

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2016

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

For the transition period from _____ to _____

Commission file number 001-10196**AFTERMASTER, INC.**

(Exact name of Registrant as specified in its charter)

DELAWARE**23-2517953**

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

**6671 Sunset Blvd., Suite 1520
Hollywood, CA 90028**

(Address of principal executive offices) (Zip Code)

(310) 657-4886

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

☒ Yes ☐ No (Not required)

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

Large accelerated filer

☐

Accelerated filer

☐

Non-accelerated filer

☐

Smaller reporting company

☒

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

☐ Yes ☒ No

At February 14, 2017, the number of shares outstanding of Common Stock, \$0.001 par value, was 109,540,477 shares.

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PART I - FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS.**

AFTERMASTER, INC.
Consolidated Balance Sheets

	December 31, 2016 (Unaudited)	June 30, 2016
<u>ASSETS</u>		
Current Assets		
Cash	\$ 224,120	\$ 394,325
Accounts receivable, net	17,198	11,389
Inventory	330,077	-
Available for sale securities	48,000	63,600
Prepaid expenses	804,778	1,078,819
Total Current Assets	<u>1,424,173</u>	<u>1,548,133</u>
Property and equipment, net	318,994	294,557
Intangible assets, net	117,024	99,186
Deposits	33,363	33,363
Prepaid expenses, net of current	<u>13,623</u>	<u>18,217</u>
Total Assets	<u><u>\$ 1,907,177</u></u>	<u><u>\$ 1,993,456</u></u>
<u>LIABILITIES AND STOCKHOLDERS' DEFICIT</u>		
Current Liabilities		
Accounts payable and other accrued expenses	\$ 244,069	\$ 225,001
Accrued interest	105,047	77,335
Deferred revenue	762,658	740,200
Accrued consulting services - related party	47,066	28,561
Lease payable	22,536	984
Notes payable - related party	580,000	575,000
Notes payable	40,488	40,488
Convertible notes payable - related party	3,925,000	3,925,000
Convertible notes payable, net of discount of \$6,495 and \$22,282, respectively	<u>2,131,269</u>	<u>1,029,718</u>
Total Current Liabilities	7,858,133	6,642,287
Total Liabilities	<u>7,858,133</u>	<u>6,642,287</u>
Stockholders' Deficit		
Convertible preferred stock, Series A; \$0.001 par value; 100,000 shares authorized, 15,500 shares issued and outstanding	16	16
Convertible preferred stock, Series A-1; \$0.001 par value; 3,000,000 shares authorized 2,735,000 and 2,185,000 shares issued and outstanding, respectively	2,735	2,185
Convertible preferred stock, Series B; \$0.001 par value; 200,000 shares authorized, 3,500 shares issued and outstanding	3	3
Convertible preferred stock, Series C; \$0.001 par value; 1,000,000 shares authorized, 13,404 shares issued and outstanding	13	13
Convertible preferred stock, Series D; \$0.001 par value; 375,000 shares authorized, 130,000 shares issued and outstanding	130	130
Convertible preferred stock, Series E; \$0.001 par value; 1,000,000 shares authorized,	275	275

275,000 shares issued and outstanding		
Convertible preferred stock, Series P; \$0.001 par value; 600,000 shares authorized, 86,640 shares issued and outstanding	87	87
Convertible preferred stock, Series S; \$0.001 par value; 50,000 shares authorized, -0- shares issued and outstanding	-	-
Common stock, authorized 250,000,000 shares, par value \$0.001; 108,854,548 and 102,133,344 shares issued and outstanding, respectively	108,861	102,140
Additional paid In capital	62,070,833	58,997,912
Accumulated other comprehensive income	18,000	33,600
Accumulated Deficit	<u>(68,151,909)</u>	<u>(63,785,192)</u>
Total Stockholders' Deficit	<u>(5,950,956)</u>	<u>(4,648,831)</u>
Total Liabilities and Stockholders' Deficit	<u>\$ 1,907,177</u>	<u>\$ 1,993,456</u>

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

AFTERMASTER, INC.
Consolidated Statements of Operations
(Unaudited)

	For the Three Months Ended		For the Six Months Ended	
	December 31,	December 31,	December 31,	December 31,
	2016	2015	2016	2015
REVENUES				
AfterMaster Revenues	48,739	36,154	\$ 103,225	\$ 55,934
Licensing Revenues	-	-	-	1,800,000
Total Revenues	<u>48,739</u>	<u>36,154</u>	<u>103,225</u>	<u>1,855,934</u>
COSTS AND EXPENSES				
Cost of Revenues (Exclusive of Depreciation and Amortization)	157,680	108,949	319,775	202,083
Depreciation and Amortization Expense	45,015	17,983	85,554	35,001
Research and Development	26,020	42,300	93,015	69,085
Advertising and Promotion Expense	2,565	142,867	17,644	144,385
Legal and Professional Expense	30,804	130,678	55,070	257,412
Non-Cash Consulting Expense	659,938	1,307,966	1,531,909	2,187,511
General and Administrative Expenses	915,206	980,387	1,628,042	2,112,369
Total Costs and Expenses	<u>1,837,228</u>	<u>2,731,130</u>	<u>3,731,009</u>	<u>5,007,846</u>
Loss from Operations	<u>(1,788,489)</u>	<u>(2,694,976)</u>	<u>(3,627,784)</u>	<u>(3,151,912)</u>
Other Expense				
Interest Expense	(378,522)	(250,345)	(747,595)	(430,725)
Change in Fair Value of Derivative	(463)	-	(574)	4,374,585
Loss on Available for Sale Securities	-	(1,770,000)	-	(1,770,000)
Gain Loss on Extinguishment of Debt	9,236	47,897	9,236	143,344
Total Other Expense	<u>(369,749)</u>	<u>(1,972,448)</u>	<u>(738,933)</u>	<u>2,317,204</u>
Loss Before Income Taxes	<u>(2,158,238)</u>	<u>(4,667,424)</u>	<u>(4,366,717)</u>	<u>(834,708)</u>
Income Tax Expense	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
NET LOSS	<u>\$ (2,158,238)</u>	<u>\$ (4,667,424)</u>	<u>\$ (4,366,717)</u>	<u>\$ (834,708)</u>
Preferred Stock Accretion and Dividends	<u>(45,620)</u>	<u>(16,789)</u>	<u>(87,858)</u>	<u>(19,427)</u>
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	<u>\$ (2,203,858)</u>	<u>\$ (4,684,213)</u>	<u>\$ (4,454,575)</u>	<u>\$ (854,135)</u>
Basic and diluted Loss Per Share of Common Stock	<u>\$ (0.02)</u>	<u>\$ (0.05)</u>	<u>\$ (0.04)</u>	<u>\$ (0.01)</u>
Weighted Average Number of Shares Outstanding	<u>104,726,332</u>	<u>98,587,644</u>	<u>104,045,562</u>	<u>97,041,083</u>
Other Comprehensive Income, net of tax				
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	<u>(2,203,858)</u>	<u>(4,684,213)</u>	<u>(4,454,575)</u>	<u>(854,135)</u>
Unrealized loss on AFS Securities	<u>(39,000)</u>	<u>-</u>	<u>(15,600)</u>	<u>-</u>
COMPREHENSIVE LOSS	<u>\$ (2,242,858)</u>	<u>\$ (4,684,213)</u>	<u>\$ (4,470,175)</u>	<u>\$ (854,135)</u>

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

AFTERMASTER, INC.
Consolidated Statements of Cash Flows
(Unaudited)

