

Denim.LA, Inc.

Audited Financial Statements
December 31, 2018 and 2017

DENIM.LA, INC.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Denim.LA, Inc.
Los Angeles, CA

Opinion on the Financial Statements

We have audited the accompanying balance sheets of Denim.LA, Inc. (the "Company") as of December 31, 2018 and 2017, and the related statements of operations, stockholders' deficit, 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 referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, 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 of America.

Going Concern

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company's net losses from inception, negative cash flow from operations, and lack of liquidity raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. 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 audits in accordance with the auditing standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 audits 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 supporting the amounts and disclosure in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ dbbmckennon

We have served as the Company's auditor since 2018

Newport Beach, California
May 2, 2019

DENIM.LA, INC.
BALANCE SHEETS
As of December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 584,481	\$ 346,900
Inventory	1,208,642	991,987
Deferred offering costs	101,762	6,539
Prepaid expenses	178,414	96,668
Total Current Assets	<u>2,073,299</u>	<u>1,442,094</u>
Non-Current Assets:		
Property, equipment, and software, net	113,630	28,772
Deposits	58,000	35,195
Total Non-Current Assets	<u>171,630</u>	<u>63,967</u>
TOTAL ASSETS	<u>\$ 2,244,929</u>	<u>\$ 1,506,061</u>

See accompanying notes to financial statements

DENIM.LA, INC.
BALANCE SHEETS
As of December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Liabilities:		
Current Liabilities:		
Accounts payable	\$ 987,554	\$ 864,960
Accrued expenses and other liabilities	518,933	428,904
Deferred revenue	274,959	49,054
Due to related parties	415,380	44,168
Venture debt, net of discount of \$225,720	3,774,280	-
Total Current Liabilities	<u>5,971,106</u>	<u>1,387,086</u>
Long-Term Liabilities:		
Venture debt, net of discount of \$191,471	0	2,658,529
Total Liabilities	<u>5,971,106</u>	<u>4,045,615</u>
Commitments and contingencies (Note 10)		
Stockholders' Deficit:		
Series Seed convertible preferred stock, \$0.0001 par, 20,714,518 shares authorized, 20,714,518 and 20,714,518 shares issued and outstanding at December 31, 2018 and 2017, respectively. Convertible into one share of common stock. Liquidation preference of \$5,592,920 and \$5,592,920 as of December 31, 2018 and 2017, respectively.	2,071	2,071
Series A convertible preferred stock, \$0.0001 par, 14,481,413 shares authorized, 5,650,903 and 5,650,903 shares issued and outstanding at December 31, 2018 and 2017, respectively. Convertible into one share of common stock. Liquidation preference of \$2,712,433 and \$2,712,433 as of December 31, 2018 and 2017, respectively.	565	565
Series A-2 convertible preferred stock, \$0.0001 par, 20,000,000 shares authorized, 5,932,742 and 2,584,766 shares issued and outstanding at December 31, 2018 and 2017, respectively. Convertible into one share of common stock. Liquidation preference of \$2,966,371 and \$1,292,383 as of December 31, 2018 and 2017, respectively.	593	258
Series A-3 convertible preferred stock, \$0.0001 par, 18,867,925 shares authorized, 3,447,608 and 0 shares issued and outstanding at December 31, 2018 and 2017, respectively. Convertible into one share of common stock. Liquidation preference of \$1,827,232 and \$0 as of December 31, 2018 and 2017, respectively.	345	-
Series CF convertible preferred stock, \$0.0001 par, 2,000,000 shares authorized, 124,204 and 0 shares issued and outstanding at December 31, 2018 and 2017, respectively. Convertible into one share of common stock. Liquidation preference of \$64,586 and \$0 as of December 31, 2018 and 2017, respectively.	12	-
Undesignated preferred stock, \$0.0001 par, 936,144 and 804,069 shares authorized, 0 and 0 issued and outstanding as of December 31, 2018 and 2017, respectively.	-	-
Common Stock, \$0.0001 par, 110,000,000 and 100,000,000 shares authorized, 10,377,615 and 10,377,615 shares issued and outstanding, 10,377,615 and 10,377,615 vested as of December 31, 2018 and 2017, all respectively.	1,038	1,038
Additional paid-in capital	13,241,211	9,696,864
Capital contribution receivable	-	(2,154)
Subscription receivable	(8,283)	-
Accumulated deficit	(16,963,729)	(12,238,196)
Total Stockholders' Deficit	<u>(3,726,177)</u>	<u>(2,539,554)</u>
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	<u>\$ 2,244,929</u>	<u>\$ 1,506,061</u>

See accompanying notes to financial statements

DENIM.LA, INC.
STATEMENTS OF OPERATIONS
For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Net revenues	\$ 3,777,493	\$ 3,849,646
Costs of net revenues	<u>1,656,332</u>	<u>1,584,333</u>
Gross Profit	2,121,161	2,265,313
Operating Expenses:		
Sales and marketing	2,042,360	1,603,678
Distribution	976,517	979,074
General and administrative	<u>3,121,355</u>	<u>2,602,881</u>
Total Operating Expenses	<u>6,140,232</u>	<u>5,185,633</u>
Loss from operations	(4,019,071)	(2,920,320)
Other Income (Expense):		
Interest expense	(705,662)	(418,403)
Other non-operating income	-	51,714
Total Other Income (Expense)	<u>(705,662)</u>	<u>(366,689)</u>
Provision for income taxes	<u>800</u>	<u>800</u>
Net Loss	<u>\$ (4,725,533)</u>	<u>\$ (3,287,809)</u>
Weighted-average vested common shares outstanding		
-Basic and Diluted	<u>10,377,615</u>	<u>10,377,615</u>
Net loss per common share		
-Basic and Diluted	<u>\$ (0.46)</u>	<u>\$ (0.32)</u>

See accompanying notes to financial statements

DENIM.LA, INC.
STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIT
For the years ended December 31, 2018 and 2017

	Series Seed Convertible Preferred Stock		Series A Convertible Preferred Stock		Series A-2 Convertible Preferred Stock		Series A-3 Convertible Preferred Stock		Series CF Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Capital Contribution Receivable	Subscription Receivable	Accumulated Deficit	Total Stockholders' Deficit
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount					
Balance at December 31, 2016	20,714,518	\$ 2,071	4,054,227	\$ 405	-	\$ -	-	\$ -	-	\$ -	10,377,615	\$ 1,038	\$ 7,602,504	\$ (2,154)	\$ -	(8,950,387)	(1,346,523)
Stock-based compensation	-	-	-	-	-	-	-	-	-	-	-	-	177,975	-	-	-	177,975
Issuance of Series A preferred stock	-	-	1,498,274	150	-	-	-	-	-	-	-	-	716,173	-	-	-	716,323
Issuance of Series A-2 preferred stock	-	-	-	-	2,584,766	258	-	-	-	-	-	-	1,292,125	-	-	-	1,292,383
Conversion of convertible notes payable - related party	-	-	98,402	10	-	-	-	-	-	-	-	-	49,613	-	-	-	49,623
Offering costs	-	-	-	-	-	-	-	-	-	-	-	-	(330,093)	-	-	-	(330,093)
Fair value of warrant issuances	-	-	-	-	-	-	-	-	-	-	-	-	188,567	-	-	-	188,567
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(3,287,809)	(3,287,809)
Net Loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Balance at December 31, 2017	<u>20,714,518</u>	<u>\$ 2,071</u>	<u>5,650,903</u>	<u>\$ 565</u>	<u>2,584,766</u>	<u>\$ 258</u>	<u>-</u>	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>	<u>10,377,615</u>	<u>\$ 1,038</u>	<u>\$ 9,696,864</u>	<u>\$ (2,154)</u>	<u>\$ -</u>	<u>(12,238,196)</u>	<u>(2,539,554)</u>
Stock-based compensation	-	-	-	-	-	-	-	-	-	-	-	-	217,009	-	-	-	217,009
Issuance of Series A-2 preferred stock	-	-	-	-	3,347,976	335	-	-	-	-	-	-	1,673,653	-	-	-	1,673,988
Issuance of Series CF preferred stock	-	-	-	-	-	-	-	-	124,204	12	-	-	64,574	-	-	-	64,586
Issuance of Series A-3 preferred stock	-	-	-	-	-	-	3,447,608	345	-	-	-	-	1,826,887	-	-	-	1,827,232
Subscription receivable from Series CF	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(8,283)	-	(8,283)
Write off of contribution receivable	-	-	-	-	-	-	-	-	-	-	-	-	-	2,154	-	-	2,154
Offering costs	-	-	-	-	-	-	-	-	-	-	-	-	(385,719)	-	-	-	(385,719)
Fair value of warrant issuances - venture debt	-	-	-	-	-	-	-	-	-	-	-	-	147,943	-	-	-	147,943
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(4,725,533)	(4,725,533)
Balance at December 31, 2018	<u>20,714,518</u>	<u>\$ 2,071</u>	<u>5,650,903</u>	<u>\$ 565</u>	<u>5,932,742</u>	<u>\$ 593</u>	<u>3,447,608</u>	<u>\$ 345</u>	<u>124,204</u>	<u>\$ 12</u>	<u>10,377,615</u>	<u>\$ 1,038</u>	<u>\$ 13,241,211</u>	<u>\$ -</u>	<u>\$ (8,283)</u>	<u>(16,963,729)</u>	<u>(3,726,177)</u>

Undesignated preferred stock had no activity or balances for the periods presented

See accompanying notes to financial statements

DENIM.LA, INC.
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash Flows From Operating Activities		
Net Loss	\$ (4,725,533)	\$ (3,287,809)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	26,346	20,557
Stock-based compensation	217,009	177,975
Write-off of capital contribution receivable	2,154	-
Gain on forgiven debt	-	(33,168)
Fair value of warrants issued for services	-	113,520
Amortization of loan discount	78,833	15,400
Amortization of loan fees	92,361	48,442
Changes in operating assets and liabilities:		
(Increase)/Decrease in other receivable	-	12,275
(Increase)/Decrease in inventory	(216,655)	(158,552)
(Increase)/Decrease in prepaid expenses	(81,746)	(78,135)
Increase/(Decrease) in accounts payable	122,595	(378,691)
Increase/(Decrease) in accrued expenses and other liabilities	90,028	70,261
Increase/(Decrease) in deferred revenue	225,905	21,663
Net Cash Used In Operating Activities	<u>(4,168,703)</u>	<u>(3,456,262)</u>
Cash Flows From Investing Activities		
Purchase of property, equipment, and software	(111,204)	(23,038)
Deposits	(22,805)	(12,429)
Proceeds from repayment of related party receivable	171,900	-
Net Cash Provided by (Used In) Investing Activities	<u>37,891</u>	<u>(35,467)</u>
Cash Flows From Financing Activities		
Proceeds (repayment) - related parties	199,312	(275,138)
Proceeds from issuance of preferred stock	3,557,523	2,008,706
Offering costs	(480,942)	(291,298)
Proceeds from issuance of venture debt, net of fees	1,092,500	2,672,499
Repayments on business loan	-	(455,152)
Net Cash Provided By Financing Activities	<u>4,368,393</u>	<u>3,659,617</u>
Net Change In Cash and Cash Equivalents	237,581	167,888
Cash and Cash Equivalents at Beginning of Year	346,900	179,012
Cash and Cash Equivalents at End of Year	<u>\$ 584,481</u>	<u>\$ 346,900</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	\$ 534,096	\$ 393,360
Cash paid for income taxes	<u>\$ 800</u>	<u>\$ 800</u>
Supplemental Disclosure of Non-Cash Financing Activities		
Conversion of notes payable - related party to preferred stock	\$ -	\$ 49,623
Discount due to warrants and beneficial conversion feature	<u>\$ -</u>	<u>\$ 56,970</u>
Warrants issued for offering costs	<u>\$ 62,590</u>	<u>\$ 18,077</u>
Warrants issued with venture debt	<u>\$ 147,943</u>	<u>\$ 188,567</u>

See accompanying notes to financial statements

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

NOTE 1: NATURE OF OPERATIONS

Denim.LA, Inc. (the "Company"), is a corporation organized September 17, 2012 under the laws of Delaware as a limited liability company under the name Denim.LA LLC. The Company converted to a Delaware corporation on January 30, 2013 and changed its name to Denim.LA, Inc. The Company does business under the names DSTLD and Digital Brands Group. The Company sells premium denim and other products direct to consumers.

NOTE 2: GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has not generated profits since inception, has sustained net losses of \$4,725,533 and \$3,287,809 for the years ended December 31, 2018 and 2017, respectively, and has incurred negative cash flows from operations for the years ended December 31, 2018 and 2017. The Company has historically lacked liquidity to satisfy obligations as they come due and as of December 31, 2018, the Company had a working capital deficit of \$3,897,807. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern for the next twelve months is dependent upon its ability to generate sufficient cash flows from operations to meet its obligations, which it has not been able to accomplish to date, and/or to obtain additional capital financing. No assurance can be given that the Company will be successful in these efforts.

NOTE 3: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP").

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified, as a result of change in accounting policy on the classification of shipping and handling, merchant fees, and packaging materials and supplies, from cost of net revenues to sales and marketing, see Note 3 - accounting policy in Cost of Sales and Shipping and Handling. The Company adopts this change in accounting policy to be consistent with comparable companies in its industry. The change in accounting policy has been applied retrospectively. Further, some of prior year amounts were reclassified to conform on the current year presentation.

