

HEALTHWAREHOUSE.COM, INC.

A Delaware Corporation

7107 Industrial Road
Florence, KY 41042
(800)748-7001

www.healthwarehouse.com
support@healthwarehouse.com

SIC Code: 5912 - Drugstores and Proprietary Stores

Annual Report

For the year ended December 31, 2018

As of December 31, 2018, the number of shares outstanding of our Common Stock was 49,018,548.

Indicate by check mark whether the company is a shell company (as defined in Rule 405 of the Securities Act of 1933 and Rule 12b-2 of the Exchange Act of 1934).

Yes No

Indicate by check mark if whether the company's shell status has changed since the previous reporting period.

Yes No

Indicate by check mark whether a Change in Control of the company has occurred over this reporting period.

Yes No

HEALTHWAREHOUSE.COM, INC.

Annual Report

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PART I – ENTITY AND SECURITY INFORMATION

1) Name of the issuer and its predecessors (if any):

HealthWarehouse.com, Inc. (the “Company”, “Issuer” or “HEWA”)

Formerly Ion Networks, Inc., formed on August 5, 1998 as a Delaware company.

MicroFrame, Inc. was merged into Ion Networks, Inc. on March 16, 1999, with Ion Networks, Inc. as the surviving entity.

Name changed to Clacendix, Inc. on January 3, 2008.

Name changed to HealthWarehouse.com, Inc. on July 31, 2009.

2) Security Information

Security information as of December 31, 2018:

Title and Class of Security	Par Value	Trading Symbol	CUSIP	Total Shares Authorized	Total Shares Outstanding	Public Float	Shareholders of Record
Common Stock	\$0.001	HEWA	42227G202	100,000,000	49,018,548	11,417,172	259
Preferred Stock – Series A	\$0.001	Not Applicable	Not Applicable	200,000	-0-	-0-	0
Preferred Stock – Series B	\$0.001	Not Applicable	Not Applicable	625,000	517,359	-0-	2
Preferred Stock – Series C	\$0.001	Not Applicable	Not Applicable	10,000	10,000	-0-	3

On April 14, 2017, HEWA filed a Form 15 with the Securities and Exchange Commission terminating the registration of its Common Stock under Rule 12 g-4(a)(1) of the Securities Exchange Act of 1934. As of this date, the Company has no plans to reregister the common stock under the Securities Exchange Act of 1934.

Transfer Agent:

American Stock Transfer & Trust Company, LLC
6201 15th Avenue
Brooklyn, NY 11219
Phone: (718) 921-8200

Is the Transfer Agent registered under the Exchange Act? Yes: No:

Describe any trading suspension orders issued by the SEC in the past 12 months: None

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past 12 months: None.

3) Issuance History

A. Changes to the Number of Outstanding Shares

Number of Shares outstanding as of January 1, 2017		Opening Balance							
		Common		42,582,613					
		Preferred Series B		517,359					
		Preferred Series C		10,000					
Date	Transaction Type	Number of Shares Issued	Class of Securities	Value of shares issued (\$ per share) at issuance	Issued at discount to market at time of issuance?	Individual/Entity Shares were issued to	Reason for share issuance or Nature of Services Provided	Restricted or Unrestricted as of this filing?	Exemption or Registration Type
1/6/17	New	66,660	Common	\$0.12	Yes	Daniel Seliga, former Employee (current CFO)	Exercise of stock option	Restricted	
3/23/17	New	302,001	Common	\$0.25	No	Directors (Scott, Ross, Heimbrock, Weiss)	Stock Based Compensation	Restricted	
4/3/17	New	400,000	Common	\$0.22	No	Tom Bosse	Extinguishment of Accounts Payable for Legal services.	Restricted	
4/6/17	New	411,490	Common	\$0.16	No	Directors (Scott, Ross, Heimbrock, Weiss, Smyjunas)	Stock Based Compensation	Restricted	
4/7/17	New	937,500	Common	\$0.16	No	Joseph Heimbrock, Director	Sales of stock under Section 4(2) and Rule 506 of Regulation D under the Securities Act of 1933	Restricted	
4/7/17	New	625,000	Common	\$0.16	No	Cormag Holdings, Ltd. (Mark Scott, Director)	Sales of stock under Section 4(2) and Rule 506 of Regulation D under the Securities Act of 1933	Restricted	
4/7/17	New	312,500	Common	\$0.16	No	Osgar Holdings Ltd.	Sales of stock under Section 4(2) and Rule 506 of Regulation D under the Securities Act of 1933	Restricted	
8/24/17	New	16,667	Common	\$0.11	Yes	Luke Hoffman, Employee	Exercise of stock option	Restricted	
9/1/17	New	210,652	Common	\$0.25	No	Directors (Scott, Heimbrock, Weiss, Britts)	Stock Based Compensation	Restricted	
9/7/17	New	1,000	Common	\$0.35	Yes	Terri Woods, Employee	Exercise of stock option	Restricted	
11/9/17	New	1,000	Common	\$0.35	Yes	China Childers, Employee	Exercise of stock option	Restricted	
11/13/17	New	66,660	Common	\$0.09 - \$0.11	Yes	Sharon Highlander, Former Employee	Exercise of stock option	Restricted	
10/5/17	New	103,920	Common	\$0.51	No	Directors (Scott, Heimbrock, Weiss, Britts)	Stock Based Compensation	Restricted	
10/27/17	New	300,000	Common	\$0.20	Yes	Plough Penny Partners L.P.	Exercise of stock warrants	Restricted	
11/10/17	New	1,333,334	Common	\$0.24	Yes	Cormag Holdings, Ltd. (Mark Scott, Director)	Exercise of stock warrants	Restricted	
1/10/18	New	123,256	Common	\$0.43	No	Directors (Scott, Heimbrock, Weiss, Britts)	Stock Based Compensation	Restricted	
2/1/18	New	537,500	Common	\$0.25	Yes	Eugene McKenna, Greg Matzel, James Wicklund, Michael McKenna, PJ Burbach, Will Gilbert, Hein Tran	Cashless deemed exercise of stock warrants	Restricted	
2/26/18	New	274,219	Common	\$0.25	Yes	Scott Greiper	Cashless exercise of stock warrants	Restricted	
3/14/18	New	50,000	Common	\$0.60	No	Joseph Peters	Stock Based Compensation	Restricted	
4/18/18	New	86,884	Common	\$0.61	No	Directors (Scott, Heimbrock, Weiss, Britts)	Stock Based Compensation	Restricted	
7/10/18	New	96,364	Common	\$0.55	No	Directors (Scott, Heimbrock, Weiss, Britts)	Stock Based Compensation	Restricted	
8/21/18	New	10,000	Common	\$0.09	Yes	Melissa Greenlee	Exercise of stock option	Restricted	
10/17/18	New	169,328	Common	\$0.31	No	Directors (Scott, Heimbrock, Weiss, Britts)	Stock Based Compensation	Restricted	
Number of Shares outstanding as of December 31, 2018		Ending Balance							
		Common		49,018,548					
		Preferred Series B		517,359					
		Preferred Series C		10,000					

All shares issued in the transactions detailed above, contain a legend that states that the shares were issued in a transaction not registered under the Securities Act of 1933 and may not be transferred unless registered or pursuant to an exemption therefrom.

Please see Footnote 12 - Subsequent Events to the Company's consolidated financial statements below for information related to the Company's issuance of common stock related to stock-based compensation for directors and executives.

B. Debt Securities, Including Promissory and Convertible Notes

Date of Note Issuance	Outstanding Balance (\$) as of 12/31/2018	Principal Amount at Issuance (\$)	Interest Accrued (\$) as of 12/31/2018	Maturity Date	Conversion Terms	Name of Note Holder	Reason for Issuance
4/7/17	\$ -	\$ 1,000,000	n/a	3/31/2018	None	Kapok Ventures Limited	Repay existing indebtedness
10/31/17	\$ 1,989,678	\$ 2,000,000	\$ -	9/30/2019, as amended	None	Kapok Ventures Limited	Refinance existing loan balance and partially fund purchase of automation equipment
12/6/17	\$ -	\$ 400,000	n/a	5/31/2018, as amended	None	Melrose Capital Advisors, LLC	To fund litigation settlement
5/31/18	\$ 500,000	\$ 500,000	\$ -	9/30/2019, as amended	None	Melrose Capital Advisors, LLC	Refinance existing loan balance and partially fund purchase of automation equipment

Please see Footnote 6 – Notes Payable to the Company's consolidated financial statements for more information.

4) Financial Statements

- a) The following financial statements were prepared in accordance with U.S. GAAP.
- b) The financial statements for this reporting period were prepared by Daniel Seliga, Chief Financial Officer of the Company.

See PART II –CONSOLIDATED FINANCIAL STATEMENTS below.

5) Issuer's Business, Products and Service

- A) Description of the Issuer's business operations:

HealthWarehouse.com, Inc. is an online pharmacy, licensed and/or authorized to sell and deliver prescriptions in 50 United States and the District of Columbia focusing on the out-of-pocket prescription drug market, a market which is expected to continue to grow. The Company sells directly to individual consumers who purchase prescription medications and OTC products over the Internet. HealthWarehouse.com is currently 1 of 74 Verified Internet Pharmacy Practice Websites ("VIPPS") accredited by the National Association of Boards of Pharmacy ("NABP").

- B) The wholly-owned subsidiaries of HealthWarehouse.com, Inc. are Hwareh.com, Inc., Hocks.com, Inc., ION Holding NV, ION Belgium NV. Hocks.com, Inc., ION Holding NV and ION Belgium NV are inactive subsidiaries.
- C) Principal products and services: The Company sells directly to individual consumers who purchase prescription medications and OTC products over the Internet. The Company offers over 6,200 prescription medications and over 6,000 OTC products.

6) Issuer's Facilities

HealthWarehouse.com, Inc.'s corporate headquarters is located at 7107 Industrial Road, Florence, Kentucky, 41042 which also houses its inventory and pharmacy and customer service operations. The Company occupies 28,494 square feet of office, storage, and warehouse space under a lease with a monthly rental and the lease expires December 31, 2024.

7) Officers, Directors, and Control Persons

A. Names of Officers and Directors

The following table sets forth certain information with respect to the directors and executive officers of the Company as of the date of this information statement December 31, 2018. Please see detailed director biographies contained in the Company's 2018 Annual Meeting and Proxy Statement filed with the OTC Markets on October 22, 2018.