	For the Six Months Ended December 31,	
	<u>2016</u>	<u>2015</u>
OPERATING ACTIVITIES		
Net Loss	\$ (4,366,717)	\$ (834,708)
Adjustments to reconcile net loss to cash from operating activities:		
Depreciation and amortization	85,554	35,001
Share-based compensation - Common Stock	218,538	158,537
Share-based compensation - warrants and options	23,976	-
Share-based compensation - warrants	13,204	452,960
Common stock issued for services and rent	18,897	208,959
Common stock issued for preferred dividends	-	11,981
Common stock issued to extend the maturity dates on debt	120,000	-
Amortization of debt discount and issuance costs	152,513	22,527
Closing fees	-	15,000
(Gain)/Loss on extinguishment of debt	(9,236)	(143,344)
Gain (loss) remeasurement of derivative	574	(4,374,585)
Loss on Available for Sale Securities	-	1,770,000
Licensing Revenue from the issuance of AFS Securities	-	(1,800,000)
Changes in Operating Assets and Liabilities:		
Accounts receivables	(5,809)	(3,515)
Inventory	(330,077)	-
Other assets	1,086,909	1,675,938
Accounts payable and accrued expenses	19,068	320,304
Accrued interest	437,950	(7,564)
Deferred revenue	22,458	301,805
Accrued consulting services - related party	18,505	1,891
Net Cash Used in Operating Activities	<u>(2,493,693)</u>	<u>(2,188,813)</u>
INVESTING ACTIVITIES		
Purchase of property and equipment	(96,029)	(24,825)
Purchase of intangible assets	<u>(31,800)</u>	<u>-</u>
Net Cash Used in Investing Activities	<u>(127,829)</u>	<u>(24,825)</u>
FINANCING ACTIVITIES		
Offering costs for Common shares sold	-	(104,910)
Common Stock issued for cash, conversion of options/warrants	906,224	-
A-1 Preferred Stock issued for cash	373,541	439,000
Proceeds from convertible notes payable - related party	17,500	-
Repayments of convertible notes payable - related party	(12,500)	-
Proceeds from convertible notes payable	1,160,000	585,000
Repayments of convertible notes payable	(15,000)	(17,500)
Lease Payable	21,552	(19,978)
Net Cash Provided by Financing Activities	<u>2,451,317</u>	<u>881,612</u>
NET CHANGE IN CASH	(170,205)	(1,332,026)
CASH AT BEGINNING OF PERIOD	<u>394,325</u>	<u>2,185,702</u>

CASH AT END OF PERIOD	\$ 224,120	\$ 853,676
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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

CASH PAID FOR:

Interest	\$ -	\$ -
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NON CASH FINANCING ACTIVITIES:

Beneficial conversion feature	\$ 30,519	\$ -
Conversion of notes and Interest into common stock	\$ 580,238	\$ 783,606
Conversion of preferred stock for common stock	\$ -	\$ 50
Conversion of Derivative Liability	\$ 73,432	\$ 8,443,357
MTM on AFS securities	\$ 15,600	\$ -
Common stock issued with convertible debt	\$ 33,349	\$ -
Common stock issued for prepaid expenses	\$ 808,274	\$ -
Derivative liability	\$ 72,858	\$ -
Original Issue Discount	\$ -	\$ 100,000
Finder's Fee	\$ -	\$ 35,000

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

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 1 – CONDENSED FINANCIAL STATEMENTS

The accompanying financial statements have been prepared by the Company without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows at December 31, 2016, and for all periods presented herein, have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's June 30, 2016 audited financial statements. The results of operations for the periods ended December 31, 2016 and 2015 are not necessarily indicative of the operating results for the full years.

NOTE 2 – GOING CONCERN

The Company's financial statements are prepared using generally accepted accounting principles in the United States of America applicable to a going concern which contemplates the realization of assets and liquidation of liabilities in the normal course of business. The Company has an accumulated deficit of \$68,151,909, negative working capital of \$6,433,960, and currently has revenues which are insufficient to cover its operating costs, which raises substantial doubt about its ability to continue as a going concern. The Company has not yet established an ongoing source of revenues sufficient to cover its operating costs and allow it to continue as a going concern.

The future of the Company as an operating business will depend on its ability to (1) obtain sufficient capital contributions and/or financing as may be required to sustain its operations and (2) to achieve adequate revenues from its ProMaster and AfterMaster businesses. Management's plan to address these issues includes, (a) continued exercise of tight cost controls to conserve cash, (b) obtaining additional financing, (c) more widely commercializing the AfterMaster and ProMaster products, and (d) identifying and executing on additional revenue generating opportunities.

The ability of the Company to continue as a going concern is dependent upon its ability to successfully accomplish the plans described in the preceding paragraph and eventually secure other sources of financing and attain profitable operations. The accompanying financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern. If the Company is unable to obtain adequate capital, it could be forced to cease operations.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Significant estimates are made in relation to the allowance for doubtful accounts and the fair value of certain financial instruments.

Principles of Consolidation

The consolidated financial statements include the accounts of AfterMaster, Inc. and its subsidiaries. All significant inter-Company accounts and transactions have been eliminated.

Investments

Our available for securities are considered Level 1. Realized gains and losses on these securities are included in "Other income (expense) – net" in the consolidated statements of income using the specific identification method. Unrealized gains and losses, on available-for-sale securities are recorded in accumulated other comprehensive income (accumulated OCI). Unrealized losses that are considered other than temporary are recorded in other income (expense) – net, with the corresponding reduction to the carrying basis of the investment.

Our short-term investments are recorded at amortized cost, and the respective carrying amounts approximate fair values. Our available for securities maturing within one year are recorded in "Other current assets," on the balance sheets.

Accounts Receivables

Accounts receivables are stated at amounts management expects to collect. An allowance for doubtful accounts is provided for uncollectible receivables based upon management's evaluation of outstanding accounts receivable at each reporting period considering historical experience and customer credit quality and delinquency status. Delinquency status is determined by contractual terms. Bad debts are written off against the allowance when identified.

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Fair Value Instruments

Cash is the Company's only financial asset or liability required to be recognized at fair value and is measured using quoted prices for active markets for identical assets (Level 1 fair value hierarchy). The carrying amounts reported in the balance sheets for accounts receivable and accounts payable and accrued expenses approximate their fair market value based on the short-term maturity of these instruments.

The fair value of the Company's notes payable at December 31, 2016 is approximately \$6,676,757. Market prices are not available for the Company's loans due to related parties or its other notes payable, nor are market prices of similar loans available. The Company determined that the fair value of the notes payable based on its amortized cost basis due to the short term nature and current borrowing terms available to the Company for these instruments.

Reclassification

Certain amounts in the prior period financial statements have been reclassified to conform to the current period presentation. These reclassifications had no effect on reported losses.

Derivative Liabilities

The Company has financial instruments that are considered derivatives or contain embedded features subject to derivative accounting. Embedded derivatives are valued separately from the host instrument and are recognized as derivative liabilities in the Company's balance sheet. The Company measures these instruments at their estimated fair value and recognizes changes in their estimated fair value in results of operations during the period of change. The Company has a sequencing policy regarding share settlement wherein instruments with the earliest issuance date would be settled first. The sequencing policy also considers contingently issuable additional shares, such as those issuable upon a stock split, to have an issuance date to coincide with the event giving rise to the additional shares.

Using this sequencing policy, the Company used this sequencing policy, all instruments convertible into common stock, including warrants and the conversion feature of notes payable, issued subsequent to July 5, 2016 until the note was converted on the same day were derivative liabilities. The Company again used this sequencing policy, all instruments convertible into common stock, including warrants and the conversion feature of notes payable, issued subsequent to August 19, 2016 until the note was converted on August 22, 2016 were derivative liabilities.