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

The effects of the change in accounting policy and reclassification on the financial statements are as follows:

	2017			As reclassified
	As previously presented	Change in accounting policy Increase (Decrease)	Reclassification Increase (Decrease)	
<u>Statements of operation</u>				
Cost of net revenues	2,259,531	(675,198)	-	1,584,333
Sales and marketing	1,718,106	675,198	(1,493,308)	1,603,678
Compensation and benefits	1,324,415	-	(1,324,415)	-
Distribution	-	-	976,517	976,517
General and administrative	1,280,149	-	1,841,206	3,121,355

These reclassifications had no effect on the reported net loss, balance sheets and statements of cash flows.

For the years ended December 31, 2018 and 2017, shipping and handling, merchant fees, and packaging materials and supplies amounted to \$469,139 and \$491,090, \$174,835 and \$168,909, \$21,416 and \$15,199, all respectively.

Various balance sheet accounts have been reclassified from prior year presentation to condense the statements.

Cash Equivalents and Concentration of Cash Balance

The Company considers all highly liquid securities with an original maturity of less than three months to be cash equivalents. The Company's cash and cash equivalents in bank deposit accounts, at times, may exceed federally insured limits. The Company's cash balance of certain accounts exceeded the FDIC insured limits by \$147,709 and \$41,298 as of December 31, 2018 and 2017, respectively.

Capital Contribution Receivable

The Company records stock issuances at the effective date. If the contribution is not funded upon issuance, the Company records a capital contribution receivable as an asset on a balance sheet. When contributed capital receivables were not received prior to the issuance of financial statements at a reporting date in satisfaction of the requirements under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 505-10-45-2, the contributed capital is reclassified as a contra account to stockholders' deficit on the balance sheet.

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

Fair Value of Financial Instruments

FASB guidance specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy are as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as exchange-traded instruments and listed equities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly (e.g., quoted prices of similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active).

Level 3 - Unobservable inputs for the asset or liability. Financial instruments are considered Level 3 when their fair values are determined using pricing models, discounted cash flows or similar techniques and at least one significant model assumption or input is unobservable.

The carrying amounts reported in the balance sheets approximate their fair value.

Inventory

Inventory is stated at the lower of cost or market and accounted for using the weighted average cost method. The inventory balances as of December 31, 2018 and 2017 consist entirely of finished good products purchased for resale and any materials the Company purchased to modify the products. The Company has outsourced the warehousing and fulfillment of its inventory to a third party.

Property, Equipment, and Software

Property, equipment, and software are recorded at cost. Depreciation/amortization is recorded for property, equipment, and software using the straight-line method over the estimated useful lives of assets. The Company reviews the recoverability of all long-lived assets, including the related useful lives, whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset might not be recoverable. The balances at December 31, 2018 and 2017 consist of software with three (3) year lives, property and equipment with 3-10 year lives, and leasehold improvements which are depreciated over the shorter of the lease life or expected life.

Depreciation and amortization charges on property, equipment, and software are included in general and administrative expenses and amounted to \$26,346 and \$20,557 for the years ended December 31, 2018 and 2017, respectively. Capital assets as of December 31, 2018 and 2017 are as follows:

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

	<u>2018</u>	<u>2017</u>
Computer equipment	\$ 52,936	\$ 59,779
Furniture and fixtures	66,328	10,754
Leasehold improvements	<u>40,351</u>	<u>81,325</u>
	159,615	151,858
Accumulated depreciation	<u>(50,235)</u>	<u>(123,086)</u>
Property and equipment, net	<u>\$ 109,380</u>	<u>\$ 28,772</u>
Software	\$ 56,450	\$ 52,200
Accumulated amortization	<u>(52,200)</u>	<u>(52,200)</u>
Software, net	<u>\$ 4,250</u>	<u>\$ -</u>

Impairment of Long-lived Assets

The Company continually monitors events and changes in circumstances that could indicate carrying amounts of long-lived assets may not be recoverable. When such events or changes in circumstances are present, the Company assesses the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future cash flows is less than the carrying amount of those assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell.

Accrued Expenses and Other Liabilities

The Company accrued expenses and other liabilities line in the balance sheets is comprised of the following as of December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Accrued expenses	\$ 185,526	\$ 133,475
Reserve for returns	188,532	193,737
Other liabilities	109,527	89,849
Sales tax liability	<u>35,348</u>	<u>11,843</u>
	<u>\$ 518,933</u>	<u>\$ 428,904</u>

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

Convertible Instruments

U.S. GAAP requires companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments according to certain criteria. The criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument. An exception to this rule is when the host instrument is deemed to be conventional as that term is described under applicable U.S. GAAP.

When the Company has determined that the embedded conversion options should not be bifurcated from their host instruments, the Company records, when necessary, discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note. Debt discounts under these arrangements are amortized over the term of the related debt to their stated date of redemption. The Company also records, when necessary, deemed dividends for the intrinsic value of conversion options embedded in preferred shares based upon the differences between the fair value of the underlying common stock at the commitment date of the transaction and the effective conversion price embedded in the preferred shares.

Accounting for Preferred Stock

ASC 480, *Distinguishing Liabilities from Equity*, includes standards for how an issuer of equity (including equity shares issued by consolidated entities) classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity.

Management is required to determine the presentation for the preferred stock as a result of the redemption and conversion provisions, among other provisions in the agreement. Specifically, management is required to determine whether the embedded conversion feature in the preferred stock is clearly and closely related to the host instrument, and whether the bifurcation of the conversion feature is required and whether the conversion feature should be accounted for as a derivative instrument. If the host instrument and conversion feature are determined to be clearly and closely related (both more akin to equity), derivative liability accounting under ASC 815, *Derivatives and Hedging*, is not required. Management determined that the host contract of the preferred stock is more akin to equity, and accordingly, liability accounting is not required by the Company. The Company has presented preferred stock within stockholders' equity.

Costs incurred directly for the issuance of the preferred stock are recorded as a reduction of gross proceeds received by the Company, resulting in a discount to the preferred stock. The discount is not amortized.

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

Revenue Recognition

The Company recognizes revenue when: (1) persuasive evidence exists of an arrangement with the customer reflecting the terms and conditions under which products or services will be provided; (2) delivery has occurred or services have been provided; (3) the fee is fixed or determinable; and (4) collection is reasonably assured. The Company typically collects revenue upon sale and recognizes the revenue when the item has shipped. Orders that have been placed and paid as of year-end but have not been shipped are recorded to deferred revenue. Sales tax is collected on sales in California and these taxes are recorded as a liability until remitted. The Company estimates returns based on its historic results and return policy in place at the sale date and records an allowance against revenues for this estimate. Liabilities are recorded for promotional credits and store credit issued to customers. The reserve for returns totaled approximately \$189,000 and \$194,000 as of December 31, 2018 and 2017, respectively, and is included in reserves for returns in the accompanying balance sheets.

Cost of Sales

Cost of sales consists primarily of inventory sold and related freight-in. The Company adopts a change in accounting policy to exclude merchant fees, outbound shipping and handling and packaging materials and supplies from cost of sales, see Note 3 - Reclassifications.

Shipping and Handling

The Company recognizes shipping and handling billed to customers as a component of net revenues, and the cost of shipping and handling as a component of sales and marketing. The Company adopts a change in accounting policy to exclude the shipping and handling from cost of net revenues, see Note 3 – Reclassifications. Total shipping and handling billed to customers as a component of net revenues was approximately \$57,000 and \$60,000 for the years ended December 31, 2018 and 2017, respectively. Total shipping and handling costs included in sales and marketing was approximately \$469,000 and \$491,000 for the years ended December 31, 2018 and 2017, respectively.

Advertising and Promotion

Advertising and promotional costs are expensed as incurred. Advertising and promotional expense for the years ended December 31, 2018 and 2017 amounted to approximately \$1,372,000 and \$1,345,000, respectively, which is included in sales and marketing expense.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718, *Compensation - Stock Compensation*. Under the fair value recognition provisions of ASC 718, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period, which is generally the option vesting period. The Company uses the Black-Scholes option pricing model to determine the fair value of stock options.

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The Company measures compensation expense for its non-employee stock-based compensation under ASC 505, *Equity*. The fair value of the option issued or committed to be issued is used to measure the transaction, as this is more reliable than the fair value of the services received. The fair value is measured at the value of the Company's common stock or stock award on the date that the commitment for performance by the counterparty has been reached or the counterparty's performance is complete. The fair value of the equity instrument is charged directly to stock-based compensation expense and credited to additional paid-in capital.

Deferred Offering Costs

The Company complies with the requirements of FASB ASC 340-10-S99-1 with regards to offering costs. Prior to the completion of an offering, offering costs are capitalized. The deferred offering costs are charged to additional paid-in capital or as a discount to debt, as applicable, upon the completion of an offering or to expense if the offering is not completed.

Income Taxes

The Company uses the liability method of accounting for income taxes as set forth in ASC 740, *Income Taxes*. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is unlikely that the deferred tax assets will not be realized. We assess our income tax positions and record tax benefits for all years subject to examination based upon our evaluation of the facts, circumstances and information available at the reporting date. In accordance with ASC 740-10, for those tax positions where there is a greater than 50% likelihood that a tax benefit will be sustained, our policy will be to record the largest amount of tax benefit that is more likely than not to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where there is less than 50% likelihood that a tax benefit will be sustained, no tax benefit will be recognized in the financial statements.

Net Loss per Share

Net earnings or loss per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding during the period, excluding shares subject to redemption or forfeiture. The Company presents basic and diluted net earnings or loss per share. Diluted net earnings or loss per share reflect the actual weighted average of common shares issued and outstanding during the period, adjusted for potentially dilutive securities outstanding. Potentially dilutive securities are excluded from the computation of the diluted net loss per share if their inclusion would be anti-dilutive. As all potentially dilutive securities are anti-dilutive as of December 31, 2018 and 2017, diluted net loss per share is the same as basic net loss per share for each year. Potentially dilutive items outstanding as of December 31, 2018 and 2017 are as follows:

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	<u>2018</u>	<u>2017</u>
Series Seed Preferred Stock (convertible to common stock)	20,714,518	20,714,518
Series A Preferred Stock (convertible to common stock)	5,650,903	5,650,903
Series A-2 Preferred Stock (convertible to common stock)	5,932,742	2,584,766
Series CF Preferred Stock (convertible to common stock)	124,204	-
Series A-3 Preferred Stock (convertible to common stock)	3,447,608	-
Common stock warrants	4,197,745	2,949,398
Preferred stock warrants	547,140	175,503
Exercisable stock options	13,278,843	11,583,214
Total potentially dilutive shares	<u>53,893,703</u>	<u>43,658,302</u>

Concentrations

Two vendors as of December 31, 2017 made up 21% and 17% of accounts payable. All of these concentrations relate to vendors that provided inventory during 2018 and 2017 (see below). There were no vendors representing over 10% of accounts payable as of December 31, 2018.

The Company utilized two vendors that made up 29% and 26% of all inventory purchases, respectively during the year ended December 31, 2018 and two vendors that made up 22% and 59% of all inventory purchases, respectively during the year ended December 31, 2017. The loss of one of these vendors, may have a negative short-term impact on the Company's operations; however, we believe there are acceptable substitute vendors that can be utilized longer-term.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, *Leases* (Topic 842). This ASU requires a lessee to recognize a right-of-use asset and a lease liability under most operating leases in its balance sheet. The ASU is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. We are continuing to evaluate the impact of this new standard on our financial reporting and disclosures.

In June 2018, the FASB issued ASU No. 2018-07, *Compensation - Stock Compensation* (Topic 718): *Improvements to Nonemployee Share-Based Payment Accounting* ("ASU 2018-07"). ASU 2018-07 eliminates the separate accounting model for nonemployee share-based payment awards and generally requires companies to account for share-based payment transactions with nonemployees in the same way as share-based payment transactions with employees. The accounting remains different for attribution, which represents how the equity-based payment cost is recognized over the vesting period, and a contractual term election for valuing nonemployee equity share options. ASU 2018-07 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018 with early adoption permitted. The Company is in process of assessing the impact of the adoption of ASU 2018-07 on the financial statements.

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In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) and has issued subsequent amendments to this guidance. This new standard will replace all current guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for interim and annual periods beginning after December 31, 2018. The standard may be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is currently reviewing the provisions of the new standard.

Management does not believe that any other recently issued, but not yet effective, accounting standards could have a material effect on the accompanying financial statements. As new accounting pronouncements are issued, the Company will adopt those that are applicable under the circumstances.

NOTE 4: LONG-TERM DEBT

Business Loan

On May 18, 2016, the Company closed on a loan with MBMJ Capital LLC dba Continental Business Credit, which includes the following funding mechanisms. The loans required a minimum monthly interest charge of \$2,500, are subject to a default rate of an additional 7% on the stated interest rates, and required a \$10,000 facility fee at closing.

