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**UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA**

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JOE W. MAY, Individually and on Behalf
of All Others Similarly Situated,

Plaintiff,

v.

KUSHCO HOLDINGS, INC.,
NICHOLAS KOVACEVICH,
CHRISTOPHER TEDFORD,
JIM MCCORMICK, and CHRIS
MARTIN.

Case No.

CLASS ACTION COMPLAINT

JURY TRIAL DEMANDED

Plaintiff Joe W. May (“Plaintiff”), individually and on behalf of all other persons similarly situated, by Plaintiff’s undersigned attorneys, for Plaintiff’s complaint against Defendants, alleges the following based upon personal knowledge as to Plaintiff and Plaintiff’s own acts, and information and belief as to all other matters, based upon, *inter alia*, the investigation conducted by and through Plaintiff’s attorneys, which included, among other things, a review of the Defendants’ public documents, conference calls and

1 announcements made by Defendants, United States Securities and Exchange Commission
2 (“SEC”) filings, wire and press releases published by and regarding KushCo Holdings,
3 Inc. (“KushCo” or the “Company”), analysts’ reports and advisories about the Company,
4 and information readily obtainable on the Internet. Plaintiff believes that substantial
5 evidentiary support will exist for the allegations set forth herein after a reasonable
6 opportunity for discovery.
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9 **NATURE OF THE ACTION AND OVERVIEW**

10 1. This is a federal securities class action on behalf of all persons and entities
11 who purchased or otherwise acquired KushCo securities between July 13, 2017 and April
12 9, 2019, both dates inclusive (the “Class Period”), seeking to recover damages caused by
13 Defendants’ violations of the federal securities laws and to pursue remedies under Sections
14 10(b) and 20(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule
15 10b-5 promulgated thereunder, against the Company and certain of its top officials.
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19 2. KushCo was founded in 2010 and is headquartered in Garden Grove,
20 California. The Company was formerly known as Kush Bottles, Inc. and changed its name
21 to KushCo Holdings, Inc. in September 2018.
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23 3. KushCo primarily engages in the wholesale distribution of packaging
24 supplies in the United States, Canada, Europe, and internationally. KushCo offers pop-
25 top bottles; child resistant exit, paper exit, and foil barrier bags; tubes; and polystyrene,
26 silicone-lined polystyrene or glass containers. KushCo also provides vaporizer cartridges,
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1 heating technologies, batteries, and disposable units; and hydrocarbon gases, including
2 isobutene, n-butane, propane, ethanol, pre-mixes, custom blends, and other solvents.

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4 4. KushCo's products are used by urban farmers, green house growers, and
5 medical and recreational cannabis dispensaries. In addition, KushCo operates a creative
6 design agency for cannabis and non-cannabis clients that provide brand strategy, design
7 and marketing, Web application development, and e-commerce solutions. KushCo sells
8 its products directly, as well as through website and re-distributors.

9
10 5. In the past several years, KushCo has expanded its services through the
11 acquisition of several companies in the cannabis industry. For example, in May 2017,
12 KushCo acquired CMP Wellness LLC ("CMP Wellness"), a privately-held manufacturer
13 and distributor of Med-ePen brand vaporizer pens, cartridges, tanks, and accessories.
14
15 Then, in May 2018, KushCo acquired Summit Innovations, LLC ("Summit"), a distributor
16 of hydrocarbon products, such as propane and butane, to the legal cannabis industry.
17
18 Finally, in July 2018, KushCo acquired The Hybrid Creative ("Hybrid"), a self-described
19 premier creative agency for cannabis ventures, including branding, marketing, web, and
20 strategy.
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23 6. Throughout the Class Period, Defendants made materially false and
24 misleading statements regarding the Company's business, operational and compliance
25 policies. Specifically, Defendants made false and/or misleading statements and/or failed
26 to disclose that: (i) KushCo made material accounting errors in connection with its
27 acquisitions of CMP Wellness, Summit, and Hybrid; (ii) as a result, KushCo's previously
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1 issued financial statements as of and for the fiscal years ended August 31, 2018 and August
2 31, 2017, included in the Company's Annual Reports on Form 10-K for such periods, and
3
4 financial statements as of and for the quarterly periods ended May 31, 2017, November
5 30, 2017, February 28, 2018, May 31, 2018 and November 30, 2018, included in the
6 Company's Quarterly Reports on Form 10-Q for such periods, could not be relied upon;
7
8 (iii) KushCo's net loss for the fiscal year ended August 31, 2018, was more than twice as
9 high than previously reported; (iv) KushCo and its management's assurances that its
10 financial statements for those fiscal years and periods were accurate and fairly reported
11 could not be relied upon; and (v) as a result, the Company's public statements were
12 materially false and misleading at all relevant times.

