UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2023

OR

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

Commission File Number: 001-41266

CEA INDUSTRIES INC.
(Exact name of registrant as specified in its charter)

Nevada	**27-3911608**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
385 South Pierce Avenue, Suite C Louisville, Colorado 80027	**80027**
(Address of principal executive offices)	(Zip code)

(303) 993-5271
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.00001 par value	CEAD	Nasdaq Capital Markets
Warrants to purchase common stock	CEADW	Nasdaq Capital Markets

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the last 90 days. **YES** ☒ **NO** ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). **YES** ☒ **NO** ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	☐	**Accelerated Filer**	☐
Non-accelerated Filer	☒	**Smaller Reporting Company**	☒
		Emerging Growth Company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). **YES** ☐ **NO** ☒

As of August 14, 2023, the number of outstanding shares of common stock of the registrant was 8,076,372.

CEA Industries Inc.
Quarterly Report on Form 10-Q
For the Quarterly Period Ended June 30, 2023

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In this Quarterly Report on Form 10-Q, unless otherwise indicated, the "Company", "we", "us" or "our" refer to CEA Industries Inc. and, where appropriate, its wholly owned subsidiary.

CAUTIONARY STATEMENT

This Quarterly Report on Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2, contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical fact but are based on current management expectations that involve substantial risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential," or "continue" or the negative of these terms or other similar words. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements including, but not limited to, any projections of revenue, gross profit, earnings or loss, tax provisions, cash flows or other financial items; any statements of the plans, strategies or objectives of management for future operations; any statements regarding current or future macroeconomic or industry-specific trends or events and the impact of those trends and events on us or our financial performance; any statements regarding pending investigations, legal claims or tax disputes; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing.

These forward-looking statements are subject to known and unknown risks, uncertainties, assumptions and other factors that could cause our actual results of operations, financial condition, liquidity, performance, prospects, opportunities, achievements or industry results, as well as those of the markets we serve or intend to serve, to differ materially from those expressed in, or suggested by, these forward-looking statements. These forward-looking statements are based on assumptions regarding our present and future business strategies and the environment in which we operate. Important factors that could cause those differences include, but are not limited to:

- our business prospects and the prospects of our existing and prospective customers;
- our overall financial condition, including the impact of higher interest rates and inflation, business disruption due to the COVID-19 pandemic, the Ukraine war, and the supply chains on which we depend;

- the impact on our business from our restructuring and cost containment actions taken in the first quarter of 2023 and continuing thereafter;
- the inherent uncertainty of product development and product selection to meet client requirements;
- regulatory, legislative and judicial developments, especially those related to changes in, and the enforcement of, cannabis laws;
- increasing competitive pressures in the CEA (Controlled Environment Agriculture) industry and our engineering service and product supply position within the industry;
- the ability to effectively operate our business, including servicing our existing customers and obtaining new business;
- our relationships with our customers and suppliers;

- the continuation of normal payment terms and conditions with our customers and suppliers, including our ability to obtain advance payments from our customers;
- general economic conditions, our customers' operations and access to capital, and market and business disruptions including severe weather conditions, natural disasters, health hazards, terrorist activities, financial crises, political crises or other major events, or the prospect of these events, adversely affecting demand for the products and services offered by us in the markets in which we operate;
- the business disruptions that are happening in the CEA industry, including bankruptcies and shifting market demands, that are having an adverse impact on the demand for our engineering services and construction solutions and, consequently, our revenues;
- the supply of products from our suppliers and our ability to complete contracts, some of which depend on other actors for a comprehensive project completion;
- changes in our business strategy and development plans, and in our plans for seeking strategic alternatives;
- our ability to attract and retain qualified personnel;
- our ability to raise equity and debt capital, as needed from time to time, to fund our operations and business strategy, including possible strategic alternatives and acquisitions;
- our ability to identify, complete and integrate potential strategic alternatives and acquisitions;
- future revenue being lower than expected;
- The substantial changes in the amount and current size of our backlog and our ability to convert backlog into revenue in a timely manner, or at all; and
- our intention not to pay dividends.

These factors should not be construed as exhaustive and should be read with the other cautionary statements in this report.

Although we believe that we use reasonable assumptions for these forward-looking statements, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Quarterly Report on Form 10-Q should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in "Item 1A – Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2022, as updated from time to time in the Company's filings with the U.S. Securities and Exchange Commission (the "SEC"). You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. Except as required by the federal securities laws, we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q. The forward-looking statements and projections contained in this Quarterly Report on Form 10-Q are intended to be within the meaning of "forward-looking statements" in Section 27A of the Securities Act of 1933, as amended (the "Securities Act").

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CEA Industries Inc.
Condensed Consolidated Balance Sheets
(in US Dollars except share numbers)

	June 30, 2023 (Unaudited)	December 31, 2022
ASSETS		
Current Assets		
Cash and cash equivalents	$ 14,197,485	$ 18,637,114
Accounts receivable, net	293,767	2,649
Inventory, net	397,155	348,411
Prepaid expenses and other	520,256	1,489,921
Total Current Assets	15,408,663	20,478,095
Noncurrent Assets		
Property and equipment, net	53,225	68,513
Intangible assets, net	1,830	1,830
Deposits	14,747	14,747

Operating lease right-of-use asset		409,981		462,874
Total Noncurrent Assets		479,783		547,964
TOTAL ASSETS	$	15,888,446	$	21,026,059
LIABILITIES AND SHAREHOLDERS' EQUITY				
LIABILITIES				
Current Liabilities				
Accounts payable and accrued liabilities	$	798,624	$	1,207,258
Deferred revenue		625,911		4,338,570
Accrued equity compensation		-		89,970
Current portion of operating lease liability		122,272		118,235
Total Current Liabilities		1,546,807		5,754,033
Noncurrent Liabilities				
Operating lease liability, net of current portion		319,247		376,851
Total Noncurrent Liabilities		319,247		376,851
TOTAL LIABILITIES		1,866,054		6,130,884
Commitments and Contingencies (Note 6)		-		-
SHAREHOLDERS' EQUITY				
Preferred stock, $0.00001 par value; 25,000,000 shares authorized; 0 shares issued and outstanding		-		-
Common stock, $0.00001 par value; 200,000,000 authorized; 8,076,372 and 7,953,974 shares issued and outstanding, respectively		81		80
Additional paid in capital		49,426,065		49,173,836
Accumulated deficit		(35,403,754)		(34,278,741)
Total Shareholders' Equity		14,022,392		14,895,175
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	15,888,446	$	21,026,059

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

CEA Industries Inc.
Condensed Consolidated Statements of Operations
(in US Dollars except share numbers)
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	**2022**	**2023**	**2022**
Revenue, net	$ 1,063,714	$ 3,014,885	$ 5,746,287	$ 4,759,312
Cost of revenue	985,021	2,708,646	4,814,318	4,362,565
Gross profit	78,693	306,239	931,969	396,747
Operating expenses:				
Advertising and marketing expenses	33,091	309,690	235,414	560,705
Product development costs	74	56,577	76,487	195,495
Selling, general and administrative expenses	750,156	1,080,094	1,770,858	2,391,871
Goodwill impairment charges	-	631,064	-	631,064
Total operating expenses	783,321	2,077,425	2,082,759	3,779,135
Operating loss	(704,628)	(1,771,186)	(1,150,790)	(3,382,388)
Other income (expense):				
Other income (expense), net	2,074	-	7,778	185,000
Interest income (expense), net	8,979	10,600	17,999	13,860
Total other income (expense)	11,053	10,600	25,777	198,860
Loss before provision for income taxes	(693,575)	(1,760,586)	(1,125,013)	(3,183,528)
Income taxes	-	-	-	-
Net loss	$ (693,575)	$ (1,760,586)	$ (1,125,013)	$ (3,183,528)
Convertible preferred series B stock dividends	-	-	-	(35,984)
Deemed dividend on convertible preferred series B stock on down round	-	-	-	(439,999)
Net loss available to common shareholders	$ (693,575)	$ (1,760,586)	$ (1,125,013)	$ (3,659,511)
Loss per common share – basic and diluted	$ (0.09)	$ (0.23)	$ (0.14)	$ (0.59)

Weighted average number of common shares outstanding, basic and diluted	8,076,372	7,801,211	8,074,064	6,220,600

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

CEA Industries Inc.
Condensed Consolidated Statements of Changes in Shareholders' Equity
For the Three and Six Months Ended June 30, 2023 and June 30, 2022
(in US Dollars except share numbers)
(Unaudited)

	Common Stock		Additional		
	Number of Shares	Amount	Paid in Capital	Accumulated Deficit	Shareholders' Equity
Balance March 31, 2023	8,076,372	$ 81	$ 49,410,899	$ (34,710,179)	$ 14,700,801
Fair value of vested stock options granted to employees	-	-	15,166	-	15,166
Net loss	-	-	-	(693,575)	(693,575)
Balance June 30, 2023	8,076,372	$ 81	$ 49,426,065	$ (35,403,754)	$ 14,022,392

	Common Stock		Additional		
	Number of Shares	Amount	Paid in Capital	Accumulated Deficit	Shareholders' Equity
Balance December 31, 2022	7,953,974	$ 80	$ 49,173,836	$ (34,278,741)	$ 14,895,175
Fair value of vested stock options granted to employees	-	-	150,914	-	$ 150,914
Common shares issued in settlement of restricted stock units issued to directors	122,398	1	(1)	-	-
Fair value of restricted stock units issued to directors	-	-	101,316	-	$ 101,316
Net loss	-	-	-	(1,125,013)	$ (1,125,013)
Balance June 30, 2023	8,076,372	$ 81	$ 49,426,065	$ (35,403,754)	$ 14,022,392

	Common Stock		Additional		
	Number of Shares	Amount	Paid in Capital	Accumulated Deficit	Shareholders' Equity
Balance March 31, 2022	7,784,444	$ 78	$ 48,958,618	$ (30,204,508)	$ 18,754,188
Fair value of vested stock options granted to employees	-	-	126,635	-	126,635
Fair value of restricted stock units issued to directors	-	-	6,245	-	6,245
Cashless exercise of prefunded warrants	169,530	2	(2)	-	-
Net loss	-	-	-	(1,760,586)	(1,760,586)
Balance June 30, 2022	7,953,974	$ 80	$ 49,091,496	$ (31,965,094)	$ 17,126,482

	Common Stock		Additional		
	Number of Shares	Amount	Paid in Capital	Accumulated Deficit	Shareholders' Equity
Balance December 31, 2021	1,600,835	$ 16	$ 25,211,017	$ (28,781,566)	$ (3,570,533)
Fair value of vested stock options granted to employees	-	-	159,573	-	159,573
Fair value of vested stock options granted to directors	-	-	29,656	-	29,656
Common shares issued in settlement of restricted stock units issued to directors	3,367	-	24,994	-	24,994
Fair value of restricted stock units issued to directors	-	-	11,173	-	11,173
Issuance of common shares to round up partial shares following reverse split	6,798	-	-		-
Common shares and warrants issued for cash	5,811,138	58	21,711,073	-	21,711,131
Common shares and warrants issued on conversion of series B preferred stock	362,306	4	1,979,996	-	1,980,000
Dividends on series B preferred stock	-	-	(35,984)	-	(35,984)
Cashless exercise of prefunded warrants	169,530	2	(2)	-	-
Net loss	-	-	-	(3,183,528)	(3,183,528)
Balance June 30, 2022	7,953,974	$ 80	$ 49,091,496	$ (31,965,094)	$ 17,126,482

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

CEA Industries Inc.
Condensed Consolidated Statements of Cash Flows
(in US Dollars except share numbers)
(Unaudited)

	For the Six Months Ended June 30,	
	2023	**2022**
Cash Flows From Operating Activities:		
Net loss	$ (1,125,013)	$ (3,183,528)

Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and intangible asset amortization expense	14,988	16,697
Share-based compensation	162,260	225,396
Provision for doubtful accounts	2,096	(9,182)
Provision for excess and obsolete inventory	60,574	(34,417)
Loss on disposal of assets	100	4,060
Amortization of operating lease ROU asset	52,893	51,061
Goodwill impairment charges	-	631,064
Changes in operating assets and liabilities:		
Accounts receivable	(293,214)	48,153
Inventory	(109,318)	10,986
Prepaid expenses and other	969,665	(1,692,816)
Accounts payable and accrued liabilities	(408,634)	(317,453)
Deferred revenue	(3,712,659)	3,095,431
Operating lease liability, net	(53,567)	(39,870)
Accrued equity compensation	-	(37,251)
Net cash provided by (used in) operating activities	(4,439,829)	(1,231,669)
Cash Flows From Investing Activities		
Purchases of property and equipment	-	(13,948)
Proceeds from the sale of property and equipment	200	2,250
Net cash provided by (used in) investing activities	200	(11,698)
Cash Flows From Financing Activities		
Payment of dividends on series B preferred stock	-	(35,984)
Redemption of series B preferred stock	-	(1,980,000)
Net cash proceeds on sale of common stock and warrants, net of expenses	-	21,711,131
Net cash provided by financing activities	-	19,695,147
Net change in cash and cash equivalents	(4,439,629)	18,451,781
Cash and cash equivalents, beginning of period	18,637,114	2,159,608
Cash and cash equivalents, end of period	$ 14,197,485	$ 20,611,388
Supplemental cash flow information:		
Interest paid	$ -	$ -
Income taxes paid	$ -	$ -
Non-cash investing and financing activities:		
Unpaid purchases of equipment and other assets	$ -	$ 16,400
Conversion of series B preferred stock	-	$ 1,980,000
Deemed dividend on series B preferred stock arising on down round	-	$ 439,999
Cashless exercise of prefunded warrants		$ 2
Options issued for accrued equity compensation liability	$ 89,970	$ 83,625

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

CEA Industries Inc.
Notes to Condensed Consolidated Financial Statements
June 30, 2023
(in US Dollars except share numbers)
(Unaudited)

Note 1 – Nature of Operations and Significant Accounting Policies

Description of Business

CEA Industries Inc., formerly Surna Inc. (the "Company"), was incorporated in Nevada on October 15, 2009. We design, engineer and sell environmental control and other technologies for the Controlled Environment Agriculture ("CEA") industry. The CEA industry is one of the faster-evolving sectors of the United States' economy. From leafy greens (kale, Swiss chard, mustard, cress), microgreens (leafy greens harvested at the first true leaf stage), ethnic vegetables, ornamentals, and small fruits (such as strawberries, blackberries and raspberries) to bell peppers, cucumbers, and tomatoes and cannabis and hemp, more and more producers consider or act to grow crops indoors in response to market dynamics or as part of their preferred farming practice. In service of the CEA industry, we provide: (i) architectural design and licensed engineering of commercial scale thermodynamic systems specific to cultivation facilities, (ii) liquid-based process cooling systems and other climate control systems, (iii) air handling equipment and systems, (iv) air sanitation products, (v) LED lighting, (vi) benching and racking solutions for indoor cultivation, (vii) proprietary and third party controls systems and technologies used for environmental, lighting, and climate control, and (viii) preventive maintenance services, through our partnership with a certified service contractor network, for CEA facilities. Our customers include commercial, state- and provincial-regulated CEA growers in the U.S. and Canada. Customers are those growers building new facilities and those expanding or retrofitting existing facilities. Currently, our revenue stream is derived primarily from supplying our products, services, and technologies to commercial indoor facilities ranging from several thousand to more than 100,000 square feet. Headquartered in Louisville, Colorado, we leverage our experience in this space to bring value-added climate control solutions to our customers that help improve their overall crop quality and yield, optimize energy and water efficiency, and satisfy the evolving state and local codes, permitting and regulatory requirements. Although most of our customers do, we neither produce nor sell cannabis or its related products.

Impact of the COVID-19 Pandemic on Our Business

The impact of the government and the business economic response to the COVID-19 pandemic affected demand across the majority of our markets and disrupted workflow and completion schedules on projects. We believe we continue to see adverse effects on our sales, project implementation, supply chain infrastructure, operating margins, costs, and working capital.

Due to this uncertainty, we continue to monitor costs and continue to take actions to reduce costs in order to mitigate the long-term impact of the

COVID-19 pandemic to the best of our ability. However, these actions may not be sufficient in the long run to avoid reduced sales, increased losses, and reduced operating cash flows in our business. During the year ended December 31, 2022, and continuing into the current fiscal quarter, the Company experienced delays in the receipt of equipment it had ordered to meet its customer orders due to disruption and delays in its supply chain. Consequently, our revenue recognition of some customer sales has been delayed until future periods when the shipment of orders can be completed.

Impact of Ukrainian Conflict

Currently, we believe that the conflict between Ukraine and Russia does not have any direct impact on our operations, financial condition, or financial reporting. We believe the conflict will have only a general impact on our operations in the same manner as it has a general impact on all businesses that have their operations limited to North America resulting from international sanction and embargo regulations, possible shortages of goods and goods incorporating parts that may be supplied from the Ukraine or Russia, supply chain challenges, and the international and US domestic inflationary results of the conflict and government spending for and funding of our country's response. As our operations are related only to the North American controlled environment agricultural industry, largely within the cannabis space, we do not believe we will be targeted for cyber-attacks related to this conflict. We have no operations in the countries directly involved in the conflict or are specifically impacted by any of the sanctions and embargoes, as we principally operate in the United States and Canada. We do not believe that the conflict will have any impact on our internal control over financial reporting. Other than general securities market trends, we do not have reason to believe that investors will evaluate the company as having special risks or exposures related to the Ukrainian conflict.

Inflation

Our operations are being influenced by the inflation existent in the larger economy and in the industries related to building renovations, retrofitting and new build CEA facilities in which we operate. We believe that we will continue to face inflationary increases in the cost of products and our operations, which will adversely affect our margins and financial results and the pricing of our service and product supply contracts. Inflation is reflected in higher wages, increased pricing of equipment, delivery and transportation costs, and general operational expenses. As we move forward, we plan to continuously monitor our various contract terms and may decide to add clauses that will permit us to adjust pricing if inflation and price increase pressures on us will impact our ability to perform our contracts and maintain our margins.

Financial Statement Presentation

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect reported amounts and related disclosures.

Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Pursuant to these rules and regulations, certain information and note disclosures, normally included in financial statements prepared in accordance with GAAP, have been condensed or omitted. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2023 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2023. The balance sheet information as of December 31, 2022 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements. For further information, refer to the consolidated financial statements and notes thereto contained in the Annual Report on Form 10-K for the year ended December 31, 2022.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its controlled and wholly owned subsidiaries, Hydro Innovations, LLC ("Hydro") and Surna Cultivation Technologies LLC ("SCT"). Intercompany transactions, profit, and balances are eliminated in consolidation.

Use of Estimates

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and that affect the reported amounts of revenue and expenses during the reporting period. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates. Key estimates include: allocation of transaction prices to performance obligations under contracts with customers, standalone selling prices, timing of expected revenue recognition on remaining performance obligations under contracts with customers, valuation of intangible assets and goodwill, valuation of equity-based compensation, valuation of deferred tax assets and liabilities, warranty accruals, accounts receivable and inventory allowances, and legal contingencies.

Cash, Cash Equivalents, and Restricted Cash

All highly liquid investments with original maturities of three months or less at the date of purchase are considered to be cash equivalents. The Company may, from time to time, have deposits in financial institutions that exceed the federally insured amount of $250,000. As of June 30, 2023, the balance in the Company's accounts was approximately $14,197,000, consequently approximately $13,947,000 of this balance was not insured by the FDIC. The Company has not experienced any losses to date on depository accounts.

(in US Dollars except share numbers)

Income (Loss) Per Common Share

Basic income (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding during the period without consideration of common stock equivalents. Diluted net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding and potentially dilutive common stock equivalents, including stock options, warrants and restricted stock units and other equity-based awards, except in cases where the effect of the common stock equivalents would be antidilutive. Potential common stock equivalents consist of common stock issuable upon exercise of stock options and warrants and the vesting of restricted stock units using the treasury method.

As of June 30, 2023, and June 30, 2022, there were respectively, 8,009,889 and 7,882,061, potentially dilutive equity instruments outstanding in respect of warrants options to purchase shares of the Company's common stock and restricted stock units that were convertible into shares of the Company's common stock. Of these potentially dilutive equity instruments outstanding, 7,623,772 related to warrants outstanding at both June 30, 2023 and June 30, 2022 issued in connection with the sale of our shares of series B Preferred stock and common stock. The remaining 386,117 and 252,289 potentially dilutive equity instruments outstanding as of June 30, 2023 and June 30, 2022, respectively, related to options to purchase shares of the Company's common stock and restricted stock units that were convertible into shares of the Company's common stock that had been issued to our directors and staff as compensation.

Goodwill

The Company recorded goodwill in connection with its acquisition of Hydro Innovations, LLC in July 2014. Goodwill is reviewed for impairment annually or more frequently when events or changes in circumstances indicate that fair value of the reporting unit has been reduced to less than its carrying value. The Company performs a quantitative impairment test annually on December 31 by comparing the fair value of the reporting unit with its carrying amount, including goodwill. The Company's fair value is calculated using a market valuation technique whereby an appropriate control premium is applied to the Company's market capitalization as calculated by applying its publicly quoted share price to the number of its common shares issued and outstanding. If the fair value of the reporting unit exceeds its carrying amount, goodwill is considered not impaired. An impairment charge would be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. The Company determined that it has one reporting unit.

As of June 30, 2022, the Company experienced a triggering event due to a drop in its stock price and performed a quantitative analysis for potential impairment of its goodwill. Based on this analysis, the Company determined that its carrying value exceeded its fair value. As a result, the Company recorded a non-cash goodwill impairment charge of $631,064 at June 30, 2022. No income tax benefit related to this goodwill impairment charge was recorded at June 30, 2022.

Temporary Equity

Shares of preferred stock that are redeemable for cash or other assets are classified as temporary equity if they are redeemable, at the option of the holder, at a fixed or determinable price on a fixed or determinable date or upon the occurrence of an event that is not solely within the control of the Company. Redeemable equity instruments are initially carried at the fair value of the equity instrument at the issuance date, net of issuance costs, which is subsequently adjusted to redemption value (including the amount for dividends earned but not yet declared or paid) at each balance sheet date if the instrument is currently redeemable or if it is probable that the instrument will become redeemable.

Revenue Recognition

The following table sets forth the Company's revenue by source:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	**2022**	**2023**	**2022**
Equipment and systems sales	$ 899,748	$ 2,791,141	$ 5,296,574	$ 4,433,713
Engineering and other services	103,232	192,076	227,643	278,125
Shipping and handling	4,775	31,668	17,335	47,474
Miscellaneous	55,959	-	204,735	-
Total revenue	$ 1,063,714	$ 3,014,885	$ 5,746,287	$ 4,759,312

Miscellaneous revenue of $55,959 and $204,735 recognized during the three and six months ended June 30, 2023, respectively, represents non-refundable deposits, forfeited by former customers on previously cancelled contracts.

Revenue Recognition Accounting Policy Summary

The Company accounts for revenue in accordance with ASC 606. Under the revenue standard, a performance obligation is a promise in a contract with a customer to transfer a distinct good or service to the customer. Most of the Company's contracts contain multiple performance obligations that include engineering and technical services as well as the delivery of a diverse range of climate control system equipment and components, which can span multiple phases of a customer's project life cycle from facility design and construction to equipment delivery and system installation and start-up. The Company does not provide construction services or system installation services. Some of the Company's contracts with customers contain a single performance obligation, typically engineering only services contracts.

A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. When there are multiple performance obligations within a contract, the Company allocates the transaction price to each performance obligation based on the standalone selling price. When estimating the selling price, the Company uses various observable inputs. The best observable input is the Company's actual selling price for the same good or service, however, this input is generally not available for the Company's contracts containing multiple performance obligations. For engineering services, the Company estimates the standalone selling price by reference to certain physical characteristics of the project, such as facility size and mechanical systems involved, which are indicative of the scope and complexity of the mechanical engineering services to be provided. For equipment sales, the standalone selling price is determined by forecasting the expected costs of the equipment and components and then adding an appropriate margin, based on a range of acceptable margins established by management. Depending on the nature of the performance obligations, the Company may use a combination of different methods and observable inputs if certain performance obligations have highly variable or uncertain standalone selling prices. Once the selling prices are determined, the Company applies the relative values to the total contract consideration and estimates the amount of the transaction price to be recognized as each promise is fulfilled.