Joseph Peters was appointed Interim President and Chief Executive Officer on April 11, 2017 and elected to the Company's Board of Directors on July 24, 2017.

Effective January 1, 2018, the Company entered into employment agreements with Mr. Peters and Daniel Seliga appointing them as Chief Executive Officer and Chief Financial Officer, respectively. In addition, Mr. Peters was named President of the Company in February 2018.

The Company held its 2018 Annual Meeting of Stockholders on October 17, 2018 and announced that its shareholders had elected the nominees to new one-year terms on its Board of Directors, ratified a proposal to modify an existing equity incentive plan and ratified the appointment of its independent accounting firm for the 2018 fiscal year.

Re-elected to the Board of Directors at the stockholders' meeting were Joseph Peters, Mark Scott, Dr. Stephen Weiss and Jack Britts.

Holders of the Company's Series B Preferred shares separately elected Joe Heimbrock, to the designated Series B Preferred seat on the Board.

Effective September 1, 2018, Blair Magnus and Timothy Reilly were appointed to non-voting observer positions to the Board of Directors as required by agreements with the Company's lenders. See Note 6 – Notes Payable to the consolidated financial statements for additional information.

Name	Title
Joseph B. Peters	President and Chief Executive Officer, and Director
Daniel J. Seliga	Chief Financial Officer
Mark D. Scott	Director
Dr. Stephen J. Weiss	Director
Joseph Heimbrock	Director
Jack Britts	Director

B. Control Persons

The following individuals and entities are the beneficial owners of more than five percent (5%) of HEWA's Common Stock as of December 31, 2018. If any of the beneficial shareholders are corporate shareholders, the name and address of the person(s) owning or controlling such corporate shareholders and the resident agents of the corporate shareholders are provided.

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Name	Affiliation	Address	Number of shares owned	Share Class	Ownership Percentage of Class Outstanding	Beneficial Ownership
MVI Partners and Joe Heimbrock, Director	Director	3299 Hughes Court, Taylor Mill, KY 41015	494,913; 1,375,408	Series B Common	96%; 2.8%	13.3% *
Dr. Bruce Bedrick	>5%	5375 Monterey Circle #32, Delray Beach, FL 33484	3,990,000	Common	8.1%	11.7%
Cormag Holdings, LTD and Mark D. Scott, Director	Director	104 Falcon Ridge Drive, Winnipeg, Manitoba, Canada R3Y1X6	5,456,427	Common	11.1%	11.1%
Dellave Holdings, LLC, Melrose Capital Advisors LLC and Tim Reilly	>5%	1085 Gulf of Mexico Drive, Longboat Key, FL 34228	4,367,457	Common	8.9%	8.9%
Lalit Dhadphale	>5%	182 Uccello Drive, Las Vegas, NV 89138	3,022,479	Common	6.2%	6.2%
Osgar Holdings and Hong Penner	>5%	400 St. Mary Avenue, 9th Floor, Winnipeg, Manitoba, Canada R3C4K5	1,979,167	Common	4.0%	5.6%
SCW Holdings LLP and Dr. Stephen J. Weiss	Director	10405 East McDowell Mountain Ranch Road, Scottsdale, Arizona 85255	1,020,566	Common	2.1%	2.7%
Jack Britts	Director	2021 Saint Andrews Road, Greensboro, NC 27408	118,958	Common	0.2%	0.2%
Joseph B. Peters	President and Chief Executive Officer, and Director	9085 Braxton Drive, Union, KY 41091	50,000	Common	0.1%	1.2%
Daniel J. Seliga	Chief Financial Officer and Principal Financial Officer	3524 Paxton Avenue, Cincinnati, OH 45208	788,436	Common	1.6%	2.0%

* Each Preferred B share is convertible into 11.97 common shares as of December 31, 2018.

8) Legal/Disciplinary History

A. Please identify whether any of the persons listed above have, in the past ten years, been the subject of:

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);

None

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities;

None

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated; or

Dr. Bruce Bedrick, a beneficial owner of 10% or more of the common stock, was subject to a Final Judgment with the United States District Court, Central District of California, related to a Complaint filed by the Securities and Exchange Commission on March 9, 2017. The Final Judgement was filed by the Securities and Exchange Commission on December 22, 2017.

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred suspended or otherwise limited such person's involvement in any type of business or securities activities.

None

9) Third Party Providers

Legal Counsel

General Counsel

Name: Mark Kobasuk
Address 1: 7393 Pinehurst Drive
Address 2: Cincinnati, OH 45244
Phone: (513) 607-9078
Email: mgklaw1@gmail.com

Securities Counsel

Name: Kenneth Tabach
Firm: Silver, Freedman, Taff & Tiernan LLP
Address 1: 3299 K Street, N.W. Suite 100
Address 2: Washington, DC 20007
Phone: (202) 295-4500
Email: ktabach@sfttlaw.com

and

Name: Mark J. Zummo
Firm: Kohnen & Patton, LLP
Address 1: 201 East Fifth Street, Suite 800
Address 2: Cincinnati, OH 45202
Phone: (513) 381-0656
Email: mzummo@kplaw.com

Accounting/Auditing Firm

Firm: Marcum LLP
Address 1: 750 Third Avenue, 11th Floor
Address 2: New York, NY 10017
Phone: (212) 485-5500
Email: info@marcumllp.com

On October 17, 2018, at the 2018 Annual Meeting of Stockholders, the stockholders ratified the selection of Marcum LLP to serve as the Company's independent registered public accounting firm for the year ended December 31, 2018.

10) Issuer Certification

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Joseph Peters, certify that:

1. I have reviewed this annual disclosure statement of HealthWarehouse.com, Inc.
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: March 21, 2019 /s/ Joseph B. Peters

Joseph B. Peters
Chief Executive Officer and President

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Daniel Seliga, certify that:

1. I have reviewed this annual disclosure statement of HealthWarehouse.com, Inc.
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report; and
3. Based on my knowledge, the financial statements, and other financial information included in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: March 21, 2019 /s/ Daniel J. Seliga

Daniel J. Seliga
Chief Financial Officer

PART II –CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of
HealthWarehouse.com, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Healthwarehouse.com, Inc. (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of operations, changes in stockholders' deficiency and cash flows for each of the two years in the period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Explanatory Paragraph - Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As more fully described in Note 2, the Company has a significant working capital deficiency, has incurred significant losses and needs to raise additional funds to meet its obligations and sustain its operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated 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 the Company's 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 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 regarding the amounts and disclosures 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 presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Marcum LLP

Marcum LLP

We have served as the Company's auditor since 2009.

New York, NY
March 21, 2019

HEALTHWAREHOUSE.COM, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	<u>December 31,</u> <u>2018</u>	<u>December 31,</u> <u>2017</u>
Assets		
Current assets:		
Cash	\$ 2,934	\$ 3,349
Restricted cash	425,513	378,708
Accounts receivable	127,861	79,030
Inventories	209,607	253,420
Prepaid expenses and other current assets	104,041	108,096
Total current assets	869,956	822,603
Deposit	-	440,000
Property and equipment, net	1,174,814	309,096
Web development costs, net	-	1,053
Total assets	\$ 2,044,770	\$ 1,572,752
Liabilities and Stockholders' Deficiency		
Current liabilities:		
Accounts payable	\$ 853,693	\$ 792,824
Accrued expenses and other current liabilities	1,427,727	1,071,439
Current portion of capital lease payable	5,736	-
Notes payable, net of debt discount of \$12,262 as of December 31, 2018 and \$0 as of December 31, 2017	2,477,416	400,000
Note payable and other advances – related parties	-	29,102
Redeemable preferred stock - Series C; par value \$0.001 per share; 10,000 designated Series C; 10,000 issued and outstanding as of December 31, 2018 and 2017 (aggregate liquidation preference of \$1,000,000)	1,000,000	1,000,000
Total current liabilities	5,764,572	3,293,365
Long term liabilities:		
Notes payable, net of debt discount of \$61,312 as of December 31, 2017	-	1,378,688
Capital lease payable - non-current	6,557	-
Total long term liabilities	6,557	1,378,688
Total liabilities	5,771,129	4,672,053
Commitments and contingencies		
Stockholders' deficiency:		
Preferred stock – par value \$0.001 per share; authorized 1,000,000 shares; issued and outstanding as of December 31, 2018 and 2017 as follows:		
Convertible preferred stock - Series A – 200,000 shares designated Series A; 44,443 shares available to be issued; no shares issued and outstanding	-	-
Convertible preferred stock - Series B – 625,000 shares designated Series B; 517,359 shares issued and outstanding as of December 31, 2018 and 2017 (aggregate liquidation preference of \$5,915,742 and \$5,573,509 as of December 31, 2018 and 2017, respectively)	517	517
Common stock – par value \$0.001 per share; authorized 100,000,000 shares; 50,197,760 and 48,850,209 shares issued and 49,018,548 and 47,670,997 shares outstanding as of December 31, 2018 and 2017, respectively	50,197	48,850
Additional paid-in capital	33,682,223	33,151,341
Treasury stock, at cost, 1,179,212 shares as of December 31, 2018 and 2017	(3,419,715)	(3,419,715)
Accumulated deficit	(34,039,581)	(32,880,294)
Total stockholders' deficiency	(3,726,359)	(3,099,301)
Total liabilities and stockholders' deficiency	\$ 2,044,770	\$ 1,572,752

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

HEALTHWAREHOUSE.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended	
	December 31,	
	2018	2017
Net sales	\$ 15,748,162	\$ 14,847,262
Cost of sales	<u>5,526,865</u>	<u>5,009,663</u>
Gross profit	10,221,297	9,837,599
Operating expenses:		
Selling, general and administrative expenses	10,598,867	9,359,593
Impairment of fixed assets	170,000	-
Total Operating Expenses	<u>10,768,867</u>	<u>9,359,593</u>
Income (loss) from operations	(547,570)	478,006
Interest expense	<u>(269,484)</u>	<u>(106,231)</u>
Net income (loss)	(817,054)	371,775
Preferred stock:		
Series B convertible preferred stock contractual dividends	<u>(342,233)</u>	<u>(342,232)</u>
Net income (loss) attributable to common stockholders	<u>\$ (1,159,287)</u>	<u>\$ 29,543</u>
Per share data:		
Net income (loss) – basic	\$ (0.02)	0.01
Net income (loss) – diluted	(0.02)	0.01
Series B convertible preferred stock contractual dividends	<u>(0.01)</u>	<u>(0.01)</u>
Net income (loss) attributable to common stockholders - basic	<u>\$ (0.02)</u>	<u>\$ 0.00</u>
Net income (loss) attributable to common stockholders - diluted	<u>\$ (0.02)</u>	<u>\$ 0.00</u>
Weighted average number of common shares outstanding - basic	<u>48,695,935</u>	<u>45,214,968</u>
Weighted average number of common shares outstanding - diluted	<u>48,695,935</u>	<u>51,880,200</u>

