 2023, we incurred professional fees of \$743 compared to \$2,543 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.

In nine months ended June 30, 2023, we incurred general and administrative costs of \$6,602 compared to \$8,744, 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 nine months ended June 30, 2023, we did recognize impairment expense of \$471 compared to \$795 in the comparable period of the prior year. This expense relates to the impairment of investments and non-refundable deposits.

The Company recognized other expenses of \$1,022 during the nine months ended June 30, 2023, compared to other income during the nine months ended June 30, 2022, of \$5,457. The other expenses were primarily related to the loss on a sale of a subsidiary for the nine months ended June 30, 2023. The other income for the nine months ended June 30, 2022, primarily related to the change in fair value of warrants offset slightly by impairment expense.

In the nine months ended June 30, 2023, we did not recognize any loss from discontinued operations. In the nine months ended June 30, 2022, we had recognized a loss of discontinued operations of \$1,745 related to the divestiture of Driven.

## **LIQUIDITY AND FINANCIAL CONDITION**

### **Liquidity and Capital Resources**

On June 30, 2023, we had working capital deficit of approximately \$2.1 million, which included cash and cash equivalents of \$1.7 million. We reported a net loss of approximately \$7.4 million and our net cash used in operating expenses totaled \$1.3 million, our cash provided by investing activities was \$0.9 million, and cash flows provided by financing activities totaled \$0.5 million.

### **Cash Flow**

Net cash flows used in continuing operating activities was approximately \$1,580 for the nine months ended June 30, 2023, as compared net cash flow used in operating activities of approximately \$5,764 for the nine months ended June 30, 2022, a change of approximately \$4,184.

- Net cash flow used in operating activities for the nine months ended June 30, 2023 primarily reflected a net loss of \$7,389 adjusted for the add-back of non-cash items consisting of depreciation and amortization of approximately \$821, stock-based compensation and consulting expense of approximately \$382, amortization of debt discount of \$1,007, impairment of intangible assets of \$471, amortization of intangible assets of \$529, non-cash rent and interest expense of \$146, foreign currency translation adjustment of \$53, loss on sale of long-lived assets of \$178, offset by a decrease in warrant and derivative liability of \$322, changes in operating assets and liabilities consisting of a decrease in accounts receivable of \$46, a decrease in inventory of \$1,372, an increase in accounts payable and accrued expenses of \$427, and a decrease in prepaids of \$333, and an increase in other assets of \$367. Net cash flow used in operating activities for the nine months ended June 30, 2022 primarily reflected a net loss of \$7,177 adjusted for the add-back of non-cash items consisting of loss from discontinued operations of \$1,745, depreciation and amortization of approximately \$1,247, stock-based compensation and consulting expense of approximately \$880, amortization of debt discount of \$13, amortization of intangible assets of \$655, impairment of investments of \$288, issuance of common stock in connection with consulting agreements and interest payments of \$189, recognition of derivative liability of \$340, offset by a decrease in warrant liability of \$2,183, gain on extinguishment of debt of \$803, foreign currency translation adjustment of \$62, a gain from disposal of a subsidiary of \$831, gain on sale of property of \$1,155, change operating assets and liabilities consisting of a decrease in inventory of \$21, a decrease in accounts payable and accrued expenses of \$124, a decrease in prepaids of \$217, an increase in other of \$103, and a decrease in other assets of \$1,402.
- Net cash flow provided by investing activities for the nine months ended June 30, 2023, amounted to \$949 and consisted of the sale of investments of \$973, and the purchase of property and equipment of \$24. Net cash flow provided by investing activities for the nine months ended June 30, 2022, amounted to \$3,329 and consisted of \$206 used in the purchase of property and equipment, \$1,651 provided from the sale of an equity method investment, and \$2,173 provided from the sale of a property. Additionally, a net of \$288 was provided by investments, and \$1 related to repayment of a related party.
- Net cash provided by financing activities was \$811 for the nine months ended June 30, 2023, as compared to net cash provided by financing activities of \$31 for the nine months ended June 30, 2022. During the nine months ended June 30, 2023, we received proceeds from notes payable and advances of \$1,470, offset by repayments of \$627 of notes payable, and distributions of \$32. Net cash provided by financing activities was \$31 for the nine months ended June 30, 2022. During the nine months ended June 30, 2022, we received proceeds of \$285 for the issuance of common shares, \$625 related to note payables offset by repayments of \$879 of notes payable.