The Company values these convertible notes payable using the multinomial lattice method that values the derivative liability within the notes based on a probability weighted discounted cash flow model. The resulting liability is valued at each reporting date and the change in the liability is reflected as change in derivative liability in the statement of operations.

Income Taxes

There is no income tax provision for the six months ended December 31, 2016 and 2015 due to net operating losses for which there is no benefit currently available.

At December 31, 2016, the Company had deferred tax assets associated with state and federal net operating losses. The Company has recorded a corresponding full valuation allowance as it is more likely than not that some portion of all of the deferred tax assets will not be realized.

Revenue Recognition

The Company applies the provisions of FASB ASC 605, *Revenue Recognition in Financial Statements*, which provides guidance on the recognition, presentation and disclosure of revenue in financial statements. ASC 605 outlines the basic criteria that must be met to recognize revenue and provides guidance for disclosure related to revenue recognition policies. In general, the Company recognizes revenue related to goods and services provided when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the fee is fixed or determinable, and (iv) collectability is reasonably assured.

Loss Per Share

Basic earnings (loss) per Common Share is computed by dividing losses attributable to Common shareholders by the weighted-average number of shares of Common Stock outstanding during the period. The losses attributable to Common shareholders was increased for accrued and deemed dividends on Preferred Stock during the three and six months ended December 31, 2016 and 2015 of \$45,620 and \$16,789 and \$87,858 and \$19,427, respectively.

Diluted earnings per Common Share is computed by dividing income (loss) attributable to Common shareholders by the weighted-average number of Shares of Common Stock outstanding during the period increased to include the number of additional Shares of Common Stock that would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding convertible Preferred Stock, stock options, warrants, and convertible debt. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's Common Stock can result in a greater dilutive effect from potentially dilutive securities.

AFTERMASTER, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and June 30, 2016

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

For the six months ended December 31, 2016 and 2015, all of the Company's potentially dilutive securities (warrants, options, convertible preferred stock, and convertible debt) were excluded from the computation of diluted earnings per share as they were anti-dilutive. The total number of potentially dilutive Common Shares that were excluded were 26,336,572 and 13,658,151 at December 31, 2016 and 2015, respectively.

Recent Accounting Pronouncements

Management has considered all recent accounting pronouncements issued since the last audit of our consolidated financial statements. The Company's management believes that these recent pronouncements will not have a material effect on the Company's consolidated financial statements.

NOTE 4 – SECURITIES AVAILABLE-FOR-SALE

On November 10, 2014, the Company received 600,000 shares of b Booth stock as part of an Asset License agreement with b Booth. The following table presents the amortized cost, gross unrealized gains, gross unrealized losses, and fair market value of available-for-sale equity securities, nearly all of which are attributable to the Company's investment in b Booth stock, as follows:

	December 31, 2016					
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Gross realized gains	Gross realized losses	Fair value
Equity securities	\$ 63,600	\$ -	\$ (15,600)	\$ -	\$ -	\$ 48,000

	June 30, 2016					
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Gross realized gains	Gross realized losses	Fair value
Equity securities	\$ 1,800,000	33,600	\$ -	\$ -	\$ (1,770,000)	\$ 63,600

NOTE 5 – NOTES PAYABLEConvertible Notes Payable

In accounting for its convertible notes payable, proceeds from the sale of a convertible debt instrument with Common Stock purchase warrants are allocated to the two elements based on the relative fair values of the debt instrument without the warrants and of the warrants themselves at time of issuance. The portions of the proceeds allocated to the warrants are accounted for as paid-in capital with an offset to debt discount. The remainder of the proceeds are allocated to the debt instrument portion of the transaction as prescribed by ASC 470-25-20. The Company then calculates the effective conversion price of the note based on the relative fair value allocated to the debt instrument to determine the fair value of any beneficial conversion feature ("BCF") associated with the convertible note in accordance with ASC 470-20-30. The BCF is recorded to additional paid-in capital with an offset to debt discount. Both the debt discount related to the issuance of warrants and related to a BCF is amortized over the life of the note.

Convertible Notes Payable – Related Parties

Convertible notes payable due to related parties consisted of the following as of December 31, 2016 and June 30, 2016, respectively:

Convertible Notes Payable – Related Parties

	December 31, 2016	June 30, 2016
Various term notes with total face value of \$3,925,000 issued from February 2010 to April 2013, interest rates range from 10% to 15%, net of unamortized discount of \$0 as of December 31, 2016 and June 30, 2016.	\$ 3,925,000	\$ 3,925,000
Total convertible notes payable – related parties	3,925,000	3,925,000

2/15/2017	Blueprint		
Less current portion		<u>3,925,000</u>	<u>3,925,000</u>
Convertible notes payable – related parties, long-term		<u>\$ -</u>	<u>\$ -</u>

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 5 – NOTES PAYABLE - continued

The notes were amended on February 15, 2016 to March 16, 2016. The Company evaluated amendment under ASC 470-50, “*Debt - Modification and Extinguishment*”, and concluded that the extension did not result in significant and consequential changes to the economic substance of the debt and thus resulted in a modification of the debt and not extinguishment of the debt.

Convertible Notes Payable - Non-Related Parties

Convertible notes payable due to non-related parties consisted of the following as of December 31, 2016 and June 30, 2016, respectively:

	December 31, 2016	June 30, 2016
\$15,000 face value, issued in October 2011, interest rate of 10% and a default rate of 15%, matures in June 2012, net of unamortized discount of \$0 as of December 31, 2016 and June 30, 2016, respectively. The note is currently in default.	\$ 15,000	\$ 15,000
\$50,000 face value of which \$50,000 was converted.	-	50,000
\$20,000 face value, issued in June 2014, interest rate of 6%, matures December 2014, net unamortized discount of \$0 as of December 31, 2016 and June 30, 2016, respectively. The note is currently in default.	20,000	20,000
\$7,000 face value, issued in July 2014, interest rate of 6%, matures October 2014, net unamortized discount of \$0 as of December 31, 2016 and June 30, 2016, respectively. The note is currently in default.	7,000	7,000
\$100,000 face value, issued in October 2015, interest rate of 6%, matures February 2017.	100,000	100,000
\$600,000 face value, issued in November 2015, interest rate of 0%, an OID of \$100,000, matures Jan 2017, net unamortized discount of \$0 of December 31, 2016 and June 30, 2016, respectively.	600,000	600,000
\$100,000 face value, issued in February 2016, interest rate of 10%, matures February 2017, net unamortized discount of \$438 and \$2,993 as of December 31, 2016 and June 30, 2016, respectively.	99,562	97,007
\$15,000 face value, issued in February 2016, interest rate of 10%, matures February 2017, net unamortized discount of \$65 and \$462 as of December 31, 2016 and June 30, 2016, respectively.	14,935	14,538
\$25,000 face value, issued in February 2016, interest rate of 10%, matures February 2017, net unamortized discount of \$110 and \$3,354 as of December 31, 2016 and June 30, 2016, respectively.	24,890	21,646
\$10,000 face value, issued in February 2016, interest rate of 10%, matures February 2017, net unamortized discount of \$147 and \$1,382 as of December 31, 2016 and June 30, 2016, respectively.	9,853	8,618
\$100,000 face value, issued in March 2016, interest rate of 10%, matures March 2017, net unamortized discount of \$5,214 and \$13,765 as of December 31, 2016 and June 30, 2016, respectively.	94,786	86,235
\$10,000 face value, issued in March 2016, interest rate of 10%, matures March 2017, net unamortized discount of \$521 and \$462 and \$326 as of December 31, 2016 and June 30, 2016, respectively.	9,479	9,674
\$50,000 face value, issued in July 2016, interest rate of 0%, matures January 2017, a gain on extinguishment of debt was recorded totaling \$5,418 net unamortized discount of \$0 as of December 31, 2016.	44,582	-