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

HEALTHWAREHOUSE.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIENCY
FOR THE YEAR ENDED DECEMBER 31, 2017

	Series B Convertible		Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Deficit	Total Stockholders' Deficiency
	Preferred Stock								
	Shares	Amount	Shares	Amount		Shares	Amount		
Balances, January 1, 2017	517,359	\$ 517	43,761,825	\$ 43,762	\$ 32,014,629	1,179,212	\$ (3,419,715)	\$ (32,909,837)	\$ (4,270,644)
Stock-based compensation	-	-	1,028,063	1,028	267,048	-	-	-	268,076
Exercise of options into common stock			151,987	152	17,647	-	-	-	17,799
Warrants issued in exchange for extension of notes payable	-	-	-	-	7,100	-	-	-	7,100
Stock issued in exchange for services			400,000	400	87,600				88,000
Sale of common stock for cash	-	-	1,875,000	1,875	298,125	-	-	-	300,000
Contractual dividends on Series B convertible preferred stock	-	-	-	-	-	-	-	(342,232)	(342,232)
Warrants issued as debt discount in connection with notes payable	-	-	-	-	65,400	-	-	-	65,400
Inducement charge for warrants exercised at discount					15,425				15,425
Exercise of warrants into common stock	-	-	1,633,334	1,633	378,367	-	-	-	380,000
Net income	-	-	-	-	-	-	-	371,775	371,775
Balances, December 31, 2017	<u>517,359</u>	<u>\$ 517</u>	<u>48,850,209</u>	<u>\$ 48,850</u>	<u>\$ 33,151,341</u>	<u>1,179,212</u>	<u>\$ (3,419,715)</u>	<u>\$ (32,880,294)</u>	<u>\$ (3,099,301)</u>

HEALTHWAREHOUSE.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIENCY (continued)
FOR THE YEAR ENDED DECEMBER 31, 2018

	Series B Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Deficit	Total Stockholders' Deficiency
	Shares	Amount	Shares	Amount		Shares	Amount		
Balances, December 31, 2017	517,359	\$ 517	48,850,209	\$ 48,850	\$ 33,151,341	1,179,212	\$ (3,419,715)	\$ (32,880,294)	\$ (3,099,301)
Stock-based compensation	-	-	525,832	525	530,804	-	-	-	531,329
Exercise of options into common stock	-	-	10,000	10	890	-	-	-	900
Contractual dividends on Series B convertible preferred stock	-	-	-	-	-	-	-	(342,233)	(342,233)
Exercise of warrants into common stock	-	-	811,719	812	(812)	-	-	-	-
Net loss	-	-	-	-	-	-	-	(817,054)	(817,054)
Balances, December 31, 2018	<u>517,359</u>	<u>\$ 517</u>	<u>50,197,760</u>	<u>\$ 50,197</u>	<u>\$ 33,682,223</u>	<u>1,179,212</u>	<u>\$ (3,419,715)</u>	<u>\$ (34,039,581)</u>	<u>\$ (3,726,359)</u>

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

HEALTHWAREHOUSE.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended	
	December 31	
	2018	2017
Cash flows from operating activities		
Net loss	\$ (817,054)	\$ 371,775
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	123,862	77,065
Stock-based compensation	626,329	351,076
Impairment loss on website development costs	-	15,425
Loss on disposition of equipment	7,807	-
Gain on settlement of accrued expenses	-	(139,479)
Amortization of debt discount	49,050	4,088
Impairment of fixed assets	170,000	
Write off of web development costs	-	13,700
Changes in operating assets and liabilities:		
Accounts receivable	(48,831)	(13,599)
Inventories	43,813	(44,005)
Prepaid expenses and other current assets	4,055	(12,520)
Accounts payable	60,869	(960,724)
Accrued expenses and other current liabilities	(80,945)	(243,570)
Net cash provided by (used in) operating activities	138,955	(580,768)
Cash flows from investing activities		
Capital expenditures	(1,148,304)	(33,254)
Progress payments deposited with equipment manufacturer	440,000	(450,000)
Net cash used in investing activities	(708,304)	(483,254)
Cash flows from financing activities		
Repayment of capital lease	(5,737)	-
Proceeds from exercise of stock options		17,799
Proceeds from issuance of notes payable	649,678	1,840,000
Repayment of notes payable	-	(1,300,000)
Proceeds from the exercise of warrants	900	380,000
Proceeds from sale of common stock	-	300,000
Repayment of notes payable and other advances – related parties	(29,102)	(38,803)
Net cash provided by financing activities	615,739	1,198,996
Net decrease in cash	46,390	134,974
Cash and restricted cash - beginning of period	382,057	247,083
Cash and restricted cash - end of period	\$ 428,447	\$ 382,057
Cash paid for:		
Interest	\$ 269,484	\$ 106,231
Non-cash investing and financing activities:		
Cashless exercise of warrants into common stock	\$ 812	\$ -
Conversion of accounts payable to common stock	\$ -	\$ 88,000
Acquisition of capital equipment under capital lease	\$ 18,030	\$ -
Warrants issued in connection with notes payable	\$ -	\$ 65,400
Warrants issued for extension of notes payable		\$ 7,100
Accrual of contractual dividends on Series B convertible preferred stock	\$ 342,233	\$ 342,232
Common stock issued to satisfy accrued directors' fees	\$ 53,000	\$ 247,750
Common stock issued to satisfy accrued non-cash executive bonus	\$ 30,000	\$ -
Write-off of fully-depreciated asset	\$ 13,383	\$ -

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

HEALTHWAREHOUSE.COM, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Organization and Basis of Presentation

HealthWarehouse.com, Inc. ("HEWA" or the "Company"), a Delaware company incorporated in 1998, is an online mail order pharmacy, licensed and/or authorized to sell and deliver prescriptions in all 50 United States and the District of Columbia focusing on the out-of-pocket prescription drug market. The Company is a Verified Internet Pharmacy Practice Site ("VIPPS") accredited by the National Association of Boards of Pharmacy ("NABP"). The Company markets a complete range of generic, brand name, and pet prescription medications as well as over-the-counter ("OTC") medications and products.

2. Going Concern and Management's Liquidity Plans

The Company has financed its operations primarily through debt and equity financings. Additional borrowings from the Company's lenders during 2017 and 2018 have not been sufficient to satisfy the Company's current obligations. As of December 31, 2018, the Company had a working capital deficiency of \$4,894,616 and a stockholder deficiency of \$3,726,359. The Company has historically incurred significant net losses, including a net loss of \$817,054 for the year ended December 31, 2018. Although the Company generated cash from operating activities of \$138,955 during 2018, that amount was not sufficient to meet its current obligations. These conditions indicate that there is substantial doubt about the Company's ability to continue as a going concern within one year after the date that the financial statements are issued.

The Company is subject to a 2013 Notice of Redemption related to its Series C Redeemable Preferred Stock aggregating \$1,000,000, whereby, the Company must now apply all of its assets to redemption of the Series C Preferred Stock and to no other corporate purpose, except to the extent prohibited by Delaware law governing distributions to stockholders (the Company is not permitted to utilize toward the redemption those assets required to pay its debts as they come due and those assets required to continue as a going concern).

The Company recognizes it will need to raise additional capital in order to meet its payment obligations. There is no assurance that additional financing will be available when needed, that management will be able to obtain financing on terms acceptable to the Company or that the Company will become profitable and generate positive operating cash flow in an amount sufficient to meet its obligations. If the Company is unable to raise or generate sufficient additional funds, it will have to develop and implement a plan to attempt to extend note repayments, attempt to negotiate the preferred stock redemption until sufficient additional capital is raised to support further operations. There can be no assurance that such a plan will be successful. If the Company is unable to obtain financing on a timely basis, the Company could be forced to sell its assets, discontinue its operations, and /or seek reorganization under the U.S. bankruptcy code.

Accordingly, the accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"), which contemplates continuation of the Company as a going concern and the realization of assets and the satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the consolidated financial statements do not necessarily represent realizable or settlement values. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

3. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of HealthWarehouse.com, Inc., Hwareh.com, Inc., Hocks.com, Inc., ION Holding NV, ION Belgium NV, its wholly-owned subsidiaries. ION Holding NV and ION Belgium NV are inactive subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at

the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's significant estimates include reserves related to accounts receivable, the net realizable value of inventory, the recoverability and useful lives of long-lived assets and website development costs, the valuation allowance related to deferred tax assets, the valuation of equity instruments, debt discounts and contingencies.

Reclassifications

Certain accounts in the prior period consolidated financial statements have been reclassified for comparison purposes to conform to the presentation of the current period consolidated financial statements. These reclassifications had no effect on the previously reported net loss.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. As of December 31, 2018 and 2017, the Company did not have any cash equivalents.

Restricted Cash

Restricted cash represents cash held by the Company's credit card processor as a reserve to cover potential future refunds and funds held by the senior lender as collateral for the Company's Senior Note. See Note 6 – Notes Payable to the consolidated financial statements for additional information. Cash and Restricted Cash, as presented on the consolidated statements of cash flows, consists of \$2,934 and \$425,513, as of December 31, 2018, respectively, and \$3,349 and \$378,708 as of December 31, 2017, respectively.

Accounts Receivable and Allowance for Doubtful Accounts Receivable

The Company's management has established an allowance for doubtful accounts sufficient to cover probable and reasonably estimable losses. The nature of the business is that the majority of payments are received before the product is shipped. If the financial conditions of customers were to materially deteriorate, an increase in the allowance amount could be required. The allowance for doubtful accounts considers several factors, including collection experience, current economic trends, estimates of forecasted write-offs, aging of the accounts receivable, and other factors. The Company has determined that an allowance for doubtful accounts was not necessary as of December 31, 2018 and 2017.