## CRITICAL ACCOUNTING POLICIES

### *Principles of Consolidation*

The Company's policy is to consolidate all entities that it controls by ownership of a majority of the outstanding voting stock. In addition, the Company consolidates entities that meet the definition of a variable interest entity ("VIE") for which it is the primary beneficiary. The primary beneficiary is the party who has the power to direct the activities of a VIE that most significantly impact the entity's economic performance and who has an obligation to absorb losses of the entity or a right to receive benefits from the entity that could potentially be significant to the entity. For consolidated entities that are less than wholly owned, the third party's holding of equity interest is presented as noncontrolling interests in the Company's Consolidated Balance Sheets and Consolidated Statements of Changes in Stockholders' Equity. The portion of net loss attributable to the noncontrolling interests is presented as net loss attributable to noncontrolling interests in the Company's Consolidated Statements of Operations.

### *Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income, and expenses. The most significant estimates included in these consolidated financial statements are those associated with the assumptions used to value equity instruments, valuation of its long live assets for impairment testing, valuation of intangible assets, and the valuation of inventory. These estimates and assumptions are based on current facts, historical experience and various other factors believed to be reasonable given the circumstances that exist at the time the financial statements are prepared. Actual results may differ materially and adversely from these estimates. To the extent there are material differences between the estimates and actual results, the Company's future results of operations will be affected.

### *Impairment of Long-Lived Assets*

The Company reviews the carrying value of its long-lived assets, which include property and equipment, for indicators of impairment whenever events or changes in circumstances indicate that the carrying value of an asset or asset group may not be recoverable. 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. The Company does not test for impairment in the year of acquisition of properties, as 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. In cases where estimated future net undiscounted cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of the asset or asset group. 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 prospectively over the newly determined remaining estimated useful lives.

### *Goodwill and Intangible Assets*

*Goodwill.* Goodwill represents the excess acquisition cost over the fair value of net tangible and intangible assets acquired. Goodwill is not amortized and is subject to annual impairment testing on or between annual tests if an event or change in circumstance occurs that would more likely than not reduce the fair value of a reporting unit below its carrying value. In testing for goodwill impairment, the Company has the option to first assess qualitative factors to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, the Company concludes that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is not required. If the Company concludes otherwise, the Company is required to perform the two-step impairment test. The goodwill impairment test is performed at the reporting unit level by comparing the estimated fair value of a reporting unit with its respective carrying value. If the estimated fair value exceeds the carrying value, goodwill at the reporting unit level is not impaired. If the estimated fair value is less than the carrying value, further analysis is necessary to determine the amount of impairment, if any, by comparing the implied fair value of the reporting unit's goodwill to the carrying value of the reporting unit's goodwill.

*Intangible Assets.* Intangible assets deemed to have finite lives are amortized on a straight-line basis over their estimated useful lives, where the useful life is the period over which the asset is expected to contribute directly, or indirectly, to our future cash flows. Intangible assets are reviewed for impairment on an interim basis when certain events or circumstances exist. For amortizable intangible assets, impairment exists when the carrying amount of the intangible asset exceeds its fair value. At least annually, the remaining useful life is evaluated.

An intangible asset with an indefinite useful life is not amortized but assessed for impairment annually, or more frequently, when events or changes in circumstances occur indicating that it is more likely than not that the indefinite-lived asset is impaired. Impairment exists when the carrying amount exceeds its fair value. In testing for impairment, the Company has the option to first perform a qualitative assessment to determine whether it is more likely than not that an impairment exists. If it is determined that it is not more likely than not that an impairment exists, a quantitative impairment test is not necessary. If the Company concludes otherwise, it is required to perform a quantitative impairment test. To the extent an impairment loss is recognized, the loss establishes the new cost basis of the asset that is amortized over the remaining useful life of that asset, if any. Subsequent reversal of impairment losses is not permitted.

During the nine months ended June 30, 2023, and 2022, the Company determined that there were \$471 and \$795 losses related to the impairment of goodwill and intangible assets, respectively.

### ***Business Combinations***

The Company applies the provisions of ASC 805 in the accounting for acquisitions. ASC 805 requires the Company to recognize separately from goodwill the assets acquired, and the liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions to accurately apply preliminary value to assets acquired and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, these estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments in the current period, rather than a revision to a prior period. Upon the conclusion of the measurement period or final determination of the values of the assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded in the consolidated statements of operations. Accounting for business combinations requires management to make significant estimates and assumptions, especially at the acquisition date, including estimates for intangible assets, contractual obligations assumed, restructuring liabilities, pre-acquisition contingencies, and contingent consideration, where applicable. Although the Company believes the assumptions and estimates made have been reasonable and appropriate, they are based in part on historical experience and information obtained from management of the acquired companies and are inherently uncertain. Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates, or actual results.

### ***Revenue Recognition***

The Company recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Accounting Standards Codification (ASC) Topic 606, Revenue from Contracts with Customers (Topic 606), the entity performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The Company only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services promised within each contract and determines those that are performance obligations and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

Revenue for the Company's product sales has not been adjusted for the effects of a financing component as the Company expects, at contract inception, that the period between when the Company's transfers control of the product and when the Company receives payment will be one year or less. Product shipping and handling costs are included in cost of product sales.