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 5 – NOTES PAYABLE - continued

\$30,000 face value, issued in August 2016, interest rate of 0%, matures January 2017, net unamortized discount of \$0 as of December 31, 2016.	15,000	-
\$50,000 face value, issued in August 2016, interest rate of 0%, matures August 2017.	50,000	-
\$30,000 face value, issued in August 2016, interest rate of 0%, matures January 2017, a gain on extinguishment of debt was recorded totalling \$3,818 net unamortized discount of \$0 as of December 31, 2016. The note is currently in default.	26,182	-
\$1,000,000 face value, issued in September 2016, interest rate of 10%, matures December 2016, net unamortized discount of \$0 as of December 31, 2016.	1,000,000	-
Total convertible notes payable – non-related parties	2,131,269	1,029,718
Less current portion	2,131,269	1,029,718
Convertible notes payable – non-related parties, long-term	<u>\$ -</u>	<u>\$ -</u>

On October 27, 2015, the Company issued a convertible note to an unrelated individual for \$100,000 that matures on February 27, 2016. The note bears interest rate of 6% per annum and is convertible into shares of the Company's Common stock at \$0.50 per share. The note was amended on May 23, 2016 to extend the maturity date to July 23, 2016 and amended again on November 15, 2016 to extend the maturity date to January 31, 2017. The Company evaluated amendment under ASC 470-50, "*Debt - Modification and Extinguishment*", and concluded that the extension did not result in significant and consequential changes to the economic substance of the debt and thus resulted in a modification of the debt and not extinguishment of the debt. The note is currently in default.

On July 26, 2016, the Company issued a convertible note to an unrelated individual for \$50,000 that matures on September 26, 2016. The note bears interest rate of 0% per annum and is convertible into shares of the Company's Common stock at \$0.40 per share, as part of the note the company issued options to purchase 35,000 shares of 144 restricted common stock at an exercise price \$0.50 for a two-year period. The note was amended on November 21, 2016 to extend the maturity date to January 31, 2017. The Company evaluated amendment under ASC 470-50, "*Debt - Modification and Extinguishment*", and concluded that the extension did result in significant and consequential changes to the economic substance of the debt and thus resulted in a extinguishment of the debt and not modification of the debt resulting in a gain on extinguishment of debt of \$5,418. The note is currently in default.

On August 08, 2016, the Company issued a convertible note to an unrelated individual for \$30,000 that matures on October 08, 2016. The note bears interest rate of 0% per annum and is convertible into shares of the Company's Common stock at \$0.40 per share, as part of the note the company issued options to purchase 21,000 shares of 144 restricted common stock at an exercise price \$0.50 for a two-year period. The note was amended on November 21, 2016 to extend the maturity date to January 31, 2017. The Company evaluated amendment under ASC 470-50, "*Debt - Modification and Extinguishment*", and concluded that the extension did not result in significant and consequential changes to the economic substance of the debt and thus resulted in a extinguishment of the debt and not modification of the debt resulting in a gain on extinguishment of debt of \$3,818. The note is currently in default.

On August 11, 2016, the Company issued a convertible note to an unrelated individual for \$30,000 that matures on October 11, 2016. The note bears interest rate of 0% per annum and is convertible into shares of the Company's Common stock at \$0.40 per share, as part of the note the company issued options to purchase 21,000 shares of 144 restricted common stock at an exercise price \$0.50 for a two-year period. The Company paid \$15,000 of principal. The note was amended on November 15, 2016 to extend the maturity date to January 31, 2017. The Company evaluated amendment under ASC 470-50, "*Debt - Modification and Extinguishment*", and concluded that the extension did not result in significant and consequential changes to the economic substance of the debt and thus resulted in a modification of the debt and not extinguishment of the debt.

On August 26, 2016, the Company issued a convertible note to an unrelated individual for \$50,000 that matures on August 26, 2017. The note bears interest rate of 10% per annum and is convertible into shares of the Company's Common stock at \$0.40 per share.

On September 1, 2016, an unrelated individual converted a convertible note entered into on August 21, 2012, with a principal balance of \$50,000 and \$21,164 in accrued interest at a rate of \$0.25 per share of the Company's Common stock for 280,650 shares.

On September 27, 2016, the Company issued a convertible note to an unrelated individual for \$1,000,000 that matures on December 22, 2016. The note was amended subsequently in February 2, 2017 to extend the maturity date to February 2, 2020. The fund will be

used for the manufacturing of the companies AfterMaster Pro TV box. The note bears interest rate of 10% per annum and is convertible into shares of the Company's Common stock at \$0.40, per share, as part of the note the company issued 100,000 shares of 144 restricted common stock for a value of \$33,349.

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 5 – NOTES PAYABLE - continuedNotes Payable – Related Parties

Notes payable due to related parties consisted of the following as of December 31, 2016 and June 30, 2016, respectively:

	December 31, 2016	June 30, 2016
Various term notes with total face value of \$627,500, of which, \$610,000 was issued from April 2011 to January 2014 with a maturity date of June 2015, and \$17,500 issued in November 2016 payable on demand, interest rates range from 0% to 15%, net of unamortized discount of \$0 as of December 31, 2016 and June 30, 2016, respectively, of which \$47,500 has been paid. The notes issued from April 2011 to January 2014 are currently in default.	\$ 580,000	\$ 575,000
Total notes payable – related parties	580,000	575,000
Less current portion	580,000	575,000
Notes payable - related parties, long term	<u>\$ -</u>	<u>\$ -</u>

Notes Payable – Non-Related Parties

Notes payable due to non-related parties consisted of the following as of December 31, 2016 and June 30, 2016, respectively:

	December 31, 2016	June 30, 2016
Various term notes with total face value of \$40,488 due upon demand, interest rates range from 0% to 14%.	\$ 40,488	\$ 40,488
Total note payable – non-related parties	40,488	40,488
Less current portion	40,488	40,488
Notes payable – non-related parties, long-term	<u>\$ -</u>	<u>\$ -</u>

NOTE 6 – CONVERTIBLE PREFERRED STOCK

The Company has authorized 10,000,000 shares of \$0.001 par value per share Preferred Stock, of which the following were issued outstanding:

	Shares Allocated	Shares Outstanding	Liquidation Preference
Series A Convertible Preferred	100,000	15,500	-
Series A-1 Convertible Preferred	3,000,000	2,735,000	290,668
Series B Convertible Preferred	200,000	3,500	79,099
Series C Convertible Preferred	1,000,000	13,404	-
Series D Convertible Preferred	375,000	130,000	130,000
Series E Convertible Preferred	1,000,000	275,000	275,000
Series P Convertible Preferred	600,000	86,640	-
Series S Convertible Preferred	50,000	-	-
Total Preferred Stock	<u>6,325,000</u>	<u>3,259,044</u>	<u>\$ 774,767</u>

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 6 – CONVERTIBLE PREFERRED STOCK - continued

The Company's Series A Convertible Preferred Stock ("Series A Preferred") is convertible into Common Stock at the rate of 0.025 share of Common stock for each share of the Series A Preferred. Dividends of \$0.50 per share annually from date of issue, are payable from retained earnings, but have not been declared or paid.

The Company's Series A-1 Senior Convertible Redeemable Preferred Stock ("Series A-1 Preferred") is convertible at the rate of 2 shares of Common Stock per share of Series A-1 Preferred. The dividend rate of the Series A-1 Senior Convertible Redeemable Preferred Stock is 6% per share per annum in cash, or commencing on June 30, 2009 in shares of the Company's Common Stock (at the option of the Company).

