

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

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED **DECEMBER 31, 2023**

or

☐ TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: **001-39933**

URBAN-GRO, INC.

(Exact name of registrant as specified in its charter)

Delaware

46-5158469

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

1751 Panorama Point, Unit G, Lafayette, CO

80026

(720) 390-3880

(Address of principal executive office)

(Zip Code)

(Registrant's telephone number, including area code)

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

Title of each class

Trading Symbol(s)

Name of each exchange on which registered

Common Stock, \$0.001 par value

UGRO

NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ Yes ☒ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 past 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "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 has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☐

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). ☐

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter on June 30, 2023 was \$10,984,218.

As of March 16, 2024, the registrant had 12,271,393 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Annual Report on Form 10-K is incorporated by reference from the Registrant's definitive proxy statement relating to the 2024 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Annual Report on Form 10-K relates.

TABLE OF CONTENTS

Item No.		Page No.
	Cautionary Information about Forward-Looking Statements	3
PART I		3
Item 1.	Business	3
Item 1A.	Risk Factors	16
Item 1B.	Unresolved Staff Comments	27
Item 1C.	Cybersecurity	27
Item 2	Properties	28
Item 3.	Legal Proceedings	28
Item 4.	Mine Safety Disclosures	29
PART II		30
Item 5.	Market for the Registrant’s Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities	30
Item 6.	[Reserved]	31
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	31
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	35
Item 8.	Financial Statements and Supplementary Data	35
Item 9.	Changes in and Disagreements on Accounting and Financial Disclosure	35
Item 9A.	Controls and Procedures	35
Item 9B.	Other Information	36
Item 9C.	Disclosure Regarding Foreign Jurisdictions that Prevent Inspections	36
PART III		37
Item 10.	Directors, Executive Officers and Corporate Governance	37
Item 11.	Executive Compensation	37
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	37
Item 13.	Certain Relationships and Related Transactions, and Director Independence	37
Item 14.	Principal Accounting Fees and Services	37
PART IV		37
Item 15.	Exhibits, Financial Statement Schedules	37
Item 16.	Form 10-K Summary	38
	Signatures	39
	Index to Financial Statements	F-1

Cautionary Information about Forward-Looking Statements

This Annual Report on Form 10-K (“Form 10-K” or this “Report”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), including statements related to: future events; challenges we may face; growth strategy; expansion and future operations; the ability to recognize backlog as revenue; financial position; estimated or projected revenues, losses, costs, gross profit, earnings or other financial items; business strategy, prospects, plans and objectives of management; anticipated or pending investigations, legal claims, proceedings or litigation that may involve or affect us; implementation of ESG initiatives; industry-specific trends, events or regulations and the impact of those trends, events and regulations on us or our financial performance; and updates to regulations and the impact of those regulations on us. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as “seek,” “anticipate,” “plan,” “continue,” “estimate,” “expect,” “may,” “will,” “project,” “predict,” “potential,” “target,” “intend,” “could,” “might,” “should,” “believe” and variations of such words or their negative and similar expressions. Forward-looking statements should not be read as a guarantee of future performance or results and may not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on management’s belief, based on currently available information, as to the outcome and timing of future events.

Important factors known to us that could cause such material differences are identified in this Report, including the factors described in Part I, Item 1A, “Risk Factors,” and other cautionary statements described in this Report on Form 10-K. These factors are not necessarily all of the important factors that could cause actual results or events to differ materially from those expressed in the forward-looking statements. Other unknown or unpredictable factors could also cause actual results or events to differ materially from those expressed in the forward-looking statements. urban-gro, Inc. is under no obligation to correct or update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any future disclosures we make on related subjects in future reports to the Securities and Exchange Commission (“SEC”).

PART I

ITEM 1. BUSINESS

Background

urban-gro, Inc. (together with its wholly owned subsidiaries, collectively “urban-gro,” “we,” “us,” or “the Company”) was originally formed on March 20, 2014, as a Colorado limited liability company. On March 10, 2017, we converted to a Colorado corporation and exchanged shares of our common stock for every member’s interest issued and outstanding on the date of conversion. On October 29, 2020, we reincorporated as a Delaware corporation. On December 31, 2020, we effected a 1-for-6 reverse stock split with respect to our common stock. All information in this Report gives effect to this reverse stock split, including restating prior period reported amounts. On February 12, 2021, we completed an uplisting to the Nasdaq Capital Market (“Nasdaq”) under the ticker symbol “UGRO”.

Overview

urban-gro is an integrated professional services and construction design-build firm. Our business focuses primarily on providing fee-based knowledge-based services as well as the value-added reselling of equipment. We derive income from our ability to generate revenue from our clients through the billing of our employees’ time spent on client projects. We offer value-added architectural, engineering, systems procurement and integration, and construction design-build solutions to customers operating in the controlled environment agriculture (“CEA”) and industrial and other commercial (“Commercial”) sectors. Our evolution, both organically and through the acquisition of engineering, architecture, and construction management firms has enabled us to successfully diversify into the commercial sectors of the clients we serve, as well as the capabilities we offer, which we believe has helped insulate our business from any one sector. Even with this successful diversification, our main focus and value-add has always been and remains in providing solutions to our CEA clients, where we have experience and expertise in designing, engineering, building, and integrating complex environmental equipment systems into indoor CEA cultivation and retail facilities, and then providing ongoing maintenance, training, and support services to those same facilities.

We aim to work with our clients from inception of their project in a way that provides value throughout the life of their facility. Clients, regardless of sector they are in, engage us to deliver their vision because of our experience and expertise, and because our integrated, design-build solutions offer a value-add approach to design, engineering, procurement, construction-management, construction, and equipment integration, providing a single point of accountability across all aspects of a project.

For our CEA clients in particular, we create high-performance indoor cultivation facilities to grow specialty crops, including cannabis as well as produce such as leafy greens, vegetables, herbs and berries. We also provide design-build solutions for our CEA clients' retail facilities. We help our clients achieve operational efficiency and economic advantages through a full spectrum of professional services and programs focused on facility optimization and environmental health which establish facilities that allow clients to manage, operate and perform at the highest level throughout their entire cultivation lifecycle once they are up and running. For these CEA clients, our team provides services to meet the most stringent regulatory environments, whether they are energy efficiency goals, Good Agricultural and Collection Practices ("GACP"), or Good Manufacturing Practice ("GMP") and/or European Medicine Agency EU GMP ("EU/GMP") certification.

While we have successfully diversified our target markets across several commercial sectors, the majority of our clients are commercial CEA cultivators. We believe a key differentiation point that clients value is the depth of our employees' and Company's experience. As of December 31, 2023, we employed 130 full time employees, approximately two-thirds of which are considered experts in their areas of focus. Our team includes Designers (Architects, Interior Designers, Cultivation Space Planners), Engineers (Mechanical, Electrical, Plumbing, Controls, and Fire Protection), Construction Managers (Project Managers and Supervisors), and horticulturists. As a company, we have worked on over 1000 CEA projects, and believe that the experience of our team and Company provides clients with the confidence that will proactively keep them from making common costly mistakes during the design and build process that would impact operational stages. Our expertise translates into clients saving time, money, and resources through expertise that they can leverage without having to add headcount to their own operations. We provide this experience in addition to offering a platform of the highest quality equipment systems that can be integrated holistically into our clients' facilities.

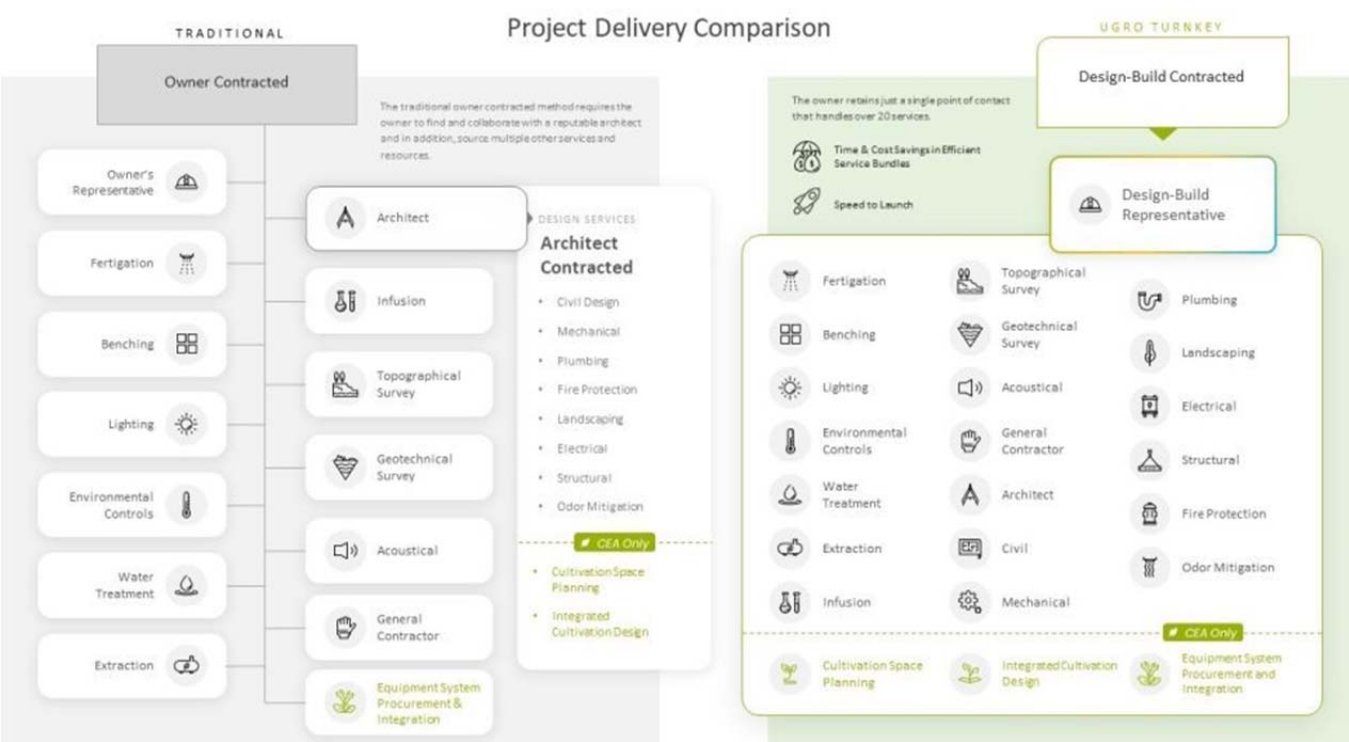
Since January 1, 2023, we have announced the following contracts:

- September 26, 2023 - Awarded contract for more than \$11.0 million of design-build services with an existing client in the Hospitality & Recreation sector to be recognized over the next six quarters. While this contract has been started as of December 31, 2023, the Company now expects that the contract will take two quarters longer than expected to complete, therefore extending into 2025.
- October 2, 2023 - Secured contracts of nearly \$8.0 million across four clients in the CEA sector to be recognized over the next four quarters. While the largest of these contracts, valued at approximately \$7 million dollars, did start in the first quarter of 2024, the Company now it will be completed by the first quarter of 2025, one additional quarter more than had been forecast. The Company expects that the other three contracts will be completed in the previously announced timeframe.
- October 4, 2023 - Signed multiple contracts valued at more than \$4.5 million to be recognized over the next two quarters. The Company expects that these contracts will be completed in the previously announced timeframe.
- November 30, 2023 - Awarded \$9.6 million industrial design-build contract with an existing CPG client to be recognized over the next three quarters. While this contract did not start as anticipated in the fourth quarter of 2023, the value was increased to \$11 million dollars with the addition of supplying mechanical equipment systems to the scope, it did kick off in the first quarter of 2024. The Company now expects that the contract will take one additional quarter over the previously announced timeframe to be completed.
- January 2, 2024 - Secures design-build contract valued at approximately \$20.0 million of design-build services with an existing vertically integrated United States based multi-state cannabis cultivation and retail dispensary operator to be recognized over the next six quarters. This contract was not started as of December 31, 2023, but kicked off in the first quarter of 2024, and the Company still expects that the contract will be completed in the previously announced timeframe.

Our Solutions

Since commencing business in March 2014, we have expanded our ongoing operations across North America and Europe while diversifying our services offerings organically and through acquisitions into full design-build solutions by adding design, engineering, construction, and construction-management services, introducing new equipment solutions, products and services, and successfully diversifying into several additional commercial sectors beyond cannabis-focused CEA, including produce-focused CEA; or vertical farming, healthcare, industrial, commercial packaged goods (“CPG”), and retail. We are a trusted partner and adviser to our clients and provide value to our clients regardless of the sector in which they sit or solution for which they are utilizing us.

As is detailed in the Project Delivery Comparison chart below, in the CEA sector, the advantages of the urban-gro design-build model vs the traditional owner-contracted model are clear. There is a single responsible party for our clients’ needs from conception through operational start. This results in greater efficiencies throughout the design-build process and a faster speed to launch. Additionally, our experience and expertise within our sectors help to prevent costly mistakes for our clients.



Outlined below is an example of a complete end-to-end design-build project that demonstrates how we provide value to our clients over time.



Our design-build solution, when focused on indoor CEA, offers an integrated suite of in-house services and equipment systems that generally fall within the following categories:

- **Service Solutions:**
 - Architectural Design, Engineering, and Construction Services – A comprehensive collection of services including:
 - i. Pre-Construction Services
 - ii. Cultivation Space Programming (“CSP”)
 - iii. Architectural Design and Interior Design
 - iv. Engineering
 - v. Integrated Cultivation Design (“ICD”)
 - vi. Owner’s Representative Services / Construction Management (“CM”)
 - vii. General Contracting (“GC”)
 - Additional Service Offerings including:
 - i. Facility and Equipment Commissioning Services
 - ii. gro-care® Crop and Asset Protection Services including Training Services, Equipment Maintenance Services, Asset Protection Program, and an Interactive Online Operating Support System (“OSS”) for gro-care® and client document delivery and project management
 - iii. Property Condition Assessment (“PCA”)
- **Integrated Equipment Systems Solutions:**
 - Design, Source, and Integration of Complex Environmental Equipment Systems including Heating, Ventilation, and Air Conditioning (“HVAC”) solutions, Environmental Controls, Fertigation, and Irrigation Distribution
 - Value-Added Reselling (“VAR”) of Cultivation Equipment Systems
 - Strategic Vendor Relationships with Premier Manufacturers

Service Solutions

Architectural Design, Engineering, and Construction Services

We generate revenue by providing our clients with design-build service offerings that include architectural, interior, and engineering design, construction and construction management, as well as services for the operational stages of the facility. Our in-house architectural, interior design, engineering, construction and cultivation design services integrate design with pre-construction services and thereby reduce project schedule and capital investments.

Pre-Construction Services include providing a forecast summary of what it will take to get a high-performance facility built, giving initial indication and detailed analysis of budget, timeline/schedule, and potential large decision impacts including value analysis and value engineering options. The integration of Pre-Construction Services can expedite project completion, lower initial project costs, and help reduce costly change orders.

CSP is an early-stage engagement with stakeholders that provides an optimized basis of design including the interaction of people, plants, and processes. The output of CSP provides an optimized analysis of spatial needs based on stipulated criteria and can accelerate construction and regulatory approval paths, save stakeholders money and time, and enable a process-driven decision-making approach.

Architectural Design is the implementation of a defined process from development of vision to built environment. Architecture includes the integration and coordination of all project required disciplines such as civil, landscape, structural, mechanical, plumbing and electrical engineering, fire protection, security, interior design, and other specialty disciplines. Our services are built around an integrated design process focused on the collaborative development of client-driven solutions. Specific to the CEA industry, our team's understanding of the relationship between people, plants, and process helps clients maximize profits and efficiencies while minimizing capital investments, and operational and maintenance costs.

Interior Design involves branding and development of the interior aesthetic vision. Our collaborative and integrated approach from our award-winning team begins with inspiration boards focused on understanding the client's aesthetic desires. Interior design is holistic and thereby includes all aspects of the building interiors from full branding to the selection and design of all finishes and interior systems. Common discussions beyond aesthetics include the cost, durability, and maintainability of systems presented.

Mechanical, Electrical, and Plumbing ("MEP") engineering design focuses on the entire building, not just the cultivation space, which in turn eliminates the "gap" between cultivation systems and the building systems. We provide engineered construction contract documents for mechanical, HVAC, plumbing and electrical systems required for the building permits necessary to obtain a Certificate of Occupancy. Our team evaluates client capabilities, needs, desires, and budget in development of recommended systems through a client-focused collaborative process culminating in the delivery of high-performance and low-maintenance systems.

ICD creates cultivation space-focused design layouts that integrate climate control, fertigation, benching, air flow, and lighting. Our ICD team's deep understanding of cultivation systems provides the foundation for ensuring optimal space utilization as they utilize an integrated and collaborative design process focused on understanding, vetting, and implementing the client's vision. Products utilized in the ICD's basis-of-design ensures the integration of high-quality systems and product performance. These detailed ICD plans are taken through the construction document stage and are leveraged by our clients to efficiently solicit contractor bids.

Construction and Construction Management provides all the additional necessary parts to deliver our clients' projects, from the initial estimate and bid process, to subcontractor selection, and management of all construction details. Our skilled project managers, specialized within our clients' sectors, maintain knowledgeable open lines of communication with both clients, onsite superintendents, and internal and external construction partners to manage expectations, costs and schedules.

Our Additional Service Offerings

Our Facility and Equipment Commissioning Services provide a cultivation-level view of the complex system made up by each piece of equipment and ensures systems are running properly. Many of the current service options available to CEA cultivation clients are isolated to vendors providing post-sale service for a single piece of equipment. Our team confirms contractors and specialty trades are installing systems to the design intent allowing for rapid installation, continuous process improvement, and increased revenue for our clients.

gro-care® is a highly differentiated service offering that provides a combination of CEA cultivation facility commissioning and an asset protection program through training, equipment maintenance, on-demand support, standard operating procedures (“SOP”), and a client-specific OSS that acts as an online hub for clients’ ongoing services. Combined, this solution focuses on the troubleshooting, tuning, and support of a myriad of cultivation systems and equipment while further providing guidance for client interactions with tradespeople working on HVAC, electrical, and plumbing in the facility on an ongoing basis.

Our PCA offering provides value to all clients regardless of sector, but also adds unique value for our clients in the CEA sector. PCA includes researching historical records of the building as related to code issues, field documentation of existing conditions, a report of findings with materials systems categorized by condition, and a capital expenditure report for correction of any deficiencies. For our clients in the CEA sector, our PCA offering provides analysis of components specifically within CEA facilities, both with an eye towards critical cultivation and manufacturing systems as well as helping clients understand a facility’s ability to meet any state regulations that may have evolved such as adherence to standards such as Current Good Manufacturing Practices (“cGMP”), EU-GMP, and/or World Health Organization guidelines on GACP. PCA provides necessary data for clients to understand options for optimizing operational performance, understanding deficiencies, and properly preparing for necessary capital expenditures.

Integrated Equipment Solutions

While our engineers play an integral part in the design of most of the complex equipment systems that are then integrated into a CEA facility, we also provide consultative reselling of more common solutions that we integrate into the overall design. For CEA, the environmental goal is to maintain a stable and consistent vapor pressure deficit (“VPD”) according to the client’s priorities through environmental control of relative humidity and temperature during all stages of growth. There are four main variables in CEA that affect plant growth (and can impact VPD): (i) water and nutrients; (ii) environmental control; (iii) CO₂; and (iv) lighting. The complex equipment systems that we design and procure for our clients play an important role in helping control and maintain the cultivation facility’s environment for plants.

Design, Source, and Integration of Complex Environmental Equipment Systems

Complex Environment Systems for CEA include environmental controls, fertigation and irrigation distribution, a complete line of water treatment and wastewater reclamation systems, and HVAC equipment systems.

As related to systems and equipment, the most significant and influential variable within a CEA facility is the ability to control and maintain the cultivation environment. This is accomplished through the integration of mechanical systems (HVAC), lighting, air movement systems, irrigation systems, and environmental controls. Maintaining a consistent desired temperature and humidity level within the cultivation spaces ensures less stress on plants. urban-gro designs these systems to fit within our clients’ budgets and provides our clients’ facilities a more stable environment to maximize plant health and yields, minimize crop loss, minimize utility costs, save on capital equipment, and maximize sustainability.

Value-Added Reselling of Cultivation Equipment Systems

We act as an experienced vendor providing VAR to our clients when selling vetted best-in-class commercial horticulture lighting solutions, rolling and automated container benching systems, specialty fans, fertigation/irrigation systems, environmental control systems, and microbial mitigation and odor reduction systems. The acquired knowledge of how each of these systems work in combination with and in tangent to the overall ecosystem is a significant benefit that our engineers and product experts offer to our clients. Not only are many competing products reviewed in each category with the intention of vetting the best solution, but we also continually search out and review competing technologies to ensure that only the best-in-class equipment systems are integrated into our projects. As such, we believe it will be imperative to maintain and to continue to develop close relationships with both existing and new leading technology and manufacturing providers.

Today, we typically do not sell any cultivation equipment systems individually as a one-time sale. The majority of equipment sales are sold as part of a larger all-encompassing project solution that spans over a 12 to 24 month period and includes design, engineering, and the sale of both custom complex and more standard equipment systems.

Strategic Vendor Relationships with Premier Manufacturers

We work closely with leading technology and manufacturing providers to deliver an integrated solution designed to achieve the stated objectives of our clients. We pride ourselves as being equipment agnostic – meaning we do not have allegiances to any single manufacturer – we offer the solution that will best meet the design and budget constraints of our clients and design, engineer, and integrate whatever equipment fits the client’s needs.

Revenues and Gross Profit Margins

As our business has evolved and diversified into design-build offerings, our margin profiles have changed. Professional service revenues for engineering design services contracts can be hundreds of thousands of dollars, depending on the spectrum of services desired by the client and the size of the facility. Construction design-build contracts can run in the tens of millions of dollars depending on the overall size of the facility. Equipment revenues for customized equipment systems can be millions of dollars, depending on the size of the cultivation facilities, the complexity and types of systems purchased by the client, and the number of systems purchased by the client. Sales of other products are typically of a recurring nature each month to a client and can be in the tens of thousands of dollars.

Targeted gross profit margins for each of the Company’s revenue categories are as follows:

- Professional services - greater than forty percent;
- Construction design-build services - greater than six percent;
- Customized equipment systems - greater than ten percent; and
- Other products revenues - greater than fifteen percent.