Generally, satisfaction occurs when control of the promised goods is transferred to the customer or as services are rendered or completed in exchange for consideration in an amount for which the Company expects to be entitled. The Company recognizes revenue for the sale of goods when control transfers to the customer, which primarily occurs at the time of shipment. The Company's historical rates of return are insignificant as a percentage of sales and, as a result, the Company does not record a reserve for returns at the time the Company recognizes revenue. The Company has elected to exclude from the measurement of the transaction price all taxes (e.g., sales, use, value added, and certain excise taxes) that are assessed by a governmental authority in connection with a specific revenue-producing transaction and collected by the Company from the customer. Accordingly, the Company recognizes revenue net of sales taxes. The revenue and cost for freight and shipping is recorded when control over the sale of goods passes to the Company's customers.

The Company also has performance obligations to perform certain engineering services that are satisfied over a period of time. Revenue is recognized from this type of performance obligation as services are rendered based on the percentage completion towards certain specified milestones.

The Company offers assurance-type warranties for its products and products manufactured by others to meet specifications defined by the contracts with customers and does not have any material separate performance obligations related to these warranties. The Company maintains a warranty reserve based on historical warranty costs.

Disaggregation of Revenue

In accordance with ASC 606-10-50-5 through 6, the Company considered the appropriate level of disaggregated revenue information that depicts how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Additionally, per the implementation guidance in ASC 606-10-55-90 through 91, the Company also considered (a) disclosures presented outside of the financial statements such as earnings releases and investor presentations, (b) information regularly reviewed by the Chief Operating Decision Maker for evaluating the financial performance of operating segments and (c) other information that is similar to the types of information identified in (a) and (b) and that is used by the Company or users of the Company's financial statements to evaluate financial performance or make resource allocation decisions. Finally, we considered the examples of categories found in the guidance that might be appropriate, including: (a) type of good or service (major product lines), (b) geographical region (country or region), (c) market or type of customer (government or non-government customers), (d) type of contract (fixed-price or time-and-materials), (e) contract duration (short- or long-term), (f) timing of transfer of goods or services (point-in-time or over time) and (g) sales channels (direct to customers or through intermediaries).

Based on the aforementioned guidance and considerations, the Company determined that disaggregation of revenue by sales, services, shipping and handling, and miscellaneous was required.

Other Judgments and Assumptions

The Company typically receives customer payments in advance of its performance of services or transfers of goods. Applying the practical expedient in ASC 606-10-32-18, which the Company has elected, the Company does not adjust the promised amount of consideration for the effects of a significant financing component since the Company expects, at contract inception, that the period between when the Company transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. Accordingly, the remaining performance obligations related to customer contracts does not consider the effects of the time value of money.

Applying the practical expedient in ASC 340-40-25-4, the Company recognizes the incremental costs of obtaining contracts as an expense when incurred since the amortization period of the assets that the Company otherwise would have recognized is one year or less. These costs include certain sales commissions and incentives, which are included in selling, general and administrative expenses, and are payable only when associated revenue has been collected and earned by the Company.

Contract Assets and Contract Liabilities

Contract assets reflect revenue recognized and performance obligations satisfied in advance of customer billing. Contract liabilities relate to payments received in advance of the satisfaction of performance under the contract. The Company receives payments from customers based on the terms established in its contracts.

Contract assets include unbilled amounts where revenue recognized exceeds the amount billed to the customer and the right of payment is conditional, subject to completing a milestone, such as a phase of a project. The Company typically does not have material amounts of contract assets since revenue is recognized as control of goods are transferred or as services are performed. As of June 30, 2023 and December 31, 2022, the Company had no contract assets.

Contract liabilities consist of advance payments in excess of revenue recognized. The Company's contract liabilities are recorded as a current liability in deferred revenue in the consolidated balance sheets since the Company generally expects to recognize revenue in less than one year. Non-refundable customer deposits are recognized as revenue when previously abandoned customer contracts have been forfeited. As of June 30, 2023, and December 31, 2022, deferred revenue, which was classified as a current liability, was $625,911 and $4,338,570, respectively.

For the three and six months ended June 30, 2023, the Company recognized revenue of $ 45,716 and $3,898,622, respectively, related to the deferred revenue at January 1, 2023 For the three and six months ended June 30, 2022, the Company recognized revenue of $1,030,830 and $2,193,204, respectively, related to the deferred revenue at January 1, 2022.

(in US Dollars except share numbers)

Remaining Performance Obligations

Remaining performance obligations, or backlog, represents the aggregate amount of the transaction price allocated to the remaining obligations that the Company has not performed under its customer contracts. The Company has elected not to use the optional exemption in ASC 606-10-50-14, which exempts an entity from such disclosures if a performance obligation is part of a contract with an original expected duration of one year or less. Accordingly, the information disclosed about remaining performance obligations includes all customer contracts, including those with an expected duration of one year or less.

Industry uncertainty, project financing concerns, and the licensing and qualification of our prospective customers, which are out of the Company’s control, make it difficult for the Company to predict when it will recognize revenue on its remaining performance obligations. There are risks that the Company may not realize the full contract value on customer projects in a timely manner or at all, and completion of a customer’s cultivation facility project is dependent upon the customer’s ability to secure funding and real estate, obtain a license and then build their cultivation facility so they can take possession of the equipment. Accordingly, the time it takes for customers to complete a project, which corresponds to when the Company is able to recognize revenue, is driven by numerous factors including: (i) the large number of first-time participants interested in the indoor cannabis cultivation business; (ii) the complexities and uncertainties involved in obtaining state and local licensure and permitting; (iii) local and state government delays in approving licenses and permits due to lack of staff or the large number of pending applications, especially in states where there is no cap on the number of cultivators; (iv) the customer’s need to obtain cultivation facility financing; (v) the time needed, and coordination required, for our customers to acquire real estate and properly design and build the facility (to the stage when climate control systems can be installed); (vi) the large price tag and technical complexities of the climate control and air sanitation system; (vii) the availability of power; and (viii) delays that are typical in completing any construction project. Further, based on the current economic climate, t and the Company’s recent cost cutting measures, there is no assurance that the Company will be able to fulfill its backlog, and the Company may experience contract cancellations, project scope reductions and project delays.

As of June 30, 2023, the Company’s remaining performance obligations, or backlog, was approximately $ 1,066,000. The decline in backlog was primarily the result of lower bookings. The Company has entered into fewer and smaller new contracts. There is significant uncertainty regarding the timing of the Company’s recognition of revenue on its remaining performance obligations, and there is no certainty that these will result in actual revenues. The backlog at June 30, 2023, includes booked sales orders of $250,000 from three customers that the Company does not expect to be realized until 2024, if at all. Our projected revenue amount contains a booked sales order of $279,000 (26% of the total backlog) from one customer that we believe is at risk of cancellation based on conversations with this customer. Given the current supply chain and bottleneck issues that are still being worked through by the Company’s supply chain partners, the Company believes that contract fulfillment could be delayed for these reasons.

The remaining performance obligations expected to be recognized through 2024 are as follows:

	2023	2024	Total
Remaining performance obligations related to engineering only paid contracts	$ -	$ -	$ -
Remaining performance obligations related to partial equipment paid contracts	816,000	250,000	1,066,000
Total remaining performance obligations	$ 816,000	$ 250,000	$ 1,066,000

Product Warranty

The Company warrants the products that it manufactures for a warranty period equal to the lesser of 12 months from start-up or 18 months from shipment. The Company’s warranty provides for the repair, rework, or replacement of products (at the Company’s option) that fail to perform within stated specification. The Company’s third-party suppliers also warrant their products under similar terms, which are passed through to the Company’s customers.

The Company assesses the historical warranty claims on its manufactured products and, since 2016, warranty claims have been approximately 1% of annual revenue generated on these products. Based on the Company’s warranty policy, an accrual is established at 1% of the trailing 18 months revenue. The Company continues to assess the need to record a warranty reserve at the time of sale based on historical claims and other factors. As of June 30, 2023, and December 31, 2022, the Company had an accrued warranty reserve amount of $193,498 and $180,457, respectively, which are included in accounts payable and accrued liabilities on the Company’s consolidated balance sheets.

Accounting for Share-Based Compensation

The Company recognizes the cost resulting from all share-based compensation arrangements, including stock options, restricted stock awards and restricted stock units that the Company grants under its equity incentive plan in its condensed consolidated financial statements based on their grant date fair value. The expense is recognized over the requisite service period or performance period of the award. Awards with a graded vesting period based on service are expensed on a straight-line basis for the entire award. Awards with performance-based vesting conditions, which require the achievement of a specific company financial performance goal at the end of the performance period and required service period, are recognized over the performance period. Each reporting period, the Company reassesses the probability of achieving the respective performance goal. If the goals are not expected to be met, no compensation cost is recognized and any previously recognized amount recorded is reversed. If the award contains market-based vesting conditions, the compensation cost is based on the grant date fair value and expected achievement of market condition and is not subsequently reversed if it is later determined that the condition is not likely to be met or is expected to be lower than initially expected.

The grant date fair value of stock options is based on the Black-Scholes Option Pricing Model (the “Black-Scholes Model”). The Black-Scholes Model requires judgmental assumptions including volatility and expected term, both based on historical experience. The risk-free interest rate is based on

(in US Dollars except share numbers)

U.S. Treasury interest rates whose term is consistent with the expected term of the option. The Company determines the assumptions used in the valuation of option awards as of the date of grant. Differences in the expected stock price volatility, expected term or risk-free interest rate may necessitate distinct valuation assumptions at those grant dates. As such, the Company may use different assumptions for options granted throughout the year. During the six months ended June 30, 2023, the valuation assumptions used to determine the fair value of each option award on the date of grant were: expected stock price volatility of 152.23%; expected term in years of 10 and risk-free interest rate of 3.48%.

The grant date fair value of restricted stock and restricted stock units is based on the closing price of the underlying stock on the date of the grant.

The Company has elected to reduce share-based compensation expense for forfeitures as the forfeitures occur since the Company does not have historical data or other factors to appropriately estimate the expected employee terminations and to evaluate whether particular groups of employees have significantly different forfeiture expectations.

The following is a summary of share-based compensation expenses included in the condensed consolidated statements of operations for the three and six months ended June 30, 2023 and June 30, 2022:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
Share-based compensation expense included in:				
Cost of revenue	$ -	$ 5,104	$ 4,898	$ 5,895
Advertising and marketing expenses	-	4,080	1,113	6,842
Product development costs	-	4,961	3,570	4,961
Selling, general and administrative expenses	15,166	81,482	152,679	170,446
Total share-based compensation expense included in consolidated statement of operations	$ 15,166	$ 95,627	$ 162,260	$ 188,144

Included in the expense for the three and six months ended June 30, 2022, is an accrual for $ 46,374 and $46,374, respectively, for the 2022 Annual Employee Incentive Compensation Plan. No accrual is being recorded in 2023.

Concentrations

Two customers accounted for 64%, and 10% of the Company's revenue for the three months ended June 30, 2023. Three customers accounted for 44%, 23% and 14% of the Company's revenue for the six months ended June 30, 2023. Two customers accounted for 53% and 12% of the Company's revenue for the three months ended June 30, 2022 and one customer accounted for 47% of the Company's revenue for the six months ended June 30, 2022.

Three customers accounted for 69%, 17%, and 12% of the Company's accounts receivable as of June 30, 2023. Two customers accounted for 57% and 43% of the Company's accounts receivable as of December 31, 2022.

Recently Issued Accounting Pronouncements

In March 2023, the FASB issued ASU 2023-01 to require entities to classify and account for leases with related parties on the basis of legally enforceable terms and conditions of the arrangement. The amendments are effective in periods beginning after December 15, 2023, including interim periods within those fiscal years. The Company does not expect this ASU to have a material impact on its consolidated results of operations, cash flows and financial position.

In December 2022, the FASB issued ASU No. 2022-06, which defers the sunset date of *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting* ("ASU 2020-04") from December 31, 2022 to December 31, 2024. ASU No. 2022-06 was effective upon issuance. Topic 848 provides temporary optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting, providing optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. The Company does not expect this ASU to have a material impact on its consolidated results of operations, cash flows and financial position.