Due to the fact that the Series A-1 Preferred has certain features of debt and is redeemable, the Company analyzed the Series A-1 Preferred in accordance with ASC 480 and ASC 815 to determine if classification within permanent equity was appropriate. Based on the fact that the redeemable nature of the stock and all cash payments are at the option of the Company, it is assumed that payments will be made in shares of the Company's Common Stock and therefore, the instruments are afforded permanent equity treatment.

The Company's Series B Convertible 8% Preferred Stock ("Series B Preferred") is convertible at the rate of 0.067 share of Common Stock for each share of Series B Preferred. Dividends from date of issue are payable on June 30 from retained earnings at the rate of 8% per annum but have not been declared or paid.

The Company's Series C Convertible Preferred Stock ("Series C Preferred") is convertible at a rate of 0.007 share of Common Stock per share of Series C Preferred. Holders are entitled to dividends only to the extent of the holders of the Company's Common Stock receive dividends.

The Company's Series D Convertible Preferred Stock ("Series D Preferred") is convertible at a rate of 0.034 share of Common Stock per share of Series D Preferred. Holders are entitled to a proportionate share of any dividends paid as though they were holders of the number of shares of Common Stock of the Company into which their shares of are convertible as of the record date fixed for the determination of the holders of Common Stock of the Company entitled to receive such distribution.

The Company's Series E Convertible Preferred Stock ("Series E Preferred") is convertible at a rate of 0.034 share of Common Stock per share of Series E Preferred. Holders are entitled to a proportionate share of any dividends paid as though they were holders of the number of shares of Common Stock of the Company into which their shares of are convertible as of the record date fixed for the determination of the holders of Common Stock of the Company entitled to receive such distribution.

The Company's Series P Convertible Preferred Stock ("Series P Preferred") is convertible at a rate of 0.007 share of Common Stock for each share of Series P Preferred. Holders are entitled to dividends only to the extent of the holders of the Company's Common Stock receive dividends.

In the event of a liquidation, dissolution or winding up of the affairs of the Company, holders of Series A Preferred Stock, Series P Convertible Preferred Stock, Series C Convertible Preferred Stock have no liquidation preference over holders of the Company's Common Stock. Holders of Second Series B Preferred Stock have a liquidation preference over holders of the Company's Common Stock and the Company's Series A Preferred Stock. Holders of Series D Preferred Stock are entitled to receive, before any distribution is made with respect to the Company's Common Stock, a preferential payment at a rate per each whole share of Series D Preferred Stock equal to \$1.00. Holders of Series E Preferred Stock are entitled to receive, after the preferential payment in full to holders of outstanding shares of Series D Preferred Stock but before any distribution is made with respect to the Company's Common Stock, a preferential payment at a rate per each whole share of Series E Preferred Stock equal to \$1.00. Holders of Series A-1 Preferred Stock are superior in rank to the Company's Common Stock and to all other series of Preferred Stock heretofore designated with respect to dividends and liquidation.

The activity surrounding the issuances of the Preferred Stock is as follows:

During the six months ended December 31, 2016 the Company issued 550,000 shares of Series A-1 Preferred Stock for \$550,000 in cash and paid \$176,459 in cash offering costs.

During the fiscal years ended June 30, 2016 the Company issued 1,669,000 shares of Series A-1 Preferred Stock for \$1,382,390 in cash, net of \$286,610 of issuance costs, respectively. The Company had two conversions of 100,000 shares of Series A-1 Preferred

Stock for 200,000 shares of Common Stock, and issued 59,326 shares of Common Stock of payment of \$26,769 in accrued dividends.

During the six months ended December 31, 2016 and 2015, the outstanding Preferred Stock accumulated \$45,620 and \$16,789 in dividends on outstanding Preferred Stock. The cumulative dividends in arrears as of December 31, 2016 were approximately \$810,451.

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
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NOTE 7 – COMMON STOCK

The Company has authorized 250,000,000 shares of \$0.001 par value per share Common Stock, of which 108,854,548 and 102,133,344 were issued outstanding as of December 31, 2016 and June 30, 2016, respectively. The Company amended its articles of incorporation on August 28, 2015 to increase the number of authorized shares to 250,000,000. The activity surrounding the issuances of the Common Stock is as follows:

For the Six Months Ended December 31, 2016

The Company issued 848,755 shares of Common Stock for the conversion of notes and accrued interest valued at \$190,164.

The Company also issued 100,000 shares of Common Stock as incentive to notes valued at \$33,349 and recorded \$30,519 in beneficial conversion features related to new issuances of debt.

The Company issued 1,149,860 shares of Common Stock as payment for services and rent valued at \$451,130.

The Company issued 3,020,750 shares of Common Stock for the conversion warrants valued at \$906,225.

As share-based compensation to employees and non-employees, the Company issued 575,951 shares of common stock valued at \$218,538, based on the market price of the stock on the date of issuance. As interest expense on outstanding notes payable, the Company issued 1,025,888, shares of common stock valued at \$390,073 based on the market price on the date of issuance.

Fiscal Year Ended June 30, 2016

The Company issued 2,667,919 shares of Common Stock for the conversion of notes and accrued interest valued at \$446,757.

The Company also issued 200,000 shares of Common Stock for the conversion of 100,000 shares of Series A-1 Preferred Stock and issued 59,326 shares of Common Stock of payment of \$26,769 in accrued dividends.

The Company also issued 886,098 shares of Common Stock for the conversion warrants valued at \$175,914.

The Company also issued 26,000 shares of Common Stock as incentive to notes valued at \$10,284 and recorded \$22,375 in beneficial conversion features related to new issuances of debt.

The Company issued 496,137 shares of Common Stock as payment for services and rent valued at \$225,413.

As share-based compensation to employees and non-employees, the Company issued 812,804 shares of common stock valued at \$364,851, based on the market price of the stock on the date of issuance. As interest expense on outstanding notes payable, the Company issued 1,704,803 shares of common stock valued at \$762,076 based on the market price on the date of issuance.

NOTE 8 – STOCK PURCHASE OPTIONS AND WARRANTS

The Board of Directors on June 10, 2009 approved the 2009 Long-Term Stock Incentive Plan. The purpose of the 2009 Long-term Stock Incentive Plan is to advance the interests of the Company by encouraging and enabling acquisition of a financial interest in the Company by employees and other key individuals. The 2009 Long-Term Stock Incentive Plan is intended to aid the Company in attracting and retaining key employees, to stimulate the efforts of such individuals and to strengthen their desire to remain with the Company. A maximum of 1,500,000 shares of the Company's Common Stock is reserved for issuance under stock options to be issued under the 2009 Long-Term Stock Incentive Plan. The Plan permits the grant of incentive stock options, nonstatutory stock options and restricted stock awards. The 2009 Long-Term Stock Incentive Plan is administered by the Board of Directors or, at its direction, a Compensation Committee comprised of officers of the Company.

Stock Purchase Options

During the six months ended December 31, 2016 and fiscal year ended June 30, 2016, the Company did not issue any stock purchase options.

The following table summarizes the changes in options outstanding of the Company during the six months ended December 31, 2016.

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
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NOTE 8 – STOCK PURCHASE OPTIONS AND WARRANTS - continued

Date Issued	Number of Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Expiration Date (yrs)	Value if Exercised
Balance June 30, 2016	25,000	\$ 0.15	\$ 0.24	2.00	\$ 3,750
Granted	-	-	-	-	-
Exercised	-	-	-	-	-
Cancelled/Expired	-	-	-	-	-
Outstanding as of December 31, 2016	25,000	\$ 0.15	\$ 0.24	1.50	\$ 3,750

The following table summarizes the changes in options outstanding of the Company during the fiscal year ended June 30, 2016.