Inventories

The Company measures inventory at the lower of cost or net realizable value, defined as estimated selling prices in the ordinary course of business, less reasonably predictable costs of disposal. The Company performs regular reviews of inventory quantities on hand and evaluates the realizable value of its inventories. The valuation process for excess or slow-moving inventory contains uncertainty because management must use judgment to estimate when the inventory will be sold and the quantities and prices at which the inventory will be sold in the normal course of business. The Company adjusts the carrying value of the inventory as necessary with estimated valuation reserves for excess, obsolete, and slow-moving inventory by comparing the individual inventory items to forecasted product demand, taking into account current risks, trends and changes in industry conditions. The inventory is valued at the lower of cost or net realizable value with cost determined using the first-in, first-out method.

Property and Equipment, net

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. The costs of additions and betterments are capitalized and expenditures for repairs and maintenance, which do not extend the economic useful life of the related assets, are expensed in the period incurred. Gains or losses on disposal of property and equipment are reflected in the statements of operations in the period of disposal.

Impairment of Long-Lived Assets

The Company reviews the carrying value of intangibles and other long-lived assets for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is measured by comparing the carrying amount of the asset or asset group to the undiscounted cash flows that the asset or asset group is expected to generate. If the undiscounted cash flows of such assets are less than the carrying amount, the impairment to be recognized is measured by the amount by which the carrying amount of the property, if any, exceeds its fair value. During the year ended December 31, 2018, the Company replaced its existing automation equipment with new automation equipment. The Company intends to sell the old equipment and as a result, recognized a loss of \$170,000 to reduce the book value of the equipment to its estimated salvage value.

Website Development Costs

The Company capitalizes costs associated with the development of its website. During the years ended December 31, 2018 and 2017, the Company did not capitalize any of its website development costs. The Company is amortizing the website development costs on a three-year straight-line basis and incurred amortization expense of \$1,053 and \$21,148 during the years ended December 31, 2018 and 2017, respectively. In addition, the Company recognized a \$13,700 impairment loss in June 2017 as the result of a project not being implemented. As of December 31, 2018, unamortized website development costs totaled \$0.

Fair Value of Financial Instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. These fair value measurements apply to all financial instruments that are measured and reported on a fair value basis.

Based on the observability of the inputs used in the valuation techniques, financial instruments are categorized according to the fair value hierarchy, which ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1 - Observable inputs such as quoted prices in active markets.

Level 2 - Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.

Level 3 - Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the assignment of an asset or liability within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The carrying value of items included in the Company's working capital approximates fair value because of the relatively short maturity of these instruments. The Company's notes payable approximate fair value because the terms are substantially similar to comparable debt in the marketplace.

Income Taxes

Deferred tax assets and liabilities are determined on the basis of the difference between the tax basis of assets and liabilities and their respective financial reporting amounts ("temporary differences") at enacted tax rates in effect for the years in which the temporary differences are expected to reverse.

U.S. GAAP prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Management has evaluated and concluded that there were no material uncertain tax positions requiring recognition in the Company's financial statements as of December 31, 2018 and 2017. The Company does not expect any significant changes in the unrecognized tax benefits within twelve months of the reporting date.

The Company classifies interest expense and any related penalties related to income tax uncertainties as a component of income tax expense. No interest or penalties have been recognized during the years ended December 31, 2018 and 2017.

Debt Discounts

The Company records, as a discount to notes and convertible notes, the relative fair value of warrants issued in connection with the issuances and the intrinsic value of any conversion options 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 to interest expense using the interest method over the earlier of the term of the related debt or their earliest date of redemption.

Revenue Recognition

Revenues for the sales of products are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable and collectability is reasonably assured. The Company defers revenue when cash has been received from the customer, but delivery has not yet occurred. Such amounts are reflected as deferred revenues in the accompanying consolidated financial statements.

Shipping and Handling Costs

The Company policy is to provide free standard shipping and handling for most orders. Shipping and handling costs incurred are recognized in selling, general and administrative expenses. Such amounts aggregated \$1,626,049 and \$1,692,736 for the years ended December 31, 2018 and 2017, respectively.

In certain circumstances, shipping and handling costs are charged to the customer and recognized in Net Sales. The amounts recognized in Net Sales for the years ended December 31, 2018 and 2017 were \$373,638 and \$480,444, respectively.

Advertising and Marketing Expenses

The Company expenses all advertising and marketing costs as incurred and were \$1,315,616 and \$1,225,763 for the years ended December 31, 2018 and 2017, respectively.

Sales Taxes

The Company accounts for sales taxes imposed on its goods and services on a net basis in the consolidated statements of operations. During 2018 and continuing into 2019, various states have enacted or are considering enacting legislation to require the collection of sales tax on ecommerce transactions shipped to their state. Such requirements vary by state and are subject to specified de minimis levels and various exclusions, including prescription medication. Compliance with current legislation enacted is not expected to have a material impact on the Company's future operations or results.

Net Earnings (Loss) Per Share of Common Stock

Basic net earnings (loss) per share is computed by dividing net earnings (loss) attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net earnings per share reflects the potential dilution that could occur if securities or other instruments to issue common stock were exercised or converted into common stock.

	December 31	
	2018	2017
Numerator		
Net income (loss) attributable to common shareholders	\$ (1,159,287)	\$ 29,543
Denominator:		
Weighted-average common shares, basic	48,695,935	45,214,968
Weighted-average common shares, diluted*	<u>48,695,935</u>	<u>51,880,200</u>
Net income (loss) per common share:		
Basic	\$ (0.02)	\$ 0.00
Diluted	<u>\$ (0.02)</u>	<u>\$ 0.00</u>

* The diluted earnings per common share in 2017 included the weighted-average effect of 701,667 stock options and 6,027,784 stock warrants that are potentially dilutive to earnings per share for the year ended December 31, 2017, since the exercise price of such securities was less than the weighted average market price of \$0.31 during the period.

Potentially dilutive securities are excluded from the computation of net earnings per share if their inclusion would be anti-dilutive and consist of the following:

	December 31,	
	2018	2017
Options	2,954,845	1,021,345
Warrants	4,866,151	6,541,151
Series B Convertible Preferred Stock	<u>6,192,788</u>	<u>6,192,788</u>
Total potentially dilutive shares	<u><u>14,013,784</u></u>	<u><u>13,755,284</u></u>

Stock-Based Compensation

Stock-based compensation expense for all stock-based payment awards is based on the estimated fair value of the award. For employees and directors, the award is measured on the grant date. For non-employees, the award is measured on the grant date and is then remeasured at each vesting date and financial reporting date. The Company recognizes the estimated fair value of the award as compensation cost over the requisite service period of the award, which is generally the option vesting term. The Company generally issues new shares of common stock to satisfy option and warrant exercises.

Preferred Stock

Preferred shares subject to mandatory redemption (if any) are classified as liability instruments and are measured at fair value. The Company classifies conditionally redeemable preferred shares, which includes preferred shares that feature redemption rights that are either within the control of the holder or subject to redemption upon the occurrence of uncertain events not solely within the Company's control, as temporary equity. At all other times, the Company classifies its preferred shares in stockholders' deficiency.

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.

Common Stock Warrants and Other Derivative Financial Instruments

The Company classifies as equity any contracts that (i) require physical settlement or net-share settlement or (ii) provide the Company with a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement) providing that such contracts are indexed to the Company's own stock. The Company classifies as assets or liabilities any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the Company's control) or (ii) gives the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement). The Company assesses classification of its common stock purchase warrants and other free-standing derivatives at each reporting date to determine whether a change in classification between assets and liabilities is required.

The Company evaluated its free-standing warrants to purchase common stock to assess their proper classification in the consolidated balance sheet as of December 31, 2018 and 2017 using the applicable classification criteria enumerated under U.S. GAAP and determined that the common stock purchase warrants contain fixed settlement provisions.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, "*Revenue from Contracts with Customers*", which provides guidance for revenue recognition. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14 which delayed the effective date of the new revenue guidance by one year. As a result, the provisions of ASU 2014-09, and subsequent amendments, are effective for the Company for annual reporting periods beginning after December 15, 2018. The Company is in the process of evaluating the impact of adoption of this update on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires that a lessee recognize the assets and liabilities that arise from operating leases. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Public business entities should apply the amendments in ASU 2016-02 for fiscal years beginning after December 15, 2019. Early application is permitted for all public business entities and all nonpublic business entities upon issuance. The Company is in the process of evaluating the impact of adoption of this update on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "*Compensation - Stock Compensation*" (Topic 718): *Improvements to Employee Share-Based Payment Accounting*. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for the Company beginning January 1, 2018. The Company does not expect that the impact of adoption of this update will be significant on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "*Classification of Certain Cash Receipts and Cash Payments (Topic 230)*". ASU 2016-15 adds and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows, reducing the existing diversity in practice that has resulted from the lack of consistent principles on this topic. ASU

2016-15 is effective for the Company beginning January 1, 2018. Early adoption is permitted. The Company does not expect that the impact of adoption of this update will be significant on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “*Statement of Cash Flows (Topic 230): Restricted Cash.*” ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The guidance is effective for the Company in the first quarter of 2019 and early adoption is permitted. ASU 2016-18 must be applied retrospectively to all periods presented. The Company adopted ASU 2016-18 in the presentation of its statement of cash flows for the year ended December 31, 2018 and retrospectively to the year ended December 31, 2017.