In September 2022, the FASB issued Update 2022-04, "Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations". The update was issued in response to requests from financial statement users for increased transparency surrounding the use of supplier finance programs. The amendments in Update 2022-04 require that a buyer in a supplier finance program disclose sufficient information about the program to allow a user of financial statements to understand the program's nature, activity during the period, changes from period to period, and potential magnitude. The amendments in this update do not affect the recognition, measurement, or financial statement presentation of obligations covered by supplier finance programs. The amendments in this update are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years, except for the amendment on rollforward information, which is effective for fiscal years beginning after December 15, 2023. Early adoption is permitted. The Company does not expect this ASU to have a material impact on its consolidated results of operations, cash flows and financial position.

In October 2021, the FASB issued ASU 2021-08, " *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers"*, which requires companies to apply ASC 606, "Revenue from Contracts with Customers" to recognize and measure contract assets and contract liabilities from contracts with customers acquired in a business combination. This creates an exception to the general recognition and measurement principle in ASC 805, which uses fair value. The guidance is effective for fiscal years beginning after December 15, 2022 and interim periods within those fiscal years. Early adoption is permitted, and the guidance should be applied prospectively. The impact of the standard on Company's consolidated financial statements is dependent on the size and frequency of any future acquisitions the Company may complete.

(in US Dollars except share numbers)

In March 2020, the FAS issued ASU No. 2020-04 " *Reference Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting" ("ASU 2020-04").* ASU 2020-04 provides optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. The amendments are effective for the Company as of March 12, 2020 through December 31, 2022. The adoption of this guidance has not had a material impact on the Company's consolidated financial statements.

Other accounting standards that have been issued or proposed by FASB that do not require adoption until a future date are not expected to have a material impact on the financial statements upon adoption. The Company does not discuss recent pronouncements that are not anticipated to have an impact on or are unrelated to its financial condition, results of operations, cash flows or disclosures.

Note 2 – Leases

In February 2016 the FASB issued ASU 2016-02, *Leases (Topic 842)* ("ASC 842" or the "new lease standard"). The Company adopted ASC 842 as of January 1, 2019, using the effective date method.

The new standard provides a number of optional practical expedients in transition. The Company has elected to apply the "package of practical expedients" which allow the Company to not reassess: (i) whether existing or expired arrangements contain a lease, (ii) the lease classification of existing or expired leases, or (iii) whether previous initial direct costs would qualify for capitalization under the new lease standard. The Company has also elected to apply the short-term lease exemption for all leases with an original term of less than 12 months, for purposes of applying the recognition and measurements requirements in the new lease standard.

On July 28, 2021, the Company entered into an agreement to lease 11,491 square feet of office and manufacturing space (the "New Facility Lease"), in Louisville, CO. The New Facility Lease commenced on November 1, 2021 and continues through January 31, 2027 . From November 2021 through January 2022, the monthly rent was abated. Beginning February 2022, the monthly rent is $10,055 and will increase by 3% annually every November through the end of the New Facility Lease term. Pursuant to the New Facility Lease, the Company made a security deposit of $14,747. The Company has the option to renew the New Facility Lease for an additional five years. Additionally, the Company pays the actual amounts for property taxes, insurance, and common area maintenance. The New Facility Lease agreement contains customary events of default, representations, warranties, and covenants.

Upon commencement of the New Facility Lease, the Company recognized on the balance sheet an operating lease right-of-use asset and lease liability in the amount of $582,838. The lease liability was initially measured as the present value of the unpaid lease payments at commencement and the ROU asset was initially measured at cost, which comprises the initial amount of the lease liability adjusted for lease payments made at or before the lease commencement date, plus any initial direct costs incurred less any lease incentives received. The renewal option to extend the New Facility Lease is not included in the right-of-use asset or lease liability, as the option is not reasonably certain to be exercised. The Company regularly evaluates the renewal option and when it is reasonably certain of exercise, the Company will include the renewal period in its lease term.

The lease cost, cash flows and other information related to the New Facility Lease were as follows:

	As of June 30, 2023
Operating lease right-of-use asset	$ 409,981
Operating lease liability, current	$ 122,272
Operating lease liability, long-term	$ 319,247
Remaining lease term	3.6 years
Discount rate	3.63%

	For the Six Months Ended June 30, 2023
Operating cash outflow from operating lease	$ 62,138

Future annual minimum lease payments on the New Facility Lease as of June 30, 2023 are as follows:

As of June 30, 2023

Years ended December 31,	
2023 (excluding the six months ended June 30, 2023)	$ 62,759
2024	128,643
2025	132,503
2026	136,473
Thereafter	11,654
Total minimum lease payments	472,032
Less imputed interest	(30,513)
Present value of minimum lease payments	$ 441,519

Note 3 – Inventory

Inventory consisted of the following:

	June 30,	**December 31,**

		2023		2022
Finished goods	$	398,455	$	270,555
Work in progress		-		155
Raw materials		130,180		148,608
Allowance for excess & obsolete inventory		(131,480)		(70,907)
Inventory, net	$	397,155	$	348,411

Overhead expenses of $15,055 and $12,770 were included in the inventory balance as of June 30, 2023, and December 31, 2022, respectively.

Advance payments on inventory purchases are recorded in prepaid expenses until title for such inventory passes to the Company. Prepaid expenses included approximately $10,000 and $1,176,000 in advance payments for inventory for the periods ended June 30, 2023, and December 31, 2022, respectively.

Note 4 – Property and Equipment

Property and equipment consisted of the following:

		June 30, 2023		December 31, 2022
Furniture and equipment	$	275,994	$	278,389
Vehicles		15,000		15,000
		290,994		293,389
Accumulated depreciation		(237,769)		(224,876)
Property and equipment, net	$	53,225	$	68,513

Depreciation expense was $14,988 for the six months ended June 30, 2023. For the six months ended June 30, 2023, $ 1,749 was allocated to cost of sales, $437 was allocated to inventory with the remainder recorded as selling, general, and administrative expense.

Note 5 – Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following:

		June 30, 2023		December 31, 2022
Accounts payable	$	280,763	$	311,162
Sales commissions payable		2,061		25,951
Accrued payroll liabilities		231,182		465,094
Product warranty accrual		193,498		180,457
Other accrued expenses		91,120		224,594
Total	$	798,624	$	1,207,258

Note 6 – Commitments and Contingencies

Litigation

From time to time, in the normal course of its operations, the Company is subject to litigation matters and claims. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict, and the Company's view of these matters may change in the future as the litigation and events related thereto unfold. The Company expenses legal fees as incurred. The Company records a liability for contingent losses when it is both probable that a liability has been incurred and the amount of the loss is known. An unfavorable outcome to any legal matter, if material, could have an adverse effect on the Company's operations or its financial position, liquidity or results of operations.

Leases

The Company has a lease agreement for its manufacturing and office space. Refer to *Note 2 Leases* above.

Other Commitments

In the ordinary course of business, the Company enters into commitments to purchase inventory and may also provide indemnifications of varying scope and terms to customers, vendors, lessors, business partners, and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company's breach of such agreements, services to be provided by the Company, or from intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers and employees that will require the Company to, among other things, indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers, or employees. The Company maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its directors and certain of its officers and employees, and former officers, directors, and employees of acquired companies, in certain circumstances.

Note 7 – Stockholders' Equity

As of June 30, 2023, the Company had 200,000,000 shares of common stock and 25,000,000 shares of preferred stock authorized at a $0.00001 par value.

As of June 30, 2023, 8,076,372 shares of common stock were issued and outstanding and no shares of preferred stock were issued and outstanding.

Directors Remuneration

On January 3, 2022, the Company issued 3,125 non-qualified stock options under the 2021 Equity Incentive Plan to each of two existing directors. The options had an exercise price of $4.80, vested immediately and had a term ending at the earlier of five years after the date on which the optionee's continuous service ends, or the tenth anniversary on which the option was granted.

On January 17, 2022, the Company issued an RSU grant of 3,367 shares of common stock under the 2021 Equity Incentive Plan to each of two new directors, 1,684 shares of common stock vested immediately on grant date and the remaining 1,683 shares of common stock vested on January 17, 2023. 1,684 shares of common stock were issued on January 17, 2022 to each of the two new directors in settlement of the RSUs that vested immediately and a further 1,683 shares of common stock were issued to each of the two new directors on January 17, 2023 in settlement of the remainder.

On January 3, 2023, the Company issued an RSU grant of 29,758 shares of common stock under the 2021 Equity Incentive Plan to each of its four independent directors. The RSUs were granted as an equity retention award pursuant to the Company's compensation plan for independent directors effective January 17, 2022 and vested immediately on the grant date. A total of 119,032 shares of the Company's common stock were issued in settlement of the RSUs.

Revised Compensation Plan

On January 17, 2022, the Board of Directors revised the previously adopted compensation plan. This plan superseded the plan adopted on August 20, 2021. The Plan was effective retroactively for the then current independent directors and for independent directors elected or appointed after the Effective Date.

The plan is divided into two phases: from the Effective Date of the Plan until February 9, 2022, the day prior to the listing of the Company securities on Nasdaq. ("Pre-uplist") and from February 10, 2022, the uplist date forward ("Post-uplist").

Pre-uplist phase: The Company paid its independent directors an annual cash fee of $ 15,000, payable quarterly in advance on the first business day of each quarter, as consideration for their participation in: (i) any regular or special meetings of the Board or any committee thereof attended in person, (ii) any telephonic meeting of the Board or any committee thereof in which the director is a member, (iii) any non-meeting consultations with the Company's management, and (iv) any other services provided by them in their capacities as directors (other than services as the Chairman of the Board, the Chairman of the Company's Audit Committee, and the Committee Chairman).

At the time of initial election or appointment, each independent director received an equity retention award in the form of restricted stock units ("RSUs"). The aggregate value of the RSUs at the time of grant was to be $25,000, with the number of shares underlying the RSUs to be determined based on the closing price of the Company's common stock on the date immediately prior to the date of grant. Vesting of the RSUs was as follows: (i) 50% at the time of grant, and (ii) 50% on the first anniversary of the grant date.

In addition, on the first business day of January each year, each independent director will also receive an equity retention award in the form of RSUs. The aggregate value of the RSUs at the time of grant will be $25,000, with the number of shares underlying the RSUs to be determined based on the closing price of the Company's common stock on the date immediately prior to the date of grant. These RSUs will be fully vested at date of grant.

The Company pays the Audit Committee Chairman an additional annual fee of $ 10,000, payable quarterly in advance, for services as the Audit Committee Chairman.

The Company pays the Chairmen of any other committees of the Board an additional annual fee of $ 5,000, payable quarterly in advance, for services as a Committee Chairman.

There is no additional compensation paid to members of any committee of the Board. Interested (i.e. Executive directors) serving on the Board do not receive compensation for their Board service.

Post-uplist phase: The Company will pay its independent directors an annual cash fee of $ 25,000, payable quarterly in advance on the first business day of each quarter. All other terms remain the same.

Each director is responsible for the payment of any and all income taxes arising with respect to the issuance of common stock and the vesting and settlement of RSUs.

The Company reimburses independent directors for out-of-pocket expenses incurred in attending Board and committee meetings and undertaking certain matters on the Company's behalf.

All independent directors, Messrs. Shipley, Etten, Reisner, and Mariathasan are subject to the Plan.

Each independent director is responsible for the payment of any and all income taxes arising with respect to the issuance of any equity awarded under the plan, including the exercise of any non-qualified stock options.

Employee directors do not receive separate fees for their services as directors.

Reverse Stock Split

On January 17, 2022, the Company's Board of Directors approved a reverse stock split at a ratio of one-for-one hundred and fifty. The reverse stock split was implemented effective January 27, 2022. The par value for the Common Stock was not affected.

An additional 6,798 shares of common stock were issued to round up partial shares following the reverse split.

As a result of this reverse stock split, the number of the Company's shares of common stock issued and outstanding at December 31, 2021 was reduced from 240,125,224 to 1,600,835. All Common Stock, warrants, options and per share amounts set forth herein are presented to give retroactive effect to the Reverse Split for all periods presented.

Change in Authorized Share Capital

In connection with the aforementioned reverse stock split, the Company's Board of Directors approved the reduction of the authorized capital of the Company to 200,000,000 shares of common stock and 25,000,000 shares of preferred stock.