Date Issued	Number of Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Expiration Date (yrs)	Value if Exercised
Balance June 30, 2015	80,000	\$ 0.66	\$ 0.59	1.20	\$ 52,900
Granted	-	-	-	-	-
Exercised	-	-	-	-	-
Cancelled/Expired	(55,000)	0.89	-	-	(49,150)
Outstanding as of June 30, 2016	25,000	\$ 0.15	\$ 0.24	2.00	\$ 3,750

Stock Purchase Warrants

During the six months ended December 31, 2016, the Company issued warrants to purchase a total of 2,639,000. The Company issued 77,000 warrants in conjunction with three promissory notes executed in July 2016 and August 2016. The Company also issued 1,100,000 warrants as part of a private placement. The Company modified and exercised 3,020,750 warrants and recorded \$10,797 in prepaid expenses and \$13,204 in interest expenses and received \$906,225 in cash. The warrants were valued using the Black-Scholes pricing model under the assumptions noted below. The Company apportioned value to the warrants based on the relative fair market value of the Common Stock and warrants.

During the fiscal year ended June 30, 2016, the Company issued warrants to purchase a total of 5,172,000. The Company issued 100,000 warrants in conjunction to an employment agreement entered into in July 2015 and 1,244,000 warrants in conjunction with a consulting agreement entered into December 2015 to June 2016. The Company issued 75,000 warrants in conjunction with a promissory note executed in October 2015. The Company issued 50,000 warrants as part of a commission's agreement, 175,000 warrants as part of four advisory agreements. The Company also issued 3,338,000 warrants as part of a private placement and 190,000 warrants as part a finder's fee agreement. The warrants were valued using the Black-Scholes pricing model under the assumptions noted below. The Company apportioned value to the warrants based on the relative fair market value of the Common Stock and warrants.

The following table presents the assumptions used to estimate the fair values of the stock warrants and options granted:

	December 31, 2016	June 30, 2016
Expected volatility	98-104%	106-114%
Expected dividends	0%	0%
Expected term	3 Years	2-5 Years
Risk-free interest rate	0.76-0.92%	0.71-1.01%

AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 8 – STOCK PURCHASE OPTIONS AND WARRANTS - continued

The following table summarizes the changes in warrants outstanding issued to employees and non-employees of the Company during the six months ended December 31, 2016.

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Expiration Date (yrs)	Value if Exercised
Outstanding as of June 30, 2016	35,034,550	\$ 0.36	\$ 0.45	4.31	\$ 12,767,108
Granted	2,639,000	0.43	0.34	2.02	706,433
Exercised	(3,020,750)	-	-	-	-
Cancelled/Expired	(1,695,199)	0.34	-	-	(1,698,921)
Outstanding as of December 31, 2016	32,957,601	\$ 0.36	\$ 0.62	4.15	\$ 11,774,620

The following table summarizes the changes in warrants outstanding issued to employees and non-employees of the Company during the fiscal year ended June 30, 2016.

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Expiration Date (yrs)	Value if Exercised
Outstanding as of June 30, 2015	31,981,778	\$ 0.43	\$ 0.50	4.98	\$ 13,585,289
Granted	5,172,000	0.45	0.33	3.52	2,316,000
Exercised	(813,360)	-	-	-	(630,364)
Cancelled/Expired	(1,175,868)	0.53	-	-	(2,513,817)
Outstanding as of June 30, 2016	35,034,550	\$ 0.36	\$ 0.45	4.31	\$ 12,767,108

NOTE 9 – FINANCIAL INSTRUMENTS

The Company has financial instruments that are considered derivatives or contain embedded features subject to derivative accounting. Embedded derivatives are valued separately from the host instrument and are recognized as derivative liabilities in the Company's balance sheet. The Company measures these instruments at their estimated fair value and recognizes changes in their estimated fair value in results of operations during the period of change. The Company has estimated the fair value of these embedded derivatives for convertible debentures and associated warrants using a multinomial lattice model as of December 31, 2016 and 2015. The fair values of the derivative instruments are measured each quarter, which resulted in a gain (loss) of \$(574) and \$4,374,585, and derivative expense of \$0 and \$0 during the six months ended December 31, 2016 and 2015, respectively. As of December 31, 2016 and June 30, 2016, the fair market value of the derivatives aggregated \$0 and \$0, respectively, using the following assumptions: estimated 3-0 year term, estimated volatility of 104.34 -71.93%, and a discount rate of 0.88-0.24%.

NOTE 10 – FAIR VALUE MEASUREMENTS

For asset and liabilities measured at fair value, the Company uses the following hierarchy of inputs:

- Level one — Quoted market prices in active markets for identical assets or liabilities;
- Level two — Inputs other than level one inputs that are either directly or indirectly observable; and
- Level three — Unobservable inputs developed using estimates and assumptions, which are developed by the reporting entity and reflect those assumptions that a market participant would use.

Liabilities measured at fair value on a recurring basis at December 31, 2016, are summarized as follows:

	Level 1	Level 2	Level 3	Total
Fair value of derivatives	\$ -	\$ -	\$ -	\$ -

Securities available-for-sale

\$	48,000	\$	-	\$	-	\$	48,000
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AFTERMASTER, INC.
Notes to Consolidated Financial Statements
December 31, 2016 and June 30, 2016

NOTE 10 – FAIR VALUE MEASUREMENTS - continued

Liabilities measured at fair value on a recurring basis at June 30, 2015, are summarized as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Fair value of derivatives	\$ -	\$ -	\$ -	\$ -
Securities available-for-sale	\$ 63,600	\$ -	\$ -	\$ 63,600

NOTE 11 – COMMITMENTS AND CONTINGENCIES

Legal Proceedings

The Company may become involved in certain legal proceedings and claims which arise in the normal course of business. The Company is not a party to any litigation. To the best of the knowledge of our management, there are no material litigation matters pending or threatened against us.

Lease Agreements

We lease offices in Hollywood, California (located at 6671 Sunset Blvd., Suite 1520, 1518 and 1550, Hollywood, California, 90028) for corporate, research, engineering and mastering services. The lease expires on December 31, 2017. The total lease expense for the facility is approximately \$15,375 per month, and the total remaining obligations under these leases at December 31, 2016, were approximately \$226,769

We lease a warehouse space located at 8260 E Gelding Drive, Suite 102, Scottsdale, Arizona, 85260. The lease expires on February 28, 2019. The total lease expense for the facility is approximately \$1,821 per month, and the total remaining obligations under these leases at December 31, 2016 were approximately \$56,685

We lease corporate offices located at 7825 E Gelding Drive, Suite 101, Scottsdale, Arizona, 85260. The lease expires on April 30, 2021. The total lease expense for the facility is approximately \$7,148 per month, and the total remaining obligations under these leases at December 31, 2016 were approximately \$437,455

Below is a table summarizing the annual operating lease obligations over the next 5 years:

Year	Lease Payments
2017	142,992
2018	208,117
2019	108,068
2020	94,547
2021	97,315
Total	<u>\$ 651,039</u>

Other

The Company has not declared dividends on Series A or B Convertible Preferred Stock or its Series A-1 Convertible Preferred Stock. The cumulative dividends in arrears through December 31, 2016 were approximately \$810,451.

As of the date of this filing, the Company has not filed its tax return for the fiscal year ended 2015 and 2016.

NOTE 13 - SUBSEQUENT EVENTS

In accordance with ASC 855, Company's management reviewed all material events through the date of this filing and determined that there were the following material subsequent events to report:

AFTERMASTER, INC.