In June 2018, the FASB issued ASU 2018-07, Stock Compensation (Topic 718); Improvements to Non-employer Share-Based Payment Accounting. The amendment aligns the accounting for share based payments issued to employees and non-employees. The amendments in this update are effective for public companies for annual periods beginning after December 15, 2018, including interim periods within those periods. The Company is currently reviewing the impact of the adoption of ASU 2018-07 on its consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-09, “Codification Improvements” (“ASU 2018-09”). These amendments provide clarifications and corrections to certain ASC subtopics including the following: Income Statement - Reporting Comprehensive Income – Overall (Topic 220-10), Debt - Modifications and Extinguishments (Topic 470-50), Distinguishing Liabilities from Equity – Overall (Topic 480-10), Compensation - Stock Compensation - Income Taxes (Topic 718-740), Business Combinations - Income Taxes (Topic 805-740), Derivatives and Hedging – Overall (Topic 815- 10), and Fair Value Measurement – Overall (Topic 820-10). The majority of the amendments in ASU 2018-09 will be effective in annual periods beginning after December 15, 2018. The Company is currently evaluating and assessing the impact this guidance will have on its consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-10, “Codification Improvements to Topic 842, Leases” (“ASU 2018-10”). The amendments in ASU 2018-10 provide additional clarification and implementation guidance on certain aspects of the previously issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”) and have the same effective and transition requirements as ASU 2016-02. Upon the effective date, ASU 2018-10 will supersede the current lease guidance in ASC Topic 840, Leases. Under the new guidance, lessees will be required to recognize for all leases, with the exception of short-term leases, a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis. Concurrently, lessees will be required to recognize a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2018-10 is effective for emerging growth companies for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The guidance is required to be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative periods presented in the financial statements. The Company is currently assessing the impact this guidance will have on its consolidated financial statements.

In July 2018, the FASB issued Accounting Standards Update No. 2018-11, “Leases (Topic 842): Targeted Improvements,” (“ASU 2018-11”). The amendments in ASU 2018-11 related to transition relief on comparative reporting at adoption affect all entities with lease contracts that choose the additional transition method and separating components of a contract affect only lessors whose lease contracts qualify for the practical expedient. The amendments in ASC Topic 842 are effective for emerging growth companies for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company is currently assessing the impact this guidance will have on its consolidated financial statements.

There were no other recent accounting standard updates that the Company has not yet adopted that we believe would have a material impact on our consolidated financial statements.

4. Property and Equipment, Net

Property and equipment, net consisted of the following:

	<u>December 31,</u>		Useful Life (Years)
	<u>2018</u>	<u>2017</u>	
Computer Software	\$ 230,299	\$ 230,299	5 years
Equipment	1,529,714	551,015	10 years
Office Furniture and Equipment	102,443	98,192	7 years
Computer Hardware	50,998	50,997	5 years
Leasehold Improvements	322,973	322,973	(a)
Total	<u>2,236,427</u>	<u>1,253,476</u>	
Less: Accumulated Depreciation	<u>(1,061,613)</u>	<u>(944,380)</u>	
Property and Equipment, Net	<u>\$ 1,174,814</u>	<u>\$ 309,096</u>	

(a) Lesser of useful life or initial term of lease

Depreciation expense for the above assets for the years ended December 31, 2018 and 2017 was \$122,809 and \$55,918, respectively.

5. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following:

	<u>December 31,</u>	
	<u>2018</u>	<u>2017</u>
Salaries and Benefits	\$ 240,264	\$ 186,340
Dividend Payable	1,026,699	684,465
Accrued Interest	28,436	28,436
Accrued Rent	6,169	2,850
Severance	-	72,986
Accrued Director Fees	53,000	53,000
Deferred Revenue	4,399	11,206
Other	68,760	32,156
	<u>\$ 1,427,727</u>	<u>\$ 1,071,439</u>

6. Notes Payable

Notes payable consisted of the following:

	<u>December 31,</u>	
	<u>2018</u>	<u>2017</u>
Melrose Note	\$ 500,000	\$ 400,000
Kapok Promissory Note	1,989,678	1,440,000
Less debt discount	<u>(12,262)</u>	<u>(61,312)</u>
Total debt	2,477,416	1,778,688
Less current portion	<u>(2,477,416)</u>	<u>(400,000)</u>
Long-term debt, less current portion	<u>\$ -</u>	<u>\$ 1,378,688</u>

Kapok Promissory Note

The Company is a party to a promissory note (the "Kapok Promissory Note" or "Senior Note") and a security agreement (the "Kapok Security Agreement") with Kapok Ventures Limited, which commenced in 2017. Under the terms of the Kapok Promissory Note, the Company may borrow up to an aggregate of \$2,000,000 (as amended) from Kapok. The Kapok Promissory Note bears interest on the unpaid principal balance until the full amount of principal has been paid at a variable rate equal to the prime rate plus four and one-quarter percent (4.25%) per annum (9.75% at December 31, 2018). During the year ended December 31, 2018, Kapok advanced \$549,678 to the Company. Under the terms of the Kapok Promissory Note, the Company has agreed to make monthly payments of accrued interest on the first day of every month, through the September 30, 2019 maturity date.

The investor rights agreement of the Company's Series B preferred shares limits the total debt of the Company to \$1 million. The Company has received waivers to temporarily exceed the limit in connection with the extensions and increase of the Kapok Promissory Note. The waiver related to the Kapok Promissory Note expires on September 30, 2019.

Pursuant to the Kapok Security Agreement, the Company granted Kapok a first priority security interest in all of the Company's assets, in order to secure the Company's obligation to repay the Kapok Promissory Note, including a Deposit Account Control Agreement, dated as of June 30, 2017, which granted the Lender a security interest in certain bank accounts of the Company. The Kapok Loan Agreements contain customary negative covenants restricting the Company's ability to take certain actions without Kapok's consent, including incurring additional indebtedness, transferring or encumbering assets, paying dividends or making certain other payments, and acquiring other businesses. The repayment of the Kapok Promissory Note may be accelerated prior to the maturity date upon certain specified events of default, including failure to pay, bankruptcy, breach of covenant, and breach of representations and warranties.

The proceeds from the Kapok Promissory Note were used to partially repay existing indebtedness and to partially fund the acquisition of pharmacy automation equipment.

On December 6, 2017, the Company issued to Kapok five-year warrants to purchase 40,000 shares of common stock at an exercise price of \$0.35 per share for an aggregate grant date value of \$11,911 which was record as stock-based compensation during the year ended December 31, 2017. The warrants were issued as a requirement of their waiver to allow for the Melrose Promissory Note (detailed below).

As part of a consent provided by Kapok related to the extension of the maturity date of the Melrose Promissory Note, the Company granted Kapok, effective September 1, 2018, the right to appoint a representative to a non-voting observer position to the Board of Directors until the full balance of the Kapok Promissory Note is repaid. The Company is required to provide compensation of \$1,000 per month to the Kapok representative.

Melrose Promissory Note

The Company is a party to a promissory note (the "Melrose Promissory Note") and a security agreement (the "Melrose Security Agreement") with Melrose Capital Advisors, LLC. Under the terms of the Melrose Promissory Note, the Company borrowed an aggregate of \$500,000 from Melrose (the "Melrose Loan") as of December 31, 2018. The Melrose Promissory Note bears interest on the unpaid principal balance until the full amount of principal has been paid at a fixed rate equal to 10% per annum. During the year ended December 31, 2018, Melrose advanced \$100,000 to the Company. Under the terms of the Melrose Promissory Note, the Company has agreed to make monthly payments of accrued interest on the first day of every month. The principal amount and all unpaid accrued interest on the Melrose Promissory Note is payable on September 30, 2019.

Pursuant to the Melrose Security Agreement, the Company granted a junior security interest in all of the Company's assets, in order to secure the Company's obligation to repay the Melrose Promissory Note. The Melrose security interest is junior to the Kapok security interest. The Melrose Loan Agreements contain customary negative covenants restricting the Company's ability to take certain actions without Melrose's consent, including incurring additional indebtedness, transferring or encumbering assets, paying dividends or making certain other payments, and acquiring other businesses. The repayment of the

Melrose Promissory Note may be accelerated prior to the maturity date upon certain specified events of default, including failure to pay, bankruptcy, breach of covenant, and breach of representations and warranties.

The proceeds from the Melrose Promissory Note were used to repay a portion of the settlement amount related to the Taft litigation and to partially fund the acquisition of pharmacy automation equipment. See Section 8 Commitments and Contingent Liabilities – Litigation.

The investor rights agreement of the Company's Series B preferred shares limits the total debt of the Company to \$1 million. The Company has received waivers to temporarily exceed the limit to allow for the Melrose Promissory Note. The waiver related to the Melrose Promissory Note expires on March 31, 2019.

As part of an agreement related to the extension of the maturity date of the Melrose Promissory Note, the Company granted Melrose, effective September 1, 2018, the right to appoint a representative to a non-voting observer position to the Board of Directors until August 31, 2019. The Company is required to provide compensation of \$1,000 per month to the Melrose representative.

7. Stockholders' Deficiency

The Company is authorized to issue up to 100,000,000 shares of common stock with a par value of \$0.001 per share and 1,000,000 shares of preferred stock with a par value of \$0.001 per share.

OTC Market Tier Change

On April 14, 2017, the Company filed a Form 15 with the Securities and Exchange Commission terminating the registration of its common stock under Rule 12 g-4(a)(1) of the Securities Exchange Act of 1934. The Company transitioned to the OTC Pink Sheets – Current Information tier of the OTC Market on July 10, 2017.

Common Stock

On April 3, 2017, the Company issued 400,000 shares of common stock in exchange for the extinguishment of \$88,000 of accounts payable balance for legal services. The shares were valued at \$0.22 per share which was the closing price of the shares on the date of the grant.

Effective April 7, 2017 the Company entered into Subscription Agreements (the "Subscription Agreements") with three affiliated accredited investors, namely Joseph Heimbrock, Cormag Holdings, Ltd. and Osgar Holdings Ltd. (collectively, the "Investors") and sold 1,875,000 shares of the Company's common stock, at \$0.16 per share for an aggregate price of \$300,000.

Through MVI Partners, LLC, Mr. Heimbrock holds substantially all of the Company's outstanding shares of Series B Preferred Stock and Mr. Heimbrock is a member of the Company's Board of Directors. Cormag Holdings, Ltd. is owned by Mark D. Scott, the Company's Chairman of the Board of Directors and owns greater than 5% of the Company's outstanding shares of common stock. Osgar Holdings Ltd. is the beneficial owner of more than 5% of the Company's outstanding shares of common stock. Hong Penner is the President and sole shareholder of Osgar Holdings Ltd. and she and her husband Brent Penner have loaned Kapok Limited Ventures, a British Columbia corporation ("Kapok") \$250,000 for purposes of financing the Company's Kapok Promissory Note.