Gross profit margins are highly dependent on the complexity and size of the project.

Our Clients

We primarily market and sell our solutions to clients in the CEA and Commercial sectors. In the CEA sector, our clients include operators and facilitators in both the cannabis and produce markets in the United States, Canada, and Europe. In the Commercial sector, we work with leading food and beverage consumer packaged goods companies in the United States, and clients in healthcare, higher education, and hospitality.

Environment, Social, and Governance

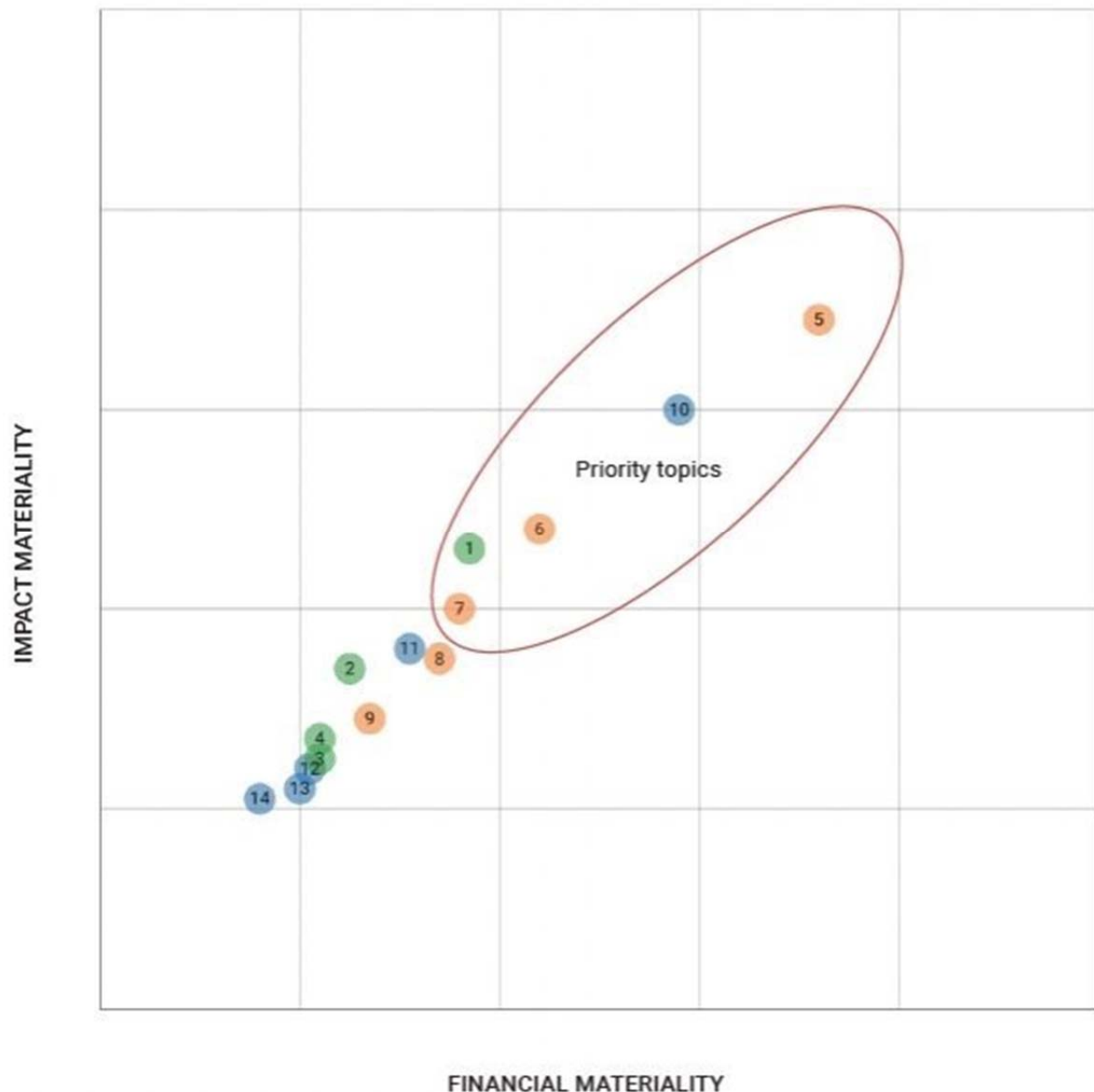
At urban-gro, we recognize the critical role that sustainable and responsible business practices play in shaping a resilient and prosperous future. In 2023, we partnered with an ESG service provider to proactively embark on our corporate ESG journey. While we are not formally aligning with a specific framework, we are using the World Economic Forum (WEF)’s Stakeholder Capitalism Metrics as a guide for our reporting. The WEF has created a framework of ESG metrics and disclosures based on what it refers to as the four pillars: Planet, People, Prosperity, and Governance. Currently in the final stages of development, our inaugural ESG report will be published on our website and will serve as a reflection of our commitment to transparency and the integration of ESG principles into our core business strategies.

urban-gro’s ESG initiative is led by a Board of Directors subcommittee which was formed in recognition of the increasing importance of sustainable and ethical business practices and responsible governance in the modern business landscape. In partnership with the broader Board of Directors, the ESG committee aims to:

- Strengthen the alignment of our corporate values
- Align stakeholder expectations
- Manage risk
- Ensure compliance
- Support investor relations
- Enhance the brand
- Boost innovation and efficiency
- Boost employee engagement
- Create long-term value
- Adapt to changing markets and trends

To better understand the topics most material to our business and actively engage stakeholders, urban-gro conducted a double materiality assessment to gain ‘inside-out’ and ‘outside-in’ perspectives. We engaged 29 internal and external stakeholders with a web-based materiality survey to gather quantitative and qualitative insights on impacts, risks, and opportunities. Analysis of this data identified 14 sustainability areas that present material impacts and opportunities for our organization. Of those 14, we prioritized the top five to inform our decision-making and reporting goals for the upcoming year. The top five topics are listed below:

- Data and Cybersecurity
- Business Ethics
- Diversity, Inclusion, and Equal Opportunity
- Energy Management
- Recruitment, Development, and Retention



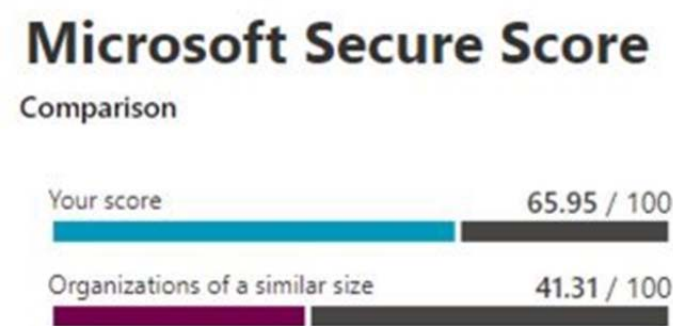
Environment

Focus on environmental material matters, stakeholders emphasized energy and water management alongside clean technology to foster sustainable, efficient, and regulatory compliance in our operational practices. Climate adaptation and transition risk management were classified as essential in the Materiality Assessment in navigating the shift toward a low-carbon economy. As a professional services design-build firm focused on Controlled Environment Agriculture (CEA), our approach to sustainable facility design and construction has a direct impact on environmental well-being. We aim to be a part of the solution to the climate challenge by aligning with CEA industry best practices around water conservation and reuse, reduction of the carbon footprint associated with production and distribution, and increasing the efficiency of harvests. Our team has worked on over 1,000 CEA projects around the world and combined with our team’s experience with Leadership in Energy and Environmental Design (LEED) and (EU)GMP facility certification, we are successfully reducing waste, water consumption, and carbon consumption across multiple market sectors. As technological advancement continues, we intend to work with our partners to incorporate more earth-friendly practices and solutions in CEA and other commercial sectors. Such concepts include, but are not limited to, active energy management, HVAC efficiency, and innovations in lighting.

By helping to reduce our clients’ footprints, we recognize the importance of measuring and reducing our own carbon footprint as well. While we have not formally begun measuring and reporting on our greenhouse gas (GHG) emissions due to our small size and the early nature of our operations, as we grow and add resources—or if the results of future stakeholder Materiality Assessments emphasize a growing interest in this metric—we will further investigate regular GHG emissions monitoring and reporting.

Social

Data and cybersecurity topped the social material matters, with the criticality of safeguarding data integrity, privacy, and resilience against cyberattacks essential to maintaining stakeholder trust, regulatory compliance, and business continuity. We understand the material effects that cybersecurity has on our business operations and have various measures in place to monitor and safeguard our information technology systems. These tactics include ongoing employee training, maintenance of backup and protective systems, and use of modern endpoint detection and response tools. We operate in a fully cloud-based environment to enhance scalability, flexibility and resilience against damage, disruption, and unauthorized access. In 2023, we documented over 100 hours of company-wide training. Documented policies and requirements cover topics like data security, email, hardware and software compliance, network security, password policy, patch policy, purchasing policy, and technology disposal. A combination of these and other efforts like third-party supported internal and external pen testing, real-time backups, and full adoption of the NIST Cyber Security Framework 2.0 have resulted in a nearly 25-point advantage in urban-gro’s Microsoft Secure Score relative to other similar-sized businesses.



Promoting diversity and employee well-being is likewise crucial to building trust, fostering innovation and resilience, and driving long-term organizational success. In the Materiality Assessment, stakeholders noted how promoting diversity in the workforce enhances morale, productivity, and social cohesion within communities. By fostering an inclusive workplace culture, urban-gro not only meets societal expectations but also contributes to economic equity and social progress. In the spirit of this commitment, the Company introduced a ‘floating holiday’ in 2024 that allows each employee flexibility and choice when it comes to observing holidays. The ‘floating holiday’ aims to empower each of our team members to celebrate meaningful moments in a way that aligns with their values and beliefs. We are also proud supporters of several charities and associations including Teens for Food Justice, an organization that is catalyzing a youth-led movement to end food insecurity through high-capacity, school-based hydroponic farming. Our company and/or employees are also members of industry associations and trade groups like American Hort, Association for Vertical Farming, the American Society of Heating, Refrigeration, and Air-Conditioning (ASHRAE), the Georgia City-County Management Association (GCCMA), the Georgia Chapter of APPA (GAPPA), the Global Cannabis Network Collective (GCNC), the National Cannabis Industry Association (NCIA), and the National Cannabis Roundtable (NCR). At urban-gro, we understand that the workplace reflects the world around us, and we want to ensure that everyone feels valued and respected.

Governance

From a governance perspective, prioritizing ethics, resilient business models, and effective governance was highlighted by stakeholders in the Materiality Assessment to bring integrity, adaptability, and sustained performance amidst evolving market landscapes. Stakeholders recognized how adherence to high ethical standards fosters transparency, accountability, and investor confidence. urban-gro takes a multi-pronged approach to guide a successful governance program and ensure that our stakeholders' best interests are acted upon. This starts with our strong and diverse Board of Directors comprised of leaders from a variety of fields and backgrounds. The Board Diversity matrix is published annually on our website ir.urban-gro.com and within our proxy materials. Currently, we utilize four Board committees:

- The Audit Committee: Focuses on internal controls, risk management, and multi-discipline oversight enabled by its charter and structure.
- The Compensation Committee: Focuses on compensation principles, policies, and practices for all employees.
- The Nominating and Corporate Governance Committee: Oversees the Company's corporate governance practices and procedures and recruits, nominates, and makes recommendations to retain Board members.
- The Environmental, Social, Governance Committee: Oversees the Company's approach to ESG practices and procedures.

In addition to charters for the committees listed above, we have a Code of Business Ethics and Conduct along with documented policies related to Anti-Corruption/Code of Business Ethics, Whistleblower Policy and Hotline, Enterprise Risk Management, Independent Pay Consultant, and Insider Trading. By upholding governance excellence, we aim to mitigate risks and contribute to the stability and integrity of our business environment.

Costs and Effects of Compliance with Environmental Laws

Our current business operations are not subject to any material environmental laws, rules or regulations that would have an adverse material effect on our business operations or financial condition or result in a material compliance cost.

Growth Strategy

Our employees and the application of their acquired knowledge are our most valuable assets as an organization. Our growth strategy involves leveraging this considerable strength as a basis for growth across three pillars of focus and exploration. These three pillars allow us to continue to provide value to our current and future clients:

- Leverage our sector diversification and in-house capability offerings
- Focus on design-build solution
- Expand our regional client base

Leverage our Sector Diversification and In-House Capability Offerings

Our vision is to be a leading provider for purpose-built turnkey indoor CEA facilities. To that end, we have and continue to seek to diversify our service capabilities to provide value to our clients through acting as a single point of responsibility in our turnkey design-build, approach. While we will continue to expand our services organically, we began this journey through the acquisition of engineering, architecture, and construction management firms over the last 18-month period. This in-house service capability diversification also brought with it a diversified client base that included clients from sectors outside of CEA. We expect to continue to compete successfully in all of these sectors as we believe it helps us attract the best talent, weather the downturns of any one sector, and continue to find growth and future returns for our shareholders.

We believe that acting as a single point of responsibility as a provider of turnkey design-build solutions, especially one with the depth and breadth of experience within all sectors that we've served, we can get our clients to market more quickly and more efficiently than others.

We intend to continue to leverage all our service capabilities within our design-build delivery model, across sectors, to grow the services and value we are providing to our clients. As an example, some clients may currently only be engaged with us for architectural design - we plan to leverage our in-house model and take advantage of every opportunity to cross sell our other services such as engineering; or construction management or general contracting, to provide further value to our clients and grow our revenues and margin dollars.

Focus on Design-Build Solution

As written previously, through both organic and inorganic means, we have diversified our in-house service capabilities so that we are able to provide full turnkey design-build solutions to our clients. These design-build projects allow us to engage with a client at the conception of a project and act as a single point of responsibility to provide value throughout and beyond the project lifecycle. These design-build projects are also much larger from a revenue and project complexity perspective - instead of working on 100s of projects, our goal will be to grow through working on a smaller number of projects of a much larger size, allowing us to capture greater revenue and more margin dollars and overall, provide greater value to our clients. We expect these larger projects will also provide us with the foresight to more accurately forecast our future quarterly business performance.

Expand our Regional Client Base

While continuing to focus on building out our solution set and expanding our client base in all sectors, and more specifically establishing our end-to-end solution as the industry standard for CEA indoor cultivation in the U.S. market, we also plan to continue to expand our reach within Europe.

We are focused on securing and providing value to clients in the CEA sector, and continue to develop and iterate on our marketing and outreach plans as the sector comes online slowly. We have thus far signed several engagements with CEA clients in multiple countries and look to continue our growth through this geographic expansion.

Our Competition

We believe that our experience and expertise combined with our complex end-to-end design-build solutions places us as a growing leader in the indoor-CEA sector. Within that CEA sector, we do face competition from companies that offer some, but not all, portions of an all-encompassing design-build facility solution. We compete for projects with other smaller and mid-sized companies that focus solely on architectural and interior design, engineering, construction, or product sales. For services, we see these competitors as offering similar specific area solutions, though not integrated nor as in depth on fertigation design. For product sales, we currently view our competition to be focused on predominantly commodity “off-the-shelf” items like lighting and other cultivation staple products, both pre-startup and post-startup. This competition comes from traditional wholesale horticulture dealers, online retailers, and some manufacturers who sell direct.

Greenhouse manufacturers and European systems integrators may increasingly seek to offer comprehensive product and service solutions to compete with our integrated solution, but they are primarily focused on the greenhouse industry, and not on indoor-CEA facilities. European systems integrators in particular are experienced and have a strong operating history in traditional horticulture and provide specialized, intensive, and large-scale solutions that revolve around greenhouse projects. Instead of competing with these integrators, we find ourselves working with them and combining synergies to work on projects together.

For our clients from non-CEA sectors such as Industrial, Food and Beverage CPG, Healthcare, Education, and Civic, we believe we face more competition from those who offer some, but not all, portions of a design-build facility solution but also those who employ the design-build methodology. We believe we compete successfully here because while the overall design-build projects come at higher revenues and margin dollars, the projects from non-CEA on which we typically engage are of a size that we believe is smaller than our design-build competitors are set up to take on. In addition, the majority of our non-CEA client base is developed from long-term relationships that provide our Company with a strategic advantage.

Regulation

As it relates to our business conducted in the legalized cannabis-focused CEA segment, the regulations for each region are detailed as follows.

U.S. Regulations

While we do not generate any revenue from the direct sale of cannabis products, we have historically, and may continue to, offer our solutions to indoor cultivators that are engaged in various aspects of the cannabis industry. Tetrahydrocannabinol (“THC”), one of the main active chemicals in cannabis, is a Schedule I controlled substance and is illegal under federal law. Even in those states in which the use of cannabis has been legalized, its use remains a violation of federal laws.

A Schedule I controlled substance is defined as a substance that has no currently accepted medical use in the United States, a lack of safety for use under medical supervision and a high potential for abuse. The Department of Justice defines Schedule I controlled substances as “the most dangerous drugs of all the drug schedules with potentially severe psychological or physical dependence.” If the federal government decides to enforce the Controlled Substances Act with respect to cannabis, persons that are charged with distributing, possessing with intent to distribute, or growing cannabis could be subject to fines and terms of imprisonment, the maximum being life imprisonment and a \$50 million fine. Any such change in the federal government’s enforcement of current federal laws could cause significant financial damage to us. While we do not intend to harvest, distribute or sell cannabis, we may be irreparably harmed by a change in enforcement by the federal or state governments.

Since the use of THC is illegal under federal law, most federally chartered banks will not accept deposit funds from businesses involved with cannabis. Consequently, businesses involved in the cannabis industry generally bank with state-chartered banks and credit unions who provide banking to the industry.

Although cultivation and distribution of cannabis for medical use is permitted in many states, subject to compliance with applicable state and local laws, rules, and regulations, THC is illegal under federal law. Strict enforcement of federal law regarding cannabis could result in material adverse effects on our business and revenues. Though the cultivation and distribution of cannabis containing THC remains illegal under federal law, H.R. 83, enacted by Congress on December 16, 2014, provides that none of the funds made available to the DOJ pursuant to the 2015 Consolidated and Further Continuing Appropriations Act may be used to prevent states from implementing their own laws that authorize the use, distribution, possession, or cultivation of medical cannabis. While this appropriations measure has remained in effect from 2016 through 2022, continued re-authorization cannot be guaranteed. If this appropriations rider is no longer in effect, the risk of federal enforcement and override of state cannabis laws would increase. However, state laws do not supersede the prohibitions set forth in the federal drug laws.

In order to participate in either the medical or adult use sides of the cannabis industry, all businesses must obtain licenses from the state and local jurisdictions. In addition, in most jurisdictions, all owners and employees must obtain an occupational license to be permitted to own or work in a facility. Applicants for licenses undergo a background investigation, including a criminal record check for all owners and employees.

Laws and regulations affecting the medical cannabis industry are constantly changing, which could detrimentally affect our existing and proposed operations. Local, state and federal medical cannabis laws and regulations are broad in scope and subject to evolving interpretations, which could require us to incur substantial costs associated with compliance or alter our business plan. In addition, violations of these laws, or allegations of such violations, could disrupt our business and result in a material adverse effect on our operations. Regulations may be enacted in the future that may be directly applicable to our business. We cannot predict the nature of any future laws, regulations, interpretations or applications, nor can we determine what effect additional governmental regulations or administrative policies and procedures, when and if promulgated, could have on our business.

Intellectual Property

The success of our business depends, in part, on our ability to maintain and protect our proprietary technologies, information, processes and know-how. We rely primarily on patent, trademark, copyright and trade secret laws in the U.S. and similar laws in other countries, confidentiality agreements and procedures and other contractual arrangements to protect our technology and confidential information. Our patents are limited to certain sensors that we obtain from third party manufacturers that do not contribute materially to our sales or profitability. Our trademarks are solely for branding purposes, although we no longer sell any goods or services under the Soleil brand. As of the date of this Report, the following summarizes the status of our registrations, pending applications, and issued U.S. patents:

Trademarks

We have received the following trademark registrations:

Trademark	Jurisdiction	Registration Number	Registration Date	Status
URBAN-GRO	United States	4618322	October 07, 2014	Registered
URBAN-GRO	United Kingdom	3266415	January 19, 2018	Registered
URBAN-GRO	European Union	017391806	October 31, 2018	Registered
URBAN-GRO	Canada	1930075	November 13, 2018	Registered
URBAN-GRO	WIPO	1548013	July 08, 2020	Registered
URBAN-GRO	United Kingdom	UK0081548013	July 08, 2020	Registered
URBAN-GRO	Canada (Madrid)	A0098111	July 08, 2020	Registered
URBAN-GRO	European Union (Madrid)	A0098111	July 08, 2020	Registered
URBAN-GRO	United States	97213742	February 7, 2023	Registered
SOLEIL	United States	5209707	May 23, 2017	Registered
SOLEIL	United Kingdom	3266410	March 09, 2018	Registered
SOLEIL	Canada	1083969	October 07, 2020	Registered
SOLEIL	European Union	017391781	September 11, 2018	Registered
SOLEIL	United Kingdom	UK00917391781	September 08, 2018	Registered
OPTI-DURA	United States	5770091	June 04, 2019	Registered
OPTI-DURA	Canada	TMA1070145	January 20, 2020	Registered
GRO-CARE	European Union	1560748	August 24, 2020	Registered
GRO-CARE	European Union	017391806	October 29, 2019	Registered
GRO-CARE	United Kingdom	UK00917391806	October 29, 2018	Registered
GRO-CARE	Canada (Madrid)	A0099548	August 24, 2020	Registered
GRO-CARE	WIPO	A0099548	August 24, 2020	Registered

We have applied for and are awaiting receipt of the following trademark registrations:

Trademark	Jurisdiction	Application Number	Filing Date	Status
URBAN-GRO	United States	88898690	May 03, 2020	Pending
URBAN-GRO	United States	97213778	January 11, 2022	Pending
GRO-CARE	United States	88898692	May 03, 2020	Pending

Patents

Title	Jurisdiction	Application Number	Filing Date	Patent Number and Issue Date	Status
Sensor bus architecture for modular sensor systems	United States	15/626,085	June 17, 2017	10,499,123 (December 3, 2019)	Issued Expire in 2037
Modular sensor architecture for soil and water analysis at various depths from the surface	United States	15/626,079	June 17, 2017	10,405,069 (September 3, 2019)	Issued Expire in 2037
Modular sensor architecture for soil and water analysis at various depths from the surface	United States	16/519,800	July 23, 2019	10,955,402 (March 23, 2021)	Issued Expire in 2037

We rely on trade secret protection and confidentiality agreements to safeguard our interests with respect to proprietary know-how that is not patentable and processes for which patents are difficult to enforce. We believe that many elements of our design and engineering processes involve proprietary know-how, technology or data that are not covered by patents or patent applications, including technical processes, test equipment designs, algorithms and procedures.