Notes to Consolidated Financial Statements

December 31, 2016 and June 30, 2016

NOTE 13 - SUBSEQUENT EVENTS - continued

On November 20, 2015, the Company issued a convertible note to an unrelated company for \$600,000 that matures on May 20, 2016. The note bears 0% interest and had an original issue discount (OID) of \$100,000. This note is not convertible unless there is a default event, so no BCF was valued. The Company extended the maturity date for the sixth time by issuing additional \$30,000 convertible notes on January 1, 2017 to February 15, 2017 per the terms of the note there are no derivatives until it becomes convertible on the original note, however the \$30,000 addition for the extension is to be considered derivatives. The Lender released a clarification of amendments to convertible promissory notes that explained the \$30,000 extension fees are the only portion that is to be considered as convertible and converts within 2 days of issuance. The intent of the amendment agreements were to insure the original note dated November 20, 2015 in the amount of \$600,000 remain current and is not convertible until the borrower defaulted under the amendment agreement dated January 1, 2017. Due to the conversion into 145,929 shares of common stock on January 1, 2017 (extension date) and January 3, 2017 (conversion date) sequencing is required on other instruments. Because the terms do not dictate a maximum numbers of convertible shares, the ability to settle these obligations with shares would be unavailable causing these obligations to potentially be settled in cash. This condition creates a derivative liability Under ASC 815-40. The Company has a sequencing policy regarding share settlement wherein instruments with the earliest issuance date would be settled first. The sequencing policy also considers contingently issuable additional shares, such as those issuable upon a stock split, to have an issuance date to coincide with the event giving rise to the additional shares. During the extension and conversion day period no additional convertible instruments were issued, therefore on the extension was considered in the derivative calculation.

On February 2, 2017, the Company amended the convertible note dated September 27, 2016 for \$1,000,000 to extend the maturity date to February 2, 2020 and issued 20,000 warrants valued at \$31,822. The Company evaluated amendment under ASC 470-50, "*Debt - Modification and Extinguishment*", and concluded that the extension did not result in significant and consequential changes to the economic substance of the debt and thus resulted in a modification of the debt and not extinguishment of the debt.

On February 3, 2017, the Company issued a convertible note to an unrelated company for \$258,000 that matures on August 3, 2017. The note bears 12% interest per annum and is convertible into shares of the Company's common stock at 57.5% of the lowest price of the Company's Common Stock during the thirty (30) trading days immediately prior to the conversion date. Additionally, the note contains a ratchet provision. The Company determined under ASC 815, that the embedded conversion feature (if offering of common stock is at no consideration or at a price that is lower than the effective conversion price on the date shares are offered for sale, then a ratchet down of effective exercise price to price per share offered for common stock would be used to determine additional shares to be issued). The Company has determined that this ratchet provision indicates that these shares, if issued, are not indexed to the Company's own stock and, therefore, is an embedded derivative financial liability, which requires bifurcation and to be separately accounted for. At each reporting period, the Company will mark this derivative financial instrument to its estimated fair value.

In conjunction with the note, the Company issued to the holder 550,000 refundable shares of restricted Common Stock to be held in a treasury account and will be returned to the company if the note is paid on or before the due date. The value of the BCF recorded was \$163,749 and the debt discount related to the attached relative fair value of the restricted Common Stock was \$94,251, for a total debt discount of \$258,000, and a derivative expense of \$65,750.

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

This Annual Report (the "Report") includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended, and as contemplated under the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to such matters as the Company's (and its subsidiaries) business strategies, continued growth in the Company's markets, projections, and anticipated trends in the Company's business and the industry in which it operates anticipated financial performance, future revenues or earnings, business prospects, projected ventures, new products and services, anticipated market performance and similar matters. All statements herein contained in this Report, other than statements of historical fact, are forward-looking statements.

When used in this Report, the words "may," "will," "expect," "anticipate," "continue," "estimate," "project," "intend," "budget," "budgeted," "believe," "will," "intends," "seeks," "goals," "forecast," and similar words and expressions are intended to identify forward-looking statements regarding events, conditions, and financial trends that may affect our future plans of operations, business strategy, operating results, and financial position. These forward-looking statements are based largely on the Company's expectations and are subject to a number of risks and uncertainties, certain of which are beyond the Company's control. We caution our readers that a variety of factors could cause our actual results to differ materially from the anticipated results or other matters expressed in the forward looking statements, including those factors described under "Risk Factors" and elsewhere herein. In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained in this Report will in fact transpire or prove to be accurate. These risks and uncertainties, many of which are beyond our control, include:

- *the sufficiency of existing capital resources and our ability to raise additional capital to fund cash requirements for future operations;*
- *uncertainties involved in growth and growth rate of our operations, business, revenues, operating margins, costs, expenses and acceptance of any products or services;*
- *uncertainties involved in growth and growth rate of our operations, business, revenues, operating margins, costs, expenses and acceptance of any products or services;*
- *volatility of the stock market, particularly within the technology sector;*
- *our dilution related to all equity grants to employees and non-employees;*
- *that we will continue to make significant capital expenditure investments;*
- *that we will continue to make investments and acquisitions;*
- *the sufficiency of our existing cash and cash generated from operations;*
- *the increase of sales and marketing and general and administrative expenses in the future;*
- *the growth in advertising revenues from our websites and studios will be achievable and sustainable;*
- *that seasonal fluctuations in Internet usage and traditional advertising seasonality are likely to affect our business; and*
- *general economic conditions.*

Although we believe the expectations reflected in these forward-looking statements are reasonable, such expectations cannot guarantee future results, levels of activity, performance or achievements. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report.

All references in this report to "we," "our," "us," the "Company" or "AfterMaster" refer to AfterMaster, Inc., and its subsidiary and predecessors.

General

Corporate Background

We are a Delaware public Company traded on the Over-The-Counter Bulletin Board (ticker symbol: AFTM). As of February 14, 2017, there were 109,540,477 shares of Common Stock issued and outstanding. The Company's office and principal place of business, research, recording and mastering studios are located at 6671 Sunset Blvd., Suite 1520, Hollywood, CA 90028, and its telephone number is (310) 657-4886. The Company also has an office at 7825 E. Gelding Drive, Suite 101, Scottsdale, Arizona 85260 USA, and its telephone number is (480) 556-9303.

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

Business

Aftermaster, Inc. ("the Company") is an audio technology company located in Hollywood, California and Scottsdale, Arizona. The Company's wholly-owned subsidiaries include AfterMaster HD Audio Labs, Inc. and MyStudio, Inc.

The Company and its subsidiaries are engaged in the development and commercialization of proprietary (patents issued and pending), leading-edge audio and video technologies for professional and consumer use, including AfterMaster® audio, ProMaster™, Aftermaster Pro™ and MyStudio®. The Company also operates recording and mastering studios at its Hollywood facility.

AfterMaster holds an unparalleled position in the audio technology industry and it is operated by a world-class team with successful track records and extensive experience in music and audio technology. The AfterMaster team has produced, engineered and mastered more hit music than any other audio company in the world. We believe that our expertise and technical skills have led us to develop audio technologies unmatched in the audio industry. www.aftermaster.com

Summary

The Company continued to record modest revenues for the quarter ending December 31, 2016. The Company had expected to recognize \$762,688 in revenues (currently recorded as deferred revenue) in the quarter from sales it has generated through presales of its Aftermaster Pro devices. However, parts availability and manufacturing challenges delayed the commencement of commercial scale manufacturing during the quarter. This delay impacted not only the inclusion of the deferred revenue but also revenue expected from retailers during the quarter ending December 31, 2016.