On March 14, 2018, the Company issued 50,000 shares of common stock to an executive of the Company for payment of the noncash portion of his 2017 bonus per the terms of his employment agreement. The shares had a grant date value of \$30,000. Such amount was included in accrued expenses and other current liabilities as of December 31, 2017.

During the years ended December 31, 2018 and 2017, the Company issued an aggregate of 475,832 and 1,028,063 shares of common stock, respectively, to directors of the Company for payment of their accrued noncash portion of their director's fees. The shares had an aggregate grant date value of \$212,000 and \$247,750 for the years ended December 31, 2018 and 2017, respectively, of which \$53,000 and \$75,500 had been accrued at December 31, 2017 and 2016, respectively. The shares were valued at the closing prices for the Company's common stock on the dates of grant which ranged between \$0.16 and \$0.61 per share.

Stock-based compensation expense related to common stock issued was recorded in the consolidated statements of operations as a component of selling, general and administrative expenses and totaled \$212,000 and \$259,667 for the years ended December 31, 2018 and 2017, respectively.

Preferred Stock

Series A Preferred Stock

The Company has designated 200,000 of the 1,000,000 authorized shares of preferred stock as Series A Convertible Preferred Stock (“Series A Preferred Stock”). The Series A Preferred Stock is non-voting, has a liquidation preference equal to its purchase price, and does not pay dividends. The holders can call for the conversion of the Series A Preferred Stock at any time and are entitled to half a share of the Company’s common stock for each share of Series A Preferred Stock converted. As of December 31, 2018, 44,443 shares of Series A Preferred Stock are available to be issued. There were no shares of Series A Preferred Stock outstanding as of December 31, 2018 or 2017.

Series B Preferred Stock

The Company has designated 625,000 of the 1,000,000 authorized shares of preferred stock as Series B Convertible Preferred Stock (“Series B Preferred Stock”). The Series B Preferred Stock has voting rights equal to one vote for each common share equivalent, has a liquidation preference equal to its purchase price, and receives preferred dividends equal to 7% of all outstanding shares in either cash or payment-in-kind. The holders can call for the conversion of the Series B Preferred Stock at any time and are entitled to five shares of the Company’s common stock for each share of Series B Preferred Stock converted.

In addition, the Series B Preferred Stock is subject to weighted average anti-dilution protection whereby if shares of common stock are sold below the current conversion price, the conversion price is reduced pursuant to a pre-defined formula. As of December 31, 2018 and 2017, Series B holders were entitled to convert into 11.97 shares of the Company’s common stock for each share of Series B Preferred Stock due to the anti-dilution provision. The anti-dilution provision represents a beneficial conversion feature. As of December 31, 2018, an incremental 3,605,993 shares of common stock are issuable at conversion of the Series B Convertible Preferred Stock as compared to the original terms. Using the commitment date common stock price in effect, the commitment date value of the incremental shares is \$9,101,527.

However, recognition of beneficial conversion features is limited to the aggregate gross proceeds allocated to the preferred stock of \$3,199,689 (422,315 shares of Series B Convertible Preferred Stock times \$9.45 per share less the proceeds allocated to the warrants of \$791,188) less the \$1,666,967 beneficial conversion feature already recognized on the original 365,265 shares of Series B Preferred Stock (prior to the issuance of additional shares as payment-in-kind in lieu of cash dividends). Due to these limitations, no beneficial conversion feature value was recorded for the years ended December 31, 2018 and 2017. The investor rights agreement of the Company’s Series B preferred shares limits the total debt of the Company to \$1 million. The agreement also limits the ability to raise preferred equity at current market conversion rates.

As of the years ended December 31, 2018 and 2017, the Company had accrued contractual dividends of \$1,026,699 and \$684,465, respectively, related to the Series B Preferred Stock.

Series C Preferred Stock

The Company’s Certificate of Designation designates 10,000 shares of the Company's preferred stock as Series C Preferred Stock to be issued at an original issue price of \$100 per share. The Series C Preferred Stock has voting rights equal to one vote for each share held, has a liquidation preference equal to its purchase price, and has certain redemption rights available at the option of the holder. The Series C Preferred Stock is non-convertible and does not pay dividends.

On October 17, 2011, the Company received net cash proceeds of \$1,000,000 for the sale of 10,000 shares of Series C Preferred Stock to a greater than 10% stockholder of the Company. Since certain of the Company’s preferred shares contain redemption rights which are not solely within the Company’s control, these issuances of preferred stock were initially presented as temporary equity. On February 13, 2013, the Company received a Notice of Redemption of Series C Preferred Stock and as a result, the shares are classified as a current liability as of December 31, 2018 in the Company’s consolidated balance sheet.

Incentive Compensation / Stock Option Plans

The Company sponsors an Incentive Compensation Plan (the “2009 Plan”) which was approved by the Board of Directors and the Company’s Stockholders, and initially allowed the total number of shares of common stock issuable pursuant to the 2009 Plan to be 2,881,425 shares.

The 2009 Plan imposes individual limitations on the amount of certain awards. Under these limitations during any fiscal year of the Company, the number of options, stock appreciation rights, shares of restricted stock, shares of deferred stock, performance shares and other stock based-awards granted to any one participant under the 2009 Plan may not exceed 250,000 shares, subject to adjustment in certain circumstances. The maximum amount that may be paid out as performance units in any 12-month performance period is an aggregate value of \$2,000,000, and the maximum amount that may be paid out as performance units in any performance period greater than 12 months is an aggregate value of \$4,000,000. The maximum term of each option or stock appreciation right, the times at which each option or stock appreciation right will be exercisable, and provisions requiring forfeiture of unexercised options or stock appreciation rights at or following termination of employment generally are fixed by the board of directors or committee of the Company’s board of directors designated to administer the 2009 Plan (the “Committee”), except that no option or stock appreciation right may have a term exceeding ten years. The exercise price per share subject to an option and the grant price of a stock appreciation rights are determined by the Committee, but in the case of an incentive stock option (ISO) must not be less than the fair market value of a share of common stock on the date of grant.

Following the approval of the Board of Directors and stockholders of record as of August 25, 2014, the Company adopted the 2014 Equity Incentive Plan (the “2014 Plan”) which made a total of 6,000,000 shares of common stock authorized and available for issuance pursuant to awards granted under the 2014 Plan.

The 2014 Plan limit imposes individual limitations on the amount of certain awards. Under these limitations during any fiscal year of the Company, the number of options, stock appreciation rights, shares of restricted stock, shares of deferred stock, performance shares and other stock based-awards granted to any one participant under the 2014 Plan may not exceed 1,500,000 shares, subject to adjustment in certain circumstances. The maximum number of shares that may be awarded that are not subject to performance targets is an aggregate of 1,200,000 shares. The maximum term of each option or stock appreciation right, the times at which each option or stock appreciation right will be exercisable, and provisions requiring forfeiture of unexercised options or stock appreciation rights at or following termination of employment generally are fixed by the Committee designated to administer the 2014 Plan, except that no option or stock appreciation right may have a term exceeding ten years. The exercise price per share subject to an option and the grant price of a stock appreciation rights are determined by the Committee, but in the case of an incentive stock option (ISO) must not be less than the fair market value of a share of common stock on the date of grant.

Following the approval of the Board of Directors and stockholders of record as of October 17, 2018, the Company modified certain terms of the 2014 Plan including an increase in the total of shares of common stock authorized and available for issuance pursuant to awards granted under the 2014 Plan to 12,000,000 and an increase in the maximum number of shares that may be awarded that are not subject to performance targets to 6,000,000.

Stock Options

Grants

During the year ended December 31, 2018, the Company granted options to executives and key employees of the Company to purchase an aggregate of 2,800,000 shares of common stock under a previously approved plan at exercise price ranging between \$0.36 and \$0.61 per share for an aggregate grant date value of \$1,301,983. The options vest over a three-year period and have a term of ten years. The options granted included options to purchase an aggregate of 750,000 shares of common stock that were issued to replace options previously issued to key employees during the same year.

During the year ended December 31, 2017, the Company granted options to an officer of the Company to purchase an aggregate of 100,000 shares of common stock under the 2014 Plan at an exercise price of \$0.22 per share for an aggregate grant date value of \$21,493. The options vested immediately and have a term of ten years.

Exercise

During the year ended December 31, 2018, the Company received proceeds of \$900 from the exercise of options to purchase 10,000 shares of common stock. The options had exercise prices of \$0.09 per share.

During the year ended December 31, 2017, the Company received proceeds of \$17,799 from the exercise of options to purchase 151,987 shares of common stock. The options had exercise prices ranging from \$0.09 and \$0.35 per share.

The aggregate intrinsic value of the options exercised was \$3,100 and \$36,821 for the years ended December 31, 2018 and 2017, respectively.

Valuation and Amortization

Option valuation models require the input of highly subjective assumptions. The fair value of the stock-based payment awards is estimated utilizing the Black-Scholes option model. The volatility component of this calculation is derived from the historical trading prices of the Company's own common stock. The Company accounts for the expected life of options in accordance with the "simplified" method for "plain vanilla" share options. The risk-free interest rate was determined from the implied yields of U.S. Treasury zero-coupon bonds with a remaining life consistent with the expected term of the options.

In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. In estimating the Company's forfeiture rate, the Company analyzed its historical forfeiture rate, the remaining lives of unvested options, and the number of vested options as a percentage of total options outstanding. If the Company's actual forfeiture rate is materially different from its estimate, or if the Company reevaluates the forfeiture rate in the future, the stock-based compensation expense could be significantly different from what the Company has recorded in the current period. The Company estimated forfeitures related to option grants at a weighted average annual rate of 0% per year for options granted during the years ended December 31, 2018 and 2017, respectively.

In applying the Black-Scholes option pricing model to stock options granted, the Company used the following weighted average assumptions:

	Year Ended December 31,	
	2018	2017
Risk-free interest rate	2.49% to 2.89%	2.00%
Expected dividend yield	0.00%	0.00%
Expected volatility	185.0% to 191.0%	192.0%
Weighted average expected life (contractual term) in years	6.0	5.5

Stock-based compensation expense related to stock options was recorded in selling, general and administrative expenses in the consolidated statements of operations and totaled \$289,329 and \$46,247 for the years ended December 31, 2018 and 2017, respectively.

As of December 31, 2018, stock-based compensation expense related to stock options of \$606,149 remains unamortized which is being amortized over the weighted average remaining period of 2.3 years.