Revolving Inventory Finance Facility: The Company could borrow up to 50% of the book value of all eligible inventory in its possession. The balance of the loan was to be paid down daily with proceeds from the sale of inventory. The loan was revolving, and therefore the Company could continue to draw on the note up to 50% of eligible inventory as the loan was being paid down. The maximum credit limit for this loan was \$1,000,000. This loan bore interest at prime plus 11.50% per annum, with a minimum rate of 15% (15.5% at December 31, 2016) payable monthly. The loan had a one-year term. The balance outstanding on this note as of December 31, 2016, inclusive of accrued interest, was \$455,152. The proceeds of this loan were used for operations. The loan was repaid in its entirety in conjunction with the 2017 venture debt discussed in the following section of this note in April 2017.

Total interest and fees recognized on these business loans for the years ended December 31, 2018 and 2017 was \$0 and \$65,587, respectively.

Venture Debt

In March 2017, the Company entered into a senior credit agreement with an outside lender for up to \$4,000,000, dependent upon the achievement of certain milestones. The initial close amount was a minimum of \$1,345,000. The loan bears interest at 12.5% per annum, compounded monthly, plus fees. A 5% closing fee is due upon each closing, legal and accounting fees of up to \$40,000, and management fees of \$4,167-\$5,000 per month. The loan requires monthly payments of interest commencing March 31, 2017, and a balloon payment for the full principal amount at maturity in March 2020. In 2018, the maturity date was extended one year, to March 2021. Prepayments are allowed, subject to various provisions, including a minimum payment amount of \$250,000.

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Repayment is accelerated upon a change in control, as defined in the agreement. The loan is senior to all other debts and obligations of the Company, is collateralized by all assets of the Company, and shares of the Company's common stock pledged by officers of the Company. As of December 31, 2018 and 2017, the loan balance is \$4,000,000 and \$2,850,000, resulting from cash disbursed to the Company of \$3,069,598 and \$1,977,098, loan fees of \$235,000 and \$177,500 charged to the loan balance, and cash disbursed to repay other debts of the Company of \$0 and \$695,402 (inclusive of \$118,402 repaid to a related party note payable (board member)), all respectively. An additional \$20,843 in loan fees were also paid, which were included as part of the discount to the loan as further discussed below. The Company failed to comply with certain debt covenants during the years ended December 31, 2018 and 2017. At December 31, 2017, the Company received a waiver from the lender and therefore, at such time, was not considered to be in default. At December 31, 2018, the waiver was not obtained. Accordingly, as of December 31, 2018, the venture debt is shown as a current liability.

Total loan fees of \$255,843 and \$198,343 as of December 31, 2018 and 2017, respectively, were incurred in conjunction with this loan, and such were recorded as a discount to the loan and are amortized under the effective interest method to interest expense over the life of the loan. For the years ended December 31, 2018 and 2017, \$92,361 and \$48,442 of these loan fees were amortized to interest expense, leaving unamortized balances of \$115,040 and \$149,901 as of December 31, 2018 and 2017, all respectively.

The lender was also granted warrants to purchase common stock representing 1% of the fully diluted capitalization of the Company for each \$1,000,000 of principal loaned under the agreement. As of December 31, 2017, warrants for 1,139,398 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years. As discussed in Note 8, these warrants were valued at \$56,970 and recorded as a discount to the note payable balance, and are being amortized under the effective interest method over the life of the loan. For the year ended December 31, 2018 and 2017, \$18,938 and \$15,400 was amortized to interest expense, respectively, leaving an unamortized balance of \$22,632 and \$41,570 as of December 31, 2018 and 2017, respectively. In 2018, warrants for 1,248,347 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years. As discussed in Note 8, these warrants were valued at \$147,943 and recorded as a discount to the note payable balance, and are being amortized under the effective interest method over the life of the loan. For the year ended December 31, 2018, \$59,895 was amortized to interest expense, leaving an unamortized balance of \$88,048 as of December 31, 2018.

As of December 31, 2018, total unamortized interest expense amounted to \$225,720, which is expected to be amortized in 2019 and 2020 by \$188,105 and \$37,615, respectively.

Interest expense and effective interest rate on this loan for the year ended December 31, 2018 and 2017 was \$526,251 and \$275,403, and 18.60% and 14.28%, all respectively.

NOTE 5: STOCKHOLDERS' DEFICIT

Convertible Preferred Stock

In July 2017, the Certificate of Incorporation was amended to increase the authorized preferred stock to 56,000,000 shares of \$0.0001 par preferred stock. The Company designated 20,714,518 shares of preferred stock as Series Seed Preferred Stock, 14,481,413 shares of preferred stock as Series A Preferred Stock, and 20,000,000 shares of Series A-2 Preferred Stock, with 804,069 shares of preferred stock undesignated.

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In June 2018, the Company amended and restated its articles of incorporation, setting its authorized common stock at 100,000,000 shares and increasing the authorized preferred stock to 58,000,000 shares. The Company designated its preferred stock as 20,714,518 shares of Series Seed Preferred Stock, 14,481,413 shares of Series A Preferred Stock, 20,000,000 shares of Series A-2 Preferred Stock, and 2,000,000 shares of Series CF Preferred Stock, and with 804,069 shares of preferred stock undesignated.

In September 2018, the Company amended and restated its articles of incorporation, increasing the authorized common stock to 110,000,000 shares and increasing the authorized preferred stock to 77,000,000 shares. The Company designated its preferred stock as 20,714,518 shares of Series Seed Preferred Stock, 14,481,413 shares of Series A Preferred Stock, 20,000,000 shares of Series A-2 Preferred Stock, 2,000,000 shares of Series CF Preferred Stock, 18,867,925 shares of Series A-3 Preferred Stock, and with 936,144 shares of preferred stock undesignated. The Company also amended the rights and privileges applicable to the various share classes to include the newly designated Series CF Preferred Stock and Series A-3 Preferred Stock. Series Seed Preferred Stock holders are entitled to vote on an as converted basis, while Series A Preferred Stock holders, Series A-2 Preferred Stock holders, Series CF Preferred Stock holders, and Series A-3 Preferred Stock holders do not have voting privileges. The preferred stockholders have certain dividend preferences over common stockholders. The preferred stock is subject to an optional conversion right, where the preferred stock is convertible into fully paid and non-assessable shares of common stock at a 1:1 rate, with certain dilution protections. All classes of preferred stock are subject to automatic conversion into the Company's common stock if and upon an initial public offering of \$25,000,000 or greater. The preferred stockholders are entitled to a liquidation preference over common stockholders of the greater of: 1) the preferred stock purchase price (\$0.27 per share for Series Seed Preferred Stock, \$0.48 per share for Series A Preferred Stock, \$0.50 per share for Series A-2 Preferred Stock, \$0.52 per share for Series CF Preferred Stock, and \$0.53 per share for Series A-3 Preferred Stock) multiplied by a multiple of 1.00 for Series A Preferred Stock, Series A-2 Preferred Stock, Series CF Preferred Stock, and Series A-3 Preferred Stock, and 1.00 or 1.25 depending upon certain conditions defined in the articles of incorporation for the Series Seed Preferred Stock; 2) on an as converted to common stock at the liquidation date.

As of December 31, 2018 and 2017, 20,714,518 and 20,714,518 shares of Series Seed Preferred Stock were issued and outstanding, 5,650,903 and 5,650,903 shares of Series A Preferred Stock were issued and outstanding, 5,932,742 and 2,584,766 shares of Series A-2 Preferred Stock were issued and outstanding, 124,204 and 0 shares of Series CF Preferred Stock were issued and outstanding, and 3,447,608 and 0 shares of Series A-3 Preferred Stock were issued and outstanding, all respectively.

Based on circumstances in place as of December 31, 2018 and 2017, the liquidation preference on the Series Seed Preferred Stock was subject to the 1.00 and 1.00 multiple and the liquidation preference on the Series A Preferred Stock was subject to a multiple of 1.00 and 1.00, all respectively. The total liquidation preferences as of December 31, 2018 and 2017 amounted to \$13,163,543 and \$9,597,736, respectively.

In 2016, the Company closed on several stock issuance rounds of its Series A Preferred Stock financing conducted under Regulation A, resulting in the issuance of 2,072,822 shares of Series A Preferred Stock at a price per share of \$0.48, providing gross proceeds of \$994,435 for the year ended December 31, 2016. During the year ended December 31, 2017, the Company issued an additional 1,596,676 shares of Series A Preferred Stock at a price per share of \$0.48, providing cash proceeds of \$716,323 and conversions of debts of \$49,623, for gross proceeds of \$765,946.

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In 2017, the Company closed on several stock issuance rounds of its Series A-2 Preferred Stock financing conducted under Regulation A, resulting in the issuance of 2,584,766 shares of Series A-2 Preferred Stock at a price per share of \$0.50, providing gross proceeds of \$1,292,383 for the year ended December 31, 2017. In 2018, the Company issued an additional 3,347,976 shares of Series A-2 Preferred Stock at a price per share of \$0.50, providing gross proceeds of \$1,673,988.

In 2018, the Company issued 124,204 shares of Series CF Preferred Stock at price of \$0.52, providing gross proceeds of \$64,586 and 3,447,608 shares of Series A-3 Preferred Stock at price per share of \$0.53, providing gross proceeds of \$1,827,232.

Common Stock

The Company authorized 110,000,000 and 100,000,000 shares of common stock at \$0.0001 par value as of December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, 10,377,615 and 10,377,615 shares of common stock were issued and outstanding, respectively.

Common stockholders have voting rights of one vote per share. The voting, dividend, and liquidation rights of the holders of common stock are subject to and qualified by the rights, powers, and preferences of preferred stockholders.

NOTE 6: RELATED PARTY TRANSACTIONS

Related Party Payable

A family member of an officer provided accounting services to the Company at a rate of \$2,500 per month commencing in 2015 through April 2016. A total of \$0 and \$20,000 was due under this arrangement as of December 31, 2018 and 2017, respectively.

Promissory Notes Payable

During 2016, the Company issued two promissory notes to related parties with combined outstanding principal balances of \$225,000 as of December 31, 2016. The notes were payable on demand. These notes bore interest at 20% per annum. In March and April of 2017, \$185,000 of these loans were repaid with the 2017 loan issuance proceeds along with accrued interest \$33,402. In March 2017, the Company converted the \$40,000 note payable, along with accrued interest of \$9,623, into 98,402 shares of its Series A Preferred Stock at a conversion rate of \$0.48 per share. Interest expense of \$11,999 was recognized on these notes during the year ended December 31, 2017, and \$0 remains unpaid and outstanding as of December 31, 2017. There was no activity or balances due under this arrangement as of and for the year ended December 31, 2018.

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Employee Backpay and Loans Receivable

Two officers of the Company deferred their salary during portions of 2014-2016. The Company commenced repaying these obligations during 2017; however, no additional payments were made during 2018. The balance of employee backpay as of December 31, 2018 and 2017 was approximately \$430,500 and \$430,500, respectively.

The Company has loaned funds to these same two officers of the Company throughout the life of the business, which net of repayments amounted to \$234,500 and \$406,400 as of December 31, 2018 and 2017. These loans are payable on demand and do not bear interest. One of the officers repaid \$171,900 during 2018. The same officer continued to fund the Company after repayment and advanced a total of \$219,312 which is included in due to related parties in the accompanying balance sheet.

Due to the right of offset of these loans receivable and backpay for the officers in question, the net payable of \$196,068 and \$24,168 as of December 31, 2018 and 2017, respectively are presented within due to related parties advances. These balances are presented net pursuant to an agreement with these officers to net the loans receivable against backpay owed in order to settle both the loans receivable and backpay if the loans are not repaid. The Company has accrued estimated employer taxes on backpay.

Payment Processor:

The Company's backend payment processor's majority shareholder is a director of the Company. Total expenses for the years ended December 31, 2018 and 2017 were \$121,223 and \$119,509, respectively, and included in costs of net revenues in the accompanying statements of operations.

NOTE 7: INCOME TAXES

Deferred taxes are recognized for temporary differences between the basis of assets and liabilities for financial statement and income tax purposes. The differences relate primarily to depreciable assets using accelerated depreciation methods for income tax purposes, share-based compensation expense, and for net operating loss carryforwards. As of December 31, 2018 and 2017, the Company had net deferred tax assets before valuation allowance of \$4,357,170 and \$4,353,273, respectively. The following table presents the deferred tax assets and liabilities by source:

	<u>2018</u>	<u>2017</u>
Deferred Tax Assets:		
Net operating loss carryforwards	\$ 4,357,985	\$ 4,300,823
Stock-based compensation	67,381	52,450
Deferred Tax Liabilities:		
Depreciation timing differences	(5,103)	(5,790)
Unamortized debt issuance costs	(63,093)	(59,613)
Valuation Allowance	<u>(4,357,170)</u>	<u>(4,287,870)</u>
Net Deferred Tax Asset	<u>-</u>	<u>-</u>

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The Company recognizes deferred tax assets to the extent that it believes that these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. The Company assessed the need for a valuation allowance against its net deferred tax assets and determined a full valuation allowance is required due to taxable losses for the years ended December 31, 2018 and 2017, cumulative losses through December 31, 2018, and no history of generating taxable income. Therefore, valuation allowances of \$4,357,170 and \$4,287,870 were recorded as of December 31, 2018 and 2017, respectively. Valuation allowance increased by \$69,300 and \$1,299,918 during the years ended December 31, 2018 and 2017, respectively. Accordingly, an \$800 provision for income taxes has been recognized for each of the years ended December 31, 2018 and 2017. Deferred tax assets were calculated using the Company's combined effective tax rate, which it estimated to be 28.0% and 39.8%, respectively. The effective rate is reduced to 0% for 2018 and 2017 due to the full valuation allowance on its net deferred tax assets.