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15 7. On April 9, 2019, KushCo issued a press release, attached as an exhibit to
16 the Company's Current Report on Form 8-K (the "April 2019 8-K"), announcing the
17 Company's decision to restate prior period financial statements for fiscal years 2017 and
18
19 2018 for non-cash items related to acquisitions of CMP Wellness, Summit, and Hybrid.

20 8. Specifically, the April 2019 8-K disclosed that KushCo had inaccurately
21 accounted for certain shared-settled contingent consideration relating to its CMP
22
23 Wellness, Summit, and Hybrid acquisitions, by recording their respective earnout
24 arrangements as equity rather than as liabilities, stating, in relevant part:

25
26 On April 8, 2019, the Audit Committee of the Board of Directors (the "Audit
27 Committee") of KushCo Holdings, Inc. (the "Company"), after discussion
28 with management of the Company and the Company's independent
registered public accounting firm, RBSM LLP ("RBSM"), concluded that *the
Company's previously issued audited consolidated financial statements as*

1 *of and for the fiscal years ended August 31, 2018 and 2017 included in the*
2 *Company's Annual Reports on Form 10-K for such periods and unaudited*
3 *condensed consolidated interim financial statements as of and for the fiscal*
4 *periods ended May 31, 2017, November 30, 2017, February 28, 2018, May*
5 *31, 2018 and November 30, 2018 included in the Company's Quarterly*
6 *Reports on Form 10-Q for such periods should no longer be relied upon.*
7 *Similarly, management's reports on the effectiveness of internal controls*
over financial reporting, earnings releases, and investor communications
describing the financial statements for the periods described above should
no longer be relied upon.

8 As part of preparing its condensed consolidated interim financial statements
9 as of and for the fiscal period ended February 28, 2019, *the Company*
10 *identified inadvertent errors in the accounting for certain shared-settled*
11 *contingent consideration ("Contingent Consideration") relating to the*
12 *Company's acquisition of CMP Wellness in May 2017, Summit*
13 *Innovations in May 2018, and Hybrid Creative in July 2018. In connection*
14 *with those acquisitions, Contingent Consideration relating to the respective*
15 *earnout arrangements were recorded as equity. Upon further evaluation,*
16 *the Company determined that the Contingent Consideration should have*
been accounted for as liabilities with changes in the fair value recorded in
the Company's consolidated statements of operations.

17 * * *

18 The Company expects the corrected misstatements to have the following
19 impact on its restated annual consolidated financial statements:

- 20
- 21 • *Increase net loss from \$10.2 million to \$24.3 million during its fiscal*
year ended August 31, 2018;
 - 22 • *Increase net income from \$0.1 million to \$1.7 million during its fiscal*
year ended August 31, 2017;
 - 23 • *No impact on its net revenue or gross profit for any of the restated*
24 *fiscal periods; and*
 - 25 • *No impact on its cash flows from operations for any of the restated*
fiscal periods.

26 The Company intends to file such amended reports as soon as practicable.

27

28 *Management has concluded that the Company's internal control over*
financial reporting and its disclosure controls and procedures were not

1 *effective as of the end of the respective restatement periods.* The Company
2 will amend any disclosures pertaining to its evaluation of such internal
3 controls and procedures, as appropriate, in connection with the amended 10-
4 K and 10-Q filings. In February 2019, the Company engaged a national
5 accounting advisory firm to assist with the design and implementation of its
6 internal controls over financial reporting based on the criteria established
7 in *Internal Control - Integrated Framework (2013)* issued by the Committee
8 of Sponsoring Organizations of the Treadway Commission.

7 (Emphases added).

8 9. On this news, KushCo's stock price fell \$0.45 per share, or 7.76%, to close
9 at \$5.35 on April 10, 2019.

10 11. As a result of Defendants' wrongful acts and omissions, and the precipitous
11 decline in the market value of KushCo' securities, Plaintiff and other Class members have
12 suffered significant losses and damages.

13 JURISDICTION AND VENUE

14 15. The claims asserted herein arise under Sections 10(b) and 20(a) of the
15 Exchange Act, 15 U.S.C. §§ 78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder,
16 17 C.F.R. § 240.10b-5.

17 12. This Court has jurisdiction over the subject matter of this action pursuant to
18 28 U.S.C. § 1331 and Section 27 of the Exchange Act, 15 U.S.C. § 78aa.

19 13. Venue is proper in this District pursuant to Section 27 of the Exchange Act,
20 15 U.S.C. § 78aa, and 28 U.S.C. § 1391(b). KushCo is headquartered in this District,
21 Defendants conduct business in this District, and a significant portion of Defendants'
22 actions took place within this District.

1 20. Defendant Chris Martin (“Martin”) served as the CFO of KushCo from July
2 2014 until July 2017.
3

4 21. The Defendants referenced above in ¶¶ 17-20 are sometimes referred to
5 herein collectively as the “Individual Defendants.”