In January of 2017, the Company engaged a new manufacturer who is now both actively fulfilling our presale commitments and ramping up production for our planned retail distribution through multiple retailers. The Company has issued an initial purchase order and a deposit for the electronic components and manufacturing of 100,000 circuit boards.

The Company recently completed an extensive renovation of a recording studio built by music legends Crosby, Stills and Nash in 1977, which is located next to its existing studios in Hollywood. The studio is now equipped with state-of-the-art recording and mixing equipment and will be used for both audio research and development as well as it will be offered for rental to musicians. The Company considers it to be one of the finest recording studios in the US and it is expected to begin generating revenue in the first quarter of 2017.

AfterMaster Audio Technology

AfterMaster audio technology was created and developed pursuant to a multi-year, multi-million dollar development effort to make digital audio sound substantially better by developing proprietary software, digital signal processing technology and consumer products. The AfterMaster Audio Labs team is comprised of a unique group of award-winning industry leaders in music, technology and audio engineering which includes Ari Blitz, Peter Doell, Rodney Jenkins, Larry Ryckman, Justin Timberlake, Paul Wolff, Andrew Wuepper and Shelly Yakus. www.AfterMaster.com/team.

AfterMaster Audio Technology is an internally-developed, proprietary (patented and patents pending) mastering, remastering and audio processing technology which makes virtually any audio source sound significantly louder, fuller, deeper and clearer. AfterMaster is a groundbreaking technology which eliminates the weaknesses found in other audio enhancement and processing technologies while offering a much superior audio experience for consumer and industrial applications. We believe that our AfterMaster audio technology is one of the most significant breakthroughs in digital audio processing technology and has the potential to create significant revenues for the Company. The broad commercialization of this technology is a top priority for the Company.

As the convergence of features on consumer electronics continues, it is becoming more difficult for leading consumer electronics companies to differentiate their products. We believe that AfterMaster provides a unique and significant competitive advantage for consumer electronics manufacturers by offering their customers a superior audio experience. AfterMaster technology can be incorporated into any audio capable device through the addition of an AfterMaster DSP chip or AfterMaster software. Such uses are intended to include phones (mobile, home, business and VoIP); headphones; televisions; stereo speakers; stereos (home, portable, commercial and automobile); and computers (desktop, laptop and tablets).

AfterMaster audio is also the only commercial audio enhancement technology available that is used for professional music mastering because it enhances the entire frequency range without distortion or changing the underlying intent of the music. The technology has been used to master music created by such artists as Lady Gaga, Nick Cannon, Janet Jackson, and many others. Further information on AfterMaster and AfterMaster products can be found at www.AfterMaster.com.

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

Icon Health and Fitness

On December 9, 2016, the Company entered into a Consulting and License Agreement with ICON Health & Fitness, Inc. ("ICON"), pursuant to which the Company would act as audio technology development consultant to develop an Aftermaster based sound module for use or integration with ICON's exercise equipment and provide audio tuning services to provide improved sound quality for ICON's audio enabled equipment, and pursuant to which ICON would pay the Company a per module fee and receive a license from the Company to use or sell the modules and use the software relating to each module.

ICON Health and Fitness, Inc. is the world's largest manufacturer and marketer of home fitness equipment. ICON manufactures treadmills, elliptical trainers, stationary bicycles, weight machines and benches, and yoga and Pilates equipment. ICON has a wide range of brands, products and technologies, and sells home fitness and health club equipment under the following brands: NordicTrack®, ProForm®, Weider®, Gold's Gym® Home Fitness and FreeMotion®. Their fitness technology brand, including WiFi-enabled fitness equipment and fitness wearables, is iFit®.

Aftermaster Attends 2017 Consumer Electronics Show (CES) in Las Vegas

Aftermaster attended the 2017 CES show in Las Vegas in early January and showcased its technology both in an on-floor display booth and in a private hotel suite. The booth contained five listening stations to demonstrate Aftermaster technology for television, consumer electronics and video games. The Company also unveiled its new Aftermaster Pro, the world's first personal audio remastering device, which it has recently started to manufacture.

During the 2016 CES show, the Company was awarded three "Innovation & Design" awards during the ShowStoppers product showcase. The Envisioneering international team of technologists, inventors, marketers and industrial designers recognized the Company for its innovation, design and revolutionary Aftermaster sound, AfterMaster TV and BelaSigna 300 AM Processor Chip. www.AfterMaster.com/news

Aftermaster Enters Into Agreement with TuneCore for Professional Music Mastering

In April of 2016, the Company announced a partnership with TuneCore, one of the world's largest independent digital music distribution and publishing administration service. Under the agreement, Aftermaster will serve as the new professional mastering service for TuneCore artists. TuneCore has one of the highest artist revenue-generating music catalogs in the world, earning TuneCore Artists \$733 million from over 36.5 billion downloads and streams since inception. TuneCore Music Distribution services help artists, labels and managers sell their music through iTunes, Amazon Music, Spotify and other major download and streaming sites while retaining 100% of their sales revenue and rights for a low annual flat fee. TuneCore artists will have direct access to Aftermaster's world-class senior mastering engineers, and within 72 hours, they will be able to get their tracks mastered and ready for distribution. The new partnership builds upon TuneCore's mission to provide independent artists with key tools to build their careers, by granting access to unparalleled mastering that meets the industry's highest standards.

Adobe Audition

Aftermaster's Promaster online audio mastering service will soon be available on Adobe® Audition® CC, a professional audio workstation for mixing, finishing and editing audio/video. The integration of ProMaster will allow Adobe Audition CC users to instantly master their original work directly within Adobe Creative Cloud®. ProMaster infuses the clearest, deepest sound quality into any recording, which elevates that audio to a studio remastered sound experience. Adobe's Audition CC with ProMaster HD will enable its users to substantially cut editing time and enhance original audio work into fuller, deeper, louder and clearer tracks. When ready, users will install the ProMaster extension from the Adobe Add-ons marketplace.

Aftermaster Consumer Electronics Products

The Company has assembled a world-class branding and design team who has designed of the first consumer electronics product developed by the Company, "Aftermaster Pro". AfterMaster Pro is the world's first personal audio re-mastering device and defines a new category in consumer electronics products by offering a product never before offered. AfterMaster Pro is a proprietary, first-to-market product which has no direct competition.

Smaller than an iPhone, Aftermaster Pro transforms the audio of your TV, smartphone, headphones, laptop, tablet, gaming unit, or virtually any audio-enabled device to sound clearer, fuller, deeper, and more exciting. AfterMaster Pro connects easily via HDMI or

3.5mm audio cables with virtually any media source (cable, satellite box, cell phone, computer, tablet, etc.). When used with a Television, Aftermaster Pro raises and clarifies dialogue in programming while significantly enhancing the quality of the overall audio content. This solves the longstanding issue with TV audio of having to continually adjust volume during a TV show to hear dialogue. When used portably with its built-in battery, Aftermaster transforms music and video to standards that we believe are superior to any portable audio enhancement device.

The Company has pre-sold thousands of Aftermaster Pro's to buyers in over 60 countries, with revenues totaling over \$750,000. A majority of the sales were at \$150 per unit. www.aftermasterpro.com. The Company had expected to begin large volume manufacturing in December but was delayed by parts supply and manufacturing challenges. The challenges led the Company to internally manufacture small volume batches to begin to fulfil presale orders. The Company recently engaged a new manufacturer and is beginning to manufacture units in commercially significant numbers. The Company has multiple retail outlets lined up to carry the Aftermaster Pro beginning in the first quarter of 2017.

Additional Aftermaster branded products are under development, which we expect to introduce in the coming year.