The Company's ability to utilize net operating loss carryforwards will depend on its ability to generate adequate future taxable income. At December 31, 2018 and 2017, the Company had net operating loss carryforwards available to offset future taxable income in the amounts of \$15,590,959 and \$10,803,916, which may be carried forward and will expire between 2034 and 2038 in varying amounts.

The Company has evaluated its income tax positions and has determined that it does not have any uncertain tax positions. The Company will recognize interest and penalties related to any uncertain tax positions through its income tax expense.

In December 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted into law and the new legislation contains several key tax provisions that affected the Company, including a reduction of the corporate income tax rate to 21% effective January 1, 2018, among others. The Company is required to recognize the effect of the tax law changes in the period of enactment, such as determining the transition tax, remeasuring deferred tax assets and liabilities, as well as reassessing the net realizability of our deferred tax assets and liabilities. The tax rate change reduced the Company's net deferred tax assets by \$1,849,596 at December 31, 2018. However, this change had no impact to the Company's net loss as the Company has not incurred a tax liability or expense for the year ended December 31, 2018 and has a full valuation allowance against its net deferred tax assets.

The Company may in the future become subject to federal, state and local income taxation though it has not been since its inception, other than minimum state tax. The Company is not presently subject to any income tax audit in any taxing jurisdiction, though its 2015-2018 tax years remain open to examination.

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NOTE 8: SHARE-BASED PAYMENTS

Warrants

In 2017, the Company issued a warrant in conjunction with a service agreement. The warrant is exercisable into 3,600,000 shares of common stock at an exercise price of \$0.16 per share. The warrant expires in June 2021. The warrant vested 1/3 at issuance, then vests at a rate of 1/36 per month at each monthly anniversary commencing June 7, 2017, subject to continuous service with the Company. As of December 31, 2017, 1,800,000 of these warrants had vested, and the agreement was terminated effective December 31, 2017. The Company determined the fair value of these warrants at the initial grant date to be \$0.048 per share under the Black-Scholes method, using the same method used for valuing employee options as noted below in the Stock Plan section, which was revalued as the warrants vested. The fair value was to be recognized ratably over the underlying vesting period of this warrant. During the year ended December 31, 2017, \$113,520 of expense was recognized to general and administrative expense related to this warrant. As the agreement terminated effective December 31, 2017, no further compensation expense has been recorded on this agreement. The range of Black-Scholes inputs utilized in calculating the fair value of this warrant were as follows:

	<u>2017</u>
Risk Free Interest Rate	1.94%-2.06%
Expected Dividend Yield	0.00%
Expected Volatility	32.00%
Expected Life (years)	3.5-4.5

In March 2017, the lender of venture debt to the Company was granted warrants to purchase common stock representing 1% of the fully diluted capitalization of the Company for each \$1,000,000 of principal loaned under the agreement, see Note 4. As of December 31, 2017, warrants for 1,139,398 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years.

The Company determined the fair value of these warrants to be \$0.05 per share under the Black-Scholes method, with the following inputs, providing a total value of \$56,970 which was recorded as a discount to the loan and is being recognized ratably over term of the loan. See Note 4 for additional information.

	<u>2017</u>
Risk Free Interest Rate	1.92%
Expected Dividend Yield	0.00%
Expected Volatility	32.00%
Expected Life (years)	5.00

In January and April 2018, the lender of venture debt to the Company was granted warrants to purchase common stock representing 1% of the fully diluted capitalization of the Company for each \$1,000,000 of principal loaned under the agreement, see Note 4. In January and April 2018, warrants for 610,578 and 637,769 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years based on the terms noted above.

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For the January 2018 warrants, the Company determined the fair value of these warrants to be \$0.118 per share under the Black-Scholes method, with the following inputs, providing a total value of \$72,048 which was recorded as a discount to the loan and is being recognized ratably over term of the loan. See Note 4 for additional information.

	<u>2018</u>
Risk Free Interest Rate	2.02%
Expected Dividend Yield	0.00%
Expected Volatility	55.00%
Expected Life (years)	5.00

The Company determined the fair value of these April 2018 warrants to be \$0.119 per share under the Black-Scholes method, with the following inputs, providing a total value of \$75,895 which was recorded as a discount to the loan and is being recognized ratably over term of the loan. See Note 4 for additional information.

	<u>2018</u>
Risk Free Interest Rate	2.43%
Expected Dividend Yield	0.00%
Expected Volatility	55.00%
Expected Life (years)	5.00

For valuing the warrants noted above, the Company uses the same assumptions used for valuing employee options as noted below in the Stock Plan section, with the exception of the useful life which is either the contractual life or for the Venture Debt the estimated life which is based on the occurrence of an acquisition or IPO.

A summary of information related to common stock warrants for the years ended December 31, 2018 and 2017 is as follows:

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	December 31, 2018		December 31, 2017	
	Common Stock Warrants	Weighted Average Exercise Price	Common Stock Warrants	Weighted Average Exercise Price
Outstanding - beginning of year	2,949,398	\$ 0.16	10,000	\$ 0.15
Granted	1,248,347	0.16	4,739,398	0.16
Exercised	-		-	
Forfeited	-		(1,800,000)	0.16
Outstanding - end of year	<u>4,197,745</u>	\$ 0.16	<u>2,949,398</u>	\$ 0.16
Exercisable at end of year	<u>4,197,745</u>	\$ 0.16	<u>2,949,398</u>	\$ 0.16

Preferred Stock Warrants

In 2017, in conjunction with the closing of its offering under Regulation A discussed in Note 4, the Company issued its broker-dealer in this offering 175,503 fully vested warrants to purchase its Series A Preferred Stock at an exercise price of \$0.48 per share, expiring in five years. The fair value of these warrants was calculated under the Black-Scholes method, using below variables, resulting in an aggregate fair value of \$18,077 being recorded to additional paid-in capital and as offering costs within additional paid-in capital.

	<u>2017</u>
Risk Free Interest Rate	2.09%
Expected Dividend Yield	0.00%
Expected Volatility	32.00%
Expected Life (years)	3.50

In 2018, in conjunction with the closing of its Series A-2 Preferred Stock offering under Regulation A discussed in Note 4, the Company issued its broker-dealer in this offering 296,637 fully vested warrants to purchase its Series A-2 Preferred Stock at an exercise price of \$0.50 per share, expiring in five years. The fair value of these warrants was calculated under the Black-Scholes method, using below variables, resulting in an aggregate fair value of \$62,590 being recorded to additional paid-in capital and as offering costs within additional paid-in capital for the year ended December 31, 2018.

	<u>2018</u>
Risk Free Interest Rate	2.63%
Expected Dividend Yield	0.00%
Expected Volatility	32.00%
Expected Life (years)	3.50

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

A summary of information related to preferred stock warrants for the years ended December 31, 2018 and 2017 is as follows:

	December 31, 2018		December 31, 2017	
	Preferred Stock Warrants	Weighted Average Exercise Price	Common Stock Warrants	Weighted Average Exercise Price
Outstanding - beginning of year	175,503	\$ 0.48	-	\$ -
Granted	371,637	0.46	175,503	0.48
Exercised	-	-	-	-
Forfeited	-	-	-	-
Outstanding - end of year	<u>547,140</u>	\$ 0.47	<u>175,503</u>	\$ 0.48
Exercisable at end of year	<u>547,140</u>		<u>175,503</u>	

Stock Plan

The Company has adopted the 2013 Stock Plan, as amended and restated (the "Plan"), which provides for the grant of shares of stock options, stock appreciation rights, and stock awards (performance shares) to employees, non-employee directors, and non-employee consultants. The number of shares authorized by the Plan was 18,693,055 shares as of both December 31, 2018 and 2017. The option exercise price generally may not be less than the underlying stock's fair market value at the date of the grant and generally have a term of ten years. The amounts granted each calendar year to an employee or non-employee is limited depending on the type of award. Stock options comprise all of the awards granted since the Plan's inception. Shares available for grant under the Plan amounted to 623,639 and 5,311,639 as of December 31, 2018 and 2017, respectively.

Vesting generally occurs over a period of immediately to four years. A summary of information related to stock options for the years ended December 31, 2018 and 2017 is as follows:

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

	December 31, 2018		December 31, 2017	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding - beginning of year	13,381,416	\$ 0.13	9,917,652	\$ 0.12
Granted	4,920,000	0.21	3,488,764	\$ 0.16
Exercised	-	-	-	-
Forfeited	(550,000)	0.11	(25,000)	\$ 0.16
Outstanding - end of year	<u>17,751,416</u>	\$ 0.15	<u>13,381,416</u>	\$ 0.13
Exercisable at end of year	<u>13,278,843</u>	\$ 0.14	<u>11,583,214</u>	\$ 0.13
Weighted average grant date fair value of options granted during year	<u>\$ 0.115</u>		<u>\$ 0.057</u>	
Weighted average duration (years) to expiration of outstanding options at year-end	<u>7.53</u>		<u>7.70</u>	

The Company measures employee stock-based awards at grant-date fair value and recognizes employee compensation expense on a straight-line basis over the vesting period of the award. Determining the appropriate fair value of stock-based awards requires the input of subjective assumptions, including the fair value of the Company's common stock, and for stock options, the expected life of the option, and expected stock price volatility. The Company used the Black-Scholes option pricing model to value its stock option awards. The assumptions used in calculating the fair value of stock-based awards represent management's best estimates and involve inherent uncertainties and the application of management's judgment. As a result, if factors change and management uses different assumptions, stock-based compensation expense could be materially different for future awards.

The expected life of stock options was estimated using the "simplified method," as the Company has limited historical information to develop reasonable expectations about future exercise patterns and employment duration for its stock options grants. The simplified method is based on the average of the vesting tranches and the contractual life of each grant. For stock price volatility, the Company uses comparable public companies as a basis for its expected volatility to calculate the fair value of options grants. The risk-free interest rate is based on U.S. Treasury notes with a term approximating the expected life of the option. The estimation of the number of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from the Company's current estimates, such amounts are recognized as an adjustment in the period in which estimates are revised. The assumptions utilized for option grants during the years ended December 31, 2018 and 2017 are as follows:

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

	<u>2018</u>	<u>2017</u>
Risk Free Interest Rate	2.83%	2.08%
Expected Dividend Yield	0.00%	0.00%
Expected Volatility	55.00%	32.00%
Expected Life (years)	5.50 - 6.25	5.75 - 6.25
Fair Value per Stock Option	\$0.11-\$0.12	\$ 0.057

The total grant-date fair value of the options granted during the year ended December 31, 2018 and 2017 was \$565,120 and \$197,560, respectively. Stock-based compensation expense of \$217,009 and \$177,975 was recognized under FASB ASC 718 for the years ended December 31, 2018 and 2017, respectively, and was recorded to compensation and benefits in the statements of operations. These costs are included in general and administrative in the accompanying statements of operations. Total unrecognized compensation cost related to non-vested stock option awards amounted to \$441,596 and \$104,657 for the years December 31, 2018 and 2017, respectively, and will be recognized over a weighted average period of 35 months as of December 31, 2018.

NOTE 9: LEASE OBLIGATIONS

Effective December 2013, the Company entered into a lease agreement for warehouse space. The lease term commenced December 1, 2013 and expired after 39 months, on February 28, 2017. Monthly lease obligations under the agreement were base rent starting at \$8,617 per month plus operating costs estimated at \$2,439, but subject to actual expenses. The base rent contractually escalated to \$8,876 per month beginning December 1, 2014 and to \$9,142 per month beginning December 1, 2015. A \$17,234 deposit was paid at the commencement of the lease.

The Company ceased using the warehouse space in August 2014, and entered into a lease agreement with a sub-lessor at a rate of \$11,056 per month. The 30-month lease term commenced September 2014 and expired in February 2017. The income from the sublease is recorded to Non-operating Income on the Statements of Operations.

The Company has entered into a lease agreement for office space effective March 1, 2014. The lease calls for monthly rent payments of \$5,000 commencing March 1, 2014 on a month-to-month basis. The company ceased using this facility in 2017.

The Company entered into four short-term lease agreements for building space during 2017, one of which terminated on December 31, 2017. The total base rent from the three remaining lease agreements is \$17,300 per month.

The Company entered into three short-term lease agreements for building space during 2018, two of which, with total base rent of \$40,000 per month, terminated on the same year. The total base rent from the one remaining lease agreement is 10% of gross sales.

In January 2018, the Company entered into a lease agreement requiring base rent payments of \$14,500 per month for a 36-month term. The lease required a \$43,500 deposit. Future payment obligations under this lease agreement are \$174,000, and \$174,000 for the years ended December 31, 2019, and 2020, respectively.

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS
As of December 31, 2018 and 2017 and for the years then ended

Total rent expense for the years ended December 31, 2018 and 2017 was \$310,493 and \$152,674, offset by non-operating rental income of \$0 and \$19,328, all respectively.