Our policy is for our employees to enter into confidentiality and proprietary information agreements with us to address intellectual property protection issues and require our employees to assign to us all of the inventions, designs and technologies they develop during the course of employment with us. However, we might not have entered into such agreements with all applicable personnel, and such agreements might not be self-executing. Moreover, such individuals could breach the terms of such agreements.

We attempt to protect our intellectual property via the deployment of non-disclosure agreements with both prospective clients and business partners as well as licensees; however, these non-disclosure agreements may not prevent a third party from infringing upon our rights.

Human Capital

As of December 31, 2023, we employed 130 employees, all of which were full-time employees. This is a decrease of 22 employees (14%) from December 31, 2022. Our employees are critical to our continued success. With approximately two-thirds of our employees considered experts, we view our employees and the depth and breadth of their experience and expertise as our competitive advantage. As such, we strive to provide an environment where urban-gro employees can have a fulfilling and productive career. We offer industry-leading employee benefits and programs to ensure the diverse needs of our employees and their families are met, including access to healthcare choices, continued growth opportunities for career development, and resources such as 401(k) plans and counseling to support their financial well-being.

The table below summarizes the change in full-time employee headcount that has occurred by quarter for the years ended December 31, 2023 and 2022:

	2023				2022			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Beginning of period headcount.....	131	137	165	152	115	121	98	86
Net change in headcount.....	(1)	(6)	(28)	13	13	(6)	3	12
Emerald acquisition.....	0	0	0	0	0	0	20	0
DVO acquisition.....	0	0	0	0	24	0	0	0
Ending of period headcount.....	<u>130</u>	<u>131</u>	<u>137</u>	<u>165</u>	<u>152</u>	<u>115</u>	<u>121</u>	<u>98</u>

Available Information

Our internet address is www.urban-gro.com and our investor relations internet address is ir.urban-gro.com. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports can be found on our investor relations website, free of charge, as soon as reasonably practical after we electronically file such material with, or furnish it to, the SEC. Information contained on our website is not incorporated by reference into this Form 10-K. The SEC maintains a public website, www.sec.gov, which contains reports, proxy and information statements, and other information regarding issuers that that file electronically with the SEC.

ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following risks and all of the other information contained in this report before deciding whether to invest in our common stock. If any of the following risks are realized, our business, financial condition and results of operations could be materially and adversely affected. In that event, the trading price of our common stock could decline and you could lose all or part of your investment in our common stock. Additional risks of which we are not presently aware or that we currently believe are immaterial may also harm our business and results of operations. Some statements in this report, including such statements in the following risk factors, constitute forward-looking statements. See the section entitled *Cautionary Information about Forward-Looking Statements* in Part I of this Report.

Risks Related to Our Operations

We have a relatively limited history of operations, a history of losses, and our future earnings, if any, and cash flows may be volatile, resulting in uncertainty about our prospects generally.

We were initially organized as a limited liability company in the State of Colorado on March 20, 2014. In March 2017, we converted into a corporation and on February 12, 2021, we completed an uplisting to Nasdaq under the ticker symbol “UGRO.” The following is a summary of our recent historical operating performance:

- During the year ended December 31, 2023, we generated revenue of \$71.5 million and incurred a net loss of \$18.7 million.
- During the year ended December 31, 2022, we generated revenue of \$67.0 million and incurred a net loss of \$15.3 million.
- During the year ended December 31, 2021, we generated revenue of \$62.1 million and incurred a net loss of \$0.9 million.
- During the year ended December 31, 2020, we generated revenue of \$25.8 million and incurred a net loss of \$5.1 million.

Our lack of a significant history and the evolving nature of the market in which we operate make it likely that there are risks inherent to our business that are yet to be recognized by us or others, or not fully appreciated, and that could result in us suffering further losses. As a result of the foregoing, an investment in our securities necessarily involves uncertainty about the stability of our operating results, cash flows and, ultimately, our prospects generally.

We had negative cash flow from operations for the fiscal years ended December 31, 2023 and December 31, 2022.

We had negative cash flow from operations of \$11.2 million for the fiscal year ended December 31, 2023 and \$12.6 for the fiscal year ended December 31, 2022. To the extent that we have negative cash flow from operations in future periods, we may need to allocate a portion of our cash reserves to fund such negative cash flow. We may also be required to raise additional funds through the issuance of equity or debt securities. We may not be able to generate positive cash flow from our operations and additional capital or other types of financing may not be available when needed or on terms favorable to us.

Our architecture, engineering, design, and construction management services have been used and may continue to be contracted for use in emerging industries that may be subject to quickly changing and inconsistent laws, regulations, practices and perceptions.

Although the demand for our architecture, engineering, design, and construction management services may be negatively impacted depending on how laws, regulations, administrative practices, judicial interpretations, and consumer perceptions develop, we cannot reasonably predict the nature of such developments or the effect, if any, that such developments could have on our business. We will continue to encounter risks and uncertainty relating to our operations that may be difficult to overcome.

We may continue to incur losses in the near future, which may impact our ability to implement our business strategy and adversely affect our financial condition.

While we are focused significantly on controlling our operating expenses by managing variable expenses, employee count, and marketing activities in order to become cash flow positive, these measures may adversely affect our future operating results if we are unable to support the business effectively. In turn, this would have a negative impact on our financial condition and potentially our share price.

We may not become profitable or generate sufficient profits from operations in the future. If our revenues do not continue to grow or our gross profits deteriorate substantially, we are likely to continue to experience losses in future periods. Collectively, this may impact our ability to implement our business strategy and adversely affect our financial condition. This potentially would have a negative impact on our share price.

We may become subject to additional regulation of CEA facilities.

Our engineering and design services are focused on facilities that grow a wide variety of crops that are subject to regulation by the United States Food and Drug Administration and other federal, state or foreign agencies. Changes to any regulations and laws that could complicate the engineering of these CEA facilities, such as waste water treatment and electricity-related mandates, make it possible that potential related enforcement could decrease the demand for our services, and in turn negatively impact our revenues and business opportunities.

Competition in our industry is intense.

There are many competitors in the horticulture industry, including many who offer somewhat categorically similar equipment solutions and services as those offered by us. In the future other companies may enter this arena by developing solutions that directly compete with us. We anticipate the presence as well as entry of other companies in this market space and acknowledge that we may not be able to establish, or if established to maintain, a competitive advantage. Some of these companies have longer operating histories, greater name recognition, larger client bases and significantly greater financial, technical, sales and marketing resources. This may allow them to respond more quickly than us to market opportunities. It may also allow them to devote greater resources to the marketing, promotion and sale of their products and/or services. These competitors may also adopt more aggressive pricing policies and make more attractive offers to existing and potential clients, employees, strategic partners, distribution channels and advertisers. Increased competition is likely to result in price reductions, reduced gross margins and a potential loss of market share.

We depend upon third-party suppliers for the equipment solutions that we sell.

We depend on outside manufacturers for the equipment solutions that we sell. While we believe that there are sufficient sources of supply available, if the third-party suppliers were to cease production or otherwise fail to supply us with products in sufficient quantities on a timely basis and we were unable to contract on acceptable terms for these equipment type products with alternative suppliers, our ability to sell these solutions would be materially adversely affected. If a sole source supplier was to go out of business, we may be unable to find a replacement for such source in a timely manner or at all. If a sole source supplier were to be acquired by a competitor, that competitor may elect not to sell to us in the future. Any inability to secure required products or to do so on appropriate terms could have a materially adverse impact on the business, financial condition, results of operations or prospects of urban-gro.

We have historically depended on a small number of clients for a substantial portion of our revenue. If we fail to retain or expand our client relationships, or if a significant client were to terminate its relationship with us or reduce its purchases, our revenue could decline significantly.

During the year ended December 31, 2023, two clients represented 43% of total revenue. During the year ended December 31, 2022 three clients represented 40% of total revenue. Although we have been able to successfully generate substantial sales to different clients over time, we may not be able to continue to do this in the future. Our operating results for the foreseeable future could continue to depend on substantial sales to a small number of clients. Our clients have no purchase commitments and may cancel, change or delay purchases with little or no notice or penalty. As a result of this, our revenue could fluctuate materially and could be materially and disproportionately impacted by purchasing decisions of any client. Clients who represented a substantial portion of our historical revenue may decide to purchase products and services from other providers in the future, which could cause our revenue to decline materially and negatively impact our financial condition and results of operations. If we are unable to diversify our client base, we will continue to be susceptible to risks associated with client concentration.

A portion of our business depends on our clients obtaining appropriate licenses from various licensing agencies.

A portion of our business depends on our clients obtaining appropriate licenses from various licensing agencies. Any or all licenses necessary for our clients to operate their businesses may not be obtained, retained or renewed. If a licensing body were to determine that one of our clients had violated applicable rules and regulations, there is a risk the license granted to that client could be revoked, which could adversely affect future sales to that client and our operations. Our existing clients may not be able to retain their licenses going forward and new licenses may not be granted to existing and new market entrants.

System security risks, data protection breaches, cyber-attacks and systems integration issues could disrupt our internal operations or services provided to clients.

Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate or compromise our confidential information or that of third parties, create system disruptions or cause shutdowns. Computer programmers and hackers also may be able to develop and deploy viruses, worms, and other malicious software programs that attack or otherwise exploit any security vulnerabilities of the products that we may sell in the future. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes. Delayed sales, lower profits, or lost clients resulting from these disruptions could adversely affect our financial results, stock price and reputation.

We may be forced to litigate to defend our intellectual property rights, or to defend against claims by third parties against urban-gro relating to intellectual property rights.

We may be forced to litigate to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of other parties' proprietary rights. Any such litigation could be very costly and could distract our management from focusing on operating our business. The existence and/or outcome of any such litigation could harm our business.

We may not be able to successfully identify, consummate or integrate acquisitions or to successfully manage the impacts of such transactions on our operations.

Part of our business strategy includes pursuing synergistic acquisitions. We have expanded, and plan to continue to expand, our business by making strategic acquisitions and regularly seeking suitable acquisition targets to enhance our growth. Material acquisitions, dispositions and other strategic transactions involve a number of risks, including: (i) the potential disruption of our ongoing business; (ii) the distraction of management away from the ongoing oversight of our existing business activities; (iii) incurring indebtedness; (iv) the anticipated benefits and cost savings of those transactions not being realized fully, or at all, or taking longer to realize than anticipated; (v) an increase in the scope and complexity of our operations; and (vi) the loss or reduction of control over certain of our assets.

The pursuit of acquisitions may pose certain risks to us. We may not be able to identify acquisition candidates that fit our criteria for growth and profitability. Even if we are able to identify such candidates, we may not be able to acquire them on terms or financing satisfactory to us. We will incur expenses and dedicate attention and resources associated with the review of acquisition opportunities, whether or not we consummate such acquisitions.

Additionally, even if we are able to acquire suitable targets on agreeable terms, we may not be able to successfully integrate their operations with ours. Achieving the anticipated benefits of any acquisition will depend in significant part upon whether we integrate such acquired businesses in an efficient and effective manner. We may not be able to achieve the anticipated operating and cost synergies or long-term strategic benefits of our acquisitions within the anticipated timing or at all. The benefits from any acquisition will be offset by the costs incurred in integrating the businesses and operations. We may also assume liabilities in connection with acquisitions to which we would not otherwise be exposed. An inability to realize any or all of the anticipated synergies or other benefits of an acquisition as well as any delays that may be encountered in the integration process, which may delay the timing of such synergies or other benefits, could have an adverse effect on our business, results of operations and financial condition.

Risks Related to the Legal Cannabis Industry

To date, the majority of our revenues have come from providing architecture and engineering design services and selling equipment systems into facilities prior to the facility becoming operational. The majority of our revenues to date have been generated from clients that operate in the legal cannabis industry.

We are broadening our market reach beyond the legal cannabis industry and are placing a substantial sales effort on expansion into the rapidly growing non-cannabis CEA vertical farming sector as well as the Commercial sector. However, on a historic basis, the majority of our clients to whom we provide facility architecture and engineering design services and sell equipment systems prior to the facility becoming operational have primarily been in the legal cannabis industry. In addition to selling directly to these clients, we also sell our equipment solutions to third parties, such as general contractors and other intermediaries, like equipment leasing companies. The majority of these solutions have been resold into the legal cannabis industry. A significant decrease in demand in the legal cannabis industry could have a material adverse effect on our revenues and the success of our business.

The cannabis industry in the U.S. is an emerging industry and has only been legalized in some states while remaining illegal in others and under U.S. federal law. Federal Prohibition makes it difficult to accurately forecast the demand for our solutions in this specific industry. Losing clients from this industry may have a material adverse effect on our revenues and the success of our business.

The legal cannabis industry is not mature in the United States and has been legalized in only some states and remains illegal in others and under U.S. federal law, making it difficult to accurately forecast demand for our solutions. Revenues could materially decline if the U.S. Department of Justice (“DOJ”) enforces federal law against the industry and some of our clients are negatively impacted.

The legal cannabis industry in the U.S. remains in state of flux, and many aspects of this industry’s development and evolution cannot be accurately predicted. Therefore, losing any clients could have a material adverse effect on our business. While we have attempted to identify our business risks in the legal cannabis industry, investors should carefully consider that there are other risks that cannot be foreseen or are not described in this Report, which could materially and adversely affect our business and financial performance.

As cannabis remains illegal under United States federal law, we may have to stop providing equipment systems and services to companies who are engaged in cannabis cultivation and other cannabis-related activities.

Cannabis, which is referred to as “Marijuana” in the Controlled Substances Act, is currently classified as a Schedule I controlled substance under the Controlled Substances Act and is illegal under United States federal law. It is illegal under United States federal law to grow, cultivate, sell or possess cannabis for any purpose or to assist or conspire with those who do so. Additionally, 21 U.S.C. 856 makes it illegal to “knowingly open, lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or using any controlled substance.” Even in those states in which the use of cannabis has been authorized under state law, its use remains a violation of federal law. Since federal law criminalizing the use of cannabis is not preempted by state laws that legalize its use, strict enforcement of federal law regarding cannabis may result in the inability of our clients that are involved in the cannabis industry to proceed with their operations, which would adversely affect our operations.

Our solutions are used by legal and licensed cannabis growers. While we are not aware of any threatened or current federal or state law enforcement actions against any supplier of equipment that might be used for cannabis cultivation, law enforcement authorities, in their attempt to regulate the illegal use of cannabis, may seek to bring an action or actions against us under the Controlled Substances Act for assisting or conspiring with persons engaged in the cultivation of cannabis.

There is also a risk that our activities could be deemed to be facilitating the selling or distribution of cannabis in violation of the Controlled Substances Act. Although federal authorities have not focused their resources on such tangential or secondary violations of the Controlled Substances Act, nor have they threatened to do so, with respect to the sale of equipment that might be used by legal and licensed cannabis cultivators, or with respect to any supplies marketed to participants in the medical and recreational cannabis industry, if the federal government were to change its practices, or were to expend its resources investigating and prosecuting providers of equipment that could be usable by participants in the medical or recreational cannabis industry, such actions could have a materially adverse effect on our operations and the sales of our products and services.

As a company with clients operating in the legal cannabis industry, we face many particular and evolving risks associated with that industry, including uncertainty of United States federal enforcement and the need to renew temporary safeguards.

The “FinCEN Memo” dated February 14, 2014, de-prioritizes enforcement of the Bank Secrecy Act against financial institutions and cannabis related businesses which utilize them. This memorandum appears to be a standalone document and is presumptively still in effect. At any time, however, the Department of the Treasury, Financial Crimes Enforcement Network, could elect to rescind the FinCEN Memo. This would make it more difficult for our clients and potential clients to access the U.S. banking systems and conduct financial transactions, which would adversely affect our operations.

In 2014, Congress passed a spending bill (“2015 Appropriations Bill”) containing a provision (“Appropriations Rider”) blocking federal funds and resources allocated under the 2015 Appropriations Bill from being used to “prevent such States from implementing their own State medical marijuana law.” The Appropriations Rider seemed to have prohibited the federal government from interfering with the ability of states to administer their medical cannabis laws, although it did not codify federal protections for medical cannabis patients and producers. Moreover, despite the Appropriations Rider, the Justice Department maintains that it can still prosecute violations of the federal cannabis ban and continue cases already in the courts. Additionally, the Appropriations Rider must be re-enacted every year. While it has been continued every year since 2015, including most recently in 2022, continued re-authorization of the Appropriations Rider cannot be guaranteed. If the Appropriation Rider is no longer in effect, the risk of federal enforcement and override of state cannabis laws would increase.

Further legislative development beneficial to our operations is not guaranteed.

Among other things, the business of our clients in the legal cannabis industry involves the cultivation, distribution, manufacture, storage, transportation and/or sale of cannabis products in compliance with applicable state law. The success of our business with respect to these clients depends on the continued development of the cannabis industry and the activity of commercial business and government regulatory agencies within the industry. The continued development of the legal cannabis industry is dependent upon continued legislative and regulatory authorization of cannabis at the state level and a continued laissez-faire approach by federal enforcement agencies. Any number of factors could slow or halt progress in this area. Further regulatory progress beneficial to the industry cannot be assured. While there may be ample public support for legislative action, numerous factors impact the legislative and regulatory process, including election results, scientific findings or general public events. Any one of these factors could slow or halt progressive legislation relating to cannabis and the current tolerance for the use of cannabis by consumers, which could adversely affect our operations.

The legal cannabis industry could face strong opposition from other industries.

We believe that established businesses in other industries may have a strong economic interest in opposing the development of the cannabis industry. Cannabis may be seen by companies in other industries as an attractive alternative to their products, including recreational cannabis as an alternative to alcohol, and medical cannabis as an alternative to various commercial pharmaceuticals. Many industries that could view the emerging legal cannabis industry as an economic threat are well established, with vast economic and United States federal and state lobbying resources. Companies within these industries could use their resources to attempt to slow or reverse legislation legalizing cannabis. Any inroads these companies make in halting or impeding legislative initiatives that would be beneficial to the legal cannabis industry could have a detrimental impact on our clients and, in turn on our operations.

The legality of cannabis could be reversed in one or more states.

The voters or legislatures of states in which cannabis has already been legalized could potentially repeal applicable laws which permit the operation of both legal medical and retail cannabis businesses. These actions might force us to cease operations in one or more states entirely.

Changing legislation and evolving interpretations of law, which could negatively impact our clients and, in turn, our operations.

Laws and regulations affecting the legal medical and adult-use cannabis industry are constantly changing, which could detrimentally affect our clients involved in that industry and, in turn, our operations. Local, state and federal cannabis laws and regulations are often broad in scope and subject to constant evolution and inconsistent interpretations, which could require our clients and ourselves to incur substantial costs associated with modification of operations to ensure compliance. In addition, violations of these laws, or allegations of such violations, could disrupt our clients' business and result in a material adverse effect on our operations. In addition, regulations may be enacted in the future that will limit the amount of cannabis growth or related products that our commercial clients are authorized to produce. We cannot predict the nature of any future laws, regulations, interpretations or applications, nor can we determine what effect additional governmental regulations or administrative policies and procedures, when and if promulgated, could have on our operations.

Regulatory scrutiny of the legal cannabis industry may negatively impact our ability to raise additional capital.

The business activities of certain of our clients rely on newly established and/or developing laws and regulations in multiple jurisdictions. These laws and regulations are rapidly evolving and subject to change with minimal notice. Regulatory changes may adversely affect our profitability or cause us to cease operations entirely. The legal cannabis industry may come under the scrutiny or further scrutiny by the United States Food and Drug Administration (the "FDA"), the SEC, the DOJ, the Financial Industry Regulatory Authority or other federal, state or nongovernmental regulatory authorities or self-regulatory organizations that supervise or regulate the production, distribution, sale or use of cannabis for medical or nonmedical purposes in the United States. The FDA currently is authorized to promulgate regulations for and oversight of CBD products. It is impossible to determine the extent of the impact of any new laws, regulations or initiatives that may be proposed, or whether any proposals will become law. The regulatory uncertainty surrounding the industry that we service may adversely affect our business and operations, including without limitation, the costs to remain compliant with applicable laws and the impairment of our ability to raise additional capital.

Banking regulations could limit access to banking services.

Since the use of cannabis is illegal under federal law, federally chartered banks will not accept deposit funds from businesses involved with cannabis. Consequently, businesses involved in the legal cannabis industry often have trouble finding a bank willing to accept their business. The inability to open bank accounts may make it difficult for our clients in the legal cannabis industry to operate and their reliance on cash can result in a heightened risk of theft, which could harm their businesses and, in turn, harm our business. Additionally, some courts have denied legal cannabis-related businesses bankruptcy protection, thus, making it very difficult for lenders to recoup their investments, which may limit the willingness of banks to lend to our clients and to us.

A drop in the retail price of cannabis products may negatively impact our business.

The fluctuations in economic and market conditions that impact the prices of commercially grown cannabis, such as increases in the supply of cannabis and decreases in demand for cannabis, could have a negative impact on our clients that are legal cannabis producers, and therefore could negatively impact our business.

Our contracts may not be legally enforceable in the United States.

Many of our historic contracts, and those we may enter into in the future, relate to services that are ancillary to the legal cannabis industry and other activities that are not legal under U.S. federal law and under some state laws. As a result, we may face difficulties in enforcing our contracts in U.S. federal and certain state courts.

Risks Related to Ownership of Our Common Stock

Our stock price could be extremely volatile. As a result, shareholders may not be able to resell their shares at or above the price they paid for them.