Summary

A summary of the stock option activity during the years ended December 31, 2018 and 2017 is presented below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding, January 1, 2017	1,294,204	\$ 0.51		
Granted	100,000	0.22		
Exercised	(151,987)	0.12		
Forfeited	(220,872)	0.28		
Outstanding, December 31, 2017	1,021,345	\$ 0.59		
Granted	2,800,000	0.47		
Exercised	(10,000)	0.09		
Forfeited	(856,500)	0.61		
Outstanding, December 31, 2018	<u>2,954,845</u>	<u>\$ 0.47</u>	<u>8.1</u>	<u>\$ 90,133</u>
Exercisable, December 31, 2018	<u>1,004,845</u>	<u>\$ 0.60</u>	<u>5.8</u>	<u>\$ 90,133</u>

The following table presents information related to stock options outstanding and exercisable at December 31, 2018:

Range of Exercise Price	Options Outstanding		Options Exercisable		
	Weighted Average Exercise Price	Outstanding Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Life In Years	Exercisable Number of Options
\$0.09 - \$0.12	\$ 0.10	591,667	\$ 0.10	6.5	591,667
\$0.22 - \$0.35	0.34	917,728	0.27	8.2	167,728
\$0.53 - \$1.60	0.49	1,388,450	0.87	2.2	188,450
\$4.10 - \$6.99	5.80	57,000	5.80	3.1	57,000
\$0.09 - \$6.99	\$ 0.47	<u>2,954,845</u>	\$ 0.60	5.8	<u>1,004,845</u>

Warrants

Valuation

In applying the Black-Scholes option pricing model to stock warrants granted, the Company used the following weighted average assumptions:

Grants

	Year Ended December 31,	
	2018	2017
Risk-free interest rate	n/a	1.58% to 2.11%
Expected dividend yield	n/a	0.00%
Expected volatility	n/a	191.0% to 200.0%
Contractual term in years	n/a	5.00

During the year ended December 31, 2017, the Company issued to a financial consultant five-year warrants to purchase 93,367 shares of common stock at exercise prices ranging between \$0.33 and \$0.50 per share for an aggregate grant date value of \$33,131.

During the year ended December 31, 2017, the Company issued to a lender five-year warrants to purchase 35,000 shares of common stock at an exercise price of \$0.225 per share for a grant date value of \$7,100. See Note 6 – Notes Payable for additional information.

During the year ended December 31, 2017, the Company issued to a lender five-year warrants to purchase 240,000 shares of common stock at exercise prices ranging between \$0.35 and \$0.43 per share for an aggregate grant date value of \$77,391.

The weighted average fair value of the stock warrants granted during the year ended December 31, 2017 was \$0.32 per share.

Exercise

During the year ended December 31, 2018, the Company issued an aggregate of 811,719 shares of common stock to holders of 1,525,000 warrants upon exercise on a cashless basis. The warrants had an exercise price of \$0.25 per share. The aggregate intrinsic value of the warrants exercised was \$444,250 for the year ended December 31, 2018.

During the year ended December 31, 2017, the Company notified certain holders of warrants of an offer to exercise their warrants at a discounted exercise price of up to 80% of the existing exercise price of their warrants. As a result of the offer, the Company received proceeds of \$380,000 from the exercise of warrants to purchase an aggregate of 1,633,334 shares of common stock for cash, including 1,333,334 warrants exercised by a director of the Company. The warrants had exercise prices ranging between \$0.20 and \$0.24 per share. The aggregate intrinsic value of the warrants exercised was \$294,333 for the year ended December 31, 2017. The Company recognized inducement expense upon the acceptance of the offer which resulted in \$15,425 of expense included in the statement of operations for the year ended December 31, 2017.

As of December 31, 2018 and 2017, there was no stock-based compensation expense related to warrants that remains unamortized.

A summary of the stock warrant activity during the years ended December 31, 2018 and 2017, respectively, is presented below:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Life In Years	Aggregate Intrinsic Value
Outstanding, January 1, 2017	7,806,118	\$ 0.30		
Granted	368,367	0.39		
Exercised	(1,633,334)	0.29		
Forfeited	-	-		
Outstanding, December 31, 2017	<u>6,541,151</u>	<u>\$ 0.31</u>		
Granted	-	-		
Exercised	(1,525,000)	0.25		
Forfeited	(150,000)	0.35		
Outstanding, December 31, 2018	<u><u>4,866,151</u></u>	<u><u>\$ 0.33</u></u>	<u><u>1.0</u></u>	<u><u>\$ 7,487</u></u>
Exercisable, December 31, 2018	<u><u>4,866,151</u></u>	<u><u>\$ 0.33</u></u>	<u><u>1.0</u></u>	<u><u>\$ 7,487</u></u>

The following table presents information related to stock warrants at December 31, 2018:

Range of Exercise Price	Warrants Outstanding		Warrants Exercisable		
	Weighted Average Exercise Price	Outstanding Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Life In Years	Exercisable Number of Warrants
\$0.15 - \$0.25	\$ 0.23	326,120	\$ 0.23	1.3	326,120
\$0.30 - \$0.35	0.31	4,510,031	0.31	0.9	4,510,031
\$4.95	4.95	30,000	4.95	3.8	30,000
\$0.15 - \$4.95	\$ 0.33	<u>4,866,151</u>	\$ 0.33	1.0	<u>4,866,151</u>

8. Commitments and Contingent Liabilities

Capital Lease

On January 11, 2018, the Company entered a three-year lease agreement related to a forklift. The terms of the lease agreement require monthly payments of \$542 with the option to purchase the forklift on the lease termination date for \$1. The transaction was recognized as a fixed asset acquisition and capital lease obligation of \$18,030.

Operating Leases

The Company is a party to a lease agreement for office and storage space for its headquarters in Florence, Kentucky. On July 30, 2018, the Company entered into an amendment of the lease agreement which extended the lease for an additional five years to December 31, 2024. The amended monthly lease rate will range between \$7,955 and \$9,498.

The Company accounts for rent expense using the straight-line method of accounting, deferring the difference between actual rent due and the straight-line amount. Deferred rent payable of \$6,169 and \$2,850 as of December 31, 2018 and 2017, respectively, has been included in accrued expenses and other current liabilities on the consolidated balance sheets.

The Company was a party to a three-year lease for \$1,000 per month to house an office, pharmacy and inventory located in Lawrenceburg, Indiana, which had a termination date of June 7, 2018. In January 2014, the Company closed and vacated the Lawrenceburg facility. In August 2017, the Company paid \$3,000 cash to the landlord to settle the amounts owed under the lease and recognized a \$48,665 gain which is recorded in Other Expense within Selling, General and Administrative expenses in the Statements of Operations.

The aggregate future minimum lease payments for operating leases, excluding renewal periods, and capital leases as of December 31, 2018 were as follows:

	<u>Operating Leases</u>	<u>Capital Leases</u>
2019	\$ 96,887	\$ 6,508
2020	99,793	6,508
2021	102,787	-
2022	105,871	-
Thereafter	221,365	-
Total	<u>\$ 626,703</u>	<u>\$ 13,016</u>
Less: Amount representing interest		<u>(723)</u>
Present value of minimum lease payments		<u>\$ 12,293</u>

During the years ended December 31, 2018 and 2017, the Company recorded aggregate rent expense of \$120,460 and \$107,445, respectively.

Employment Agreement

On March 15, 2017, the Company entered into a settlement agreement (the “Settlement Agreement”) by and between the Company and Lalit Dhadphale (“Dhadphale”) relating to a claim filed by Dhadphale in Lalit Dhadphale v. Healthwarehouse.com, Inc., Boone County, Kentucky Circuit Court, Civil Action No. 16-CI-01628 (the “Complaint”) alleging failure to pay certain severance payments pursuant to the employment agreement by and between the Company and Dhadphale. Pursuant to the Settlement Agreement, the Company agreed to pay Dhadphale \$200,000 in return for a full release of any and all future claims and a dismissal with prejudice of the Complaint within seven business days of the execution of the Settlement Agreement. The Company has agreed to pay Mr. Dhadphale \$30,000 within sixty days of the execution of the Agreement with the remaining \$170,000 payable in equal semi-monthly payments over eighteen months beginning March 15, 2017. As of December 31, 2017, the Company had accrued \$72,986 related to this liability and as of December 31, 2018, the Company fully satisfied its obligations under the agreement.

Effective January 16, 2017, Mr. Jeffrey Holtmeier, resigned his position as Chief Executive Officer and a director of the Company. On January 19, 2017, the Company and Mr. Holtmeier entered into a Separation and Release Agreement in connection with his departure where Mr. Holtmeier was paid his current salary for the period up to and including the day which is thirty days after his resignation date. In addition, the Company paid Mr. Holtmeier a \$43,750 annual bonus for 2016 which was accrued as of December 31, 2016. The bonus was paid in ten equal monthly payments beginning February 1, 2017. In addition, as of December 31, 2016, the Company had accrued \$66,950 of costs related to Mr. Holtmeier’s out-of-pocket expenses which was paid in ten equal monthly payments during 2017.

On January 18, 2017, the Board of Directors of the Company appointed John C. Pauly as the Chief Operating Officer and interim President and Chief Executive Officer of the Company. Subsequently, the Company and Mr. Pauly entered into a written agreement outlining compensation and other terms of Mr. Pauly’s employment by which Mr. Pauly was to be paid an annual salary of \$100,000. The term of Mr. Pauly’s employment with the Company was to be for a period commencing on January 18, 2017, and continuing through the close of business on December 31, 2017, unless and until terminated as provided. Effective March 31, 2017, Mr. Pauly resigned from the Company.

On July 10, 2017, the Company entered into an employment agreement with Mr. Joseph Peters. The terms of the Employment Agreement include the titles and positions of Interim Chief Executive Officer and President, an initial base salary of \$104,000 per year, subject to certain bonus and severance provisions. In addition, the Company granted to Mr. Peters stock options to purchase an aggregate of 100,000 shares of common stock under a previously approved plan at exercise price of \$0.22 per share for an aggregate grant date value of \$21,493. Mr. Peters’ agreement was bound by restrictive covenants regarding disclosure of confidential information, non-solicitation and employee non-competition.