Effective October 1, 2019, the Company adopted the requirements of ASU 2014-09 (ASC 606) and related amendments, using the modified retrospective method. The adoption of ASC 606 did not have a significant impact on the Company's revenue recognition policy as revenues related to wholesale and retail revenue are recorded upon transfer of merchandise to the customer, which was the effective policy under ASC 605 previously.

The following policies reflect specific criteria for the various revenue streams of the Company:

#### *Cannabis Dispensary, Cultivation and Production*

Revenue is recognized upon transfer of retail merchandise to the customer upon sale transaction, at which time its performance obligation is complete. Revenue is recognized upon delivery of product to the wholesale customer, at which time the Company's performance obligation is complete. Terms are generally between cash on delivery to 30 days for the Company's wholesale customers.

The Company's sales environment is somewhat unique, in that once the product is sold to the customer (retail) or delivered (wholesale) there are essentially no returns allowed or warranty available to the customer under the various state laws.

#### *Delivery*

##### 1) *Identify the contract with a customer*

The Company sells retail products directly to customers. In these sales there is no formal contract with the customer. These sales have commercial substance and there are no issues with collectability as the customer pays the cost of the goods at the time of purchase or delivery.

##### 2) *Identify the performance obligations in the contract*

The Company sells its products directly to consumers. In this case these sales represent a performance obligation with the sales and any necessary deliveries of those products.

##### 3) *Determine the transaction price*

The sales that are done directly to the customer have no variable consideration or financing component. The transaction price is the cost that those goods are being sold for plus any additional delivery costs.

##### 4) *Allocate the transaction price to performance obligations in the contract*

For the goods that the Company sells directly to customers, the transaction price is allocated between the cost of the goods and any delivery fees that may be incurred to deliver to the customer.

##### 5) *Recognize revenue when or as the Company satisfies a performance obligation*

For the sales of the Company's own goods the performance obligation is complete once the customer has received the product.

#### CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As noted earlier in Note 1, the Company, engages in a business that constitutes an illegal act under the laws of the United States Federal Government. This raises several possible issues which may impact the Company's overall operations, not the least of which are related to traditional banking and other key operational risks. Since cannabis remains illegal on the federal level, and most traditional banks are federally insured, those financial institutions will not service cannabis businesses. In states where medical or recreational marijuana is legal, dispensary owners, manufacturers, and anybody who "touches the plant," continue to face a host of operational hurdles. While local, state-chartered banks and credit unions now accept cannabis commerce, there remains a reluctance by traditional banks to do business with them. Aside from a huge inconvenience and the need to find creative ways to manage financial flow, payroll logistics, and payment of taxes, this also poses tremendous risks to controls as a result of operating a lucrative business in cash. This lack of access to traditional banking may inhibit industry growth.

Despite the uncertainties surrounding the Federal government's position on legalized marijuana, the Company does not believe these risks will have a substantive impact on its planned operations in the near term.

#### 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) *Disclosure Controls and Procedures*

We are required to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer (also our principal executive officer) and our chief financial officer (also our principal financial and accounting officer) to allow for timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 ("Exchange Act"), the Company's management, including the Company's Chief Executive Officer ("CEO") (the Company's principal executive officer) and Chief Financial Officer ("CFO") (the Company's principal financial and accounting officer), has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were not effective as of June 30, 2023 to ensure that information required to be disclosed by the Company in the reports that the Company files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. The principal basis for this conclusion is the lack of segregation of duties within our financial function and the lack of an operating Audit Committee.

#### (b) *Management's Report on Internal Control over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Because of the inherent limitations of internal control, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

We carried out an assessment, under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of the design and operation of our internal controls over financial reporting, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as of June 30, 2023. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework (2013)*. Based on that assessment and on those criteria, our CEO and CFO concluded that our internal control over financial reporting was not effective as of June 30, 2023. The principal basis for this conclusion is (i) failure to engage sufficient resources regarding our accounting and reporting obligations during our startup and (ii) failure to fully document our internal control policies and procedures.

This quarterly report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only the management's report in this quarterly report.

The Company's management, including the Company's CEO and CFO, does not expect that the Company's internal control over financial reporting will prevent all errors and all fraud. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the policies or procedures may deteriorate.

**(c) *Changes in Internal Controls***

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.

The Company's management, including the Company's CEO and CFO, does not expect that the Company's internal control over financial reporting will prevent all errors and all fraud. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the policies or procedures may deteriorate.



## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Chris Hass, et al. vs Brian Hayek, et al. Plaintiffs filed their initial complaint in the instant action on May 22, 2020. Plaintiffs filed the operative first amended complaint on August 18, 2020. On March 28, 2022, Plaintiffs obtained a stipulated judgment in this action in the amount of \$349,876.69 against Defendants Driven Deliveries, Brian Hayek (“Hayek”), and Christian Schenk (“Schenk”) (collectively, “Defendants”). (3/28/22 Judgment.) Plaintiffs declare that during the litigation of the instant action, Baumgartner negotiated the essential terms of a settlement with Driven Deliveries’ President, Salvador Villanueva (“Villanueva”), and Villanueva represented to Baumgartner that he was in charge of the litigation and a deal could be worked out between the two of them to resolve the case. Plaintiffs declare the basic terms of a settlement were reached between Villanueva and Baumgartner, and Plaintiffs signed a settlement agreement (“Settlement Agreement”) on November 24, 2020. Defendants, including Hayek, signed the Agreement on November 30, 2020. Plaintiffs declare they signed the Settlement Agreement because they knew Driven Deliveries was merging with Stem. Plaintiffs declare that for this reason, they made sure to state in the Settlement Agreement that in the event of a merger between Driven Deliveries and Stem, Stem would be bound by the Settlement Agreement and would be named on the Judgment. Plaintiffs also declare that when they signed the Settlement Agreement, they relied on the fact Hayek, Stem’s new Agreement to bind his new company. Plaintiffs declare Defendants made payments on the Settlement Agreement until November 2021, when payments stopped. Plaintiffs declare the settlement checks were mostly written by Villanueva. Plaintiffs declare that shortly after they signed the Settlement Agreement, Driven Deliveries officially completed its merger with Stem, and all of Plaintiffs’ shares in Driven Deliveries were converted to shares of Stem. In January 2022, Villanueva listed himself as President, Secretary, and Treasurer of Driven Deliveries. Plaintiffs filed the instant motion on September 8, 2022. On October 3, 2022, Defendant Driven Deliveries filed its notice of bankruptcy proceedings, and the Court ordered a stay as to Driven Deliveries. On October 20, 2022, nonparty Stem filed its opposition. On October 26, 2022, Plaintiffs filed their reply. At the November 2, 2022, hearing on the instant motion, the Court requested Plaintiffs and Stem submit supplemental briefs on which state law to apply regarding successor liability.

Under California law, Stem, as Driven Deliveries’ prior parent company was legally required to assume Driven Deliveries’ debt to Plaintiffs. If a domestic corporation owns all the outstanding shares, or owns less than all the outstanding shares but at least 90 percent of the outstanding shares of each class, of a corporation or corporations, domestic or foreign, the merger of the subsidiary corporation or corporations into the parent corporation or the merger into the subsidiary corporation of the parent corporation and any other subsidiary corporation or corporations, may be effected by a resolution or plan of merger adopted and approved by the board of the parent corporation and the filing of a certificate of ownership as provided in subdivision . The resolution or plan of merger shall provide for the merger and shall provide that the surviving corporation assumes all the liabilities of each disappearing corporation and shall include any other provisions required by this section. Stem stated in a Form S-4 Statement filed with the SEC on [date], “Driven is surviving the merger as a wholly owned subsidiary of Stem (the ‘Merger’). Stem, together with Driven following the Merger, is referred to herein as the combined company. Following the completion of the Merger, Stem will also assume Driven’s outstanding net indebtedness.” Plaintiffs argue that while the merger with Stem was pending, Driven and Stem’s COO, Brian Hayek agreed to be bound by California law in executing the Settlement Agreement. Accordingly, applying California law, Stem assumed Driven’s liability to Plaintiffs. Accordingly, the Court in California granted the Plaintiffs’ motion to amend the judgment to add nonparty Stem Holdings Inc. as an additional defendant. At this time, it is unclear whether Stem will be required to pay Plaintiff any amount on account of this matter.

The Company is subject from time to time to litigation, claims and suits arising in the ordinary course of business. To the best of our knowledge, as of August 14, 2023, the Company was not a party to any other material litigation, claim or suit whose outcome could have a material effect on the Company’s financial statements.

### 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 between October 1, 2022, and June 30, 2023:

	<u>Security</u>	<u>No. Shares</u>
Services	Common Stock	350,000
Compensation	Common Stock	24,137,500
Issuance of common stock related to debt conversions	Common Stock	12,787,723
Issuance of common stock related to rent and interest payments	Common Stock	6,895,344
Total		<u>44,170,567</u>

All of the aforementioned shares were issued by the Company pursuant to an exemption from registration pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended.

### 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>
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<a href="#">31.1/31.2</a>	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the
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Securities Exchange Act of 1934, as amended

<a href="#">32.1/32.2</a>	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	Inline XBRL Instance Document
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL 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.

August 21, 2023

By: /s/ Matthew J. Cohen

Matthew J. Cohen, President, Chief Executive Officer and Chief  
Financial Officer