The market price of our common stock may be highly volatile and could be subject to wide fluctuations. Volatility in the market price of our common stock, as well as general economic, market or political conditions, may prevent shareholders from being able to sell their shares at or above the price they paid for their shares and may otherwise negatively affect the liquidity of our common stock. Shareholders may experience a decrease, which could be substantial, in the value of their stock, including decreases unrelated to our operating performance or prospects, and shareholders could lose part or all of their investment. The price of our common stock has been, and could continue to be, subject to wide fluctuations in response to a number of factors, including those described elsewhere in this Report and others such as:

- our ability to generate revenues sufficient to achieve profitability and positive cash flow;
- competition in our industry and our ability to compete effectively;
- our ability to attract, recruit, retain and develop key personnel and qualified employees;
- reliance on significant clients and third-party suppliers;
- our ability to successfully identify and complete acquisitions and effectively integrate those acquisitions into our operations;
- our actual or anticipated operating and financial results, including how those results vary from the expectations of management, securities analysts and investors;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to us or other industry participants;
- developments in our business or operations or our industry sectors generally;
- any future offerings by us of our common stock;
- any coordinated trading activities or large derivative positions in our common stock, for example, a “short squeeze” (a short squeeze occurs when a number of investors take a short position in a stock and have to buy the borrowed securities to close out the position at a time that other short sellers of the same security also want to close out their positions, resulting in a surge in stock prices, i.e., demand is greater than supply for the stock sold short);
- legislative or regulatory changes affecting our industry generally or our business and operations specifically;
- the operating and stock price performance of companies that investors consider to be comparable to us;
- announcements of strategic developments, acquisitions, restructurings, dispositions, financings and other material events by us or our competitors;
- actions by our current shareholders, including future sales of common shares by existing shareholders, including our directors and executive officers;
- proposed or final regulatory changes or developments;
- anticipated or pending regulatory investigations, proceedings, or litigation that may involve or affect us; and
- the other factors described under *Risk Factors* in *Part I, Item 1A* of this Report.

In response to any one or more of these events, the market price of shares of our common stock could decrease significantly. In the past, securities class action litigation has often been initiated against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources and could also require us to make substantial payments to satisfy judgments or to settle litigation.

Shareholders may be diluted by future issuances of preferred stock or additional common stock in connection with our incentive plans, acquisitions or otherwise; future sales of such shares in the public market, or the expectations that such sales may occur, could lower our stock price.

Our certificate of incorporation authorizes us to issue shares of our common stock and options, rights, warrants and appreciation rights relating to our common stock for the consideration and on the terms and conditions established by our Board in its sole discretion. We could issue a significant number of shares of common stock in the future in connection with investments or acquisitions. Any of these issuances could dilute our existing shareholders, and such dilution could be significant. Moreover, such dilution could have a material adverse effect on the market price for the shares of our common stock.

The future issuance of shares of preferred stock with voting rights may adversely affect the voting power of the holders of shares of our common stock, either by diluting the voting power of our common stock if the preferred stock votes together with the common stock as a single class, or by giving the holders of any such preferred stock the right to block an action on which they have a separate class vote, even if the action were approved by the holders of our shares of our common stock.

The future issuance of shares of preferred stock with dividend or conversion rights, liquidation preferences or other economic terms favorable to the holders of preferred stock could adversely affect the market price for our common stock by making an investment in the common stock less attractive. For example, investors in the common stock may not wish to purchase common stock at a price above the conversion price of a series of convertible preferred stock because the holders of the preferred stock would effectively be entitled to purchase common stock at the lower conversion price, causing economic dilution to the holders of common stock.

We do not anticipate paying any cash dividends on our common stock in the foreseeable future.

We currently intend to retain our future earnings, if any, for the foreseeable future, to fund the development and growth of our business. We do not intend to pay any dividends to holders of our common stock in the foreseeable future. Any decision to declare and pay dividends in the future will be made at the discretion of our Board taking into account various factors, including our business, operating results and financial condition, current and anticipated cash needs, plans for expansion, any legal or contractual limitations on our ability to pay dividends under our loan agreements or otherwise. As a result, if our Board does not declare and pay dividends, the capital appreciation in the price of our common stock, if any, will be our shareholders only source of gain on an investment in our common stock, and shareholders may have to sell some or all of their common stock to generate cash flow from their investment.

If securities or industry analysts do not publish research or reports about our business, or if they downgrade their recommendations regarding our common stock, its trading price and volume could decline.

We expect the trading market for our common stock to be influenced by the research and reports that industry or securities analysts publish about us, our business or our industry. If no additional securities or industry analysts commence coverage of our company, the trading price for our stock may be negatively impacted. If one or more of our covering analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline and our common stock to be less liquid. Moreover, if one or more of the analysts who cover us downgrades our stock or publishes inaccurate or unfavorable research about our business, or if our results of operations do not meet their expectations, our stock price could decline.

Taking advantage of the reduced disclosure requirements applicable to “emerging growth companies” may make our common stock less attractive to investors.

We qualify as an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012 (“JOBS Act”). An emerging growth company may take advantage of certain reduced reporting and other requirements that are otherwise generally applicable to public companies, as described above. We currently intend to take advantage of each of these exemptions. We have elected not to opt out of such extended transition period, which means that when a standard is issued or revised and it has different application dates for public or private companies, we, as an emerging growth company, can adopt the new or revised standard at the time private companies adopt the new or revised standard. This may make a comparison of our financial statements with the financial statements of a public company that is not an emerging growth company, or the financial statements of an emerging growth company that has opted out of using the extended transition period, difficult or impossible because of the potential differences in accounting standards used. We could be an emerging growth company until December 31, 2023. We cannot predict if investors will find our common stock less attractive if we elect to rely on these exemptions, or if taking advantage of these exemptions would result in less active trading or more volatility in the price of our common stock.

Provisions of our certificate of incorporation and bylaws may delay or prevent a take-over that may not be in the best interests of our shareholders.

Provisions of our certificate of incorporation and bylaws may be deemed to have anti-takeover effects, which include when and by whom special meetings of our shareholders may be called, and may delay, defer or prevent a takeover attempt.

In addition, our certificate of incorporation authorizes the issuance of up to 3,000,000 shares of preferred stock with such rights and preferences determined from time to time by our Board. None of our preferred shares are currently issued or outstanding. Our Board may, without shareholder approval, issue preferred shares with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of our common stock.

The requirements of being a public company may strain our resources, divert management’s attention and affect our ability to attract and retain executive management and qualified Board members.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Act, and other applicable securities rules and regulations. Compliance with these rules and regulations involves significant legal and financial compliance costs, may make some activities more difficult, time-consuming or costly and may increase demand on our systems and resources, particularly after we are no longer an “emerging growth company,” as defined in the JOBS Act. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management’s attention may be diverted from other business concerns, which could adversely affect our business and operating results. We may need to hire more employees in the future or engage outside consultants, which will increase our costs and expenses.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management’s time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us, and our business may be adversely affected.

However, for as long as we remain an “emerging growth company,” we may take advantage of certain exemptions from various reporting requirements that are applicable to public companies that are not “emerging growth companies” including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. We may take advantage of these reporting exemptions until we are no longer an “emerging growth company.” December 31, 2023 was our last day as an emerging growth company, and we will no longer be eligible for these exemptions going forward.

As a result of disclosure of information in this Report and in filings required of a public company, our business and financial condition are highly visible, which may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business and operating results could be adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business and operating results.

We are subject to ongoing regulatory burdens resulting from our public listing.

We continually work with our legal, accounting and financial advisors to identify those areas in which changes should be made to our financial management control systems to manage our obligations as a public company listed on Nasdaq. These areas include corporate governance, corporate controls, disclosure controls and procedures and financial reporting and accounting systems. We have made, and will continue to make, changes in these and other areas, including our internal controls over financial reporting. However, these and other measures that we might take may not be sufficient to allow us to satisfy our obligations as a public company listed on Nasdaq on a timely basis. In addition, compliance with reporting and other requirements applicable to public companies listed on Nasdaq creates additional costs for us and requires the time and attention of management. The additional costs that we incur, the timing of such costs and the impact that management’s attention to these matters may adversely affect our business and operating results.

General Risk Factors

We are highly dependent on our management team, and the loss of our executive officers or other key employees could harm our ability to implement our strategies, impair our relationships with clients and adversely affect our business, results of operations and growth prospects.

Our success depends, in large degree, on the skills of our management team and our ability to retain, recruit and motivate key officers and employees. Our senior executive leadership team has significant experience, and their knowledge and relationships would be difficult to replace. Leadership changes will occur from time to time, and we cannot predict whether significant resignations will occur or whether we will be able to recruit additional qualified personnel. Competition for senior executives and skilled personnel in the horticulture industry is intense, which means the cost of hiring, paying incentives and retaining skilled personnel may continue to increase.

We need to continue to attract and retain key personnel and to recruit qualified individuals to succeed existing key personnel to ensure the continued growth and successful operation of our business. In addition, as a provider of custom-tailored horticulture solutions, we must attract and retain qualified personnel to continue to grow our business, and competition for such personnel can be intense. Our ability to effectively compete for senior executives and other qualified personnel by offering competitive compensation and benefit arrangements may be restricted by cash flow and other operational restraints. The loss of the services of any senior executive or other key personnel, or the inability to recruit and retain qualified personnel in the future, could have a material adverse effect on our business, financial condition or results of operations. In addition, to attract and retain personnel with appropriate skills and knowledge to support our business, we may offer a variety of benefits, which could reduce our earnings or have a material adverse effect on our business, financial condition or results of operations.

Our insurance may not adequately cover our operating risk.

We have insurance to protect our assets, operations and employees. While we believe our insurance coverage addresses all material risks to which we are exposed and is adequate and customary in our current state of operations, such insurance is subject to coverage limits and exclusions and may not be available for the risks and hazards to which we are exposed. In addition, such insurance may not be adequate to cover our liabilities or may not be generally available in the future or, if available, premiums may not be commercially justifiable. If we were to incur substantial liability and such damages were not covered by insurance or were in excess of policy limits, or if we were to incur such liability at a time when we are not able to obtain liability insurance, our business, results of operations and financial condition could be materially adversely affected.

We may be exposed to currency fluctuations.

Although our revenues and expenses are expected to be predominantly denominated in United States dollars, we may be exposed to currency exchange fluctuations. Recent events in the global financial markets have been coupled with increased volatility in the currency markets. Fluctuations in the exchange rate between the U.S. dollar, the Canadian dollar, the Euro, and the currency of other regions in which we may operate may have a material adverse effect on our business, financial condition and operating results. We may, in the future, establish a program to hedge a portion of our foreign currency exposure with the objective of minimizing the impact of adverse foreign currency exchange movements. However, even if we develop a hedging program, there can be no assurance that it will effectively mitigate currency risks.

Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial results.

U.S. generally accepted accounting principles (“U.S. GAAP”) and related pronouncements, implementation guidelines and interpretations with regard to a wide variety of matters that are relevant to our business, such as, but not limited to, revenue recognition, stock-based compensation, trade promotions, and income taxes are highly complex and involve many subjective assumptions, estimates and judgments by our management. Changes to these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported results.

Our ability to maintain our reputation is critical to the success of our business, and the failure to do so may materially adversely affect our business and the value of our common stock.

Our reputation is a valuable component of our business. Threats to our reputation can come from many sources, including adverse sentiment about our industry generally, unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, and questionable or fraudulent activities of our clients. Negative publicity regarding our business, employees, or clients, with or without merit, may result in the loss of clients, investors and employees, costly litigation, a decline in revenues and increased governmental regulation. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results and the value of our common stock may be materially adversely affected.

Increased attention to climate change and ESG matters may adversely impact our business.

We are subject to a variety of risks arising from ESG matters. ESG matters include increasing attention to climate change, climate risk, expectations on companies to address climate change, hiring practices, the diversity of the work force, racial and social justice issues involving the Company’s personnel, customers and third parties with whom it otherwise does business, and investor and societal expectations regarding ESG matters and disclosures.

Risks arising from ESG matters may adversely affect, among other things, reputation and the market price of our stock. Further, we may be exposed to negative publicity based on the identity and activities of those we do business with and the public’s view of the approach and performance of our customers and business partners with respect to ESG matters. Any such negative publicity could arise from adverse news coverage in traditional media and could also spread through the use of social media platforms. Our relationships and reputation with our existing and prospective customers and third parties with which we do business could be damaged if we were to become the subject of any such negative publicity. This, in turn, could have an adverse effect on our ability to attract and retain customers and employees and could have a negative impact on the market price for our stock. Investors have begun to consider the steps taken and resources allocated by financial institutions and other commercial organizations to address ESG matters when making investment and operational decisions. Certain investors are beginning to incorporate the business risks of climate change and the adequacy of companies’ responses to the risks posed by climate change and other ESG matters into their investment theses. These shifts in investing priorities may result in adverse effects on the market price of our stock to the extent investors determine we have not made sufficient progress on ESG matters.

In addition, customers, employees, regulators and suppliers have also been focused on ESG matters. Companies that do not adapt to or comply with ESG expectations and standards, or that are perceived to have not responded appropriately to the growing concern regarding ESG issues, regardless of whether there is a legal requirement to do so, may suffer from reputational damage and other adverse consequences. To the extent ESG matters negatively impact our reputation, we may not be able to compete as effectively to recruit or retain employees, which may adversely affect our operations.

Further, growing public concern about climate change has resulted in the increased focus of local, state, regional, national and international regulatory bodies on greenhouse gas emissions and climate change issues. Policy changes and changes in federal, state and local legislation and regulations based on concerns about climate change, including regulations aimed at limiting greenhouse gas emissions and the implementation of “green” building codes, could result in increased capital expenditures on our existing properties (for example, to improve their energy efficiency) without a corresponding increase in revenue, resulting in adverse impacts to our results of operations.

In March 2024, the SEC issued final rules on climate change disclosure requirements that will require disclosure of climate-related information by all registrants. To the extent new rules impose additional reporting obligations on us, we could face increased costs. The SEC has also announced that it is scrutinizing climate-change related disclosures in public filings, increasing the potential for enforcement if the SEC were to allege that our existing climate disclosures are misleading or deficient. However, any assessment of the potential impact of future climate change legislation, regulations or industry standards, as well as any international treaties and accords, is uncertain given the wide scope of potential regulatory change.

The current political climate and military actions in Eastern Europe could result in disruption to our operations.

Expansion into Europe to meet the demand for our services could be disrupted by the ongoing military actions in Eastern Europe. If we are unable to continue our expansion into Europe, or our expansion requires greater capital than we have budgeted, our operating results and the value of our common stock may be materially adversely affected.

Further, the conflict has led to increases in the cost of energy and the potential for energy shortages, especially in Europe. The European energy crisis has continued in 2023 amid the Russia and Ukraine war, fueling supply uncertainties and increasing the risk of energy shortages across Europe due to the lack of gas from Russia. This resulted in decisive measures implemented by the European Union to help manage security of supply and establish new sources of gas. Our customers and potential customers experienced a rapid increase in energy costs and our expectation is that the energy cost inflation will continue into 2024.

Failure to retain our existing workforce and to attract qualified new personnel in the current labor market could adversely affect our business and results of operations.

The current U.S. labor shortage has and may continue to impact our ability to hire and retain qualified personnel and may impact our ability to operate our business effectively. We may experience a labor shortage preventing us from filling targeted staffing

levels. A labor shortage may also impact our ability to attract qualified new personnel. Additionally, the COVID pandemic has changed the way businesses operate with companies allowing employees to work remotely from home or in hybrid work models. We may not be able to attract, hire or retain qualified personnel if competing companies offer a more desirable work model.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 1C. CYBERSECURITY

Cybersecurity Risks

We rely on information technology systems and networks to process, transmit, and store electronic information in our operations, including our proprietary business information and that of our customers, suppliers, and employees. We use various information technology systems and networks to manage our operations and maintain effective internal control over financial reporting. We also collect and store sensitive data, including intellectual property, proprietary business information, and personal information of our customers, suppliers, and employees, in our data centers and on our networks. The secure operation of these information technology systems and networks, and the processing and maintenance of this information, are critical to our business operations and strategy.

Despite our security measures, our information technology systems and networks may be subject to damage, disruption, or unauthorized access due to a variety of factors, including cyberattacks by computer hackers, computer viruses, ransomware, phishing, denial-of-service attacks, physical or electronic break-ins, employee error or malfeasance, power outages, natural disasters, or other catastrophic events. Any such damage, disruption, or unauthorized access could compromise our networks and the information stored there could be accessed, publicly disclosed, lost, or stolen. Any such access, disclosure, or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, regulatory penalties, disruption to our operations, damage to our reputation, loss of customers, potential harm to our competitive position, and additional costs to remediate the issue.

Cybersecurity Practices

We have implemented various measures to manage our risk of information technology systems and networks damage, disruption, or unauthorized access, including employee training, monitoring of our systems and networks, maintenance of backup and protective systems, and use of modern endpoint detection and response tools which are integrated into urban-gro's risk management systems and processes. We also operate in a fully cloud-based environment, which enhances our scalability, flexibility, and resilience and utilize 3rd parties to perform early internal and external vulnerability assessment and risk identification. We have established extensive backup and recovery procedures to ensure the continuity of our operations in a cyber incident. We also maintain cyber liability insurance coverage as part of our comprehensive risk management program. However, these measures may not be sufficient to prevent, detect, or mitigate the impact of such damage, disruption, or unauthorized access. Moreover, the regulatory environment related to information security, data protection, and privacy is increasingly demanding and complex, and compliance with applicable laws and regulations may result in significant costs or require changes in our business practices that could adversely affect our operations.

Cybersecurity Leadership

Our Board of Directors is actively involved in overseeing our cybersecurity risk management. Our Board of Directors receives quarterly updates on our cybersecurity posture, threats, and incidents from our Senior Vice President of Technology. Our Board of Directors also delegates certain oversight functions to our Audit Committee, which reviews our cybersecurity policies, procedures, controls, and audit results. Our Board of Directors and our Audit Committee regularly assess the adequacy of our cybersecurity risk management framework and the effectiveness of our mitigation strategies.

Our cybersecurity operations are led by our Senior Vice President of Technology, who has over 20 years of experience in the field of cybersecurity. He is responsible for developing and implementing our cybersecurity strategy, policies, standards, and practices. He also oversees our cybersecurity team, which includes a staff member who recently completed his master's degree in cybersecurity. Our cybersecurity team monitors, detects, responds, and reports on cybersecurity threats and incidents, and coordinates with our internal and external stakeholders to ensure the security of our information assets.

urban-gro adheres to the NIST Cybersecurity Framework 2.0, which provides a set of standards, guidelines, and best practices to manage cybersecurity-related risks. We have developed and documented our systems disaster recovery plan, which outlines the roles, responsibilities, and procedures for restoring our critical systems and data in the event of a cyber incident. We have also crafted over 12 internal policies to help maintain a secure environment, such as our information security policy, our data classification policy, our incident response policy, and our password policy. We regularly conduct phishing simulations, vulnerability scans, penetration tests, and audits to test the effectiveness of our controls and backups, and to identify and remediate any gaps or weaknesses in our cybersecurity posture.

Cybersecurity Incidents

Despite our efforts to prevent and mitigate cybersecurity incidents, we cannot guarantee that we will not experience any breaches, disruptions, or unauthorized access to our information technology systems and networks. We have experienced, and may continue to experience, cybersecurity incidents that could have a material adverse effect on our business, financial condition, results of operations, and prospects. For example, in 2019, we were a victim of a wire fraud scheme, in which a fraudulent party compromised the email account of one of our employees and sent a fraudulent wire transfer request to our bank. We believe the bank did not follow its verification procedures and executed the wire transfer without our authorization. Please see Legal Proceedings section for more information. After this incident, we implemented multi-factor authentication (MFA) across all our systems and email accounts, to prevent unauthorized access and impersonation. We also enhanced our internal controls and training to prevent and detect wire fraud and other cyber risks.

ITEM 2. PROPERTIES

Our principal place of business is located at 1751 Panorama Point, Unit G, Lafayette, Colorado, 80026. This location is leased and consists of approximately 10,000 square feet, including approximately 3,500 square feet of office space and 6,500 square feet of warehouse space. Additionally, we have six other office leases in the United States and one office lease located in the Netherlands. We currently do not own any property.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we become involved in or are threatened with legal disputes. While most of these disputes are not likely to have a material effect on our business, financial condition, or operations, the following matters are deemed by the Company to be material either due to the costs of litigation or the potential negative impacts to the Company should these matters not be resolved in our favor:

- Great Green Theory – On June 10, 2022, Emerald filed a lien and brought a suit in the Superior Court of Berkshire, Massachusetts to foreclose on the lien against Great Green Theory Land, LLC and Great Green Theory Cultivation, LLC who are the owners of the land and a construction project in Lee, Massachusetts. Emerald is claiming breach of contract and *quantum merit* against Great Green Theory for failure to pay approximately \$1.3 million in payment applications. Great Green Theory has filed counterclaims against Emerald claiming liquidated damages of approximately \$1.0 million for alleged unjustifiable delays on the project and alleging construction defects in the project. Emerald has settled two subcontractor suits against Emerald for non-payment to them of which Emerald has not received payment from Great Green Theory.
 - o Accounts receivable and accounts payable related to Great Green Theory – The selling Emerald shareholders have agreed to indemnify and defend the Company for any litigation or judgement stemming from this lawsuit. The Company has recorded \$1.3 million as a receivable and \$0.4 million as a payable to sub-contractors on the opening balance sheet as of the date of the acquisition.

- o Legal Costs to collect Great Green Theory accounts receivable – The Company has agreed to split the legal costs of this claim until the funds are recovered or until the claim of liquidated damages is relieved. Total estimated legal costs associated with this claim are approximately \$0.3 million. The Company recorded 50% of this amount as a liability on the opening balance sheet as of the date of the acquisition.
- Pullar – urban-gro’s former Chief Financial Officer, George Pullar, filed a suit in the District Court of Boulder County, Colorado against urban-gro and Bradley Natrass, in his capacity as urban-gro’s CEO, claiming breach of fiduciary duty. The claims stem from a settlement agreement with Mr. Pullar and allegations that Mr. Natrass and urban-gro failed to share enough non-public material information about urban-gro’s plans for fundraising that would have impacted Mr. Pullar’s decision to enter into the settlement agreement. urban-gro’s director and officer liability insurance carrier has indicated coverage is available to Mr. Natrass for this suit. We believe we have substantial defenses to the claim asserted in this lawsuit and intend to vigorously defend this action.
- Crest Ventures, LLC – urban-gro was sued on July 29, 2021, by Crest Ventures, LLC in a breach of contract case in the District Court for Arapahoe County, Colorado. The allegations in the action are based on a claim that Crest Ventures, LLC is entitled to commission compensation on the February 2021 uplisting of our common stock to Nasdaq. urban-gro joined as a third-party defendant, Andrew Telsey, for breach of fiduciary duty and fraud. urban-gro also counter-claimed

Crest Ventures, LLC for fraud and declaratory judgment. Mr. Telsey was urban-gro’s counsel at the time and he claims he was also a member of Crest Ventures. urban-gro entered into a finder’s fee agreement with Crest Ventures for a potential M&A transaction. Crest Ventures and Mr. Telsey claim the finder’s fee agreement also applies to the uplisting onto the Nasdaq. urban-gro denies these claims, believes Crest Ventures and Mr. Telsey are perpetrating fraud, and Mr. Telsey breached his fiduciary duties as legal counsel for urban-gro in the transaction. We believe we have substantial defenses to the claim asserted in this lawsuit and intend to vigorously defend this action. On August 11, 2023, the Company entered into a settlement agreement and mutual release (the “Settlement Agreement”) with Crest Ventures, LLC and Andrew Telsey to settle all claims in the litigation filed in the District Court for Arapahoe County, Colorado, Case No. 2021CV31301. Pursuant to the Settlement Agreement, the Company made a payment of \$1,500,000 to Crest Ventures, LLC on September 7, 2023. In connection with this settlement, the Company recorded a loss in the second quarter of 2023 of \$1,500,000 in accordance with GAAP related to loss contingencies. The case was dismissed with prejudice by the Court on October 5, 2023.