Effective January 1, 2018, the Company entered into employment agreements with Joseph Peters and Daniel Seliga contracts (the “Employment Agreements”). The terms of the Employment Agreement include a term of one year beginning on January 1, 2018 with an extension provision allowing for automatic one-year extensions, the titles and positions of Chief Executive Officer and Chief Financial Officer, respectively, an initial base salary of \$100,000 per year, subject to certain bonus and severance provisions. Each of the Employment Agreements are bound by restrictive covenants regarding disclosure of confidential information, non-solicitation and employee non-competition.

Litigation

In the ordinary course of business, we may become subject to lawsuits and other claims and proceedings that might arise from litigation matters or regulatory audits. Such matters are subject to uncertainty and outcomes are often not predictable with assurance. Our management does not presently expect that any current outstanding matters will have a material adverse effect on the Company’s consolidated financial condition or consolidated results of operations. We are not currently involved in any pending or threatened material litigation or other material legal proceedings nor have we been made aware of any penalties from regulatory audits, except as described below.

Taft Stettinius & Hollister LLC (“Taft”) filed a complaint against the Company on May 13, 2016 in the Hamilton County Court of Common Pleas, Case No. A1602800, alleging the Company owes legal fees and costs in the amount of

\$935,392, together with accrued prejudgment interest. The Company answered the complaint, denying the material allegations therein, and asserted several affirmative defenses, including excessive legal fees and charges, unauthorized and improper fees, and related defects in performance by Taft. On September 29, 2017, the Company announced that it had reached agreement with Taft for the settlement and resolution of all claims. As part of the settlement agreement, the Company paid \$950,000 to Taft on December 6, 2017.

On April 9, 2018, the Company and its President and Chief Executive Officer were named in a legal complaint filed in the United States District Court by a former employee alleging, among other items, violation of the Fair Labor Standards Act, breach of contract and unjust enrichment related to nonpayment of commissions and overtime compensation and requesting a judgment in excess of \$500,000. The suit is in the early stages and, as such, any potential liability cannot be determined at this time. Management believes that the Plaintiff's claims are groundless and we intend to contest this matter vigorously.

9. Concentrations

The Company maintains deposits in financial institutions which are insured by the Federal Deposit Insurance Corporation ("FDIC"). At various times, the Company has deposits in these financial institutions in excess of the amount insured by the FDIC.

During the year ended December 31, 2018, three suppliers represented 29%, 25% and 21% of total inventory purchases. During the year ended December 31, 2017, three suppliers represented 32%, 27% and 15% of total inventory purchases.

10. Related Party Transactions

On October 3, 2016, the Company reached a settlement with a related party in regard to certain balances of accounts receivables from and accounts payable to the related party. The Company agreed to pay \$77,606, payable in twenty-four monthly payments of \$3,234, with no interest, beginning October 15, 2016. The Company made payments of \$29,103 and \$38,803 in related to this payable during the years ended December 31, 2018 and 2017, respectively.

The Company was a party to a master services agreement for information technology and marketing analytics projects with a company that Mr. Jeff T. Holtmeier, the Company's former President and Chief Executive Officer, holds a minority ownership interest and chairman of its board of directors. During the years ended December 31, 2017 and 2016, the Company incurred \$87,704 and \$49,376 of costs under the agreement, respectively, which were recognized as web development costs. Amounts due under this agreement of approximately \$4,000 have been included in accounts payable as of December 31, 2017. The agreement terminated on December 31, 2017.

11. Income Taxes

The income tax provision (benefit) for the years ended December 31, 2018 and 2017 was as follows:

	Year Ended December 31,	
	2018	2017
Federal:		
Current	\$ 7,642	\$ -
Deferred	(109,066)	2,548,015
State and local:		
Current	-	-
Deferred	56,423	(65,238)
	(45,001)	2,482,777
Change in valuation allowance	52,643	(2,482,777)
Income tax provision (benefit)	<u>\$ 7,642</u>	<u>\$ -</u>

The effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 31, 2018 and 2017 are as follows:

	December 31,	
	2018	2017
Deferred tax assets:		
Net operating loss carryforwards	\$ 4,012,472	\$ 3,912,308
Stock-based compensation	469,178	483,067
Inventory reserves	7,040	5,989
Allowance for bad debt	-	-
Deferred Revenue	1,100	2,884
Deferred Rent	1,542	734
Charitable contribution carryforwards	-	234
Accruals	-	15,284
Total deferred tax assets	<u>4,491,332</u>	<u>4,420,500</u>
Valuation allowance	(4,456,325)	(4,403,683)
Deferred tax assets, net of valuation allowance	<u>35,007</u>	<u>16,817</u>
Deferred tax liabilities:		
Property and equipment	(35,007)	(15,183)
Web development	-	(1,634)
Deferred tax liabilities	<u>\$ (35,007)</u>	<u>\$ (16,817)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>
Change in valuation allowance	<u>\$ 52,643</u>	<u>\$ (2,482,777)</u>

The Company assesses the likelihood that deferred tax assets will be realized. To the extent that realization is not likely, a valuation allowance is established. While the Company has had a history of generating losses, the Company operated at a profit in 2017. Management believes that it is more likely than not that all of the future benefits of deferred tax assets may not be realized and has established a full valuation allowance for the years ended December 31, 2018 and 2017.

The Company files income tax returns in the U.S. Federal jurisdiction and various state and local jurisdictions, and its federal, state and local income tax returns for the tax years beginning in 2012 remain subject to examination. The Company does not currently have any Federal or State audit examinations in process by taxing authorities. The Company is in the process of filing its federal and state tax returns for the year ended December 31, 2018. When these returns are filed for the year ended December 31, 2018, the Company will have \$17,205,159 and \$16,548,522 of federal net operating loss carryforwards that may be available to offset future taxable income as of December 31, 2018 and 2017, respectively. The federal net operating loss carryforwards generated prior to 2018, if not utilized, will expire from 2028 to 2037. The federal net operating loss carryforwards generated in 2018 will carryforward indefinitely. As of December 31, 2018 and 2017, the Company had approximately \$9,984,721 and \$9,337,347 of state net operating loss carryforwards available to offset future taxable income. The state NOLs, if not utilized, will expire beginning in 2031.

In accordance with Section 382 of the Internal Revenue code, the usage of the Company's net operating loss carryforwards could be limited in the event of a change in ownership. Based upon a study that analyzed the Company's stock ownership, a change of ownership was deemed to have occurred in 2011. This change of ownership created an annual limitation on the usage of the Company's losses which are available through 2031. A full Section 382 analysis has not been prepared since 2011 and any NOLs arising since 2011 could be subject to limitation under Section 382.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (“TCJA”). The TCJA made broad and complex changes to the U.S. tax code including, but not limited to, a reduction of the federal income tax rate from 35% to 21% effective for tax years beginning after December 31, 2017. This change required the Company to remeasure our deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which generally is 21% for federal income tax purposes. As permitted by the SEC Staff Accounting Bulletin 118, “Income Tax Accounting Implications of the Tax Cuts and Jobs Act”, we recorded a provisional estimate of the effects from TCJA on our existing deferred tax balances as of December 31, 2017, and recognized a provisional amount of \$2.4 million. Since the Company had a full valuation allowance, there was no impact to income tax expense. After further analysis, we do not have any material subsequent adjustments to the amounts booked as of December 31, 2017.

For the years ended December 31, 2018 and 2017, the expected tax expense (benefit) based on the statutory rate is reconciled with the actual tax expense (benefit) as follows:

	Year Ended December 31,	
	2018	2017
US federal statutory rate	(21.0%)	34.0%
State tax rate, net of federal benefit	(4.0%)	4.0%
Permanent differences:		
Stock based compensation	8.9%	4.7%
Other	(0.1%)	2.2%
Change in Federal Tax Rate	0.0%	622.9%
Change in State Tax Rate	10.7%	0.0%
Change in valuation allowance	6.4%	(667.8%)
Income tax provision (benefit)	<u>0.9%</u>	<u>0.0%</u>

12. Subsequent Events

The Company evaluates events that have occurred after the balance sheet date but before the financial statements are issued. Based upon the evaluation, the Company did not identify any recognized or non-recognized subsequent events that would have required adjustment or disclosure in the consolidated financial statements, except as disclosed.

Issuance of Common Stock to Directors

On January 8, 2019, the Company issued an aggregate of 213,708 shares of common stock to directors of the Company for payment of their accrued noncash portion of their director’s fees for the fourth quarter of 2018. The shares had an aggregate grant date value of \$53,000 and were valued at \$0.25 per share, which was the 30 day weighted average closing price for the Company’s common stock on the date of grant. Such amount is included in accrued expenses as other liabilities as of December 31, 2018.

Issuance of Common Stock to Executives

On February 11, 2019, the Company issued 486,381 shares of common stock to executives of the Company for payment of the noncash portion of their bonus for 2018 per the terms of their employment agreements. The shares had a grant date value of \$125,000 and were valued at \$0.26 per share, which was the 30 day weighted average closing price for the Company’s common stock on the date of grant. Such amount is included in accrued expenses as other liabilities as of December 31, 2018.

Extension of Kapok & Melrose Promissory Notes

On March 20, 2019, the Company entered into amendments to the Promissory Notes provided by Kapok Ventures and Melrose Capital Advisors. The amendments extended the maturity date for both promissory notes from March 31, 2019 to September 30, 2019. The remaining terms of the Kapok and Melrose Promissory Notes were not modified. The Company received a waiver from the majority holder of the Series B convertible preferred stock prior to executing the amendment.

Litigation

On March 6, 2019, the Company was named in a class action complaint filed against the Company in the United States District Court by Kevin Garey alleging, among other items, violation of the Americans with Disabilities Act, claiming the Company's website is not fully accessible and independently usable to a visually impaired and legally blind individual. The suit is in the early stages and, as such, any potential liability cannot be determined at this time. Management and its legal counsel are reviewing and assessing the Plaintiff's claims to prepare a response.

Issuance of Options to Employee and Executives

On March 12, 2019, the Company granted stock options to purchase an aggregate of 1,250,000 shares of common stock under a previously issued incentive plan to an employee and two executives of the Company as recognition of their contributions to the Company. The options had an exercise price of \$0.32 per share. The options vest over a three-year period and have a term of ten years. The options were issued to the executives were replacements for the options issued to the same executives in January 2018.