NOTE 10: CONTINGENCIES

The Company may be subject to pending legal proceedings and regulatory actions in the ordinary course of business. The results of such proceedings cannot be predicted with certainty, but the Company does not anticipate that the final outcome, if any, arising out of any such matters will have a material adverse effect on its business, financial condition or results of operations.

NOTE 11: SUBSEQUENT EVENTS

On February 28, 2019, Black Oak Capital amended its loan agreement to lend up to an additional \$1,000,000 on a best effort basis. As of April 30, 2019, Black Oak Capital had funded \$333,000 of the additional amount. We do not expect to receive the remaining balance. As part of the amended loan, Black Oak Capital shall have the right, but not the obligation to require the company to repay the loan on a pro rata basis in increments of \$250,000 per each additional \$1,000,000 in equity raised following the occurrence of an initial public offering by the company, which raises more than \$11,000,000 in equity.

Also, as part of the amended loan, the company has authorized the issuance to Black Oak Capital of warrants to purchase at an exercise price of \$0.16, the company's common stock representing 1.358% of the capital stock of the company on a fully diluted basis for each \$250,000 loaned to the company, up to \$1 million.

Subsequent to year end, a total of 2,175,334 shares of Series A-3 Preferred Stock were sold in connection with the Company's active Regulation A+ offering for gross proceeds of \$1,152,927. Net of fees totaling \$97,996 the Company received \$1,054,931.

Management's Evaluation

Management has evaluated subsequent events through May 2, 2019, the date the financial statements were available to be issued. Based on this evaluation, no additional material events were identified which require adjustment or disclosure in these financial statements.

INTERIM FINANCIAL STATEMENTS FOR THE SIX-MONTH PERIOD ENDING JUNE 30, 2019 AND JUNE 30, 2018

Denim.LA, Inc.
A Delaware Corporation

Financial Statements as of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

DENIM.LA, INC.

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DENIM.LA, INC.
BALANCE SHEETS (UNAUDITED)
As of June 30, 2019 and December 31, 2018

	<u>June 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 55,404	\$ 584,481
Other receivables	80,625	-
Inventory	1,106,763	1,208,642
Deferred offering costs	-	101,762
Prepaid expenses	90,541	178,414
Total Current Assets	<u>1,333,333</u>	<u>2,073,299</u>
Non-Current Assets:		
Property, equipment, and software, net	95,356	113,630
Deposits	51,678	58,000
Total Non-Current Assets	<u>147,034</u>	<u>171,630</u>
TOTAL ASSETS	<u>\$ 1,480,367</u>	<u>\$ 2,244,929</u>

No assurance provided.
See accompanying notes, which are an integral part of these financial statements.

DENIM.LA, INC.
BALANCE SHEETS (CONTINUED) (UNAUDITED)
For the six-month periods ended June 30, 2019 and 2018

	June 30, 2019	December 31, 2018
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Liabilities:		
Current Liabilities:		
Accounts payable	\$ 1,972,368	\$ 987,554
Accrued expenses and other liabilities	621,718	518,933
Deferred revenue	32,055	274,959
Due to related parties	97,047	415,380
Venture debt, net of discount of \$132,157 and \$225,720, respectively	3,867,843	3,774,280
Total Current Liabilities	<u>6,591,031</u>	<u>5,971,106</u>
Total Liabilities	<u>6,591,031</u>	<u>5,971,106</u>
Commitments and contingencies (Note 10)		
Stockholders' Deficit:		
Series Seed convertible preferred stock, \$0.0001 par, 20,714,518 shares authorized, 20,714,518 and 20,714,518 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively. Convertible into one share of common stock.Liquidation preference of \$5,592,920 and \$5,592,920 as of June 30, 2019 and December 31, 2018, respectively.	2,071	2,071
Series A convertible preferred stock, \$0.0001 par, 14,481,413 shares authorized, 5,650,903 and 5,650,903 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively. Convertible into one share of common stock.Liquidation preference of \$2,712,433 and \$2,712,433 as of June 30, 2019 and December 31, 2018, respectively.	565	565
Series A-2 convertible preferred stock, \$0.0001 par, 20,000,000 shares authorized, 5,932,742 and 5,932,742 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively. Convertible into one share of common stock.Liquidation preference of \$2,966,371 and \$2,966,371 as of June 30, 2019 and December 31, 2018, respectively.	593	593
Series A-3 convertible preferred stock, \$0.0001 par, 18,867,925 shares authorized, 7,539,262 and 3,447,608 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively. Convertible into one share of common stock.Liquidation preference of \$3,995,809 and \$1,827,232 as of June 30, 2019 and December 31, 2018, respectively.	754	345
Series CF convertible preferred stock, \$0.0001 par, 2,000,000 shares authorized, 124,204 and 124,204 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively. Convertible into one share of common stock.Liquidation preference of \$64,586 and \$64,586 as of June 30, 2019 and December 31, 2018, respectively.	12	12
Undesignated preferred stock, \$0.0001 par, 936,144 and 936,144 shares authorized, 0 and 0 issued and outstanding as of June 30, 2019 and December 31, 2018, respectively.	-	-
Common Stock, \$0.0001 par, 110,000,000 and 110,000,000 shares authorized, 10,377,615 and 10,377,615 shares issued and outstanding, 10,377,615 and 10,377,615 vested as of June 30, 2019 and December 31, 2018, all respectively.	1,038	1,038
Additional paid-in capital	15,140,562	13,241,211
Capital contribution receivable	-	-
Subscription receivable	(8,283)	(8,283)
Accumulated deficit	(20,247,976)	(16,963,729)
Total Stockholders' Deficit	<u>(5,110,664)</u>	<u>(3,726,177)</u>
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	<u>\$ 1,480,367</u>	<u>\$ 2,244,929</u>

No assurance provided.
See accompanying notes, which are an integral part of these financial statements.

DENIM.LA, INC.
STATEMENTS OF OPERATIONS (UNAUDITED)
For the six-month periods ended June 30, 2019 and 2018

	<u>June 30, 2019</u>	<u>June 30, 2018</u>
Net revenues	\$ 1,762,985	\$ 1,830,214
Costs of net revenues	838,911	652,760
Gross Profit	<u>924,074</u>	<u>1,177,454</u>
Operating Expenses:		
Sales and marketing	701,782	1,030,854
Distribution	489,536	453,099
General and administrative	2,630,301	1,504,976
Total Operating Expenses	<u>3,821,619</u>	<u>2,988,929</u>
Loss from operations	<u>(2,897,545)</u>	<u>(1,811,475)</u>
Other Income (Expense):		
Interest expense	(386,702)	(320,926)
Total Other Income (Expense)	<u>(386,702)</u>	<u>(320,926)</u>
Provision for Income Taxes	-	-
Net Loss	<u>\$ (3,284,247)</u>	<u>\$ (2,132,401)</u>
Weighted-average vested common shares outstanding		
-Basic and Diluted	<u>10,377,615</u>	<u>10,377,615</u>
Net loss per common share		
-Basic and Diluted	<u>\$ (0.32)</u>	<u>\$ (0.21)</u>

No assurance provided.

See accompanying notes, which are an integral part of these financial statements. In the opinion of management all adjustments necessary in order to make the interim financial statements not misleading have been included.

DENIM.LA, INC.

STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIT (UNAUDITED)

For the six-month periods ended June 30, 2019, December 31, 2018, and June 30, 2018

	Series Seed Convertible Preferred Stock		Series A Convertible Preferred Stock		Series A-2 Convertible Preferred Stock		Series A-3 Convertible Preferred Stock		Series CF Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Capital Contribution Receivable	Subscription Receivable	Accumulated Deficit	Total Stockholders' Deficit
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount					
Balance at December 31, 2017	20,714,518	\$ 2,071	5,650,903	\$ 565	2,584,766	\$ 258	-	\$ -	-	\$ -	10,377,615	\$ 1,038	\$ 9,696,864	\$ (2,154)	\$ -	\$ (12,238,196)	\$ (2,539,554)
Stock-based compensation	-	-	-	-	-	-	-	-	-	-	-	-	108,556	-	-	-	108,556
Issuance of Series A-2 preferred stock	-	-	-	-	3,347,976	335	-	-	-	-	-	-	1,673,653	-	-	-	1,673,988
Offering costs	-	-	-	-	-	-	-	-	-	-	-	-	(216,446)	-	-	-	(216,446)
Fair value of warrant issuances	-	-	-	-	-	-	-	-	-	-	-	-	210,533	-	-	-	210,533
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,132,401)	(2,132,401)
Balance at June 30, 2018	20,714,518	\$ 2,071	5,650,903	\$ 565	5,932,742	\$ 593	-	\$ -	-	\$ -	10,377,615	\$ 1,038	\$11,473,160	\$ (2,154)	\$ -	\$ (14,370,597)	\$ (2,895,324)
Stock-based compensation	-	-	-	-	-	-	-	-	-	-	-	-	108,453	-	-	-	108,453
Issuance of Series CF preferred stock	-	-	-	-	-	-	-	-	124,204	12	-	-	64,574	-	-	-	64,586
Issuance of Series A-3 preferred stock	-	-	-	-	-	-	3,447,608	345	-	-	-	-	1,826,887	-	-	-	1,827,232
Subscription receivable from Series CF	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(8,283)	-	(8,283)
Write off of contribution receivable	-	-	-	-	-	-	-	-	-	-	-	-	-	2,154	-	-	2,154
Offering costs	-	-	-	-	-	-	-	-	-	-	-	-	(169,273)	-	-	-	(169,273)
Fair value of warrant issuances - venture debt	-	-	-	-	-	-	-	-	-	-	-	-	(62,590)	-	-	-	(62,590)
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,593,132)	(2,593,132)
Balance at December 31, 2018	20,714,518	\$ 2,071	5,650,903	\$ 565	5,932,742	\$ 593	3,447,608	\$ 345	124,204	\$ 12	10,377,615	\$ 1,038	\$13,241,211	\$ -	\$ (8,283)	\$ (16,963,729)	\$ (3,726,177)
Stock-based compensation	-	-	-	-	-	-	-	-	-	-	-	-	70,286	-	-	-	70,286
Issuance of Series A-3 preferred stock	-	-	-	-	-	-	4,091,654	409	-	-	-	-	2,168,577	-	-	-	2,168,986
Offering costs	-	-	-	-	-	-	-	-	-	-	-	-	(339,512)	-	-	-	(339,512)
Net loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(3,284,247)	(3,284,247)
Balance at June 30, 2019	20,714,518	\$ 2,071	5,650,903	\$ 565	5,932,742	\$ 593	7,539,262	\$ 754	124,204	\$ 12	10,377,615	\$ 1,038	\$15,140,562	\$ -	\$ (8,283)	\$ (20,247,976)	\$ (5,110,664)

Undesignated preferred stock had no activity or balances for the periods presented

No assurance provided.

See accompanying notes, which are an integral part of these financial statements.

DENIM.LA, INC.
STATEMENTS OF CASH FLOWS (UNAUDITED)
For the six-month periods ended June 30, 2019 and 2018

	<u>June 30, 2019</u>	<u>June 30, 2018</u>
Cash Flows From Operating Activities		
Net Loss	\$ (3,284,247)	\$ (2,132,401)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	25,562	9,694
Stock-based compensation	70,286	108,556
Amortization of loan discount	44,121	26,826
Amortization of loan fees	49,442	42,920
Changes in operating assets and liabilities:		
(Increase)/Decrease in other receivable	(80,625)	-
(Increase)/Decrease in inventory	101,879	(23,586)
(Increase)/Decrease in prepaid expenses	87,873	(193,231)
Increase/(Decrease) in accounts payable	984,814	(106,497)
Increase/(Decrease) in accrued expenses and other liabilities	102,785	(70,532)
Increase/(Decrease) in deferred revenue	(242,904)	(31,085)
Net Cash Used In Operating Activities	<u>(2,141,014)</u>	<u>(2,369,336)</u>
Cash Flows From Investing Activities		
Purchase of property, equipment, and software	(7,288)	(38,730)
Deposits	6,322	(77,254)
Proceeds from repayment of related party receivable	-	(47,753)
Net Cash Used In Investing Activities	<u>(966)</u>	<u>(163,737)</u>
Cash Flows From Financing Activities		
Repayment to related parties	(318,333)	-
Proceeds from issuance of preferred stock	2,168,986	1,673,988
Offering costs	(237,750)	(158,317)
Proceeds from issuance of venture debt, net of fees	-	1,092,500
Net Cash Provided By Financing Activities	<u>1,612,903</u>	<u>2,608,171</u>
Net Change In Cash	(529,077)	75,098
Cash at Beginning of Year	584,481	346,900
Cash at End of Year	<u>\$ 55,404</u>	<u>\$ 421,998</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	\$ 293,139	\$ 320,926
Cash paid for income taxes	<u>\$ 400</u>	<u>\$ 400</u>
Supplemental Disclosure of Non-Cash Financing Activities		
Warrants issued with venture debt	<u>\$ -</u>	<u>\$ 147,943</u>

No assurance provided.
See accompanying notes, which are an integral part of these financial statements.