- Sunflower Bank – urban-gro filed a lawsuit on November 5, 2021, against Sunflower Bank in the District Court for Boulder County, Colorado related to fraudulent wire transfers of approximately \$5.1 million that were made from our accounts at Sunflower Bank in October 2021. During 2022, \$1.7 million of these funds were returned to us and we received \$0.25 million from our insurance company. We sued Sunflower Bank for \$3.4 million, exclusive of the insurance proceeds, under a theory of breach of contract, negligence, and breach of UCC standards, as we believed that Sunflower Bank failed to follow industry standard procedures designed to prevent such a theft and was therefore liable for the unrecovered balance. Sunflower Bank filed counterclaims against us for breach of contract and negligence. urban-gro entered into a settlement agreement with Sunflower bank and received \$2.4 million in settlement proceeds on March 27, 2023. The case was dismissed with prejudice on March 29, 2023.

There can be no assurance that future developments related to pending claims filed in the future, whether as a result of adverse outcomes or as a result of significant defense costs, will not have a material effect on urban-gro’s financial condition, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

On February 17, 2021, we completed a public offering of 6,210,000 shares of our common stock, inclusive of the underwriters' full over-allotment, at \$10.00 per share for total gross offering proceeds of \$62,100,000. In connection with the offering, we received approval to list our common stock on Nasdaq Capital Market under the symbol "UGRO." Prior to the offering, shares of our common stock were quoted on the OTC Markets Group, Inc. OTCQX Marketplace under the symbol "UGRO." Although our shares were quoted on the OTCQX Marketplace from October 7, 2019 through February 11, 2021, because trading on the OTCQX Marketplace was infrequent and limited in volume, the prices at which such transactions occurred did not necessarily reflect the price that would have been paid for our common stock in a more liquid market.

The trading price of our common stock has been, and may continue to be, subject to wide price fluctuations in response to various factors, many of which are beyond our control, including those described in Part I, Item 1A, "Risk Factors."

HOLDERS

As of March 16, 2024, we had 89 holders of record of our Common Stock. The number of shareholders of record does not include beneficial owners of our common stock whose shares are held in the names of various dealers, clearing agencies, banks, brokers and other fiduciaries.

DIVIDENDS

Since our inception, we have not paid any dividends on our common stock, and we currently expect that, for the foreseeable future, all earnings, if any, will be retained for use in the development and operation of our business. In the future, our Board may decide, at its discretion, whether dividends may be declared and paid to holders of our common stock.

REPORTS

We are subject to certain reporting requirements and furnish annual financial reports to our shareholders, certified by our independent accountants, and furnish unaudited quarterly financial reports in our quarterly reports filed electronically with the SEC. All reports and information filed by us can be found at the SEC website, www.sec.gov.

UNREGISTERED SALES OF EQUITY SECURITIES

During the quarter ended December 31, 2023, we issued the following securities that were not registered under the Securities Act:

- During the quarter ended, December 31, 2023, the Company issued shares of the Company's common stock to satisfy contingent consideration purchase price liabilities for the Emerald and DVO acquisitions as follows:
 - o Emerald - 85,639 shares at an average price per share of \$1.31.
 - o DVO - 110,486 shares at an average price per share of \$1.33.

The foregoing issuances of restricted shares of common stock were issued under Section 4(a)(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D promulgated thereunder. The Company believes the issuance of the foregoing restricted shares was exempt from registration as a privately negotiated, isolated, non-recurring transaction not involving a public solicitation. No commissions were paid regarding the share issuances, and the share certificates were issued with a Rule 144 restrictive legend.

Purchase of Equity Securities by Issuer and Affiliated Purchasers

During the year ended December 31, 2023, the Company did not repurchase common stock. The Company's Board has authorized the Company to repurchase common stock through a variety of methods, including open market repurchases, purchases by contract (including, without limitation, 10b5-1 and 10b-18 plans), and/or privately negotiated transactions. The amount, timing, or prices of repurchases, may vary based on market conditions and other factors. The program does not have an expiration date and can be modified or terminated by the Board at any time. On May 24, 2021, the Board authorized a stock repurchase program to purchase up to \$5.0 million of outstanding shares of the Company's common stock. On January 18, 2022, the Board authorized a \$2.0 million increase to the stock repurchase program, to a total of \$7.0 million. On February 2, 2022, the Board authorized an additional \$1.5 million increase to the stock repurchase, to a total of \$8.5 million. On September 12, 2022, the Board authorized an additional \$2.0 million increase to the stock repurchase program, to a total of \$10.5 million. In total, the Company has repurchased 1,099,833 shares of common stock at an average price per share of \$8.25 for a total of \$9.1 million, under this program. As of December 31, 2023, we have \$1.4 million remaining under the repurchase program.

ITEM 6. [RESERVED]

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

The following discussion and analysis of our results of operations and financial condition should be read together with the financial statements and related notes and the other financial information included elsewhere in this Report. Such discussion and analysis reflects our historical results of operations and financial position. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Risk Factors" and "Cautionary Information about Forward-Looking Statements" and elsewhere in this Report. All share and per share amounts presented herein have been restated to reflect the implementation of the 1-for-6 reverse stock split as if it had occurred at the beginning of the earliest period presented.

OVERVIEW AND HISTORY – SEE "ITEM 1. BUSINESS" FOR A FURTHER DESCRIPTION OF OUR HISTORY AND BACKGROUND

urban-gro is an integrated professional services and Design-Build firm. Our business focuses primarily on providing fee-based professional services, Design-Build solutions, as well as the value-added reselling and integration of equipment systems. We derive income from our ability to generate revenue from our clients through the billing of our employees' time spent on client projects. We offer value-added architectural, engineering, systems procurement and integration, and construction solutions to customers operating in the CEA and Commercial sectors. In the CEA sector, our clients include operators and facilitators in both the cannabis and produce markets in the United States, Canada, and Europe. In the Commercial sector, we work with leading Food and Beverage CPG companies in the United States, and clients in other commercial sectors including light industrial, healthcare, higher education, laboratories, and hospitality. During 2021 and 2022, we made the following acquisitions:

- July 2021 - Three affiliated architecture design companies (the "2WR Entities")
- April 2022 - A construction Design-Build firm ("Emerald")
- October 2022 - An engineering firm ("DVO")

RESULTS OF OPERATIONS

Comparison of Results of Operations for the years ended December 31, 2023 and 2022

During the year ended December 31, 2023, we generated revenues of \$71.5 million compared to revenues of \$67.0 million during the year ended December 31, 2022, an increase of \$4.5 million, or 7%. This increase in revenues is the net result of the following changes in individual revenue components:

- Construction design-build revenues increased \$26.4 million, primarily due to significant organic growth within this group;
- Services revenue decreased \$0.9 million, which was the result of a decrease in revenues in our existing business due to negative market conditions in the CEA sector;
- Equipment systems revenue decreased \$20.7 million due to negative market conditions in the CEA sector and a reduction in capital equipment spending by customers; and
- Other revenue decreased \$0.3 million.

During the year ended December 31, 2023, cost of revenues was \$61.3 million compared to \$52.8 million during the year ended December 31, 2022, an increase of \$8.4 million, or 16%. This increase is directly attributable to the increase in revenues indicated above.

Gross profit was \$10.3 million (14% of revenue) during the year ended December 31, 2023, compared to \$14.2 million (21% of revenue) during the year ended December 31, 2022. Gross profit as a percentage of revenues decreased overall due to increases in lower margin construction design-build revenue combined with decreases in higher margin equipment systems and services revenue.

Operating expenses increased by \$0.1 million, or 0%, to \$27.0 million for the year ended December 31, 2023 compared to \$26.8 million for the year ended December 31, 2022. This increase was due to the net effects of the following:

- a \$3.8 million increase in general and administrative expenses due to an increase in legal fees defending lawsuits, increases in the average number of personnel and increases in construction design-build revenue which increased business insurance and lease costs;

- a \$3.3 million decrease in a one-time business development expense related to satisfying an equipment lighting issue encountered by a major customer; and
- a \$0.4 million decrease in share based compensation due to a reduction in the number of employees who received grants in 2023 as compared to 2022.

Non-operating expense was \$2.2 million for the year ended December 31, 2023, compared to \$3.0 million for the year ended December 31, 2022, a decrease of \$0.7 million. This decrease was primarily due to a \$1.5 million loss on settlement and a \$0.3 million impairment loss in 2023 compared to a \$2.7 million impairment loss recorded in 2022.

As a result of the above, we incurred a net loss of \$18.7 million for the year ended December 31, 2023, or a net loss per share of \$1.66, compared to a net loss of \$15.3 million for the year ended December 31, 2022, or a net loss per share of \$1.44.

NON-GAAP FINANCIAL MEASURES

The Company uses the supplemental financial measure of Adjusted Earnings before Interest, Taxes, Depreciation and Amortization (“Adjusted EBITDA”) as a measure of our operating performance. Adjusted EBITDA is not calculated in accordance with U.S. GAAP and it is not a substitute for other measures prescribed by U.S. GAAP such as net income (loss), income (loss) from operations, and cash flows from operating activities. We define Adjusted EBITDA as net income (loss) attributable to urban-gro, Inc., determined in accordance with U.S. GAAP, excluding the effects of certain operating and non-operating expenses including, but not limited to, interest expense/income, income taxes/benefit, depreciation of tangible assets, amortization of intangible assets, impairment losses, unrealized exchange gains/losses, debt forgiveness and extinguishment, stock-based compensation expense, acquisition costs, and other nonrecurring expenses that we do not believe reflect our core operating performance.

Our Board and management team focus on Adjusted EBITDA as a key performance and compensation measure. We believe that Adjusted EBITDA assists us in comparing our operating performance over various reporting periods because it removes from our operating results the impact of items that our management believes do not reflect our core operating performance.

The following table reconciles net loss attributable to the Company to Adjusted EBITDA for the periods presented:

	Years Ended December 31,	
	2023	2022
Net loss	<u>\$(18,681,061)</u>	<u>\$(15,277,909)</u>
Interest expense.....	271,686	54,579
Interest income.....	(173,895)	(329,012)
Federal and state income tax (provisions).....	(215,864)	(322,092)
Federal and state income tax payments.....	185,910	16,253
Depreciation and amortization	1,636,667	1,483,065
EBITDA	<u>\$(16,976,557)</u>	<u>\$(14,375,116)</u>
Non-recurring legal fees.....	1,249,133	352,173
One-time employee expenses.....	—	819,089
Contingent consideration - change in fair value.....	160,232	436,905
Contingent consideration - DVO acquisition	278,559	—
Reduction in force costs	346,725	—
One time business development expenses.....	—	3,299,864
Impairment loss.....	258,492	2,660,934
Loss on settlement.....	1,500,000	—
Retention incentive.....	1,242,000	—
Stock-based compensation	2,199,046	2,571,785
Transaction costs.....	30,197	347,317
Adjusted EBITDA (non-GAAP)	<u><u>\$ (9,712,173)</u></u>	<u><u>\$ (3,887,049)</u></u>

BACKLOG

Backlog is a financial measure that generally reflects the dollar value of revenue that the Company expects to realize in the future. Although backlog is not a term recognized under U.S GAAP, it is a common measure used by companies operating in our industries. We report backlog for the following revenue categories: (i) Equipment Systems; (ii) Construction Design-Build; and (iii) Services. We define backlog for Equipment Systems and Services as signed contracts, with Equipment Systems contracts generally requiring receipt of a customer deposit prior to being included in backlog. Construction Design-Build backlog is comprised of construction projects once the contract is awarded and to the extent we believe funding is probable. Our Construction Design/Build backlog consists of uncompleted work on contracts in progress and contracts for which we have executed a contract but have not commenced the work. For uncompleted work on contracts in progress, we include (i) executed change orders, (ii) pending change orders for which we expect to receive confirmation in the ordinary course of business, and (iii) claims that we have made against our customers for which we have determined we have a legal basis under existing contractual arrangements and as to which we consider collection to be probable.

Backlog for each of our revenue categories as of December 31, 2023 and December 31, 2022 is reflected in the following tables:

December 31, 2023				
	CEA	Commercial	Total	Relative Percentage
	(in millions)			
Equipment systems	\$ 1	\$ —	\$ 1	1%
Services	\$ 3	\$ 4	\$ 7	6%
Construction design-build.....	\$ 73	\$ 29	\$ 102	93%
Total backlog	<u>\$ 77</u>	<u>\$ 33</u>	<u>\$ 110</u>	100%
Relative percentage.....	70%	30%	100%	

Note: Percentages may not add up due to rounding.

December 31, 2022				
	CEA	Commercial	Total	Relative Percentage
	(in millions)			
Equipment systems	\$ 5	\$ —	\$ 5	6%
Services	\$ 4	\$ 2	\$ 6	6%
Construction design-build (1).....	\$ 67	\$ 15	\$ 82	88%
Total backlog	<u>\$ 76</u>	<u>\$ 17</u>	<u>\$ 93</u>	100%
Relative percentage.....	82%	18%	100%	

Note: Percentages may not add up due to rounding.

- (1) Construction design-build revenue and backlog relate to the operations of Emerald, which was acquired by the Company on April 29, 2022.

Historically, the majority of our Equipment Systems and Services backlog has been retired and converted into revenue within two quarters. At December 31, 2023, we expected approximately 57% of our Construction Design-Build backlog to be completed in the next 12 months. At December 31, 2023, three customers were each in excess of 10% of total backlog and in total they accounted for 74% of total backlog. At December 31, 2022, three customers were in excess of 10% of total backlog and in total they accounted for 81% of our total backlog.

Certain Construction Design-Build contracts contain options that are exercisable at the discretion of our customer to award additional work to us, without requiring us to go through an additional competitive bidding process. In addition, some customer contracts also contain task orders that are signed under master contracts pursuant to which we perform work only when the customer awards specific task orders to us.

Contracts in our Construction Design-Build backlog may be canceled or modified at the election of the customer. Many Construction Design-Build projects are added to our contract backlog and completed within the same fiscal year and therefore may not be reflected in our beginning or quarter-end Construction Design-Build backlog amounts.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2023, we had negative working capital of \$1.2 million, compared to positive working capital of \$10.3 million as of December 31, 2022, a decrease of \$11.5 million. This decrease in working capital was primarily due to a decrease in cash of \$10.9 million (which is further detailed below) and the net effects of reductions in customer deposits of \$2.0 million and prepaid expenses and other current assets of \$1.4 million. The reductions in customer deposits and prepaid expenses and other current assets corresponds to a reduction in customer orders for equipment systems which is reflected in the reduction in equipment systems backlog from December 31, 2022 to December 31, 2023 outlined in *Backlog* above. Due to the acquisition of Emerald in 2022, the Company includes in working capital contract receivables and liabilities related to construction projects. These construction working capital balances are described in further detail in our consolidated financial statements, including the accompanying notes.

As of December 31, 2023, we had cash of \$1.1 million, which represented a decrease of \$10.9 million from \$12.0 million as of December 31, 2022. Changes in cash during 2023 and 2022 are discussed below.

On December 13, 2023, UG Construction, Inc. (“UG Construction”), a wholly owned subsidiary of the Company, entered into an interest only asset based revolving loan agreement (“the Line of Credit”) with Gemini Finance Corp. (“Lender”) pursuant to which Lender extended to UG Construction the Line of Credit in an amount not to exceed \$10.0 million to be used to assist UG Construction and the Company with cash management. Lender will consider requests under the Line of Credit, which Lender may accept or reject in its discretion, until September 12, 2024 (“the Initial Term”), subject to an automatic extension for an additional nine-month term until May 12, 2025, provided that UG Construction is in compliance with all the terms of the applicable loan documents and Lender has not sent a written notice of non-renewal at least 60 days prior to expiration of the Initial Term. The Line of Credit contains standard events of default and representations and warranties by UG Construction and the Lender and the Company has entered into a Continuing Guaranty pursuant to which the Company will guarantee repayment of the loans associated with the Line of Credit (the “Guaranty Agreement”). Loans made under the Line of Credit earns interest at a monthly rate of one and seventy-five hundredths percent (1.75%). As of December 31, 2023, we had borrowed \$2.5 million under the Line of Credit.

Operating Activities:

Net cash used in operating activities was \$11.2 million during the year ended December 31, 2023. This use of cash was the net effect of the net loss of \$18.7 million, offset by non-cash expenses of \$4.8 million, and a reduction in net operating assets and liabilities of \$2.7 million. The \$2.7 million reduction in net operating assets and liabilities was due to the net effects of a \$23.4 million increase in accounts payable, contract liabilities and accrued expenses, a \$2.2 million decrease in prepayments and other assets, offset by an \$19.2 million increase in accounts receivable and a decrease in contract assets, customer deposits, operating lease liability, and contingent consideration of \$3.6 million.

Net cash used in operating activities was \$12.6 million during the year ended December 31, 2022. This use of cash was the net effect of the net loss of \$15.3 million, offset by non-cash expenses of \$6.9 million, and a decrease in net operating assets and liabilities of \$4.2 million. The \$4.2 million reduction in net operating assets and liabilities was primarily due to the net effects of a \$2.5 million increase in accounts receivable, a \$10.8 million increase in customer deposits, offset by a \$1.1 million increase in accounts payable and accrued expenses, and an \$8.4 million increase in prepayments and other assets.

Investing Activities:

Net cash provided by investing activities was \$1.7 million for the year ended December 31, 2023, primarily from the sale of our investment in XS Financial for \$2.3 million offset by the acquisition of property, plant and equipment of \$0.6 million. We had no material commitments for capital expenditures as of December 31, 2023.

Net cash used in investing activities was \$4.5 million for the year ended December 31, 2022. This use of cash was due to \$3.9 million from the acquisition of the DVO Entities and \$0.6 million for the purchase of fixed assets.

Financing Activities:

Net cash used by financing activities was \$1.4 million for the year ended December 31, 2023. Cash used from financing activities during the year ended December 31, 2023 primarily relates to cash provided by our line of credit and other financing agreements of \$3.0 million offset by \$3.8 million of payments made on the promissory note related to the DVO acquisition and \$0.7 million of payments made for the contingent consideration and finance lease.

Net cash used by financing activities was \$5.5 million for the year ended December 31, 2022. This decrease in cash primarily relates to \$4.4 million used in the repurchase of common stock and \$1.0 million paid for acquisition related contingent consideration.

Material Cash Requirements:

Our material cash requirements include payments on the promissory note associated with the DVO acquisition and operating lease payments. These obligations are described in detail in our consolidated financial statements, including the accompanying notes.

INFLATION

Inflation has resulted in increased costs for our customers. In addition, the U.S. Government has responded to inflation by raising interest rates, which has increased the cost of capital for our customers. We believe this has resulted in some customers delaying projects, reducing the scope of projects or potentially canceling projects, as well as increased costs of our operations, which has negatively impacted the results of our operations during the year ended December 31, 2023. We maintain strategies to mitigate the impact of higher material, energy and commodity costs, including cost reduction, alternative sourcing strategies, and passing along cost increase to customers, which may offset only a portion of the adverse impact. We believe the current inflationary environment has negatively impacted our customers which has led to delays in our customers starting projects, which in turn has delayed our customers from signing contracts with us.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates based on historical experience and on various other assumptions that are believed 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 may differ from these estimates under different assumptions or conditions. Please refer to *Note 2 – Summary of Significant Accounting Policies* set forth immediately following the signature page of this Report for more information on our significant accounting policies.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Recently Issued Accounting Pronouncements in *Note 2 – Summary of Significant Accounting Policies* set forth immediately following the signature page of this Report for information on new authoritative accounting guidance.

OFF-BALANCE SHEET ARRANGEMENTS

We have not entered into 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 and would be considered material to investors.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to provide this information.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplementary financial information required by this Item are set forth immediately following the signature page and are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

Our management, with the participation of our CEO and CFO, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Report.

These controls are designed to ensure that information required to be disclosed in the reports we file or submit pursuant to the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management, including our CEO and CFO to allow timely decisions regarding required disclosure.

Based on this evaluation, our CEO and CFO have concluded that our disclosure controls and procedures were effective as of December 31, 2023, at reasonable assurance levels.

We believe that our financial statements presented in this Report fairly present, in all material respects, our financial position, results of operations, and cash flows for all periods presented herein.

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdown can occur because of simple error or mistake. In particular, many of our current processes rely upon manual reviews and processes to ensure that neither human error nor system weakness has resulted in erroneous reporting of financial data.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our fiscal year ended December 31, 2023, which were identified in conjunction with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act. Those rules define internal control over financial reporting as a process designed 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 and includes those policies and procedures that:

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

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2023 and concluded that the Company's internal control over financial reporting was effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. In making this assessment, our management used the criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

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

ITEM 9B. OTHER INFORMATION

None.

ITEM 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information concerning our directors and officers is incorporated by reference to our Definitive Proxy Statement on Schedule 14A to be filed with the SEC within 120 days after the end of our fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

Information concerning our directors and officers is incorporated by reference to our Definitive Proxy Statement on Schedule 14A to be filed with the SEC within 120 days after the end of our fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information concerning our directors and officers is incorporated by reference to our Definitive Proxy Statement on Schedule 14A to be filed with the SEC within 120 days after the end of our fiscal year.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Information concerning our directors and officers is incorporated by reference to our Definitive Proxy Statement on Schedule 14A to be filed with the SEC within 120 days after the end of our fiscal year.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning our directors and officers is incorporated by reference to our Definitive Proxy Statement on Schedule 14A to be filed with the SEC within 120 days after the end of our fiscal year.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENTS SCHEDULES.