Equity Raise

On February 10, 2022, the Company signed a firm commitment underwriting agreement for the public offering of shares of common stock and warrants, which closed on February 15, 2022. The Company received net proceeds of approximately $22 million for the sale of 5,811,138 shares of common stock and 6,572,808 warrants, each warrant to purchase one share of common stock for five years, exercisable immediately, at an exercise price of $5.00. The Company also issued to the representative of the underwriters 290,557 warrants, each warrant to purchase one share of common stock at an exercise price of $5.1625, during the period commencing August 9, 2022, and expiring on February 10, 2027.

Warrant Exercise

On June 21, 2022, the Company issued 169,530 shares of its common stock in connection with the cashless exercise of 170,382 prefunded conversion warrants.

Note 8 – Equity Incentive Plans

2017 Equity Incentive Plan

Under the Company's 2017 Equity Incentive Plan, as may be modified and amended by the Company from time to time (the "2017 Equity Plan"), the Board of Directors (the "Board") (or the compensation committee of the Board, if one is established) may award stock options, stock appreciation rights ("SARs"), restricted stock awards ("RSAs"), restricted stock unit awards ("RSUs"), shares granted as a bonus or in lieu of another award, and other stock-based performance awards. The 2017 Equity Plan allocates 333,333 shares of the Company's common stock ("Plan Shares") for issuance of equity awards under the 2017 Equity Plan. If any shares subject to an award are forfeited, expire, or otherwise terminate without issuance of such shares, the shares will, to the extent of such forfeiture, expiration, or termination, again be available for awards under the 2017 Equity Plan.

During the six months ended June 30, 2023, no shares or options were issued, or cancelled under the 2017 Plan.

As of June 30, 2023, of the 333,333 shares authorized under the 2017 Plan for equity awards, 163,692 shares have been issued, awards relating to 147,132 options remain outstanding, and 22,509 shares remain available for future equity awards.

2021 Equity Incentive Plan

On March 22, 2021, the Board approved the 2021 Equity Incentive Plan (the "2021 Equity Plan"), which was approved by the stockholders on July 22, 2021. The 2021 Equity Plan permits the Board to grant awards of up to 666,667 shares of common stock. The 2021 Equity Plan provides for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), non-qualified stock options, stock appreciation rights ("SARs"), restricted stock awards and restricted stock unit awards and other equity linked awards to our employees, consultants, and directors. If an equity award (i) expires or otherwise terminates without having been exercised in full or (ii) is settled in cash (*i.e.*, the holder of the award receives cash rather than stock), such expiration, termination or settlement will not reduce (or otherwise offset) the number of shares of common stock that may be issued pursuant to this Plan.

During the six months ended June 30, 2023, the Company issued 122,398 shares of its common stock in settlement of restricted stock units issued to its independent directors under the 2021 Equity Incentive Plan, pursuant to the Director Compensation plan adopted on January 17, 2022.

During the six months ended June 30, 2023, 138,489 non-qualified stock options were issued to five employees and three former employees in respect of the Company's 2021 Equity Incentive Plan. The options vested immediately, have a term of 10 years and an exercise price of $0.8955. An expense of $89,970 in respect of this issuance had been accrued in 2022. An additional expense of $ 32,376 was recognized in 2023 upon management and board finalization and approval of the awards.

As of June 30, 2023, of the 666,667 shares authorized under the 2021 Equity Plan, 132,568 shares have been issued in settlement of restricted stock units, awards relating to 198,170 non-qualified stock options, and 40,816 incentive stock options remain outstanding, and 295,113 shares remain available for future equity awards.

There was $30,753 in unrecognized compensation expense for unvested non-qualified stock options, and incentive stock options at June 30, 2023 which will be recognized over approximately 2 years.

Non-Qualified and Incentive Stock Options

A summary of the non-qualified stock options and incentive stock options granted to employees and consultants under the 2017 and 2021 Equity Plans during the six months ended June 30, 2023, are presented in the table below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, December 31, 2022	192,073	$ 8.94	7.6	$ -
Granted	138,489	$ 0.90	6.6	$ -
Exercised	-	$ -	-	$ -
Forfeited	(1,567)	$ 4.15	8.9	$ -
Expired	-	$ -	-	$ -
Outstanding, June 30, 2023	328,995	$ 5.58	6.5	$ -
Exercisable, June 30, 2023	303,905	$ 5.61	6.4	$ -

A summary of non-vested non-qualified stock options activity for employees and consultants under the 2017 and 2021 Equity Plans for the six months ended June 30, 2023, are presented in the table below:

	Number of Options	Weighted Average Grant-Date Fair Value	Aggregate Intrinsic Value	Grant-Date Fair Value
Nonvested, December 31, 2022	28,756	$ 4.73	$ -	$ 135,932
Granted	138,489	$ 0.88	$ -	$ 121,870
Vested	(141,822)	$ 0.92	$ -	$ (131,094)
Forfeited	(333)	$ 6.67	$ -	$ (2,222)
Expired	-	$ -	$ -	$ -
Nonvested, June 30, 2023	25,090	$ 4.98	$ -	$ 124,486

For the six months ended June 30, 2023 and June 30, 2022, the Company recorded $ 60,944 and $75,947 as compensation expense related to vested options issued to employees and consultants, net of forfeitures, respectively.

A summary of the non-qualified stock options granted to directors under the 2017 Equity Plan and the 2021 Equity Plan, during the six months ended June 30, 2023, are presented in the table below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding, December 31, 2022	57,122	$ 9.44	6.0	$ -
Granted	-	-	-	$ -
Exercised	-	-	-	$ -
Forfeited/Cancelled	-	-	-	$ -
Expired	-	-	-	$ -
Outstanding, June 30, 2023	57,122	$ 9.44	5.5	$ -
Exercisable, June 30, 2023	57,122	$ 9.44	5.5	$ -

There were no non-vested, non-qualified stock options issued to directors under the 2017 Equity Plan and the 2021 Equity Plan, for the six months ended June 30, 2023.

During the six months ended June 30, 2023 and June 30, 2022, the Company incurred $ 0 and $29,656 respectively, as compensation expense related to 0 and 6,250 fully vested options issued to directors, respectively.

Restricted Stock Units

(in US Dollars except share numbers)

Effective January 3, 2023, the Company issued a total of 119,032 restricted stock units (RSUs) under the 2021 Equity Plan to its four independent directors. These RSUs vested upon grant.

Effective January 17, 2023, the Company settled 3,366 RSUs that had been issued on January 17, 2022 to two new directors and that vested after 12 months by the issuance of shares of common stock

During the six months ended June 30, 2023 and June 30, 2022, the Company recorded $ 101,316 and $36,168, respectively, as compensation expense related to vested RSUs issued to directors.

	Number of Units	Weighted Average Grant-Date Fair Value	Aggregate Intrinsic Value
Outstanding, December 31, 2022	3,366	$ 7.42	$ -
Granted	119,032	$ 0.84	$ -
Vested and settled with share issuance	(122,398)	$ 1.02	$ -
Forfeited/canceled	-	$ -	$ -
Outstanding, June 30, 2023	-	$ -	$ -

Note 9 - Warrants

The following table summarizes information with respect to outstanding warrants to purchase common stock during the six months ended June 30, 2023:

	Warrants		Weighted Average Exercise	Weighted Average Remaining Life	Aggregate Intrinsic
	Outstanding	Exercisable	Price	In Months	Value
Outstanding at December 31, 2022	7,623,772	7,623,772	$ 5.14	49	-
Granted	-	-	-	-	-
Exercised	-	-	-	-	-
Expired	-	-	-	-	-
Outstanding at June 30, 2023	7,623,772	7,623,772	$ 5.14	43	-

The following table summarizes information about warrants outstanding at June 30, 2023:

	Warrants		Weighted Average
Exercise price	Outstanding	Exercisable	Months Outstanding
$ 9.45	192,982	192,982	15
$ 10.40	34,737	34,737	16
$ 5.00	7,105,496	7,105,496	44
$ 5.16	290,557	290,557	44
	7,623,772	7,623,772	43

Note 10 – Income Taxes

As of June 30, 2023, the Company has U.S. federal and state net operating losses ("NOLs") of approximately $ 27,074,000, of which $11,196,000 will expire, if not utilized, in the years 2034 through 2037, however, NOLs generated subsequent to December 31, 2017 do not expire but may only be used against taxable income to 80%.

In addition, pursuant to Section 382 of the Internal Revenue Code of 1986, as amended, use of the Company's NOLs carryforwards may be limited in the event of cumulative changes in ownership of more than 50% within a three-year period. In addition, under Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"), and corresponding provisions of state law, if a corporation undergoes an "ownership change," which is generally defined as a greater than 50% change, by value, in its equity ownership over a three-year period, the corporation's ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes to offset its post-change income or taxes may be limited. Our sale of securities, both in September 2021 and February 2022, will need to be considered for determination of any "ownership change" that we have undergone during a determination period. If an ownership change occurs and our ability to use our net operating loss carryforwards is materially limited, it would harm our future bottom-line operating results by effectively increasing our future tax obligations.

The Company must assess the likelihood that its net deferred tax assets will be recovered from future taxable income, and to the extent the Company believes that recovery is not likely, the Company establishes a valuation allowance. Management's judgment is required in determining the Company's provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recorded against the net deferred tax assets. The Company recorded a full valuation allowance as of June 30, 2023 and December 31, 2022. Based on the available evidence, the Company believes it is more likely than not that it will not be able to utilize its net deferred tax assets in the foreseeable future. The Company intends to maintain valuation allowances until sufficient evidence exists to support the reversal of such valuation allowances. The Company makes estimates and judgments about its future taxable income that are based on assumptions that are consistent with the Company's plans. Should the actual amounts differ from the Company's estimates, the carrying value of the Company's deferred tax assets could be materially impacted.

Note 11 – Related Party Transactions

The Company entered into a manufacturer representative agreement with RSX Enterprises ("RSX") in March 2021 to become a non-exclusive representative for the Company to assist in marketing and soliciting orders. James R. Shipley, a current director of the Company, has a significant ownership interest in RSX.

Under the manufacturer representative agreement, RSX will act as a non-exclusive representative for the Company within the United States, Canada and Mexico and may receive a commission for qualified customer leads. The agreement had an initial term through December 31, 2021 with automatic one-year renewal terms unless notice is given 90 days prior to each annual expiration. During the six months ended June 30, 2023 and June 30, 2022, the Company paid $18,273 and $9,884, respectively, in commissions under this agreement.

On October 13, 2022, the Company entered into an agreement with Lone Star Bioscience, Inc. (Lone Star) to provide engineering design services. Nicholas Etten, one of our independent directors, is the Chief Executive Officer of Lone Star. The agreement totaled $2,500 with $1,250 received as a deposit in 2022. Another agreement for engineering services was signed on December 20, 2022, in the amount of $10,900. We entered into positive change orders in March 2023 of $3,577 increasing the total of the second sales order to $ 14,477. During the six months ended June 30, 2023, the Company received $14,035 in cash payments for these contracts. Revenue of $ 16,977 was recorded in the six months ended June 30, 2023 in respect of these agreements.

Note 12 – Subsequent Events

In accordance with ASC 855, *Subsequent Events*, the Company has evaluated all subsequent events through the date of issuance of these financial statements issued and determined no material subsequent events occurred after June 30, 2023 for which disclosure was required.

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

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report, which include additional information about our accounting policies, practices, and the transactions underlying our financial results, as well as with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2022, as filed with the SEC. In addition to historical information, the following discussion and other parts of this Quarterly Report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to the factors discussed under "Cautionary Statements" appearing elsewhere herein and the risks and uncertainties described or identified in "Item 1A – Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2022, as updated from time to time in the Company's filings with the SEC, and Part II, Item 1A of this Quarterly Report entitled "Risk Factors."

Non-GAAP Financial Measures

To supplement our financial results on U.S. generally accepted accounting principles ("GAAP") basis, we use non-GAAP measures including net bookings, backlog, as well as adjusted net income (loss) which reflects adjustments for certain non-cash expenses such as stock-based compensation, certain debt-related items and depreciation expense. We believe these non-GAAP measures are helpful in understanding our past performance and are intended to aid in evaluating our potential future results. The presentation of these non-GAAP measures should be considered in addition to our GAAP results and are not intended to be considered in isolation or as a substitute for financial information prepared or presented in accordance with GAAP. We believe these non-GAAP financial measures reflect an additional way to view aspects of our operations that, when viewed with our GAAP results, provide a more complete understanding of factors and trends affecting our business. For purposes of this Quarterly Report, (i) "adjusted net income (loss)" and "adjusted operating income (loss)" mean GAAP net income (loss) and operating income (loss), respectively, after adjustment for non-cash equity compensation expense, debt-related items and depreciation expense, and (ii) "net bookings" means new sales contracts executed during the quarter for which we received an initial deposit, net of any adjustments including cancellations and change orders during the quarter.