DENIM.LA, INC.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

NOTE 1: NATURE OF OPERATIONS

Denim.LA, Inc. (the "Company"), is a corporation organized September 17, 2012 under the laws of Delaware as a limited liability company under the name Denim.LA LLC. The Company converted to a Delaware corporation on January 30, 2013 and changed its name to Denim.LA, Inc. The Company does business under the name DSTLD. The Company sells premium denim and other products direct to consumers.

NOTE 2: GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has not generated profits since inception, has sustained net losses of \$3,284,247 and \$2,132,401 for the six-month periods ended June 30, 2019 and 2018, respectively, and has an accumulated deficit of \$20,247,976 as of June 30, 2019. The Company lacks liquidity to satisfy obligations as they come due with current liabilities exceeding current assets by \$5,257,698 as of June 30, 2019 and has limited liquid assets with \$55,404 of cash available as of June 30, 2019. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern for the next twelve months is dependent upon its ability to generate sufficient cash flows from operations to meet its obligations, which it has not been able to accomplish to date, and/or to obtain additional capital financing. No assurance can be given that the Company will be successful in these efforts.

NOTE 3: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (GAAP). In the opinion of management all adjustments necessary in order to make the interim financial statements not misleading have been included.

The Company adopted the calendar year as its basis of reporting.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified, as a result of change in accounting policy on the classification of shipping and handling, merchant fees, and packaging materials and supplies, from cost of net revenues to sales and marketing, see Note 3 - accounting policy in Cost of Sales and Shipping and Handling. The Company adopts this change in accounting policy to be consistent with comparable companies in its industry. The change in accounting policy has been applied retrospectively. Further, some of prior year amounts were reclassified to conform on the current period presentation.

DENIM.LA, INC.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED)
As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

The effects of the change in accounting policy and reclassification on the financial statements are as follows:

	June 30, 2018			<u>As restated</u>
	<u>As previously presented</u>	<u>Change in accounting policy</u>	<u>Reclassification</u>	
		Increase (Decrease)	Increase (Decrease)	
Statements of operation				
Net revenues	1,853,353		(23,139)	1,830,214
Cost of net revenues	966,634	(313,874)	-	652,760
Sales and marketing	1,142,660		(111,805)	1,030,854
Compensation and benefits	759,709	-	(759,709)	-
Distribution	-	313,874	139,225	453,099
General and administrative	615,610	-	889,366	1,504,976
Professional fees	180,216	-	(180,216)	-

These reclassifications had no effect on the reported net loss, balance sheets and statements of cash flows.

For the six-month periods ended June 30, 2019 and 2018, shipping and handling, merchant fees, and packaging materials and supplies amounted to \$243,126 and \$220,071, \$79,913 and \$81,216, \$3,410 and \$12,586, all respectively.

Various balance sheet accounts have been reclassified from prior year presentation to condense the statements.

Cash Equivalents and Concentration of Cash Balance

The Company considers all highly liquid securities with an original maturity of less than three months to be cash equivalents. The Company's cash and cash equivalents in bank deposit accounts, at times, may exceed federally insured limits. The Company's cash balance of certain accounts exceeded the FDIC insured limits by \$0 and \$147,709 as of June 30, 2019 and December 31, 2018, respectively.

Capital Contribution Receivable

The Company records stock issuances at the effective date. If the contribution is not funded upon issuance, the Company records a capital contribution receivable as an asset on a balance sheet. When contributed capital receivables were not received prior to the issuance of financial statements at a reporting date in satisfaction of the requirements under FASB ASC 505-10-45-2, the contributed capital is reclassified as a contra account to stockholders' equity/(deficit) on the balance sheet.

DENIM.LA, INC.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

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Fair Value of Financial Instruments

Financial Accounting Standards Board ("FASB") guidance specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy are as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as exchange-traded instruments and listed equities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly (e.g., quoted prices of similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active).

Level 3 - Unobservable inputs for the asset or liability. Financial instruments are considered Level 3 when their fair values are determined using pricing models, discounted cash flows or similar techniques and at least one significant model assumption or input is unobservable.

The carrying amounts reported in the balance sheets approximate their fair value.

Inventory

Inventory is stated at the lower of cost or market and accounted for using the weighted average cost method. The inventory balances as of June 30, 2019 and December 31, 2018 consist of products purchased for resale and any materials the Company purchased to modify the products. The Company has outsourced the warehousing and fulfillment of its inventory to a third party.

Property, Equipment, and Software

Property, equipment, and software are recorded at cost. Depreciation/amortization is recorded for property, equipment, and software using the straight-line method over the estimated useful lives of assets. The Company reviews the recoverability of all long-lived assets, including the related useful lives, whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset might not be recoverable. The balances at June 30, 2019 and December 31, 2018 consist of software with three (3) year lives and property and equipment with 3-10 year lives.

Depreciation and amortization charges on property, equipment, and software are included in general and administrative expenses and amounted to \$9,694 and \$9,694 for the six-month periods ended June 30, 2019 and 2018, respectively.

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Capital assets as of June 30, 2019 and December 31, 2018 are as follows:

	<u>6/30/2019</u>	<u>12/31/2018</u>
Computer equipment	\$ 55,421	\$ 52,936
Furniture and fixtures	71,131	66,328
Leasehold improvements	40,351	40,351
	<u>166,903</u>	<u>159,615</u>
Accumulated depreciation	(75,797)	(50,235)
Property and equipment, net	<u>\$ 91,106</u>	<u>\$ 109,380</u>
Software	\$ 56,450	\$ 56,450
Accumulated amortization	(52,200)	(52,200)
Software, net	<u>\$ 4,250</u>	<u>\$ 4,250</u>

Impairment of Long-lived Assets

The Company continually monitors events and changes in circumstances that could indicate carrying amounts of long-lived assets that may not be recoverable. When such events or changes in circumstances are present, the Company assesses the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future cash flows is less than the carrying amount of those assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell.

Accrued Expenses and Other Liabilities

The Company accrued expenses and other liabilities line in the balance sheets is comprised of the following as of June 30, 2019 and December 31, 2018:

	<u>6/30/2019</u>	<u>12/31/2018</u>
Accrued expenses	\$ 292,439	\$ 185,526
Reserve for returns	70,735	184,864
Other liabilities	193,663	113,195
Sales tax liabilities	64,881	35,348
	<u>\$ 621,718</u>	<u>\$ 518,933</u>

Convertible Instruments

U.S. GAAP requires companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments according to certain criteria. The criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument. An exception to this rule is when the host instrument is deemed to be conventional as that term is described under applicable U.S. GAAP.

DENIM.LA, INC.

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When the Company has determined that the embedded conversion options should not be bifurcated from their host instruments, the Company records, when necessary, discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note. Debt discounts under these arrangements are amortized over the term of the related debt to their stated date of redemption. The Company also records, when necessary, deemed dividends for the intrinsic value of conversion options embedded in preferred shares based upon the differences between the fair value of the underlying common stock at the commitment date of the transaction and the effective conversion price embedded in the preferred shares.

Accounting for Preferred Stock

ASC 480, Distinguishing Liabilities from Equity, includes standards for how an issuer of equity (including equity shares issued by consolidated entities) classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity. Management is required to determine the presentation for the preferred stock as a result of the redemption and conversion provisions, among other provisions in the agreement. Specifically, management is required to determine whether the embedded conversion feature in the preferred stock is clearly and closely related to the host instrument, and whether the bifurcation of the conversion feature is required and whether the conversion feature should be accounted for as a derivative instrument. If the host instrument and conversion feature are determined to be clearly and closely related (both more akin to equity), derivative liability accounting under ASC 815, Derivatives and Hedging, is not required. Management determined that the host contract of the preferred stock is more akin to equity, and accordingly, liability accounting is not required by the Company. The Company has presented preferred stock within stockholders' equity.

Costs incurred directly for the issuance of the preferred stock are recorded as a reduction of gross proceeds received by the Company, resulting in a discount to the preferred stock. The discount is not amortized.

Revenue Recognition

The Company earns revenues from merchandise sales online and through pop-up stores. The Company has elected to treat shipping and handling as fulfillment activities and not a separate performance obligation. Accordingly, we recognize revenue for our single performance obligation related to online sales and catalog sales at the time control of the merchandise passes to the customer, which is generally at the time of shipment. The Company typically collects revenue upon sale and recognizes the revenue when the item has shipped. Orders that have been placed and paid as of year-end but have not been shipped are recorded to deferred revenue. Sales tax is collected on sales in California and these taxes are recorded as a liability until remittance. The Company estimates returns based on its historic results and return policy in place at the sale date and records an allowance against revenues for this estimate. Liabilities are recorded for promotional credits and store credit issued to customers. The reserve for returns totaled approximately \$71,000 and \$185,000 as of June 30, 2019 and December 31, 2018, respectively, and is included in reserves for returns in the accompanying balance sheets.

DENIM.LA, INC.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

Cost of Sales

Cost of sales consists primarily of inventory, shipping costs and merchant fees. The Company adopts a change in accounting policy to exclude merchant fees, outbound shipping and handling and packaging materials and supplies from cost of sales, see Note 3 - Reclassifications.

Shipping and Handling

The Company recognizes shipping and handling billed to customers as a component of net revenues, and the cost of shipping and handling as a component of sales and marketing. The Company adopts a change in accounting policy to exclude the shipping and handling from cost of net revenues, see Note 3 – Reclassifications. Total shipping and handling billed to customers as a component of net revenues was approximately \$24,000 and \$27,000 for the six-month periods ended June 30, 2019 and 2018, respectively. Total shipping and handling costs included in distribution was approximately \$243,000 and \$220,000 for the six-month periods ended June 30, 2019 and 2018, respectively.

Advertising and Promotion

Advertising and promotional costs are expensed as incurred. Advertising and promotional expense for the six-month periods ended June 30, 2019 and June 30, 2018 amounted to \$473,897 and \$727,663, respectively, which is included in selling and marketing expense.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718, *Compensation - Stock Compensation*. Under the fair value recognition provisions of ASC 718, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period, which is generally the option vesting period. The Company uses the Black-Scholes option pricing model to determine the fair value of stock options.

The Company measures compensation expense for its non-employee stock-based compensation under ASC 505, Equity. The fair value of the option issued or committed to be issued is used to measure the transaction, as this is more reliable than the fair value of the services received. The fair value is measured at the value of the Company's common stock or stock award on the date that the commitment for performance by the counterparty has been reached or the counterparty's performance is complete. The fair value of the equity instrument is charged directly to stock-based compensation expense and credited to additional paid-in capital.

Deferred Offering Costs

The Company complies with the requirements of FASB ASC 340-10-S99-1 with regards to offering costs. Prior to the completion of an offering, offering costs are capitalized. The deferred offering costs are charged to additional paid-in capital or as a discount to debt, as applicable, upon the completion of an offering or to expense if the offering is not completed.

DENIM.LA, INC.**NOTES TO FINANCIAL STATEMENTS (UNAUDITED)****As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018**Income Taxes

The Company uses the liability method of accounting for income taxes as set forth in ASC 740, *Income Taxes*. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is unlikely that the deferred tax assets will not be realized. We assess our income tax positions and record tax benefits for all years subject to examination based upon our evaluation of the facts, circumstances and information available at the reporting date. In accordance with ASC 740-10, for those tax positions where there is a greater than 50% likelihood that a tax benefit will be sustained, our policy will be to record the largest amount of tax benefit that is more likely than not to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where there is less than 50% likelihood that a tax benefit will be sustained, no tax benefit will be recognized in the financial statements.

Net Loss per Share

Net earnings or loss per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding during the period, excluding shares subject to redemption or forfeiture. The Company presents basic and diluted net earnings or loss per share. Diluted net earnings or loss per share reflect the actual weighted average of common shares issued and outstanding during the period, adjusted for potentially dilutive securities outstanding. Potentially dilutive securities are excluded from the computation of the diluted net earnings or loss per share if their inclusion would be anti-dilutive. As all potentially dilutive securities are anti-dilutive as of June 30, 2019 and 2017, diluted net loss per share is the same as basic net loss per share for each year. Potentially dilutive items outstanding as of June 30, 2019 and December 31, 2018 are as follows:

	<u>6/30/2019</u>	<u>12/31/18</u>
Series Seed Preferred Stock (convertible to common stock)	20,714,518	20,714,518
Series A Preferred Stock (convertible to common stock)	5,650,903	5,650,903
Series A-2 Preferred Stock (convertible to common stock)	5,932,742	5,932,742
Series CF Preferred Stock (convertible to common stock)	124,204	124,204
Series A-3 Preferred Stock (convertible to common stock)	7,539,262	3,447,608
Common stock warrants	4,197,745	4,197,745
Preferred stock warrants	547,140	547,140
Exercisable stock options	11,224,075	13,278,843
Total potentially dilutive shares	<u>55,930,589</u>	<u>53,893,703</u>

Concentrations

The Company has a vendor that made up 14% of accounts payable as of June 30, 2019. This concentration relates to a law firm that provided services to the Company during 2019.

The Company utilized two vendors that made up 29% and 26% of all inventory purchases, respectively during the year ended December 31, 2018 and two vendors that made up 34% and 8% of all inventory purchases, respectively during the six-month period ended June 30, 2019. The loss of one of these vendors, may have a negative short-term impact on the Company's operations; however, we believe there are acceptable substitute vendors that can be utilized longer-term.