A list of financial statements filed herewith is contained is set forth on page F-1 of the financial statements that immediately follow the signature page of this Report and is incorporated by reference herein. The financial statement schedules have been omitted because they are not required, not applicable or the information has been included in our financial statements. The exhibits required by this Item are contained in the Exhibit Index beginning on the following page of this Annual Report on Form 10-K and are incorporated herein by reference.

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Exhibit Description</u>
2.1	Stock Purchase Agreement (incorporated by reference to Exhibit 2.1 to Form 8-K filed June 28, 2021), by and between 2WR Entities, urban-gro, Inc. and urban-gro Architect Holdings, LLC.
3.4	Amendment No. 1 to Bylaws of urban-gro, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K filed January 12, 2021).
4.1	Description of urban-gro, Inc.'s Common Stock.
10.1	Employment Agreement by and between urban-gro, Inc. and Jason T. Archer, dated January 12, 2023.
10.2	Form of Secured Promissory Note (incorporated by reference to Exhibit 10.2 to Form 8-K filed on December 18, 2023).
10.3	Form of Security Agreement (incorporated by reference to Exhibit 10.3 to Form 8-K filed on December 18, 2023).

10.4	Form of Continuing Guaranty (incorporated by reference to Exhibit 10.4 to Form 8-K filed on December 18, 2023).
21.1	Subsidiaries of the Registrant.
23.1	Consent of BF Borgers CPA PC.
24.1	Power of Attorney (included on signature page).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
97.1	urban-gro, Inc. Clawback Policy
101.INS	Inline XBRL Instance Document.
101.SCH	Inline XBRL Schema Document.
101.CAL	Inline XBRL Calculation Linkbase Document.
101.DEF	Inline XBRL Definition Linkbase Document.
101.LAB	Inline XBRL Label Linkbase Document.
101.PRE	Inline XBRL Presentation Linkbase Document.
104	Cover Page Interactive Data File (embedded within the Inline XBRL document).

* Denotes a management contract or compensatory plan or arrangement.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

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

URBAN-GRO, INC.

Date: March 27, 2024

By: /s/ Bradley Natrass
Bradley Natrass
Chairperson of the Board of Directors and
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Bradley Natrass, his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto such attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that such attorney-in-fact and agent, or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Bradley Natrass</u> Bradley Natrass	Chairperson of the Board of Directors and Chief Executive Officer (Principal Executive Officer)	March 27, 2024
<u>/s/ Richard A. Akright</u> Richard A. Akright	Chief Financial Officer (Principal Financial Officer) (Principal Accounting Officer)	March 27, 2024
<u>/s/ Lewis O. Wilks</u> Lewis O. Wilks	Director	March 27, 2024
<u>/s/ David Hsu</u> David Hsu	Director	March 27, 2024
<u>/s/ Sonia Lo</u> Sonia Lo	Director	March 27, 2024
<u>/s/ Anita Britt</u> Anita Britt	Director	March 27, 2024
<u>/s/ James Lowe</u> James Lowe	Director	March 27, 2024

INDEX TO FINANCIAL STATEMENTS

	<u>Page No.</u>
Report of Independent Registered Accounting Firm (PCAOB ID NO: 5041)	F-2
Consolidated Balance Sheets as of December 31, 2023 and 2022	F-3
Consolidated Statements of Operations and Comprehensive Loss for the Years ended December 31, 2023 and 2022	F-4
Consolidated Statement of Changes in Shareholders' Equity for the Years ended December 31, 2023 and 2022.....	F-5
Consolidated Statements of Cash Flows for the Years ended December 31, 2023 and 2022.....	F-6
Notes to the Consolidated Financial Statements.....	F-8

Report of Independent Registered Public Accounting Firm

To the shareholders and the Board of Directors of urban-gro, Inc. and subsidiaries

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of urban-gro, Inc. and subsidiaries (the “Company”) as of December 31, 2023 and 2022, the related consolidated statements of operations and comprehensive loss, shareholders’ equity and cash flows for the years then ended, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

/s/ BF Borgers CPA PC

BF Borgers CPA PC (PCAOB ID 5041)

We have served as the Company’s auditor since 2017.

Lakewood, CO

March 27, 2024

urban-gro, Inc.
CONSOLIDATED BALANCE SHEETS

	As of December 31,	
	2023	2022
ASSETS		
Current assets:		
Cash.....	\$ 1,112,504	\$ 12,008,003
Accounts receivable, net	26,991,739	15,380,292
Contract receivables	10,071,951	3,004,282
Prepaid expenses and other current assets.....	2,775,682	4,164,960
Total current assets	<u>40,951,876</u>	<u>34,557,537</u>
Non-current assets:		
Property and equipment, net.....	1,419,393	1,307,146
Operating lease right of use assets, net.....	2,041,217	2,618,825
Investments	—	2,559,307
Goodwill	15,572,050	15,572,050
Intangible assets, net	4,394,507	5,450,687
Total non-current assets	<u>23,427,167</u>	<u>27,508,015</u>
Total assets	<u>\$ 64,379,043</u>	<u>\$ 62,065,552</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 25,411,243	\$ 9,960,364
Contract liabilities	8,063,325	1,294,452
Accrued expenses.....	4,071,231	3,196,961
Customer deposits	603,046	2,571,161
Contingent consideration	49,830	2,799,287
Notes payable.....	3,204,840	3,832,682
Operating lease liabilities	707,141	600,816
Total current liabilities.....	<u>42,110,656</u>	<u>24,255,723</u>
Non-current liabilities:		
Operating lease liabilities	1,380,362	2,044,782
Deferred tax liability	817,419	1,033,283
Total non-current liabilities	<u>2,197,781</u>	<u>3,078,065</u>
Total liabilities	<u>44,308,437</u>	<u>27,333,788</u>
Commitments and contingencies (note 11)		
Shareholders' equity:		
Preferred stock, \$0.10 par value; 3,000,000 shares authorized; 0 shares issued and outstanding as of December 31, 2023, and 10,000,000 shares authorized; 0 shares issued and outstanding as of December 31, 2022	—	—
Common stock, \$0.001 par value; 30,000,000 shares authorized; 13,522,669 issued and 12,072,836 outstanding as of December 31, 2023, and 100,000,000 shares authorized; 12,220,593 shares issued and 10,770,760 outstanding as of December 31, 2022	13,523	12,221
Additional paid-in capital.....	88,901,583	84,882,982
Treasury shares, cost basis: 1,449,833 shares as of December 31, 2023 and 1,449,833 as of December 31, 2022	(12,045,542)	(12,045,542)
Accumulated deficit	<u>(56,798,958)</u>	<u>(38,117,897)</u>
Total shareholders' equity	<u>20,070,606</u>	<u>34,731,764</u>
Total liabilities and shareholders' equity	<u>\$ 64,379,043</u>	<u>\$ 62,065,552</u>

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

urban-gro, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	For the Years Ended December 31,	
	2023	2022
Revenues:		
Equipment systems	\$ 12,675,645	\$ 33,333,574
Services	11,923,920	12,862,308
Construction design-build	46,254,967	19,822,901
Other	688,241	1,011,151
Total revenues and other income	<u>71,542,773</u>	<u>67,029,934</u>
Cost of revenues:		
Equipment systems	11,085,306	27,963,258
Services	7,222,968	6,225,634
Construction design-build	42,442,858	17,905,172
Other	500,079	730,151
Total cost of revenues	<u>61,251,211</u>	<u>52,824,215</u>
Gross profit	<u>10,291,562</u>	<u>14,205,719</u>
Operating expenses:		
General and administrative	23,713,773	19,911,276
Stock-based compensation	2,199,046	2,571,785
Intangible asset amortization	1,056,180	1,059,779
Business development	—	3,299,864
Total operating expenses	<u>26,968,999</u>	<u>26,842,704</u>
Loss from operations	<u>(16,677,437)</u>	<u>(12,636,985)</u>
Non-operating income (expenses):		
Interest expense	(271,686)	(54,579)
Interest income	173,895	329,012
Contingent consideration	(160,232)	(436,905)
Write-down of investment	(258,492)	(2,660,933)
Loss on settlement	(1,500,000)	—
Other income (expense)	(202,973)	(139,611)
Total non-operating income (expenses)	<u>(2,219,488)</u>	<u>(2,963,016)</u>
Loss before income taxes	<u>(18,896,925)</u>	<u>(15,600,001)</u>
Income tax benefit	215,864	322,092
Net loss	<u>\$(18,681,061)</u>	<u>\$(15,277,909)</u>
Comprehensive loss	<u>\$(18,681,061)</u>	<u>\$(15,277,909)</u>
Loss per share – basic and diluted	\$ (1.66)	\$ (1.44)
Weighted average shares – basic and diluted	11,264,414	10,610,841

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

urban-gro, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional	Accumulated	Treasury	Total
	Shares	Amount	Paid in Capital	Deficit	Stock	Shareholders' Equity
Balance, December 31, 2021	11,588,110	\$ 11,588	\$ 78,679,220	\$ (22,839,988)	\$ (7,683,490)	\$ 48,167,330
Stock-based compensation.....	—	—	2,571,785	—	—	2,571,785
Common stock repurchased.....	—	—	—	—	(4,362,052)	(4,362,052)
Stock issuance related to acquisition.....	555,390	555	3,603,258	—	—	3,603,813
Stock issued in conversion of warrants.....	34,863	35	(35)	—	—	—
Stock grant program vesting.....	37,675	38	(38)	—	—	—
Stock options exercised.....	4,555	5	28,792	—	—	28,797
Net loss.....	—	—	—	(15,277,909)	—	(15,277,909)
Balance, December 31, 2022	12,220,593	\$ 12,221	\$ 84,882,982	\$ (38,117,897)	\$ (12,045,542)	\$ 34,731,764
Stock-based compensation.....	—	—	2,199,046	—	—	2,199,046
Stock issued for contingent consideration.....	897,581	897	1,819,960	—	—	1,820,857
Stock grant program vesting.....	404,495	405	(405)	—	—	—
Net loss.....	—	—	—	(18,681,061)	—	(18,681,061)
Balance, December 31, 2023	13,522,669	\$ 13,523	\$ 88,901,583	\$ (56,798,958)	\$ (12,045,542)	\$ 20,070,606

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

urban-gro, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,	
	2023	2022
Cash flows from operating activities:		
Net loss.....	\$(18,681,061)	\$(15,277,909)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization.....	1,636,667	1,483,065
Deferred income tax benefit	(215,864)	(322,092)
Stock-based compensation expense.....	2,199,046	2,571,785
Impairment of investment.....	258,492	2,660,933
Change in fair value of contingent consideration	160,232	436,905
Other, net.....	735,760	54,858
Changes in operating assets and liabilities (net of acquired amounts):		
Accounts receivable and contract receivables	(19,245,685)	(2,517,745)
Prepaid expenses and other assets and property and equipment.....	2,161,898	8,397,707
Accounts payable, contract liabilities, and accrued expenses	23,374,027	1,087,807
Change in contingent consideration from indemnification	(917,699)	—
Operating lease liability	(690,404)	(413,770)
Customer deposits.....	(1,968,115)	(10,774,290)
Net cash used in operating activities	<u>(11,192,706)</u>	<u>(12,612,746)</u>
Cash flows from investing activities:		
Sale of investments	2,326,472	—
Purchases of property and equipment	(615,170)	(580,347)
Business combinations, net of cash acquired	—	(3,871,452)
Net cash provided by (used in) investing activities	<u>1,711,302</u>	<u>(4,451,799)</u>
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of offering costs.....	—	28,796
Repurchase of common stock	—	(4,362,052)
Additions to notes payable	3,018,400	—
Repayment of finance lease ROU liability.....	(176,572)	(146,000)
Payments to settle contingent consideration	(479,362)	(1,040,386)
Repayments of notes payable.....	(3,776,561)	—
Net cash used in financing activities.....	<u>(1,414,095)</u>	<u>(5,519,642)</u>
Net change in cash.....	(10,895,499)	(22,584,187)
Cash at beginning of period.....	12,008,003	34,592,190
Cash at end of period.....	<u>\$ 1,112,504</u>	<u>\$ 12,008,003</u>

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

urban-gro, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	For the Years Ended	
	December 31,	
	2023	2022
Supplemental cash flow information:		
Cash paid for interest	\$ 142,388	\$ 28,147
Net cash paid for income taxes	\$ 185,910	\$ 16,253
Supplemental disclosure of non-cash investing and financing activities:		
Stock issued for acquisitions	\$ —	\$ 3,603,813
Operating lease right of use assets and liabilities extension.....	\$ —	\$ 1,929,121

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

urban-gro, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION AND ACQUISITIONS, BUSINESS PLAN, AND LIQUIDITY

Organization

urban-gro, Inc. (“we,” “us,” “our,” the “Company,” or “urban-gro”) is an integrated professional services and design-build firm. We offer value-added architectural, engineering, and construction management solutions to the Controlled Environment Agriculture (“CEA”), industrial, healthcare, and other commercial sectors. Innovation, collaboration, and a commitment to sustainability drive our team to provide exceptional customer experiences. To serve our horticulture clients, we engineer, design and manage the construction of indoor CEA facilities and then integrate complex environmental equipment systems into those facilities. Through this work, we create high-performance indoor cultivation facilities for our clients to grow specialty crops, including leafy greens, vegetables, herbs, and plant-based medicines. Our custom-tailored approach to design, construction, procurement, and equipment integration provides a single point of accountability across all aspects of indoor growing operations. We also help our clients achieve operational efficiency and economic advantages through a full spectrum of professional services and programs focused on facility optimization and environmental health which establish facilities that allow clients to manage, operate and perform at the highest level throughout their entire cultivation lifecycle once they are up and running. Further, we serve a broad range of commercial and governmental entities, providing them with planning, consulting, architectural, engineering and construction design-build services for their facilities. We aim to work with our clients from the inception of their project in a way that provides value throughout the life of their facility. We are a trusted partner and advisor to our clients and offer a complete set of engineering and managed services complemented by a vetted suite of select cultivation equipment systems.

Acquisitions

DVO

Effective October 31, 2022, the Company entered into an agreement with Dawson Van Orden, Inc. (“Seller” or “DVO”) and DVO’s shareholders (the “DVO Shareholders”) to acquire substantially all of the operating assets and liabilities of DVO, a Texas-based engineering firm with significant experience in indoor CEA. The purchase price of \$6.1 million, after working capital adjustments, was comprised of (i) \$1.2 million in cash, (ii) a \$3.8 million Seller’s promissory note, and (iii) \$1.1 million of the Company’s common stock. The Seller’s promissory note was initially to be paid out over four quarters beginning in January 2023. In the third quarter of 2023, a portion of that quarter’s note payment was extended to the first quarter of 2024. The Seller’s promissory note balances as of December 31, 2023, and December 31, 2022, were \$575,240 and \$3,832,682, respectively. The purchase price excludes up to \$1.1 million of contingent consideration earnout that may become payable to the sellers dependent on the continued employment of the DVO Shareholders. The contingent consideration earnout is payable, at the Company’s discretion, in cash or shares of the Company’s common stock with the value of such shares being determined based upon the volume-weighted average price (“VWAP”) of the Company’s common stock in the ten trading days prior to the end of the applicable quarter for which the quarterly gross profit is calculated.

The Company accounted for the acquisition as follows:

Purchase price.....	\$ 6,072,366
Allocation of purchase price:	
Accounts receivable, net	\$ 1,134,909
Right of use asset	\$ 1,197,310
Property and equipment	\$ 229,058
Goodwill	\$ 3,444,926
Intangible assets	\$ 1,276,000
Accrued expenses.....	\$ (12,527)
Right of use liability.....	\$ (1,197,310)

Pro-forma disclosure of the DVO acquisition is not required as the historical results of DVO were not material to the Company’s consolidated financial statements. Acquired goodwill from DVO represents the value expected to arise from organic growth and an opportunity to expand into a well-established market for the Company.

Emerald/UG Construction, Inc.

Effective April 29, 2022, the Company acquired all of the issued and outstanding capital stock of Emerald Construction Management, Inc. (“Emerald”) from its shareholders (the “Emerald Sellers”). The purchase price of \$7.7 million, after working capital adjustments, was comprised of (i) \$3.4 million in cash, (ii) \$2.5 million of the Company’s common stock, and (iii) \$1.8 million of estimated contingent consideration earnout payable to the Emerald Sellers over the term of the earnout. The total contingent earnout payable to the Emerald Sellers is \$2.0 million. Effective January 1, 2023, the terms of the contingent consideration earnout provisions were amended providing for the entire contingent consideration of up to \$2.0 million to be earned based solely on the continued employment of the Emerald Sellers for a two year period following the closing of the Emerald acquisition. This resulted in the Company recording additional contingent consideration expense of \$160,232 in the first quarter of 2023. Per the amendment, the remaining contingent consideration earnout is payable quarterly, at the Company’s discretion, in cash or in shares of the Company’s common stock with the value of such shares being determined based upon the VWAP of the Company’s common stock in the ten trading days prior to the end of the applicable quarter. Effective November 21, 2023, Emerald changed its name to UG Construction, Inc.

The Company accounted for the acquisition as follows:

Purchase price.....	\$ 7,671,557
Allocation of purchase price:	
Cash	\$ 622,641
Accounts receivable, net	\$ 2,666,811
Contract receivable	\$ 494,456
Prepayments and other assets.....	\$ 38,086
Property and equipment.....	\$ 403,008
Right of use asset	\$ 82,408
Goodwill.....	\$ 4,135,006
Intangible assets.....	\$ 3,659,000
Accrued expenses	\$ (2,361,302)
Contract liabilities.....	\$ (1,071,399)
Right of use liability.....	\$ (82,408)
Deferred tax liability.....	\$ (914,750)

The following pro-forma amounts reflect the Company’s results as if the acquisition of Emerald had occurred on January 1, 2022. These pro-forma amounts have been calculated after applying the Company’s accounting policies and adjusting the results of the acquisition to reflect the additional amortization of intangibles.

	For the Years Ended	
	December 31,	
	2023	2022
Revenues:		
Equipment systems	12,675,645	33,333,574
Services	11,923,920	12,862,308
Construction design-build	46,254,967	31,504,349
Other	688,241	1,011,151
Total revenues and other income	<u>71,542,773</u>	<u>78,711,382</u>
Net loss.....	<u>\$(18,681,061)</u>	<u>\$(13,268,226)</u>

Acquired goodwill from Emerald represents the value expected to arise from organic growth and an opportunity to expand into a well-established market for the Company.

Per the Emerald Acquisition Agreement and Plan of Merger (the “Emerald Acquisition Agreement”), when the Company acquired all of the issued and outstanding capital stock of Emerald, the Emerald Sellers indemnified the Company for any material liabilities, losses, and actions or inaction which took place prior to the acquisition and that were not disclosed as part of the transaction. To that end, a pre-acquisition Emerald project incurred a substantial loss that was not disclosed in the Emerald Acquisition Agreement. The majority shareholder of Emerald has agreed to indemnify the Company for the loss, which is currently estimated to be \$2.4 million (the “Indemnified Loss”). In the second quarter of 2023, the Company offset \$1.0 million of the Indemnified Loss against the total remaining contingent consideration and certain other liabilities owed to the majority shareholder of Emerald thereby resulting in a net amount due from the majority shareholder of Emerald to \$1.4 million. Further, the Company has agreed to satisfy up to \$1.2 million of the Indemnified Loss in the event a certain Emerald project is above a 7% profit margin, on a dollar for dollar basis.

Liquidity and Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates realization of assets and the satisfaction of liabilities in the normal course of business within one year after the date the consolidated financial statements are available to be issued.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation, Principles of Consolidation and Business Combinations

These consolidated financial statements include the accounts of urban-gro, Inc. and its wholly owned subsidiaries. They are presented in United States dollars and have been prepared in accordance with U.S. GAAP and pursuant to the rules and regulations of the SEC for condensed financial reporting. The condensed consolidated financial statements are audited and, in the Company's opinion, include all adjustments, consisting of normal recurring adjustments and accruals necessary for a fair presentation of the Company's condensed consolidated balance sheets, condensed consolidated statements of operations and comprehensive loss, condensed consolidated statements of stockholders' equity and condensed consolidated statements of cash flows for the periods presented.

Acquisitions of businesses are accounted for using the acquisition method of accounting (Accounting Standards Codification 805-10-225). The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition date fair values of the assets transferred, liabilities incurred to the former owners of the acquired entities and the equity interests issued in exchange for control of the acquired entities. Acquisition related costs are recognized in net income (loss) as incurred.

Use of Estimates

In preparing consolidated financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the reported periods. Actual results could differ from those estimates. Significant estimates include estimated revenues earned under percentage of completion construction contracts, professional service contracts, estimated useful lives and potential impairment of long-lived assets and goodwill, inventory write-offs, allowance for deferred tax assets and deferred tax liabilities, and allowance for bad-debt.

Reclassification

Certain prior year amounts have been reclassified for consistency with the current year presentation. These reclassifications had no effect on the reported results of operations.

Balance Sheet Classifications

The Company includes in current assets and liabilities the following amounts that are in connection with construction contracts that may extend beyond one year: contract assets and contract liabilities (including retainage invoiced to customers contingent upon anything other than the passage of time), capitalized costs to fulfill contracts, retainage payable to sub-contractors and accrued losses on uncompleted contracts. A one-year time period is used to classify all other current assets and liabilities when not otherwise prescribed by the applicable accounting principles.

Contract Assets and Liabilities

The timing between when Company collects cash from its construction design-build customers can create a contract asset or contract liability. Please refer to *Note 3 - Revenue from Contracts with Customers* for further discussion of the Company's contract assets and liabilities.

Functional and Reporting Currency and Foreign Currency Translation

The functional and reporting currency of the Company and its subsidiaries is US dollars. All transactions in currencies other than US dollars are translated into US dollars on the date of the transaction. Any exchange gains and losses related to these transactions are recognized in the current period earnings as other income (expense).