Our backlog, remaining performance obligations and net bookings may not be indicative of future operating results, and our customers may attempt to renegotiate or terminate their contracts for a number of reasons, including delays in or inability to obtain project financing or licensing or abandonment of the project entirely. Accordingly, there can be no assurance that contracts included in the backlog or remaining performance obligations will actually generate revenues or when the actual revenues will be generated.

Overview

CEA Industries, through our subsidiary, Surna Cultivation Technologies LLC, is a company focused on selling environmental control and other technologies and services to the Controlled Environment Agriculture ("CEA") industry. The CEA industry aims to optimize the use of horticultural resources such as water, energy, space, capital, and labor, to create an agriculture business that is more efficient and more productive than those that use traditional farming methods. Typically, the CEA industry is focused on indoor agriculture and vertical farming.

Headquartered in Colorado, we leverage our experience in the CEA industry to bring our customers a variety of value-added technology solutions that help improve their overall crop quality and yield, optimize energy and water efficiency, and satisfy the evolving state and local codes, permitting and regulatory requirements. We do this by offering our customers a variety of principal service and product offerings that include: (i) architectural design and licensed engineering of commercial scale thermodynamic systems specific to cultivation facilities, (ii) liquid-based process cooling systems and other climate control systems, (iii) air handling equipment and systems, (iv) air sanitation products, (v) LED lighting, (vi) benching and racking solutions for indoor cultivation, (vii) proprietary and third party controls systems and technologies used for environmental, lighting and climate control, and (viii) preventative maintenance services, through our partnership with a certified service contractor network, for CEA facilities.

Our revenue stream is currently derived primarily from supplying our products, services and technologies to licensed commercial indoor facilities operating in the cannabis industry. Our customers include state and provincial-regulated CEA growers located primarily in the U.S., Canada. We recently have developed customers in the non-cannabis CEA market to expand our market reach. Customers use our services for building new CEA facilities and expanding or retrofitting existing CEA facilities.

CEA growers currently face a challenging business environment that includes high energy costs, water usage and conservation issues, continuously evolving waste removal regulations, inflationary pressures, and labor shortages. In addition to these issues, our cannabis growing customers face increasingly rigorous quality standards and declining cannabis prices in a growing industry whose standards are constantly evolving. The part of the CEA industry focused on food related crops is also facing disruption from evolving market demand, competition, and reorganization, including the lack of growth capital and several noteworthy bankruptcies.

We support our clients by providing integrated mechanical, electrical, and plumbing ("MEP") engineering design, proprietary and curated environmental control equipment, and automation offerings that serve the CEA industry. Over our 16 years in business, we have served hundreds of commercial indoor CEA facilities.

We believe our customers partner with us because we have the reputation and experience to help them make cost-conscious and effective decisions on the design and engineering of their indoor cultivation facilities. CEA facilities are resource intensive, and a growing list of states have implemented building code changes that limit energy consumption in cultivation facilities. Energy and resource efficiency is a high priority to us as engineers, and the senior engineers on our team hold the Leadership in Energy and Environmental Design ("LEED") credential. We believe this sustainability-focused technical experience is crucial in the value we provide to our customers.

We have three core assets that we believe will support us as we pursue our business strategy. First, we enjoy strong relationships with relevant stakeholders in the CEA industry. Largely focused in the cannabis segment, our partnerships include relationships with new and existing growers, capital providers, consultants, independent contractors, and numerous other providers in the segment. These partnerships include agreements reached in 2022 with Merida Capital and Hydrobuilder Holdings LLC. In June we announced a marketing arrangement with Merida Capital, a cannabis-focused private equity firm, whereby Merida will use CEA Industries Inc. as its sole provider of certain products and services for its indoor cultivation facilities. This relationship resulted in a new contract in October 2022 with one of Merida's Connecticut based clients. In November of 2022 we announced a strategic alliance with Hydrobuilder Holdings that we believe will result in more project opportunities.

Second, our experience in this industry over time has built up specialized engineering know-how and experience. We have been serving indoor cultivators since 2006 and designing CEA cultivation facilities since 2016. Since then, we have tested and solidified best practices from designing environmental control systems for CEA cultivation facilities.

Third, we have a line of proprietary environmental control products that support the specific growing environments that our customers want. We believe these products offer significant benefits to our customers.

Shares of our common stock and warrants currently are traded on the Nasdaq Capital Markets under the ticker symbols "CEAD" and "CEADW", respectively.

Impact of the COVID-19 Pandemic on Our Business

The impact of the government and the business economic response to the COVID-19 pandemic affected demand across the majority of our markets and disrupted workflow and completion schedules on projects. We believe we continue to have adverse effects on our sales, project implementation, supply chain infrastructure, operating margins, costs, and working capital. Due to this uncertainty, we continue to monitor costs and continue to take actions to reduce costs in order to mitigate the long-term impact of the COVID-19 pandemic to the best of our ability. However, these actions may not be sufficient in the long run to avoid reduced sales, increased losses, and reduced operating cash flows in our business. During the year ended December 31, 2022, and continuing into the current fiscal quarter, the Company experienced delays in the receipt of equipment it had ordered to meet its customer orders due to disruption and delays in its supply chain. Consequently, our revenue recognition of some customer sales has been delayed until future periods when the shipment of orders can be completed.

Impact of Ukrainian Conflict

We believe that the conflict between Ukraine and Russia does not have any direct impact on our operations, financial condition, or financial reporting. We believe the conflict will have only a general impact on our operations in the same manner as it is having a general impact on all businesses that have their operations limited to North America resulting from international sanction and embargo regulations, possible shortages of goods and goods incorporating parts that may be supplied from the Ukraine or Russia, supply chain challenges, and the international and US domestic inflation resulting from the conflict and government spending for the Ukraine and funding of our country's response. As our operations are related only to the North American controlled agricultural industry, largely within the cannabis space, we do not believe we will be targeted for cyber-attacks related to this conflict. We have no operations in the countries directly involved in the conflict or are specifically impacted by any of the sanctions and embargoes, as we principally operate in the United States and Canada. We do not believe that the conflict will have any impact on our internal control over financial reporting. Other than general securities market trends, we do not have reason to believe that investors will evaluate the company as having special risks or exposures related to the Ukrainian conflict.

Our Bookings, Backlog and Revenue

During the three months ended June 30, 2023, we executed new sales contracts with a total contract value of $234,000. During this same period, we had cancellations of $29,000. After adjustments for these cancellations, our net bookings in the three months ended June 30, 2023 were $205,000, representing a decrease of $621,000 (or 75%) from net bookings of $826,000 in the first quarter of 2023.

Our backlog at June 30, 2023 was $1,066,000, a decrease of $803,000, or 43%, from March 31, 2023. The decrease in backlog is the result of lower bookings in the fourth quarter of 2022 and the first six months of 2023. Our backlog at June 30, 2023 includes booked sales orders of $250,000 (23% of the total backlog) from three customers that we do not expect to be realized until 2024, if at all. Included in the projected revenue is one booked sales order of $279,000 (26% of the total backlog) from one customer that we believe is at risk of cancellation based on conversations with this customer. We believe the sales orders in these portions of our backlog have an elevated level of risk and may, ultimately, be delayed or cancelled by our customers. Therefore, investors should not view backlog as earned revenue.

Our backlog has declined for several quarters. The primary reason for the decline has been fewer new order bookings. Other reasons include our ability to complete portions of contracts due to improvements in our supply chain and our ability to deliver products with fewer delays. The final reason is contract cancellations.

The following table sets forth: (i) our beginning backlog (the remaining contract value of outstanding sales contracts for which we have received an initial deposit as of the previous period), (ii) our net bookings for the period (new sales contracts executed during the period for which we received an initial deposit, net of any adjustments including cancellations and change orders during the period), (iii) our recognized revenue for the period, and (iv) our ending backlog for the period (the sum of the beginning backlog and net bookings, less recognized revenue). Based on the current economic climate and our cost cutting measures, there is no assurance that we will be able to continue to obtain the level of bookings that we have had in the past and or fulfill our current backlog, and we may experience contract cancellations, project scope reductions and project delays.

Our recognized revenue for the quarter ended March 31, 2023, in the table below, excludes $148,776 in revenue arising from the forfeiture of non-refundable deposits from former customers on previously cancelled contracts. Our recognized revenue for the quarter ended June 30, 2023, in the table below, excludes $55,959 in revenue arising from the forfeiture of non-refundable deposits from former customers on previously cancelled contracts. The contracts were removed from the backlog at the time of cancellation.

	For the quarter ended				
	June 30, 2022	September 30, 2022	December 31, 2022	March 31, 2023	June 30, 2023
Backlog, beginning balance	$ 11,179,000	$ 9,698,000	$ 6,832,000	$ 5,577,000	$ 1,869,000
Net bookings, current period	$ 1,534,000	$ 2,197,000	$ 206,000	$ 826,000	$ 205,000
Recognized revenue, current period	$ 3,015,000	$ 5,063,000	$ 1,461,000	$ 4,534,000	$ 1,008,000
Backlog, ending balance	$ 9,698,000	$ 6,832,000	$ 5,577,000	$ 1,869,000	$ 1,066,000

The completion of a customer's new build facility project is dependent upon the customer's ability to secure funding and real estate, obtain a license and then build their cultivation facility so they can take possession of the equipment. Accordingly, the time it takes for these customers to complete a new build project, which corresponds to when we are able to recognize revenue, is driven by numerous factors including: (i) the large number of first-time participants interested in the indoor cannabis cultivation business; (ii) the complexities and uncertainties involved in obtaining state and local licensure and permitting; (iii) local and state government delays in approving licenses and permits due to lack of staff or the large number of pending applications, especially in states where there is no cap on the number of cultivators; (iv) the customer's need to obtain cultivation facility financing; (v) the time needed, and coordination required, for our customers to acquire real estate and properly design and build the facility (to the stage when climate control systems can be installed); (vi) the large price tag and technical complexities of the climate control and air sanitation systems; (vii) the availability of power; and (viii) delays that are typical in completing any construction project.

As has historically been the case for the Company at each quarter-end, there remains significant uncertainty regarding the timing of revenue recognition of our backlog as of June 30, 2023.

We have provided an estimate in our condensed consolidated financial statements for when we expect to recognize revenue on our remaining performance obligations (i.e., our Q2 2023 backlog), using separate time bands, with respect to engineering only paid contracts and partial equipment paid contracts. There continues to be significant uncertainty regarding the timing of our recognition of revenue on our Q2 2023 backlog. Refer to the *Revenue Recognition* section of *Note 1* in our condensed consolidated financial statements, included as part of this Quarterly Report for additional information on our estimate of future revenue recognition on our remaining performance obligations.

Our backlog, remaining performance obligations, and net bookings may not be indicative of future operating results, and our customers may attempt to renegotiate or terminate their contracts for a number of reasons, including delays in or inability to obtain project financing or licensing or abandonment of the project entirely. Accordingly, there can be no assurance that contracts included in backlog or remaining performance obligations will generate revenues or when the revenues will be generated. Net bookings and backlog are considered non-GAAP financial measures, and therefore, they should be considered in addition to, rather than as a substitute for, our GAAP measures for recognized revenue, deferred revenue, and remaining performance obligations. Further, we can provide no assurance as to the profitability of our contracts reflected in remaining performance obligations, backlog and net bookings.

Results of Operations

Comparison of Three Months Ended June 30, 2023 and June 30, 2022

Revenues and Cost of Goods Sold

Revenue for the three months ended June 30, 2023 was $1,064,000, compared to $3,015,000 for the three months ended June 30 2022, representing a decrease of $1,951,000, or 65%. The decrease was primarily due to a decrease in bookings in the last nine months. We believe the lower bookings are due to the suppression of capital expenditures in the cannabis market environment as a result of the prolonged effects of pricing and inflationary pressure.