DENIM.LA, INC.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

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Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842). This ASU requires a lessee to recognize a right-of-use asset and a lease liability under most operating leases in its balance sheet. The ASU is effective for annual and interim periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. We are continuing to evaluate the impact of this new standard on our financial reporting and disclosures.

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting ("ASU 2018-07"). ASU 2018-07 eliminates the separate accounting model for nonemployee share-based payment awards and generally requires companies to account for share-based payment transactions with nonemployees in the same way as share-based payment transactions with employees. The accounting remains different for attribution, which represents how the equity-based payment cost is recognized over the vesting period, and a contractual term election for valuing nonemployee equity share options. ASU 2018-07 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018 with early adoption permitted. The Company is in process of assessing the impact of the adoption of ASU 2018-07 on the financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) and has issued subsequent amendments to this guidance. This new standard will replace all current guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for interim and annual periods beginning after December 31, 2018. The standard may be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company adopted this standard effective in these financial statements, which did not have an effect on its revenues or earnings.

Management does not believe that any recently issued, but not yet effective, accounting standards could have a material effect on the accompanying financial statements. As new accounting pronouncements are issued, the Company will adopt those that are applicable under the circumstances.

NOTE 4: LONG-TERM DEBT

Venture Debt

In March 2017, the Company entered into a senior credit agreement with an outside lender for up to \$4,000,000, dependent upon the achievement of certain milestones. The initial close amount was a minimum of \$1,345,000. The loan bears interest at 12.5% per annum, compounded monthly, plus fees. A 5% closing fee is due upon each closing, legal and accounting fees of up to \$40,000, and management fees of \$4,167-\$5,000 per month. The loan requires monthly payments of interest commencing March 31, 2017, and a balloon payment for the full principal amount at maturity in March 2020. In 2018, the maturity date was extended one year, to March 2021. Prepayments are allowed, subject to various provisions, including a minimum payment amount of \$250,000. Repayment is accelerated upon a change in control, as defined in the agreement. The loan is senior to all other debts and obligations of the Company, is collateralized by all assets of the Company, and shares of the Company's common stock pledged by officers of the Company. As of June 30, 2019 and December 31, 2018, the loan balance is \$4,000,000 and \$4,000,000, resulting from cash disbursed to the Company of \$3,069,598 and \$3,096,598, loan fees of \$235,000 and \$235,000, charged to the loan balance, and cash disbursed to repay other debts of the Company of \$695,402 (inclusive of \$118,402 repaid to a related party note payable (board member)), all respectively. An additional \$20,843 in loan fees were also paid, which were included as part of the discount to the loan as further discussed below. The Company failed to comply with certain debt covenants during the six-month period ended June 30, 2019 and December 31, 2018.

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Total loan fees of \$255,843 and \$255,843 as of June 30, 2019 and December 31, 2018, respectively, were incurred in conjunction with this loan, and such were recorded as a discount to the loan and are amortized under the effective interest method to interest expense over the life of the loan. For the year ended December 31, 2018, \$92,361 of these loan fees were amortized to interest expense, leaving an unamortized balance of \$115,040 as of December 31, 2018. For the six-month period ended June 30, 2019, \$49,442 of these loan fees were amortized to interest expense, leaving an unamortized balance of \$65,598 as of June 30, 2019.

The lender was also granted warrants to purchase common stock representing 1% of the fully diluted capitalization of the Company for each \$1,000,000 of principal loaned under the agreement. As of December 31, 2017, warrants for 1,139,398 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years. As discussed in Note 8, these warrants were valued at \$56,970 and recorded as a discount to the note payable balance and are being amortized under the effective interest method over the life of the loan. For the year six-month period ended June 30, 2019 and for the year ended December 31, 2018, \$9,365 and \$18,938 was amortized to interest expense, respectively, leaving an unamortized balance of \$13,267 and \$22,632 as of June 30, 2019 and December 31, 2018, respectively. In 2018, warrants for 1,248,347 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years. As discussed in Note 8, these warrants were valued at \$147,943 and recorded as a discount to the note payable balance and are being amortized under the effective interest method over the life of the loan. For the year six-month period ended June 30, 2019 and for the year ended December 31, 2018, \$34,756 and \$59,895 was amortized to interest expense, respectively, leaving an unamortized balance of \$53,292 and \$88,048 as of June 30, 2019 and December 31, 2018, respectively.

As of June 30, 2019, total unamortized interest expense amounted to \$132,157, which is expected to be amortized in 2019 and 2020 by \$94,542 and \$37,615, respectively.

Interest expense and effective interest rate on this loan for the six-month periods ended June 30, 2019 and 2018 was \$386,108 and \$315,997, and 19.31% and 15.80%, respectively.

DENIM.LA, INC.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

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NOTE 5: STOCKHOLDERS' DEFICIT

Convertible Preferred Stock

In July 2017, the Certificate of Incorporation was amended to increase the authorized preferred stock to 56,000,000 shares of \$0.0001 par preferred stock. The Company designated 20,714,518 shares of preferred stock as Series Seed Preferred Stock, 14,481,413 shares of preferred stock as Series A Preferred Stock, and 20,000,000 shares of Series A-2 Preferred Stock, with 804,069 shares of preferred stock undesignated.

In August 2018, the Company amended and restated its articles of incorporation, increasing the authorized common stock to 110,000,000 shares and increasing the authorized preferred stock to 77,000,000 shares. The Company designated its preferred stock as 20,714,518 shares of Series Seed Preferred Stock, 14,481,413 shares of Series A Preferred Stock, 20,000,000 shares of Series A-2 Preferred Stock, 2,000,000 shares of Series CF Preferred Stock, 18,867,925 shares of Series A-3 Preferred Stock, and with 936,144 shares of preferred stock undesignated.

As of June 30, 2019 and December 31, 2018, 20,714,518 and 20,714,518 shares of Series Seed Preferred Stock were issued and outstanding, 5,650,903 and 5,650,903 shares of Series A Preferred Stock were issued and outstanding, 5,932,742 and 5,932,742 shares of Series A-2 Preferred Stock were issued and outstanding, 124,204 and 124,204 shares of Series CF Preferred Stock were issued and outstanding, and 7,539,262 and 3,447,608 shares of Series A-3 Preferred Stock were issued and outstanding, all respectively.

In the July 2018 amended and restated articles of incorporation, the Company also amended the rights and privileges applicable to the various share classes to include the newly designated Series CF Preferred Stock and Series A-3 Preferred Stock. Series Seed Preferred Stockholders are entitled to vote on an as converted basis, while Series A Preferred Stock holders, Series A-2 Preferred Stock holders, Series CF Preferred Stock holders, and Series A-3 Preferred Stock holders do not have voting privileges. The preferred stockholders have certain dividend preferences over common stockholders. The preferred stock is subject to an optional conversion right, where the preferred stock is convertible into fully paid and non-assessable shares of common stock at a 1:1 rate, with certain dilution protections. All classes of preferred stock are subject to automatic conversion into the Company's common stock if and upon an initial public offering of \$25,000,000 or greater. The preferred stockholders are entitled to a liquidation preference over common stockholders of the greater of: 1) the preferred stock purchase price (\$0.27 per share for Series Seed Preferred Stock, \$0.48 per share for Series A Preferred Stock, \$0.50 per share for Series A-2 Preferred Stock, \$0.52 per share for Series CF Preferred Stock, and \$0.53 per share for Series A-3 Preferred Stock) multiplied by a multiple of 1.00 for Series A Preferred Stock, Series A-2 Preferred Stock, Series CF Preferred Stock, and Series A-3 Preferred Stock, and 1.00 or 1.25 depending upon certain conditions defined the articles of incorporation for the Series Seed Preferred Stock; 2) on an as converted to common stock at the liquidation date.

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Based on circumstances in place as of June 30, 2019 and December 31, 2018, the liquidation preference on the Series Seed Preferred Stock was subject to the 1.00 and 1.00 multiple and the liquidation preference on the Series A Preferred Stock was subject to a multiple of 1.00 and 1.00, all respectively. The total liquidation preferences as of June 30, 2019 and December 31, 2018 amounted to \$15,332,119 and \$13,163,543, respectively.

In 2016, the Company closed on several stock issuance rounds of its Series A Preferred Stock financing conducted under Regulation A, resulting in the issuance of 2,072,822 shares of Series A Preferred Stock at a price per share of \$0.48, providing gross proceeds of \$994,435 for the year ended December 31, 2016. During the year ended December 31, 2017, the Company issued an additional 1,596,676 shares of Series A Preferred Stock at a price per share of \$0.48, providing cash proceeds of \$716,323 and conversions of debts of \$49,623, for gross proceeds of \$765,946.

In 2017, the Company closed on several stock issuance rounds of its Series A-2 Preferred Stock financing conducted under Regulation A, resulting in the issuance of 2,584,766 shares of Series A-2 Preferred Stock at a price per share of \$0.50, providing gross proceeds of \$1,292,383 for the year ended December 31, 2017. In 2018, the Company issued an additional 3,347,976 shares of Series A-2 Preferred Stock at a price per share of \$0.50, providing gross proceeds of \$1,673,988.

In 2018, the Company issued 124,204 shares of Series CF Preferred Stock at price of \$0.52, providing gross proceeds of \$64,586 and 3,447,608 shares of Series A-3 Preferred Stock at price per share of \$0.53, providing gross proceeds of \$1,827,232.

During the six-month period ended June 30, 2019, the Company issued 4,091,654 shares of Series A-3 Preferred Stock at \$0.53 per share, providing gross proceeds of \$2,168,986.

Common Stock

The Company authorized 110,000,000 shares of common stock at \$0.0001 par value as of June 30, 2019 and December 31, 2018. As of June 30, 2019 and December 31, 2018, 10,377,615 and 10,377,615 shares of common stock were issued and outstanding, respectively.

Common stockholders have voting rights of one vote per share. The voting, dividend, and liquidation rights of the holders of common stock are subject to and qualified by the rights, powers, and preferences of preferred stockholders.

NOTE 6: RELATED PARTY TRANSACTIONS

Employee Backpay and Loans Receivable

Two officers of the Company deferred their salary during portions of 2014-2016. The Company commenced repaying these obligations during 2017; however, no additional payments were made during 2018. The balance of employee backpay as of June 30, 2019 and December 31, 2018 was \$430,568 and \$430,568, respectively.

DENIM.LA, INC.**NOTES TO FINANCIAL STATEMENTS (UNAUDITED)****As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018**

The Company has loaned funds to these same two officers of the Company throughout the life of the business, which net of repayments amounted to \$333,521 and \$234,500 as of June 30, 2019 and December 31, 2018, respectively. These loans are payable on demand and do not bear interest. One of the officers repaid \$171,900 during year ended December 31, 2018. The same officer continued to fund the Company after repayment and advanced a total of \$219,312 during the year ended December 31, 2018, which is included in advances from related party in the accompanying balance sheet as of December 31, 2018. During the six-month period ended June 30, 2019, this party was repaid a net total of \$317,731, which exceeded his loans resulting in a \$98,419 balance due back to the Company as of June 30, 2019.

Due to the right of offset of these loans and backpay for the officers in question, the net payable of \$97,047 and \$196,068 as of June 30, 2019 and December 31, 2018, respectively are presented within the related party payables. These balances are presented net pursuant to an agreement with these officers to net the loans receivable against backpay owed in order to settle both the loans receivable and backpay if the loans are not repaid. The Company has accrued estimated employer taxes on backpay.

Payment Processor:

The Company's backend payment processor's majority shareholder is a director of the Company. Total expenses for the six-month periods ended June 30, 2019 and 2018 were \$51,938 and \$59,274, respectively and included in costs of net revenues in the accompanying statements of operations.

NOTE 7: INCOME TAXES

Deferred taxes are recognized for temporary differences between the basis of assets and liabilities for financial statement and income tax purposes. The differences relate primarily to depreciable assets using accelerated depreciation methods for income tax purposes, share-based compensation expense, and for net operating loss carryforwards. As of June 30, 2019 and December 31, 2018, the Company had net deferred tax assets before valuation allowance of \$5,130,457 and \$4,357,170, respectively. The following table presents the deferred tax assets and liabilities by source:

	<u>6/30/2019</u>	<u>12/31/2018</u>
Deferred Tax Assets:		
Net operating loss carryforwards	\$ 5,087,106	\$ 4,357,985
Stock-based compensation	85,395	67,381
Deferred Tax Liabilities:		
Depreciation timing differences	(5,103)	(5,103)
Unamortized debt issuance costs	(36,941)	(63,093)
Valuation allowance	(5,130,457)	(4,357,170)
Net Deferred Tax Asset	<u>\$ -</u>	<u>\$ -</u>

DENIM.LA, INC.

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The Company recognizes deferred tax assets to the extent that it believes that these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. The Company assessed the need for a valuation allowance against its net deferred tax assets and determined a full valuation allowance is required due to taxable losses for the period ended June 30, 2019 and for the year ended December 31, 2018, cumulative losses through June 30, 2019, and no history of generating taxable income. Therefore, valuation allowances of \$5,130,457 and \$4,357,170 were recorded as of June 30, 2019 and December 31, 2018, respectively. Accordingly, an \$800 provision for income taxes has been recognized annually. Deferred tax assets were calculated using the Company's combined effective tax rate, which it estimated to be 28.0%. The effective rate is reduced to 0% for 2019 and 2018 due to the full valuation allowance on its net deferred tax assets.