Fair Value of Financial Instruments

The Company's financial instruments consist principally of cash, accounts receivable, accounts payable, promissory note and other current assets and liabilities. We value our financial assets and liabilities using fair value measurements. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities measured at fair value are categorized based on whether the inputs are observable in the market and the degree that the inputs are observable. The categorization of financial instruments within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. The hierarchy is prioritized into three levels (with Level 3 being the lowest) defined as follows:

- Level 1: Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.
- Level 2: Observable inputs other than prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated with observable market data.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

The carrying amount of our cash, accounts receivable, accounts payable, promissory note, and other current assets and liabilities in our consolidated financial statements approximates fair value because of the short-term nature of the instruments as of December 31, 2023 and 2022. Investments in non-marketable equity securities are carried at cost less other-than-temporary impairments as of December 31, 2023 and 2022.

There have been no changes in Level 1, Level 2, and Level 3 categorizations and no changes in valuation techniques for these assets or liabilities for the years ended December 31, 2023 and 2022.

Cash

The Company considers all highly liquid short-term cash investments with an original maturity of three months or less to be cash equivalents. As of December 31, 2023 and 2022, the Company did not maintain any cash equivalents. The Company maintains cash with financial institutions that may from time to time exceed federally-insured limits. The Company has Insured Cash Sweep programs in place with its financial institutions to ensure that these excess funds are also federally-insured. There are no restricted or compensating cash balances as of December 31, 2023.

Accounts Receivable, Net

Trade Accounts Receivable

Trade accounts receivables are carried at the original invoiced amounts less an allowance for doubtful accounts. As of December 31, 2023 and 2022, the balance of allowance for doubtful accounts was \$306,496 and \$103,653, respectively. The allowance for doubtful accounts is calculated based on a detailed review of certain individual customer accounts and an estimation of the overall economic conditions affecting the Company's customer base. The Company reviews a customer's credit history before extending credit to the customer. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additions to the allowance would be required. A provision is made against accounts receivable to the extent they are considered unlikely to be collected. Occasionally, the Company will write off bad-debt directly to the bad-debt expense account when the balance is determined to be uncollectible. Bad-debt expense for the years ended December 31, 2023 and 2022 was \$566,569 and \$110,000, respectively.

Non-trade Accounts Receivable

Non-trade accounts receivable consist of amounts due to the Company outside of our normal operating business. As of December 31, 2023 and 2022, the Company had a total of \$3,134,452 and \$2,914,112 of non-trade accounts receivable, respectively. Non trade accounts receivable as of December 31, 2023 were comprised of the remaining Indemnified Loss receivable from the majority shareholder of Emerald further detailed in *Note 1 – Organization, Acquisitions, and Liquidity* and miscellaneous non-trade accounts receivable of \$498,043. As of December 31, 2022, non-trade accounts receivables was comprised of miscellaneous non-trade accounts receivables totaling \$514,112, and non-trade accounts receivable related to litigation involving fraudulent wire transactions of \$2,400,000. On March 27, 2023, the Company entered into an agreement to settle this litigation and received a cash payment of \$2,400,000 on March 27, 2023. In connection with the settlement the Company recorded an impairment in the fourth quarter of 2022 of \$950,576.

Inventories

Inventories, consisting entirely of finished goods, are stated at the lower of cost or net realizable value, with cost determined using the weighted average cost method. The Company periodically reviews the value of items in inventory and provides write-downs or write-offs of inventory based on its assessment of market conditions. Write-downs and write-offs are charged to cost of goods sold at the realization of change in value. Once written down, inventories are carried at this lower basis until sold or scrapped.

Property, Plant, and Equipment, net

Property and equipment is stated at cost less accumulated depreciation and impairment. Expenditures for major additions and improvements are capitalized and minor replacements, maintenance, and repairs are charged to expense as incurred. When property and equipment is retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations for the respective period. Depreciation is provided over the estimated useful lives of the related assets using the straight-line method for financial statement purposes. The Company uses other depreciation methods (generally accelerated) for tax purposes where appropriate. No impairment charges were recorded for the years ended December 31, 2023 and 2022.

The estimated useful lives for significant property and equipment categories are as follows:

Computer and technology equipment	3 years
Furniture and equipment.....	5 years
Leasehold improvements	Lease term
Vehicles	3 years
Other equipment	3 or 5 years
Software.....	3 years

Operating Lease Right of Use Assets

Operating lease right of use assets are stated at cost less accumulated depreciation, amortization and impairment. The Company has various operating and finance equipment and office leases with an imputed annual interest rate of 8%.

Intangible Assets

The Company’s intangible assets, consist of legal fees for application of patents and trademarks, as well as customer relationships, trademarks and trade names and backlog from the acquisitions of DVO, 2WR and Emerald. Our patents and trademarks are recorded at cost, while the intangibles from our acquisitions are recorded at fair value and are amortized using the straight-line method over an estimated life, generally 5 years for patents, 5 years for trademarks and trade names, 7 years for customer relationships, and 1 year for backlog. Intangible assets are reported in the “Intangible Asset” line on the balance sheet.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is not amortized but is tested for impairment annually and at any time when events or circumstances suggest impairment may have occurred.

The testing for impairment consists of a comparison of the fair value of the reporting unit with its carrying amount. If the carrying amount of the reporting unit, including goodwill, exceeds the fair value, an impairment will be recognized equal to the difference between the carrying value of the reporting unit’s goodwill and the implied fair value of the goodwill. In testing goodwill for impairment, we determine the estimated fair value of our reporting units based upon a discounted future cash flow analysis. Goodwill, trade names and patents are our only indefinite-lived intangible assets. Definite-lived intangible assets are amortized using the straight-line method over the shorter of their contractual term or estimated useful lives.

Impairment of Long-lived Assets

The Company evaluates potential impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. An impairment will be recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

Investments

Investments without readily determinable fair values and for which the Company does not have the ability to exercise significant influence are accounted for at cost with adjustments for observable changes in prices or impairments.

Revenue Recognition

The Company recognizes revenue in accordance with ASC 606, *Revenue from Contracts with Customers*, which requires that five basic steps be followed to recognize revenue: (1) a legally enforceable contract that meets criteria standards as to composition and substance is identified; (2) performance obligations relating to provision of goods or services to the customer are identified; (3) the transaction price, with consideration given to any variable, noncash, or other relevant consideration, is determined; (4) the transaction price is allocated to the performance obligations; and (5) revenue is recognized when control of goods or services is transferred to the customer with consideration given to whether that control happens over time or not. Determination of criteria (3) and (4) are based on judgments regarding the fixed nature of the selling prices of the services and products delivered and the collectability of those amounts.

The Company derives revenue predominately from the sale of equipment systems, services, construction design-build, and from other various immaterial contracts with customers. Please refer to Note 3 - Revenue from Contracts with Customers for additional discussion.

Customer Deposits

For equipment systems contracts, the Company's policy is to collect deposits from customers at the beginning of the contract. Please refer to Note 3 - Revenue from Contracts with Customers for further discussion of the Company's customer deposits.

Cost of Revenues

The Company's policy is to recognize cost of revenues in the same manner as, and in conjunction with, revenue recognition. The Company's cost of revenues includes the costs directly attributable to revenue recognized and includes expenses related to the purchasing of products and providing services, costs related to construction design-build contracts, fees for third-party commissions, and shipping costs. Total shipping costs included in the cost of revenues for the years ended December 31, 2023 and 2022 were \$256,345 and \$893,517, respectively.

Advertising Costs

The Company expenses advertising costs in the periods the costs are incurred. Prepayments made under contracts are included in prepaid expenses and expensed when the advertisement is run. Total advertising expense incurred for the years ended December 31, 2023 and 2022 was \$516,522 and \$504,738, respectively.

Stock-Based Compensation

The Company periodically issues shares of its common stock and stock options to employees, directors, and consultants in non-capital raising transactions for fees and services. The Company accounts for stock grants and stock options issued to employees and directors with the award being measured at its fair value at the date of grant and amortized ratably over the vesting period. The Company accounts for stock issued to consultants with the value of the stock compensation based upon the measurement date as determined at the grant date of the award.

Warrants

The Company estimates the fair value of warrants at the respective balance sheet dates using the Black-Scholes option-pricing model based on the estimated market value of the underlying common stock at the valuation measurement date, the remaining contractual term, risk-free interest rate, and expected volatility of the price of the underlying common stock. There is a moderate degree of subjectivity involved when using option pricing models to estimate the warrants and the assumptions used in the Black-Scholes option-pricing model are moderately judgmental.

Income Taxes

The Company files income tax returns in the United States, Canada, and the Netherlands, and state and local tax returns in applicable jurisdictions. Provisions for current income tax liabilities, if any, would be calculated and accrued on income and expense amounts expected to be included in the income tax returns for the current year. Income taxes reported in earnings, if any, would also include deferred income tax provisions.

Deferred income tax assets and liabilities, if any, would be computed on differences between the financial statement bases of assets and liabilities at the enacted tax rates. Changes in deferred income tax assets and liabilities would be included as a component of income tax expense. The effect on deferred income tax assets and liabilities attributable to changes in enacted tax rates would be charged or credited to income tax expense in the period of enactment. Valuation allowances would be established for certain deferred tax assets when realization is not likely.

Assets and liabilities would be established for uncertain tax positions taken or positions expected to be taken in income tax returns when such positions, in the judgment of the Company, do not meet a more-likely-than-not threshold based on the technical merits of the positions. Valuation allowances would be established for certain deferred tax assets when realization is not likely.

Loss per Share

The Company computes net loss per share by dividing net loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share would be computed by dividing net loss by the weighted-average of all potentially dilutive shares of common stock that were outstanding during the periods presented. The diluted earnings per share calculation is not presented as it results in an anti-dilutive calculation of net loss per share.

The treasury stock method would be used to calculate diluted earnings per share for potentially dilutive stock options and share purchase warrants. This method assumes that any proceeds received from the exercise of in-the-money stock options and share purchase warrants would be used to purchase common shares at the average market price for the period.

Recently Issued Accounting Pronouncements

From time to time, the Financial Accounting Standards Board (the “FASB”) or other standards setting bodies issue new accounting pronouncements. The FASB issues updates to new accounting pronouncements through the issuance of an Accounting Standards Update (“ASU”). Unless otherwise discussed, the Company believes that the impact of recently issued guidance, whether adopted or to be adopted in the future, is not expected to have a material impact on the Company’s financial statements upon adoption.

In November 2023, the FASB issued Accounting Standards Update (“ASU”) No. 2023-07, Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures (ASU 2023-07), which requires an enhanced disclosure of significant segment expenses on an annual and interim basis. This ASU will be effective for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024. The Company does not expect this ASU to have an impact on its consolidated financial statements.

In December 2023, the FASB issued ASU No. 2023-09, Income Taxes (Topic 740): Improvements to Income Tax Disclosures (ASU 2023-09), which requires greater disaggregation of information in the effective tax rate reconciliation, income taxes paid disaggregated by jurisdiction, and certain other amendments related to income tax disclosures. This guidance will be effective for fiscal years beginning after December 15, 2024. The Company will be evaluating the impact of this ASU on its consolidated financial statements.

There are other various updates recently issued by the FASB, most of which represented technical corrections to the accounting literature or application to specific industries and are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Management has reviewed all other recently issued, but not yet effective, accounting pronouncements and does not believe the future adoption of any such pronouncements may be expected to cause a material impact on the Company's financial condition or the results of our operations.

NOTE 3 – REVENUE FROM CONTRACTS WITH CUSTOMERS

The Company recognizes revenue predominantly from the sale of equipment systems, services, construction design-build, and from other various immaterial contracts with customers from its CEA and Commercial sectors. The table below presents the revenue by source for the years ended December 31, 2023 and 2022:

For the year ended December 31, 2023				
	CEA	Commercial	Total	Relative Percentage
Equipment systems	\$ 12,675,645	\$ —	\$ 12,675,645	18%
Services	3,820,338	8,103,582	11,923,920	17%
Construction design-build.....	4,391,087	41,863,880	46,254,967	65%
Other	688,241	—	688,241	1%
Total revenues and other income	<u>\$ 21,575,311</u>	<u>\$ 49,967,462</u>	<u>\$ 71,542,773</u>	100%
Relative percentage.....	30%	70%	100%	

Note: Percentages may not calculate due to rounding.

For the year ended December 31, 2022				
	CEA	Commercial	Total	Relative Percentage
Equipment systems	\$ 33,333,574	\$ —	\$ 33,333,574	50%
Services	8,016,433	4,845,875	12,862,308	19%
Construction design-build.....	1,664,538	18,158,363	19,822,901	30%
Other	1,011,151	—	1,011,151	2%
Total revenues and other income	<u>\$ 44,025,696</u>	<u>\$ 23,004,238</u>	<u>\$ 67,029,934</u>	100%
Relative percentage.....	66%	34%	100%	

Note: Percentages may not calculate due to rounding.

Under Accounting Standards Codification (“ASC”) Topic 606, *Revenue from Contracts with Customers*, a performance obligation is a promise in a contract with a customer, to transfer a distinct good or service to the customer. Equipment systems contracts are lump sum contracts, which require the performance of some, or all, of the obligations under the contract for a specified amount. Service revenue contracts, which include both architectural and engineering designs, generally contain multiple performance obligations which can span across multiple phases of a project and are generally set forth in the contract as distinct milestones. The majority of construction design-build contracts have a single performance obligation, as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct. Some contracts have multiple performance obligations, most commonly due to the contract covering multiple phases of the project life cycle (design and construction).

The transaction price for service contracts and construction design-build contracts is allocated to each distinct performance obligation and recognized as revenue when, or as, each performance obligation is satisfied. When there are multiple performance obligations under the same service contract, the Company allocates the transaction price to each performance obligation based on the standalone selling price. In general, payment is fixed at the time of the contract and are not subject to discounts, incentives, payment bonuses, credits, and penalties, unless negotiated in an amendment.

When establishing the selling price to the customer, the Company uses various observable inputs. For equipment systems, the stand-alone selling price is determined by forecasting the expected costs of the products, and then adding in the appropriate margins established by management. For service revenues and construction design-build revenues, the Company estimates the selling price by reference to certain physical characteristics of the project, which include the facility size, the complexity of the design, and the mechanical systems involved, which are indicative of the scope and complexity for those services. Significant judgments are typically not required with respect to the determination of the transaction price based on the nature of the selling prices of the products and services delivered and the collectability of those amounts. Accordingly, the Company does not consider estimates of variable consideration to be constrained.

The Company recognizes equipment systems, services, and construction design-build revenues when the performance obligation with the customer is satisfied. For satisfaction of equipment system revenues, the Company recognizes revenue when control of the promised good transfers to the customer, which predominately occurs at the time of shipment. For service revenues, satisfaction occurs as the services related to the distinct performance obligations are rendered or completed in exchange for consideration in an amount for which the Company is entitled. The time period between recognition and satisfaction of performance obligations is generally within the same reporting period; thus, there are no material unsatisfied or partially unsatisfied performance obligations for product or service revenues at the end of the reporting period.

Construction design-build revenues are recognized as the Company's obligations are satisfied over time, using the ratio of project costs incurred to estimated total costs for each contract because of the continuous transfer of control to the customer as all of the work is performed at the customer's site and, therefore, the customer controls the asset as it is being constructed. This continuous transfer of control to the customer is further supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay the Company for costs incurred plus a reasonable profit and take control of any work in process. This cost-to-cost measure is used for our construction design-build contracts because management considers it to be the best available measure of progress on these contracts.

Contract modifications through change orders, claims and incentives are routine in the performance of the Company's construction design-build contracts to account for changes in the contract specifications or requirements. In most instances, contract modifications are not distinct from the existing contract due to the significant integration of services provided in the contract and are accounted for as a modification of the existing contract and performance obligation. Either the Company or its customers may initiate change orders, which may include changes in specifications or designs, manner of performance, facilities, equipment, materials, sites and period of completion of the work. Change orders that are unapproved as to both price and scope are evaluated as claims. The Company considers claims to be amounts in excess of approved contract prices that the Company seeks to collect from its customers or others for customer-caused delays, errors in specifications and designs, contract terminations, change orders that are either in dispute or are unapproved as to both scope and price, or other causes of unanticipated additional contract costs.

The timing of when the Company bills customers on long-term construction design-build contracts is generally dependent upon agreed-upon contractual terms, which may include milestone billings based on the completion of certain phases of the work, or when services are provided. When as a result of contingencies, billings cannot occur until after the related revenue has been recognized; the result is unbilled revenue, which is included in contract assets. Additionally, the Company may receive advances or deposits from customers before revenue is recognized; the result is deferred revenue, which is included in contract liabilities. Retainage subject to conditions other than the passage of time are included in contract assets and contract liabilities.

Contract assets represent revenues recognized in excess of amounts paid or payable (contract receivables) to the Company on uncompleted contracts. Contract liabilities represent the Company's obligation to perform on uncompleted contracts with customers for which the Company has received payment or for which contract receivables are outstanding.

The following table provides information about contract assets and contract liabilities from contracts with customers:

	As of December 31,	
	2023	2022
Contract assets:		
Revenue recognized in excess of amounts paid or payable (contract receivables) to the Company on uncompleted contracts (contract asset), excluding retainage	\$ 9,364,915	\$ 2,874,141
Retainage included in contract assets due to being conditional on something other than solely passage of time	707,036	130,141
Total contract assets	<u>\$10,071,951</u>	<u>\$ 3,004,282</u>
	As of December 31,	
	2023	2022
Contract liabilities:		
Payments received or receivable (contract receivables) in excess of revenue recognized on uncompleted contracts (contract liability)	\$ 8,009,018	\$ 1,294,452
Retainage included in contract liabilities due to being conditional on something other than solely passage of time	54,307	—
Total contract liabilities	<u>\$ 8,063,325</u>	<u>\$ 1,294,452</u>

Trade accounts receivable, net of allowance for doubtful accounts, balances from contracts with customers within the accompanying balance sheets as of December 31, 2023, and 2022, were \$23,857,287 and \$12,466,180, respectively.

For equipment systems contracts, the Company's predominant policy is to collect deposits from customers at the beginning of the contract and the balance of the contract payment prior to shipping. The Company does, in some cases, collect deposits or retainers as down payments on service contracts. Consumable products orders may be paid for in advance of shipment or for recurring customers with credit, payment terms of 30 days or less may be extended by the Company. Customer payments that have been collected prior to the performance obligation being recognized are recorded as customer deposit liabilities on the balance sheet. When the performance obligation is satisfied and all the criteria for revenue recognition are met, revenue is recognized. In certain situations when the customer has paid the deposit and services have been performed but the customer chooses not to proceed with the contract, the Company is entitled to keep the deposit and recognize revenue. Of the outstanding customer deposit balance of \$2,571,161 at December 31, 2022, \$2,569,321 was recognized as revenue in the year ended December 31, 2023. Of the customer deposit balance of \$13,345,451 at December 31, 2021, \$13,186,579 was recognized as revenue in the year ended December 31, 2022.

NOTE 4 – RELATED PARTY TRANSACTIONS

A director of the Company is an owner of Cloud 9 Support, LLC ("Cloud 9") and Potco LLC ("Potco"). Cloud 9 purchases materials from the Company for use with its customers and Potco purchases equipment from the Company for use in its cultivation facility. Another director of the Company is working on a vertical farming innovation model with a group of CEA experts ("the CEA Consortium"). The CEA Consortium contracts services from the Company related to their business model. The table below presents the revenues for these related party entities for the twelve months ended December 31, 2023, and 2022:

	Twelve Months Ended	
	December 31,	
	2023	2022
Revenues - Cloud 9	\$ 462	\$ 13,383
Revenues – Potco	987,268	12,480
Revenues - CEA Consortium	\$ 245,000	\$ —
Total revenues from related party transactions	<u>\$ 1,232,730</u>	<u>\$ 25,863</u>

The table below presents the accounts receivable from these related party entities as of December 31, 2023, and December 31, 2022:

	December 31, 2023	December 31, 2022
Accounts receivable - Cloud 9.....	\$ —	\$ 3,920
Accounts receivable – Potco.....	163,088	20,174
Accounts receivable - CEA Consortium.....	\$ 245,000	\$ —
Total accounts receivable due from related party transactions	<u>\$ 408,088</u>	<u>\$ 24,094</u>

NOTE 5 – PREPAYMENTS & OTHER ASSETS

Prepayments and other assets are comprised of prepayments paid to vendors to initiate orders and prepaid services and fees. The prepaid balances are summarized as follows:

	As of December 31, 2023	2022
Vendor prepayments.....	\$ 1,124,118	\$ 2,459,389
Prepaid services and fees	1,379,949	1,346,430
Inventories	228,858	320,372
Other assets.....	42,757	38,769
Total prepaid expenses and other assets	<u>\$ 2,775,682</u>	<u>\$ 4,164,960</u>

NOTE 6 - PROPERTY PLANT & EQUIPMENT, NET

Property Plant and Equipment balances are summarized as follows:

	As of December 31, 2023	2022
Computers and technology equipment	\$ 294,322	\$ 232,405
Furniture and fixtures	325,485	234,389
Leasehold improvements	228,760	306,719
Vehicles	432,823	456,797
Software.....	1,087,569	685,580
Other equipment	145,951	58,525
Accumulated depreciation	(1,095,517)	(667,269)
Total property plant and equipment, net	<u>\$ 1,419,393</u>	<u>\$ 1,307,146</u>

Depreciation expense for the years ended December 31, 2023 and 2022 totaled \$580,487 and \$423,286, respectively.

NOTE 7 – INVESTMENTS

The components of investments are summarized as follows:

	XS Financial	Edyza	Total
Balances, as of December 31, 2022.....	\$ 2,559,307	\$ —	\$ 2,559,307
Impairment	(258,492)	—	(258,492)
Paid in kind interest.....	25,657	—	25,657
Sale of investment	(2,326,472)	\$ —	(2,326,472)
Balances, as of December 31, 2023.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

XS Financial

On October 30, 2021, the Company participated in a convertible note offering of Xtraction Services, Inc., a/k/a XS Financial Inc. (CSE: XSF) (OTCQB: XSHLF) ("XSF"), a specialty finance company providing CAPEX financing solutions, including equipment leasing, to CEA companies in the United States. The Company invested \$2,500,000 of a total \$43,500,000 raised by XSF. Prior to any Nasdaq listing, the investment incurs 9.5% interest payable, of which, 7.5% is cash interest and 2.0% is interest paid in kind. Subsequent to any Nasdaq listing, the investment incurs 8.0% interest. The debt matures on October 28, 2023, with a one-year option at the sole discretion of XSF to extend the maturity date. In addition, the Company received 1.25 million warrants denominated in Canadian dollars ("C\$") with a C\$0.45 share price as subject to the warrant instrument. No value was attributed to the warrants at the time of the investment. In August 2023, the Company entered into an agreement to sell back its investment to XSF for \$2.3 million and cancel the warrants. The Company received the \$2.3 million in proceeds on August 30, 2023. In connection with the agreement to sell the investment, the Company recorded an impairment loss of \$0.3 million.