Cost of revenue decreased by $1,724,000, or 64%, from $2,709,000 for the three months ended June 30, 2022 to $985,000 for the three months ended June 30, 2023. The decrease was primarily due to a decrease in revenue and a decrease in variable costs, offset by higher fixed costs as a percentage of revenue, as discussed below.

Our gross profit for the three months ended June 30, 2023 was $79,000 compared to $306,000 for the three months ended June 30, 2022, a decrease of 74%. Gross profit margin decreased by 2.8 percentage points from 10.2% for the three months ended June 30, 2022 to 7.4% for the three months ended June 30, 2023 primarily due to lower revenue and an increase in fixed costs as a percentage of revenue, partially offset by a decrease in variable costs as a percentage of revenue, as described below. Additionally, total revenue in the three months ended June 30, 2023 includes $60,000 from forfeited, non-refundable deposits from former customers on previously cancelled contracts.

Our fixed costs (which include engineering, service, manufacturing and project management salaries and benefits and manufacturing overhead) totaled $320,000, or 30% of total revenue, for the three months ended June 30, 2023 as compared to $450,000, or 15% of total revenue, for the three months ended June 30, 2022. The decrease of $130,000 was primarily due to a decrease in salaries and benefits (including stock-based compensation) of $92,000 and a decrease in fixed overhead of $33,000.

Our variable costs (which include the cost of equipment, outside engineering costs, shipping and handling, travel and warranty costs) totaled $665,000, or 63% of total revenue, during the three months ended June 30, 2023, as compared to $2,259,000, or 75% of total revenue, in the three months ended June 30, 2022. The decrease in variable costs was primarily due to: (i) a decrease in equipment costs of $1,493,000 driven by higher revenue and higher equipment margins, (ii) a decrease in outside engineering costs of $71,000, and (iii) a decrease in travel of $39,000, offset by slightly higher warranty expense.

We continue to focus on gross margin improvement through a combination of efforts, including more disciplined pricing, better absorption of our fixed costs as we convert our bookings into revenue, and the implementation over time of lower-cost supplier alternatives.

Operating Expenses

Operating expenses decreased to $783,000 for the three months ended June 30, 2023, from $2,077,000 for the three months ended June 30, 2022, a decrease of $1,294,000, or 62%. The operating expense decrease consisted of: (i) a decrease of $631,000 for goodwill impairment charges, (ii) a decrease in selling, general and administrative expenses ("SG&A expenses") of $330,000, (iii) a decrease in advertising and marketing expenses of $277,000, and (iii) a decrease in product development of $57,000.

Our decrease in SG&A expenses for the three months ended June 30, 2023 compared to the three months ended June 30, 2022, was primarily due to: (i) a decrease of $175,000 in salaries and benefits (including stock-based compensation) and other employee related costs, (ii) a decrease in accounting and other professional fees of $42,000, (iii) a decrease in commissions and other sales related expense of $40,000, (iv) a decrease in travel of $33,000, (v) a decrease of $22,000 for facility and office expenses, and (vi) a decrease in insurance of $14,000.

The decrease in advertising and marketing expenses was primarily due to (i) a decrease in salaries and benefits (including stock compensation of $116,000, (ii) a decrease in advertising and promotion of $60,000, (iii) a reduction in outside services and other marketing expenses of $58,000, and (iv) a decrease in trade show related expenses of $42,000.

The decrease in product development costs was due to (i) a decrease in salaries and benefits (including stock-based compensation) of $42,000, (ii) a decrease in R&D consulting and materials expense of $10,000, and (iii) a decrease in travel of $5,000.

Operating Income (Loss)

We recognized an operating loss of $705,000 for the three months ended June 30, 2023, as compared to an operating loss of $1,771,000 for the three months ended June 30, 2022, a decrease of $1,067,000 or 60%. The operating loss for the three months ended June 30, 2023 included $15,000 of non-cash, stock-based compensation, and $7,000 of depreciation expense, compared to $96,000 of non-cash, stock-based compensation, $7,000 of depreciation expense, and $631,000 for a goodwill impairment charge for the three months ended June 30, 2022. Excluding these non-cash items, our operating loss decreased by $355,000.

Other Income (Expense)

We recognized other income (net) of $11,000 for the three months ended June 30, 2023, compared to other income (net) of $11,000 for the three months ended June 30, 2022. Other income for the three months ended June 30, 2023 and the three months ended June 30, 2022 both primarily consisted of interest income on a money market account.

Net Income (Loss)

Overall, we recognized a net loss of $694,000 for the three months ended June 30, 2023, as compared to a net loss of $1,761,000 for the three months ended June 30, 2022, a decrease of $1,067,000 or 61%. The net loss for the three months ended June 30, 2023 included $15,000 of non-cash, stock-based compensation, and $7,000 of depreciation expense, compared to $96,000 of non-cash, stock-based compensation, $7,000 of depreciation expense, and $631,000 for a goodwill impairment charge for the three months ended June 30, 2022. Excluding these non-cash items, our net loss decreased by $356,000.

Comparison of Six Months Ended June 30, 2023 and June 30, 2022

Revenues and Cost of Goods Sold

Revenue for the six months ended June 30, 2023 was $5,746,000, compared to $4,759,000 for the six months ended June 30 2022, representing an increase of $987,000, or 21%. The increase was primarily due to improvements in our supply chain and the ability to deliver products with fewer delays on contract fulfillment and revenue recognition on existing contracts during the first quarter.

Cost of revenue increased by $452,000, or 10%, from $4,363,000 for the six months ended June 30, 2022 to $4,814,000 for the six months ended June 30, 2023. The increase was primarily due to an increase in revenue and a decrease in variable and fixed costs as a percentage of revenue.

Our gross profit for the six months ended June 30, 2023 was $932,000 compared to $397,000 for the six months ended June 30, 2022, an increase of 135%. Gross profit margin increased by 8 percentage points from 8% for the six months ended June 30, 2022 to 16% for the six months ended June 30, 2023 primarily due to higher revenue and a decrease in fixed and variable costs as a percentage of revenue, as described below. Additionally, total revenue in the six months ended June 30, 2023 includes $205,000 from forfeited, non-refundable deposits from former customers on previously cancelled contracts.

Our fixed costs (which include engineering, service, manufacturing and project management salaries and benefits and manufacturing overhead) totaled $710,000, or 12% of total revenue, for the six months ended June 30, 2023 as compared to $808,000, or 17% of total revenue, for the six months ended June 30, 2022. The decrease of $98,000 was primarily due to a decrease in salaries and benefits (including stock-based compensation) of $66,000 and a decrease in fixed overhead of $31,000.

Our variable costs (which include the cost of equipment, outside engineering costs, shipping and handling, travel and warranty costs) totaled $4,104,000, or 71% of total revenue, during the six months ended June 30, 2023, as compared to $3,554,000, or 75% of total revenue, in the six months ended June 30, 2022. The increase in variable costs was primarily due to: (i) an increase in equipment costs of $643,000 driven by higher revenue, (ii) an increase in excess and obsolete inventory expense of $31,000, (iii) an increase in warranty of $19,000, offset by (iv) a decrease in outside engineering costs of $88,000, and (v) a decrease in travel of $52,000.

We continue to focus on gross margin improvement through a combination of efforts, including more disciplined pricing, better absorption of our fixed costs as we convert our bookings into revenue, and the implementation over time of lower-cost supplier alternatives.

Operating Expenses

Operating expenses decreased to $2,083,000 for the six months ended June 30, 2023, from $3,779,000 for the six months ended June 30, 2022, a decrease of $1,696,000, or 45%. The operating expense decrease consisted of: (i) a decrease of $621,000 in selling, general and administrative ("SG&A expenses") (ii) a decrease of $631,000 for goodwill impairment charges, (iii) a decrease in advertising and marketing expenses of $325,000, and

(iv) a decrease in product development of $119,000.

Our decrease in SG&A expenses for the six months ended June 30, 2023 compared to the six months ended June 30, 2022, was primarily due to: (i) a decrease of $377,000 in salaries and benefits (including stock-based compensation) and other employee related costs, (ii) a decrease in accounting and other professional fees of $170,000, (iii) a decrease in travel of $53,000, (iv) a decrease of $34,000 for facility and office expenses, and (v) a decrease in commissions and other sales related expenses of $29,000, offset by (i) an increase in investor relations expenses of $16,000, (ii) an increase in bad debt expense of $11,000, and (iii) an increase in board fees of $10,000.

The decrease in advertising and marketing expenses was primarily due to (i) a decrease in trade show related and other marketing expenses of $67,000, (ii) a decrease in outside services of $12,000, (iii) a reduction in advertising and promotion of $9,000, offset by an increase in salaries and benefits (including stock compensation) of $14,000 (related to severance payments for our reduction in force in February).

The decrease in product development costs was due to (i) a decrease in salaries and benefits (including stock-based compensation) of $28,000, (ii) a decrease in R&D consulting and materials expense of $5,000, and (iii) a decrease in travel of $2,000.

Operating Income (Loss)

We recognized an operating loss of $1,151,000 for the six months ended June 30, 2023, as compared to an operating loss of $3,382,000 for the six months ended June 30, 2022, a decrease of $2,231,000 or 66%. The operating loss for the six months ended June 30, 2023 included $162,000 of non-cash, stock-based compensation, and $13,000 of depreciation expense, compared to $188,000 of non-cash, stock-based compensation, $14,000 of depreciation expense, and $631,000 for a goodwill impairment charge for the six months ended June 30, 2022. Excluding these non-cash items, our operating loss decreased by $1,574,000.

Other Income (Expense)

We recognized other income (net) of $26,000 for the six months ended June 30, 2023, compared to other income (net) of $199,000 for the six months ended June 30, 2022. Other income for the six months ended June 30, 2023 consisted of interest income on a money market account of $18,000 and $8,000 for adjustments to our ERC credit and unclaimed property liability. Other income for the six months ended June 30, 2022 primarily consisted of $185,000 for an insurance settlement and interest income on a money market account of $14,000.

Net Income (Loss)

Overall, we recognized a net loss of $1,125,000 for the six months ended June 30, 2023, as compared to a net loss of $3,184,000 for the six months ended June 30, 2022, a decrease of $2,059,000 or 65%. The net loss for the six months ended June 30, 2023 included $162,000 of non-cash, stock-based compensation, and $13,000 of depreciation expense, compared to $188,000 of non-cash, stock-based compensation, $14,000 of depreciation expense, and $631,000 for a goodwill impairment charge for the six months ended June 30, 2022. Excluding these non-cash items, our net loss decreased by $1,401,000.

Financial Condition, Liquidity and Capital Resources

Cash, Cash Equivalents

As of June 30, 2023, we had cash and cash equivalents of $14,197,000, compared to cash and cash equivalents of $18,637,000 as of December 31, 2022. The $4,440,000 decrease in cash and cash equivalents during the six months ended June 30, 2023, was the result of cash used in operations. Our cash is held in bank depository accounts in a financial institution. During the six months ended June 30, 2023, we held deposits in this financial institution that exceeded the federally insured amount.

As of June 30, 2023, we had accounts receivable (net of allowance for doubtful accounts) of $294,000, inventory (net of excess and obsolete allowance) of $397,000, and prepaid expenses and other assets of $520,000 (including $10,000 in advance payments on inventory purchases). While we typically require advance payment before we commence engineering services or ship equipment to our customers, we have made exceptions requiring us to record accounts receivable, which carry a risk of non-collectability especially since most of our customers are funded on an as-needed basis to complete facility construction. We expect our exposure to accounts receivable risk to increase as we continue to pursue larger projects.

As of June 30, 2023, we had total accounts payable and accrued expenses of $799,000, deferred revenue of $626,000, and the current portion of operating lease liability of $122,000. As of June 30, 2023, we had working capital of $13,862,000, compared to working capital of $14,724,000 as of December 31, 2022. The decrease in our working capital was primarily related to (i) a decrease in cash of $4,440,000, (ii) a decrease in deferred revenue of $3,713,000, (iii) a decrease in accounts payable and accrued liabilities of $409,000, and (iv) a decrease in prepaid expense of $970,000.

We currently intend to retain all available funds and any future earnings for use in the operation and expansion of our business. We have never declared or paid any cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future.