The Company's ability to utilize net operating loss carryforwards will depend on its ability to generate adequate future taxable income. As of June 30, 2019 and December 31, 2018, the Company had net operating loss carryforwards available to offset future taxable income in the amounts of \$18,199,434 and \$15,590,959, which may be carried forward and will expire between 2033 and 2039 in varying amounts.

The Company has evaluated its income tax positions and has determined that it does not have any uncertain tax positions. The Company will recognize interest and penalties related to any uncertain tax positions through its income tax expense.

In December 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted into law and the new legislation contains several key tax provisions that affected the Company, including a reduction of the corporate income tax rate to 21% effective January 1, 2018, among others. The Company is required to recognize the effect of the tax law changes in the period of enactment, such as determining the transition tax, remeasuring deferred tax assets and liabilities, as well as reassessing the net realizability of our deferred tax assets and liabilities. The tax rate change reduced the Company's net deferred tax assets by \$1,849,596 at December 31, 2018. However, this change had no impact to the Company's net loss as the Company has not incurred a tax liability or expense for the year ended December 31, 2018 and has a full valuation allowance against its net deferred tax assets.

The Company may in the future become subject to federal, state and local income taxation though it has not been since its inception, other than minimum state tax. The Company is not presently subject to any income tax audit in any taxing jurisdiction, though its 2015-2018 tax years remain open to examination.

NOTE 8: SHARE-BASED PAYMENTS

Common Stock Warrants

In 2017, the Company issued a warrant in conjunction with a service agreement. The warrant is exercisable into 3,600,000 shares of common stock at an exercise price of \$0.16 per share. The warrant expires in June 2021. The warrant vested 1/3 at issuance, then vests at a rate of 1/36 per month at each monthly anniversary commencing June 7, 2017, subject to continuous service with the Company. As of December 31, 2017, 1,800,000 of these warrants had vested, and the agreement was terminated effective December 31, 2017. The Company determined the fair value of these warrants at the initial grant date to be \$0.048 per share under the Black-Scholes method, using the same assumptions used for valuing employee options as noted below in the Stock Plan section, which was revalued as the warrants vested. The fair value was to be recognized ratably over the underlying vesting period of this warrant. During the year ended December 31, 2017, \$113,520 of expense was recognized to general and administrative expense related to this warrant. As the agreement terminated effective December 31, 2017, no further compensation expense has been recorded on this agreement. The range of Black-Scholes inputs utilized in calculating the fair value of this warrant were as follows:

DENIM.LA, INC.**NOTES TO FINANCIAL STATEMENTS (UNAUDITED)****As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018**

	<u>2017</u>
Risk Free Interest Rate	1.94%-2.06%
Expected Dividend Yield	0.00%
Expected Volatility	32.00%
Expected Life (years)	3.5-4.5

In March 2017, the lender of venture debt to the Company was granted warrants to purchase common stock representing 1% of the fully diluted capitalization of the Company for each \$1,000,000 of principal loaned under the agreement, see Note 4. As of December 31, 2017, warrants for 1,139,398 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years.

The Company determined the fair value of these warrants to be \$0.05 per share under the Black-Scholes method, with the following inputs, providing a total value of \$56,970 which was recorded as a discount to the loan and is being recognized ratably over term of the loan. See Note 4 for additional information.

	<u>2017</u>
Risk Free Interest Rate	1.92%
Expected Dividend Yield	0.00%
Expected Volatility	32.00%
Expected Life (years)	5.00

In January and April 2018, the lender of venture debt to the Company was granted warrants to purchase common stock representing 1% of the fully diluted capitalization of the Company for each \$1,000,000 of principal loaned under the agreement, see Note 4. In January and April 2018, warrants for 610,578 and 637,769 shares of common stock were issued to the lender with an exercise price of \$0.16 per share, expiring after ten years based on the terms noted above.

For the January 2018 warrants, the Company determined the fair value of these warrants to be \$0.118 per share under the Black-Scholes method, with the following inputs, providing a total value of \$72,048 which was recorded as a discount to the loan and is being recognized ratably over term of the loan. See Note 4 for additional information.

	<u>2018</u>
Risk Free Interest Rate	2.02%
Expected Dividend Yield	0.00%
Expected Volatility	55.00%
Expected Life (years)	5.00

The Company determined the fair value of these April 2018 warrants to be \$0.119 per share under the Black-Scholes method, with the following inputs, providing a total value of \$75,895 which was recorded as a discount to the loan and is being recognized ratably over term of the loan. See Note 4 for additional information.

DENIM.LA, INC.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

	2018
Risk Free Interest Rate	2.43%
Expected Dividend Yield	0.00%
Expected Volatility	55.00%
Expected Life (years)	5.00

For valuing the warrants noted above, the Company uses the same assumptions used for valuing employee options as noted below in the Stock Plan section, with the exception of the useful life which is either the contractual life or for the Venture Debt the estimated life which is based on the occurrence of an acquisition or IPO.

A summary of information related to common stock warrants for the six-month period ended June 30, 2019 and year ended December 31, 2018 is as follows:

	June 30, 2019		December 31, 2018	
	Common Stock Warrants	Weighted Average Exercise Price	Common Stock Warrants	Weighted Average Exercise Price
Outstanding - beginning of year	4,197,745	\$ 0.16	2,949,398	\$ 0.16
Granted	-		1,248,347	0.16
Exercised	-		-	
Forfeited	-		-	
Outstanding - end of year	<u>4,197,745</u>	\$ 0.16	<u>4,197,745</u>	\$ 0.16
Exercisable at end of year	<u>4,197,745</u>	\$ 0.16	<u>4,197,745</u>	\$ 0.16

Preferred Stock Warrants

In 2017, in conjunction with the closing of its offering under Regulation A discussed in Note 4, the Company issued its broker-dealer in this offering 175,503 fully vested warrants to purchase its Series A Preferred Stock at an exercise price of \$0.48 per share, expiring in five years. The fair value of these warrants was calculated under the Black-Scholes method, using below variables, resulting in an aggregate fair value of \$18,077 being recorded to additional paid-in capital and as offering costs within additional paid-in capital.

	2017
Risk Free Interest Rate	2.09%
Expected Dividend Yield	0.00%
Expected Volatility	32.00%
Expected Life (years)	3.50

In 2018, in conjunction with the closing of its Series A-2 Preferred Stock offering under Regulation A discussed in Note 4, the Company issued its broker-dealer in this offering 296,637 fully vested warrants to purchase its Series A-2 Preferred Stock at an exercise price of \$0.50 per share, expiring in five years. The fair value of these warrants was calculated under the Black-Scholes method, using below variables, resulting in an aggregate fair value of \$62,590 being recorded to additional paid-in capital and as offering costs within additional paid-in capital for the year ended December 31, 2018.

DENIM.LA, INC.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

	2018
Risk Free Interest Rate	2.63%
Expected Dividend Yield	0.00%
Expected Volatility	55.00%
Expected Life (years)	3.50

A summary of information related to preferred stock warrants for the six-month period ended June 30, 2019 and year ended December 31, 2018 is as follows:

	<u>June 30, 2019</u>		<u>December 31, 2018</u>	
	Preferred Stock Warrants	Weighted Average Exercise Price	Preferred Stock Warrants	Weighted Average Exercise Price
Outstanding - beginning of year	547,140	\$ 0.47	175,503	\$ 0.48
Granted	-	-	371,637	0.46
Exercised	-		-	
Forfeited	-		-	
Outstanding - end of year	<u>547,140</u>	\$ 0.47	<u>547,140</u>	\$ 0.47
Exercisable at end of year	<u>547,140</u>		<u>547,140</u>	

Stock Plan

The Company has adopted the 2013 Stock Plan, as amended and restated (the "Plan"), which provides for the grant of shares of stock options, stock appreciation rights, and stock awards (performance shares) to employees, non-employee directors, and non-employee consultants. The number of shares authorized by the Plan was 18,693,055 shares as of both December 31, 2018 and 2017. The option exercise price generally may not be less than the underlying stock's fair market value at the date of the grant and generally have a term of ten years. The amounts granted each calendar year to an employee or non-employee is limited depending on the type of award. Stock options comprise all of the awards granted since the Plan's inception. Shares available for grant under the Plan amounted to 3,575,916 and 623,639 as of June 30, 2019 and December 31, 2018, respectively.

Vesting generally occurs over a period of immediately to four years. A summary of information related to stock options for the six-month period ended June 30, 2019 and for the year ended December 31, 2018 is as follows:

DENIM.LA, INC.

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As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

	June 30, 2019		December 31, 2018	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding - beginning of year	17,751,416	\$ 0.16	13,381,416	\$ 0.13
Granted	541,487	0.21	4,920,000	0.21
Exercised	-	-	-	-
Forfeited	(3,263,764)	0.16	(550,000)	0.11
Outstanding - end of year	<u>15,029,139</u>	\$ 0.16	<u>17,751,416</u>	\$ 0.16
Exercisable at end of year	<u>11,224,075</u>	\$ 0.14	<u>13,278,843</u>	\$ 0.14
Weighted average grant date fair value of options granted during year	<u>\$ 0.115</u>		<u>\$ 0.115</u>	
Weighted average duration (years) to expiration of outstanding options at year-end	<u>6.80</u>		<u>7.53</u>	

The Company measures employee stock-based awards at grant-date fair value and recognizes employee compensation expense on a straight-line basis over the vesting period of the award. Determining the appropriate fair value of stock-based awards requires the input of subjective assumptions, including the fair value of the Company's common stock, and for stock options, the expected life of the option, and expected stock price volatility. The Company used the Black-Scholes option pricing model to value its stock option awards. The assumptions used in calculating the fair value of stock-based awards represent management's best estimates and involve inherent uncertainties and the application of management's judgment. As a result, if factors change and management uses different assumptions, stock-based compensation expense could be materially different for future awards.

The expected life of stock options was estimated using the "simplified method," as the Company has limited historical information to develop reasonable expectations about future exercise patterns and employment duration for its stock options grants. The simplified method is based on the average of the vesting tranches and the contractual life of each grant. For stock price volatility, the Company uses comparable public companies as a basis for its expected volatility to calculate the fair value of options grants. The risk-free interest rate is based on U.S. Treasury notes with a term approximating the expected life of the option. The estimation of the number of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from the Company's current estimates, such amounts are recognized as an adjustment in the period in which estimates are revised. The assumptions utilized for option grants during the six-month periods ended June 30, 2019 and 2018 are as follows:

DENIM.LA, INC.**NOTES TO FINANCIAL STATEMENTS (UNAUDITED)****As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018**

	<u>June 30, 2019</u>	<u>June 30, 2018</u>
Risk Free Interest Rate	2.49%	2.83%
Expected Dividend Yield	0.00%	0.00%
Expected Volatility	55.00%	55.00%
Expected Life (years)	5.5-6.25	5.5-6.25
Fair Value per Stock Option	\$0.11	\$0.11 - \$0.12

The total grant-date fair value of the options granted during the six-month periods ended June 30, 2019 and 2018 was \$62,271 and \$554,100, respectively. Stock-based compensation expense of \$70,286 and \$108,556 was recognized under FASB ASC 718 for the six-month periods ended June 30, 2019 and 2017, respectively, and was recorded to compensation and benefits in the statements of operations. These costs are included in general and administrative expense in the accompanying statements of operations. Total unrecognized compensation cost related to non-vested stock option awards amounted to \$403,026 and \$441,596 for the six-month period ended June 30, 2019 and year ended December 31, 2018, respectively, and will be recognized over a weighted average period of 35 months as of June 30, 2019.

NOTE 9: LEASE OBLIGATIONS

The Company entered into three short-term lease agreements for building space during 2018, two of which, with total base rent of \$40,000 per month, terminated on the same year. The total base rent from the one remaining lease agreement is 10% of gross sales.

In January 2018, the Company entered into a lease agreement requiring base rent payments of \$14,500 per month for a 36-month term. The lease required a \$43,500 deposit. Future payment obligations under this lease agreement are \$87,000, and \$174,000 for the years ended December 31, 2019, and 2020, respectively.

Total rent expense for the six-month periods ended June 30, 2019 and 2018 was \$125,736 and \$185,029, respectively.

NOTE 10: CONTINGENCIES

The Company may be subject to pending legal proceedings and regulatory actions in the ordinary course of business. The results of such proceedings cannot be predicted with certainty, but the Company does not anticipate that the final outcome, if any, arising out of any such matter will have a material adverse effect on its business, financial condition or results of operations.

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NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

As of June 30, 2019 and December 31, 2018 and for the six-month periods ended June 30, 2019 and 2018

NOTE 11: SUBSEQUENT EVENTS

Stock Issuances

Subsequent to June 30, 2019, a total of 323,568 shares of Series A-3 Preferred Stock were sold in connection with the Company's active Regulation A+ offering for gross proceeds of \$171,491.

Management's Evaluation

Management has evaluated subsequent events through September 30, 2019, the date the financial statements were available to be issued. Based on this evaluation, no additional material events were identified which require adjustment or disclosure in these financial statements.