Edyza

The Company has a strategic investment in Edyza, Inc. ("Edyza"), a hardware and software technology company that enables dense sensor networks in agriculture, healthcare, and other environments that require precise micro-climate monitoring. The Company measures this investment at cost, less any impairment changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer.

During the third quarter of 2022, the Company fully impaired this investment. The Company notes that the intent and ability to retain its investment for a period of time sufficient to allow for any anticipated recovery has passed, causing an "other than temporary loss." The Company will continue to monitor any future changes to this impairment and seek to recover any remaining value of its 19.5% ownership. The impairment recorded was \$1.7 million.

NOTE 8 – GOODWILL & INTANGIBLE ASSETS

Goodwill

The Company has recorded goodwill in conjunction with acquisitions it has completed. The goodwill balances as of December 31, 2023 and 2022 were \$15,572,050 and \$15,572,050. Goodwill is not amortized. The Company did not record any impairment charges related to goodwill for the years ended December 31, 2023 and 2022.

Intangible Assets Other Than Goodwill

Intangible assets as of December 31, 2023 and 2022 consisted of the following:

	As of December 31, 2023		
	Cost	Accumulated Amortization	Net Book Value
Finite-lived intangible assets:			
Customer relationships	\$ 4,212,100	\$ (1,004,749)	\$ 3,207,351
Trademarks and trade names	1,778,000	(663,417)	1,114,583
Backlog and other	768,113	(723,831)	44,282
Total finite-lived intangible assets:	<u>6,758,213</u>	<u>(2,391,997)</u>	<u>4,366,216</u>
Indefinite-lived intangible assets:			
Trade name	28,291	—	28,291
Total indefinite-lived intangible assets	<u>28,291</u>	<u>—</u>	<u>28,291</u>
Total intangible assets, net	<u>\$ 6,786,504</u>	<u>\$ (2,391,997)</u>	<u>\$ 4,394,507</u>

	As of December 31, 2022		
	Cost	Accumulated Amortization	Net Book Value
Finite-lived intangible assets:			
Customer relationships	\$ 4,212,100	\$ (401,997)	\$ 3,810,103
Trademarks and trade names	1,778,000	(307,817)	1,470,183
Backlog and other	768,113	(626,003)	142,110
Total finite-lived intangible assets:	<u>6,758,213</u>	<u>(1,335,817)</u>	<u>5,422,396</u>
Indefinite-lived intangible assets:			
Trade name	28,291	—	28,291
Total indefinite-lived intangible assets	<u>28,291</u>	<u>—</u>	<u>28,291</u>
Total intangible assets, net	<u>\$ 6,786,504</u>	<u>\$ (1,335,817)</u>	<u>\$ 5,450,687</u>

Amortization expense for intangible assets subject to amortization for the years ended December 31, 2023 and 2022 was \$1,056,180 and \$1,059,779, respectively. The estimated future amortization expense for intangible assets subject to amortization at December 31, 2023, is summarized below:

For the years ending December 31,	Estimated Future Amortization Expense
2024	\$ 969,633
2025	959,788
2026	918,205
2027	693,555
2028	554,540
Thereafter	270,495
Total estimated future amortization expense	<u>\$ 4,366,216</u>

NOTE 9 – ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	As of December 31,	
	2023	2022
Accrued operating expenses	\$ 834,144	\$ 515,858
Accrued wages and related expenses	1,428,364	639,614
Accrued 401(k)	66,642	262,599
Accrued interest expense	26,000	—
Accrued sales tax payable	1,716,081	1,778,890
Total accrued expenses	<u>\$ 4,071,231</u>	<u>\$ 3,196,961</u>

Accrued sales tax payable is comprised of amounts due to various states and Canadian provinces for 2017 through 2023.

NOTE 10 – PROMISSORY NOTE AND DEBT

The table below shows outstanding promissory note and debt amounts as of December 31, 2023 and 2022.

	As of December 31,	
	2023	2022
Line of credit	\$ 2,500,000	\$ —
DVO note	575,240	3,832,682
Other financing agreements	129,600	—
Total	<u>\$ 3,204,840</u>	<u>\$ 3,832,682</u>
Less current maturities	(3,204,840)	(3,832,682)
Long Term	—	—

On December 13, 2023, UG Construction, Inc. d/b/a Emerald Construction Management, Inc. (“UG Construction”), a wholly owned subsidiary of the Company, entered into an interest only asset based revolving Loan Agreement (the “Line of Credit”) with Gemini Finance Corp. (“Lender”) pursuant to which Lender extended to UG Construction a secured line of credit in an amount not to exceed \$10,000,000, to be used to assist UG Construction and the Company with cash management. Lender will consider requests for advances under the Line of Credit, which Lender may accept or reject in its discretion, until September 12, 2024 (the “Initial Term”), subject to an automatic extension for an additional nine-month term until May 12, 2025, provided that UG Construction is in compliance with all the terms of the applicable loan documents and Lender has not sent a written notice of non-renewal at least 60 days prior to expiration of the Initial Term. The Line of Credit contains standard events of default and representations and warranties by UG Construction and the Lender and the Company have entered into a Continuing Guaranty pursuant to which the Company will guarantee repayment of the loans associated with the Line of Credit (the “Guaranty Agreement”).

Loans made under the Line of Credit shall be evidenced by a Secured Promissory Note - Revolving issued by UG Construction to the Lender (the “Promissory Note”), and each draw on the Promissory Note shall be due and payable on or before 180 days after such draw is funded to UG Construction; provided that, such draw is also subject to a mandatory prepayment upon UG Construction’s receipt of payment for any invoice previously submitted and approved for financing by Lender. Lender will receive a security interest in UG Construction’s Collateral (as defined in the “Security Agreement” entered into as part of the Line of Credit). The Promissory Note earns interest at a monthly rate of one and seventy-five hundredths percent (1.75%).

In connection with entering in the Line of Credit, the Company has agreed to issue to Bancroft Capital, LLC (the “Placement Agent”) cash and warrant compensation in two separate tranches, the first being earned upon closing of the Line of Credit and the remainder of which will be due if and when UG Construction draws more than \$4,500,000 from the Line of Credit. Both instances are detailed as follows:

1. At closing of the Line of Credit, the Placement Agent earned a cash fee of \$200,000. In addition to the cash fee, the Company will issue to the Placement Agent or its designees, \$200,000 worth of warrants (the “Placement Agent’s Warrants”) to purchase the Company’s common stock at a price per share equal to 110% of the daily volume weighted average closing price of the Company’s common stock on the Nasdaq exchange for a period consisting of ten (10) consecutive trading days ending on and inclusive of the trading day of the Closing. The Placement Agent’s Warrants will be exercisable at any time and from time to time, in whole or in part, during the four and a half-year period commencing six (6) months from the date of issuance. The Placement Agent’s Warrants will provide for registration rights (including a one-time demand registration right and unlimited piggyback rights), cashless exercise and customary anti-dilution provisions (for stock dividends and splits) and anti-dilution protection (adjustment in the number and price of such warrants and the shares underlying such warrants) resulting from corporate events (which would include dividends, reorganizations, mergers, etc.).

2. If and when Emerald draws more than \$4,500,000 from the Line of Credit, the Placement Agent will earn an additional cash fee of \$200,000, and an additional \$200,000 worth of Placement Agent’s Warrants to purchase the Company’s common stock at a price per share equal to 110% of the daily volume weighted average closing price of the Company’s common stock on the Nasdaq exchange for a period consisting of ten (10) consecutive trading days ending on and inclusive of the trading day of the date that the draws exceeding \$4,500,000 were to take place.

As part of the Asset Purchase Agreement of DVO, a non-negotiable promissory note in the aggregate principal amount of \$3,806,250, payable to DVO was issued effective November 1, 2022 (the “DVO Promissory Note”). The principal amount, together with the simple interest accrued on the unpaid principal amount outstanding was to be paid by the Company on a quarterly basis for the first four consecutive quarters, with the first payment paid in January 2023, and the remaining three payments due ten days following the end of each subsequent fiscal quarter thereafter until the earlier of the end of the fourth full fiscal quarter following the closing date December 31, 2023 or the payment in full of all amounts due. In the third quarter of 2023, a portion of that quarter’s note payment was extended to the first quarter of 2024. The DVO Promissory Note may be prepaid in whole or in part at any time without premium or penalty; provided, that each payment shall be accompanied by payment of all unpaid costs, fees and expenses, if any, which are due plus all accrued and unpaid interest due as of the date of such prepayment.

The outstanding principal balance under the DVO Promissory Note shall bear simple interest at a variable rate per annum equal to the rate of interest most recently published by JP Morgan Chase & Co. as the “prime rate” (the “Prime Rate”). Initially, interest will accrue at the Prime Rate as of the date of the DVO Promissory Note. The interest rate will be adjusted on a quarterly basis as of the first day of each full fiscal quarter following the first full fiscal quarter after the closing date to the then current Prime Rate. In connection with the extension of the DVO Promissory Note payment to the first quarter of 2024, the interest rate was revised to a fixed rate of 10%, with principal and interest to be paid on a weekly basis.

The other financing agreements relate to short-term financing of the Company’s insurance policies and are at an average interest rate of 13.6%.

NOTE 11 – OPERATING LEASE LIABILITIES AND COMMITMENTS AND CONTINGENCIES

The Company has seven operating office lease liabilities and one finance office lease liability with an imputed annual interest rate of 8%. Five of the leases were assigned to the Company in connection with the acquisitions of 2WR, Emerald, and DVO. The remaining lease terms range from less than a year to 5 years, as of December 31, 2023.

The following is a summary of operating lease liabilities:

	As of December 31,	
	2023	2022
Operating lease liabilities related to right of use assets	\$ 2,087,503	\$ 2,645,598
Less current portion	(707,141)	(600,816)
Long term	<u>\$ 1,380,362</u>	<u>\$ 2,044,782</u>

The following is a schedule showing total future minimum lease payments:

For the years ending December 31,	Minimum Lease Payments
2024	\$ 754,076
2025	573,133
2026	404,751
2027	346,812
2028	253,415
Thereafter	82,488
Total minimum lease payments	<u>\$ 2,414,675</u>
Less: Amount representing interest	<u>\$ (327,172)</u>
Net lease obligations	<u>\$ 2,087,503</u>

From time to time, the Company is involved in routine litigation that arises in the ordinary course of business. There are no legal proceedings for which management believes the ultimate outcome would have a material adverse effect on the Company's results of operations and cash flows.

On August 11, 2023, the Company entered into a settlement agreement (the "Settlement Agreement") with Crest Ventures, LLC ("Crest") and Andrew Telsey to settle all claims in the litigation filed in the District Court for Arapahoe County, Colorado, Case No. 2021CV31301. Pursuant to the Settlement Agreement, the Company paid \$1,500,000 to Crest on September 7, 2023. In connection with this settlement, the Company recorded a loss in the second quarter of 2023 of \$1,500,000 in accordance with GAAP related to loss contingencies.

NOTE 12 – RISKS AND UNCERTAINTIES

Concentration Risk

The tables below show customers who account for 10% or more of the Company's total revenues and 10% or more of the Company's accounts receivable for the periods presented:

Customers exceeding 10% of revenue

	For the Years Ended December 31,	
Company Customer Number	2023	2022
C000001462	*	10%
C000001140	*	13%
C000002463	15%	*
C000002187	28%	17%

* Amounts less than 10%

Customers exceeding 10% of accounts receivable

Company Customer Number	As of December 31,	
	2023	2022
C000002151	*	10%
C000002187	57%	24%

* Amounts less than 10%

The table below shows vendors who account for 10% or more of the Company's total purchases and 10% or more of the Company's accounts payable for the periods presented:

Vendors exceeding 10% of purchases

Company Vendor Number	For the Years Ended December 31,	
	2023	2022
V000001029	*	13%
V000002275	11%	*

* Amounts less than 10%

Vendors exceeding 10% of accounts payable:

Company Vendor Number	As of December 31,	
	2023	2022
V000002275	13%	*
V000001910	*	11%

* Amounts less than 10%

Foreign Exchange Risk

Although our revenues and expenses are expected to be predominantly denominated in United States dollars, we may be exposed to currency exchange fluctuations. Recent events in the global financial markets have been coupled with increased volatility in the currency markets. Fluctuations in the exchange rate between the U.S. dollar, the Canadian dollar, the Euro, and the currency of other regions in which we may operate may have a material adverse effect on our business, financial condition and operating results. We may, in the future, establish a program to hedge a portion of our foreign currency exposure with the objective of minimizing the impact of adverse foreign currency exchange movements. However, even if we develop a hedging program, it may not mitigate currency risks.

NOTE 13 – STOCK-BASED COMPENSATION

Stock-based compensation expense for the years ended December 31, 2023 and 2022 was \$2,199,046 and \$2,571,785, respectively based on the vesting schedule of the stock grants and options. During the year ended December 31, 2023, 510,720 shares vested and were issued to employees and directors. During the year ended December 31, 2022, 62,172 shares vested and were issued to employees and directors. No cash flow effects are anticipated for stock grants.

The Company has adopted the 2021 Omnibus Stock Incentive Plan, as amended (the "Omnibus Incentive Plan"), which provides for the issuance of incentive stock options, stock grants and stock-based awards to employees, directors, and consultants of the Company to reward and attract employees and compensate the Company's Board of Directors (the "Board") and vendors when applicable. The Omnibus Incentive Plan is administered by the Company's Board. Grants of RSUs under the Omnibus Incentive Plan are valued at no less than the market price of the stock on the date of grant. The fair value of the options is calculated using the Black-Scholes pricing model based on the estimated market value of the underlying common stock at the valuation measurement date, the remaining contractual term of the options, risk-free interest rate and expected volatility of the price of the underlying common stock of 100%. There is a moderate degree of subjectivity involved when estimating the value of stock options with the Black-Scholes option pricing model as the assumptions used are moderately judgmental. Stock grants and stock options are sometimes offered as part of an employment offer package, to ensure continuity of service or as a reward for performance. Stock grants and stock options typically require a 1 to 3 year period of continued employment or service performance before the stock grant of RSUs or stock option vests.

The following schedule shows grants of RSU activity for the years ended December 31, 2023 and 2022:

	Number of Shares
Grants unissued as of December 31, 2021	153,673
Grants awarded	542,584
Forfeiture/cancelled.....	(139,226)
Grants vested.....	(62,172)
Grants unissued as of December 31, 2022	494,859
Grants awarded	633,269
Forfeiture/Cancelled.....	(23,139)
Grants vested.....	(510,720)
Grants unissued as of December 31, 2023	594,269

The following table summarizes grants of RSU vesting periods:

Number of Shares	Unrecognized Stock Compensation Expense	As of December 31,
436,210	\$ 890,461	2024
158,059	182,418	2025
<u>594,269</u>	<u>\$ 1,072,879</u>	

The following schedules show stock option activity for the years ended December 31, 2023 and 2022:

	Number of Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price
Stock options outstanding as of December 31, 2021	641,337	7.55	\$ 6.27
Issued	76,246	9.00	\$ 10.48
Exercised.....	(4,555)	0.00	\$ 6.00
Forfeited.....	(43,640)	6.25	\$ 6.04
Stock options outstanding at December 31, 2022	<u>669,388</u>	7.85	\$ 6.77
Stock options exercisable at December 31, 2022	<u>618,651</u>	6.74	\$ 6.30

	Number of Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price
Stock options outstanding as of December 31, 2022	669,388	7.85	\$ 6.77
Issued	0	0.00	\$ —
Exercised.....	0	0.00	\$ —
Forfeited.....	(7,105)	0.00	\$ 9.39
Stock options outstanding at December 31, 2023	<u>662,283</u>	7.85	\$ 6.77
Stock options exercisable at December 31, 2023	<u>655,538</u>	7.85	\$ 6.30

The following table summarizes stock option vesting periods under the Incentive Plans:

Number of Shares	Unrecognized Stock Compensation Expense	As of December 31,
6,745	\$ 29,372	2024
<u>6,745</u>	<u>\$ 29,372</u>	

The aggregate intrinsic value of the stock options outstanding and exercisable at December 31, 2023 is \$0.

NOTE 14 – STOCKHOLDERS' EQUITY

On February 17, 2021, we completed an offering of 6,210,000 shares of our common stock, inclusive of the underwriters full over allotment, at \$10.00 per share for total gross offering proceeds of \$62,100,000. In connection with this offering, we received approval to list our common stock on the Nasdaq Capital Market under the symbol “UGRO.”

On May 24, 2021, we announced that the Board authorized a stock repurchase program to purchase up to \$5.0 million of the currently outstanding shares of the Company's common stock, over a period of 12 months through open market purchases, in compliance with Rule 10b-18 under the Securities Exchange Act of 1934. On January 18, 2022, the Board authorized a \$2.0 million increase to the stock repurchase program, to a total of \$7.0 million. On February 2, 2022, the Board authorized an additional \$1.5 million increase to the stock repurchase, to a total of \$8.5 million. On September 12, 2022, the Board authorized an additional \$2 million increase to the stock repurchase, for a total of \$10.5 million. During the twelve months ended December 31, 2023 the Company did not repurchase shares of common stock. During the twelve months ended December 31, 2022, the Company repurchased 594,918 shares of common stock at an average price per share of \$7.33, for a total price of \$4.4 million. In total, the Company has repurchased 1,099,833 shares of common stock at an average price per share of \$8.25 for a total of \$9.1 million, under this program. As of December 31, 2023, we have \$1.4 million remaining under the repurchase program.

In February 2021, the Company repurchased 350,000 shares of common stock with an average price per share of \$8.50, for a total of \$3.0 million, outside of any stock repurchase or publicly announced program.

NOTE 15 – INCOME TAXES

The Company accounts for income taxes in accordance with the asset and liability method prescribed in ASC 740, “Accounting for Income Taxes.” The Company has adopted the provisions of ASC 740-10-25, which provides recognition criteria and a related measurement model for uncertain tax positions taken or expected to be taken in income tax returns. ASC 740-10-25 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not that the position would be sustained upon examination by tax authorities. Tax positions that meet the more likely than not threshold are then measured using a probability weighted approach recognizing the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. The Company had no tax positions relating to open income tax returns that were considered to be uncertain.

The Company has experienced cumulative losses for both book and tax purposes since inception. The potential future recovery of any tax assets that the Company may be entitled to due to these accumulated losses is uncertain and any tax assets that the Company may be entitled to have been fully reserved based on management's current estimates. Management intends to continue maintaining a full valuation allowance on the Company's deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances. The deferred income tax benefit for the year ended December 31, 2023 relates to the reduction in the deferred tax liability associated with the amortization of the intangible assets from the acquisitions of the DVO, Emerald and 2WR Entities.

As of December 31, 2023, the Company had approximately \$35,479,242 of operating loss carryforwards for United States tax purposes, expiring as follows:

- \$2,182,354 expiring in 2037
- \$33,296,888 with no expiration

As of December 31, 2022, the Company had approximately \$19,346,059 of operating loss carryforwards for United States tax purposes, expiring as follows:

- \$2,182,354 expiring in 2037
- \$17,163,705 with no expiration

Realization of operating loss carryforwards to offset future operating income for tax purposes are subject to various limitations including change of ownership and current year taxable income percentage limitations. The Company has no credit carryforwards for tax purposes.

The Company's primary filing jurisdictions are the United States, Canada, and the Netherlands. Due to the Company's net operating loss carryforwards, the Company's income tax returns remain subject to examination by federal, foreign and most state taxing authorities for all tax years.

NOTE 16 – BUSINESS DEVELOPMENT

During 2021, the Company purchased lights from one of its international vendors to fulfill an order for a major customer. Subsequent to the sale, delivery and installation of the lights, the customer noted the lights were not performing as the manufacturer had stipulated. The Company performed tests of the lights and confirmed the performance metrics did not meet the manufacturer's specifications. The Company worked with the customer to determine a lighting solution of replacement lights, sourced from the vendor, that would meet their needs. The customer has been a key customer to the Company and the Company expects to continue to do significant business with the customer in the future. In order to immediately satisfy the customer in this matter, the Company agreed to supply the replacement lighting solution to the customer at the Company's expense while the Company continues to work with the vendor to resolve the original defective lighting issue, including, claims for reimbursement of the expense.

In total, the Company delivered \$3.3 million of replacement lighting equipment to the customer and recorded the full amount as a business development expense during the year ended December 31, 2022.

NOTE 17 – WARRANTS

The following table shows warrant activity for the years ended December 31, 2023 and 2022:

	Number of shares	Weighted Average Exercise Price
Warrants outstanding as of December 31, 2021	374,088	\$ 11.26
Exercised.....	(18,196)	\$ 6.00
Terminated – cashless exercise	(44,393)	\$ 6.00
Expired.....	0	\$ —
Warrants outstanding as of December 31, 2022	311,499	\$ 12.32
Warrants exercisable as of December 31, 2022	311,499	\$ 12.32
	Number of shares	Weighted Average Exercise Price
Warrants outstanding as of December 31, 2022	311,499	\$ 12.32
Exercised.....	0	\$ —
Terminated	0	\$ —
Issued for line of credit	175,531	\$ 1.25
Expired loan extension.....	(1,000)	\$ 6.00
Warrants outstanding as of December 31, 2023	486,030	\$ 8.33
Warrants exercisable as of December 31, 2023	486,030	\$ 8.33

The fair value of the warrants is calculated using the Black-Scholes pricing model based on the estimated market value of the underlying common stock at the valuation measurement date, the contractual term of the options, the risk-free interest rate at the date of grant and expected volatility of the price of the underlying common stock of 100%. There is a moderate degree of subjectivity involved when estimating the value of warrants with the Black-Scholes option pricing model as the assumptions used are moderately judgmental.

The weighted-average life of the warrants is 4.04 years. The aggregate intrinsic value of the warrants outstanding and exercisable at December 31, 2023 is \$0.

NOTE 18 – SUBSEQUENT EVENTS

None.