Because of the post-pandemic macro-economic and CEA industry economy that has developed during 2021 and 2022, and is continuing into 2023, we cannot predict the continuing level of working capital that we will have in the future. Additionally, we cannot predict that our future financial position will not deteriorate due to cancelled or delayed contract fulfillment, reduced sales and our ability to perform our contracts. As mentioned elsewhere, we have taken steps to conserve our cash resources by reducing staff and taking other cost-cutting measures.

Summary of Cash Flows

The following summarizes our approximate cash flows for the six months ended June 30, 2023 and June 30, 2022:

	For the Six Months Ended June 30,	
	2023	**2022**
Net cash used in operating activities	$ (4,440,000)	$ (1,232,000)
Net cash used in investing activities	-	(11,000)
Net cash provided by financing activities	-	19,695,000
Net increase (decrease) in cash	$ (4,440,000)	$ 18,452,000

Operating Activities

We incurred a net loss for the six months ended June 30, 2023 of $1,125,000 and have an accumulated deficit of $35,404,000 as of June 30, 2023.

Cash used in operations for the six months ended June 30, 2023 was $4,440,000 compared to cash used in operating activities of $1,269,000 for the six months ended June 30, 2022, an increase in cash usage of $3,171,000.

The increase in cash used in operating activities during the six months ended June 30, 2023 as compared to the six months ended June 30, 2022, was primarily attributable to: (i) an increase in cash used to fund working capital of $4,712,000, (ii) a decrease in net loss of $2,059,000, and (iii) a decrease in non-cash operating charges of $517,000.

The decrease in our working capital was primarily related to (i) a decrease in cash of $4,440,000, (ii) a decrease in deferred revenue of $3,713,000, (iii) a decrease in prepaid expense of $970,000, (iv) a decrease in accounts payable and accrued liabilities of $409,000, and (v) an increase in accounts receivable of $291,000.

The decrease in non-cash operating charges was primarily due to a decrease in goodwill impairment charges of $631,000, offset by an increase in the provision for excess and obsolete inventory of $95,000.

Investing Activities

Cash used in investing activities during the six months ended June 30, 2023 was $0. Cash used in investing activities during the six months ended June 30, 2022 of $12,000 was primarily related to the purchase of property and equipment.

Financing Activities

There were no cash flows from financing activities during the six months ended June 30, 2023.

Cash flows from financing activities during the six months ended June 30, 2022, was the result of cash proceeds from the sale of common stock and warrants (net of issuance costs) of $21,711,000, offset by a cash payment of $2,016,000 for the redemption of series B preferred stock, including related dividends.

Common Stock Equity Offering

On February 15, 2022, the Company completed a public offering of shares of common stock and warrants. The Company received net proceeds of approximately $21,711,000 for the sale of 5,811,138 shares of common stock and 6,572,808 warrants, each warrant to purchase one share of common stock for five years, exercisable immediately, at an exercise price of $5.00, expiring February 10, 2027. The Company also issued to the representative of the underwriters 290,557 warrants, each warrant to purchase one share of common stock at an exercise price of $5.16, during the period commencing August 9, 2022, and expiring on February 10, 2027.

The net proceeds from the offering will be used for the Company's operations, to pursue select acquisitions or strategic alternatives, and for general corporate and working capital purposes. In connection with the offering, we received approval to list our common stock on the Nasdaq Capital Market under the symbol "CEAD" and our warrants under the symbol "CEADW". Effective February 10, 2022, trading of both shares of the Company's common stock and certain of the Company's warrants commenced on the Nasdaq. See Item 5 below for discussion of the notice received from Nasdaq concerning a potential delisting.

Inflation

Recently, our operations have started to be influenced by the inflation existent in the larger economy and in the industries related to building renovations, retrofitting and new build facilities in which we operate. We are likely to continue to face inflationary increases in the cost of products and our operations, which may adversely affect our margins and financial results and the pricing of our service and product supply contracts. Inflation is reflected in higher wages, increased pricing of equipment and other products that we have contracted to provide to our customers, and generally higher prices across all sectors of the economy. As we move forward, we plan to continuously monitor our various contract terms and may decide to add clauses that will permit us to adjust pricing if inflation and price increase pressures on us will impact our ability to perform our contracts and maintain our margins.

Contractual Payment Obligations

As of June 30, 2023, our contractual payment obligations consisted of a building lease. Refer to *Note 2 – Leases* of the notes to the condensed consolidated financial statements, included as part of this Quarterly Report for a discussion of our building lease.

Commitments and Contingencies

Refer to *Note 6 – Commitments and Contingencies* of the notes to the condensed consolidated financial statements, included as part of this Quarterly Report for a discussion of commitments and contingencies.

Off-Balance Sheet Arrangements

We are required to disclose any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors. As of March 31, 2023, we had no off-balance sheet arrangements. During the three months ended March 31, 2023, we did not engage in any off-balance sheet financing activities other than those included in the "Contractual Payment Obligations" discussed above and those reflected in *Note 6* of our condensed consolidated financial statements.

Recent Developments

Refer to *Note 12 - Subsequent Events* of the notes to condensed consolidated financial statements, included as part of this Quarterly Report for certain significant events occurring since June 30, 2023.

Critical Accounting Estimates

This discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Certain accounting policies are particularly important to the understanding of our financial position and results of operations and require the application of significant judgment by our management or can be materially affected by changes from period to period in economic factors or conditions that are outside of our control. As a result, they are subject to an inherent degree of uncertainty. In applying these policies, management uses their judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical operations, our future business plans and projected financial results, the terms of existing contracts, observance of trends in the industry, information provided by our customers, and information available from other outside sources, as appropriate. Actual results could materially differ from those estimates. Key estimates include: allocation of transaction prices to performance obligations under contracts with customers, standalone selling prices, timing of expected revenue recognition on remaining performance obligations under contracts with customers, valuation of intangible assets, valuation of equity-based compensation, valuation of deferred tax assets and liabilities, warranty accruals, accounts receivable and inventory allowances, and legal contingencies.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are a smaller reporting company, as defined by Rule 12b-2 of the Exchange Act, therefore are not required to provide the information under this item.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Principal Financial and Accounting Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and Principal Financial and Accounting Officer concluded that as a result of material weakness in our internal control over financial reporting as described in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2022 filed with the SEC, our disclosure controls and procedures were not effective as of June 30, 2023.

We did not maintain effective controls over certain aspects of the financial reporting process because: (i) we lack a sufficient complement of personnel with a level of accounting expertise and an adequate supervisory review structure that is commensurate with our financial reporting requirements, (ii) there is inadequate segregation of duties due to our limited number of accounting personnel, and (iii) we have insufficient controls and processes in place to adequately verify the accuracy and completeness of spreadsheets that we use for a variety of purposes including revenue, taxes, stock-based compensation and other areas, and place significant reliance on, for our financial reporting.

We intend to take appropriate and reasonable steps to make the necessary improvements to remediate these deficiencies. We are committed to continuing to improve our financial organization including, without limitation, expanding our accounting staff and improving our systems and controls to reduce our reliance on the manual nature of our existing systems. However, due to our size and our financial resources, remediating the several identified weaknesses has not been possible and may not be economically feasible now or in the future.

Changes in Internal Control over Financial Reporting

There were no changes identified in connection with our internal control over financial reporting during the three months ended June 30, 2023, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently a party to any material legal proceedings, nor are we aware of any pending or threatened litigation that would have a material adverse effect on our business, operating results, cash flows, or financial condition should such litigation be resolved unfavorably. We have and will continue to have commercial disputes arising in the ordinary course of our business.

Item 1A. Risk Factors

In addition to the information set forth in this Form 10-Q, you should also carefully review and consider the risk factors contained in our other reports and periodic filings with the SEC, including, without limitation, the risk factors and uncertainties contained under the caption “Item 1A—Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2022 that could materially and adversely affect our business, financial condition, and results of operations. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not known to us or that we currently consider to be immaterial to our operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Nasdaq Notice Regarding Minimum Bid Price

On April 10, 2023, the Company received a letter from the Listing Qualifications Department of the Nasdaq Stock Market (“Nasdaq”) indicating that, based upon the closing bid price of the Company’s common stock for the 30 consecutive business day period between February 24, 2023, through April 6, 2023, the Company did not meet the minimum bid price of $1.00 per share required for continued listing on The Nasdaq Capital Market pursuant to Nasdaq Listing Rule 5550(a)(2). The letter also indicated that the Company will be provided with a compliance period of 180 calendar days, or until October 9, 2023 (the “Compliance Period”), in which to regain compliance pursuant to Nasdaq Listing Rule 5810(c)(3)(A).

In order to regain compliance with Nasdaq’s minimum bid price requirement, the Company’s common stock must maintain a minimum closing bid price of $1.00 for at least ten consecutive business days during the Compliance Period. In the event the Company does not regain compliance by the end of the Compliance Period, the Company may be eligible for additional time to regain compliance. To qualify for the additional time, the Company will be required to meet the continued listing requirement for the market value of its publicly held shares and all the other listing standards for The Nasdaq Capital Market and will need to provide written plan to cure the deficiency during the second compliance period. The Company may be granted an additional 180 calendar days to regain compliance if the plan is accepted by Nasdaq. However, if it appears to Nasdaq that the Company will be unable to cure the deficiency, or if the Company is not otherwise eligible for the additional cure period, Nasdaq will provide notice that the Company's common stock will be subject to delisting.

The letter has no immediate impact on the listing of the Company's common stock, which will continue to be listed and traded on The Nasdaq Capital Market, subject to the Company's compliance with the other listing requirements of The Nasdaq Capital Market.

Initiation of Strategic Alternatives Review

On May 24, 2023, the Company's Board of Directors hired Roth Capital Partners to assist in its review of strategic alternatives. While the Company is hopeful that this process increases the slate of opportunities available to create shareholder value, there can be no assurance regarding the results or outcome of this review.

Item 6. Exhibits

The documents listed in the Exhibit Index of this Form 10-Q are incorporated by reference or are filed with this Form 10-Q, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CEA INDUSTRIES INC.
(the "Registrant")

Dated: August 14, 2023

By: */s/ Anthony K. McDonald*
Anthony K. McDonald
Chief Executive Officer and President
(Principal Executive Officer)

Dated: August 14, 2023

By: */s/ Ian K. Patel*
Ian K. Patel
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
31.1 *	Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 *	Certification of Principal Financial and Accounting Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Principal Financial and Accounting, pursuant to 18 U.S.C. Section 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 Schema
101.CAL*	Inline XBRL Taxonomy Calculation Linkbase
101.DEF*	Inline XBRL Taxonomy Definition Linkbase
101.LAB*	Inline XBRL Taxonomy Label Linkbase
101.PRE*	Inline XBRL Taxonomy Presentation Linkbase
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

* Filed herewith.
** Furnished herewith.

Exhibit 31.1

CERTIFICATION PURSUANT TO RULE 13a-14(a) and 15d-14(a)
UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, Anthony K. McDonald, the Chief Executive Officer of CEA Industries Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of CEA Industries Inc. for the quarterly period ended June 30, 2023;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated August 14, 2023.

By: *_/s/ Anthony K. McDonald_*
Anthony K. McDonald
Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO RULE 13a-14(a) and 15d-14(a)
UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, Ian K. Patel, the Principal Financial and Accounting Officer of CEA Industries Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of CEA Industries Inc. for the quarterly period ended June 30, 2023;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated August 14, 2023.

By: *`/s/ Ian K. Patel`*

Ian K. Patel
Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q for the quarter ended June 30, 2023 (the “Report”) of CEA Industries Inc. (the “Registrant”), as filed with the Securities and Exchange Commission on the date hereof, I, Anthony K. McDonald, the Chief Executive Officer of the Registrant, hereby certify, to the best of my knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

	/s/ Anthony K. McDonald
Name:	Anthony K. McDonald, Chief Executive Officer
Date:	August 14, 2023

This certification accompanies this Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

Exhibit 32.2

CERTIFICATION PURSUANT TO SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q for the quarter ended June 30, 2023 (the “Report”) of CEA Industries Inc. (the “Registrant”), as filed with the Securities and Exchange Commission on the date hereof, I, Ian K. Patel, the Principal Financial and Accounting Officer of the Registrant, hereby certify, to the best of my knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

	/s/ Ian K. Patel
Name:	Ian K. Patel, Chief Financial Officer
Date:	August 14, 2023

This certification accompanies this Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.