6 22. The Individual Defendants possessed the power and authority to control the
7 contents of the Company’s SEC filings, press releases, and other market communications.
8 The Individual Defendants were provided with copies of the Company’s SEC filings and
9 press releases alleged herein to be misleading prior to or shortly after their issuance and
10 had the ability and opportunity to prevent their issuance or to cause them to be corrected.
11 Because of their positions with the Company, and their access to material information
12 available to them but not to the public, the Individual Defendants knew that the adverse
13 facts specified herein had not been disclosed to and were being concealed from the public,
14 and that the positive representations being made were then materially false and misleading.
15 The Individual Defendants are liable for the false statements and omissions pleaded herein.
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20 **SUBSTANTIVE ALLEGATIONS**

21 **Background**

22 23. KushCo was founded in 2010 and is headquartered in Garden Grove,
23 California. The Company was formerly known as Kush Bottles, Inc. and changed its name
24 to KushCo Holdings, Inc. in September 2018.
25

26 24. KushCo primarily engages in the wholesale distribution of packaging
27 supplies in the United States, Canada, Europe, and internationally. The Company offers
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1 pop-top bottles; child resistant exit, paper exit, and foil barrier bags; tubes; and
2 polystyrene, silicone-lined polystyrene or glass containers. It also provides vaporizer
3 cartridges, heating technologies, batteries, and disposable units; and hydrocarbon gases,
4 including isobutene, n-butane, propane, ethanol, pre-mixes, custom blends, and other
5 solvents.
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8 25. KushCo's products are used by urban farmers, green house growers, and
9 medical and recreational cannabis dispensaries. In addition, it operates a creative design
10 agency for cannabis and non-cannabis clients that provide brand strategy, design and
11 marketing, Web application development, and e-commerce solutions. KushCo sells its
12 products directly, as well as through Website and re-distributors.
13

14
15 26. In the past several years, KushCo has expanded its services through the
16 acquisition of several companies in the cannabis industry. For example, in May 2017,
17 KushCo acquired CMP Wellness, a privately-held manufacturer and distributor of Med-
18 ePen brand vaporizer pens, cartridges, tanks, and accessories. Then, in May 2018, KushCo
19 acquired Summit, a distributor of hydrocarbon products, such as propane and butane, to
20 the legal cannabis industry. Finally, in July 2018, KushCo acquired Hybrid, a self-
21 described premier creative agency for cannabis ventures, including branding, marketing,
22 web, and strategy.
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26 **Materially False and Misleading Statements Issued During the Class Period**

27 27. The Class Period begins on July 13, 2017, when KushCo filed its Quarterly
28 Report on Form 10-Q with the SEC, reporting the Company's financial and operating

1 results for the quarterly period ended May 31, 2017 (the “3Q 2017 10-Q”). For the period,
2 KushCo reported a net income of \$0.01 million, or \$0.00 per diluted share, on net revenue
3 of \$4.72 million, compared to a net income of \$0.02 million, or \$0.00 per diluted share,
4 on net revenue of \$2.32 million for the same period the prior fiscal year.
5

6 28. With regard to KushCo’s acquisition of CMP Wellness and the Company’s
7 subsequent contingent consideration equity, the 3Q 2017 10-Q stated, in relevant part:
8

9 In accordance with ASC 805, management has evaluated the estimated fair
10 value of the contingent consideration based a probability-weighted
11 assessment of the occurrence of CMP reaching certain gross profit earnout
12 targets. The Company recorded a contingent liability for the contingent cash
13 consideration of \$1,735,375 and recorded contingent equity consideration of
14 \$10,763,760. The fair value of the contingent equity consideration is recorded
15 in additional paid in capital.

16 The acquisition is accounted for under the acquisition method of accounting
17 in accordance with Accounting Standards Codification Topic 805, Business
18 Combinations (“ASC 805”). As such, CMP’s assets acquired and liabilities
19 assumed are recorded at their acquisition-date fair values. The results of
20 operations of CMP were consolidated beginning on the date of the
21 merger. Acquisition-related transaction costs are not included as a
22 component of consideration transferred, but are accounted for as an expense
23 in the period in which the costs are incurred. Any excess of the acquisition
24 consideration over the fair value of assets acquired and liabilities assumed is
25 allocated to goodwill. Pursuant to ASC 805, the contingent consideration was
26 recorded at its estimated fair value as of the acquisition date. The subsequent
27 accounting for contingent consideration depends on whether the contingent
28 consideration is classified as a liability or equity. The portion of contingent
consideration classified as equity is not remeasured in subsequent accounting
periods. However, contingent consideration classified as a liability is
remeasured to its fair value at the end of each reporting period and the change
in fair value is reflected in income or expense during that period. Any changes
within the measurement period resulting from facts and circumstances that
existed as of the acquisition date may result in retrospective adjustments to
the provisional amounts recorded at the acquisition date.

1 The equity consideration received by CMP members was calculated based on
2 the negotiated price per share of common stock of the Company of \$2.50,
3 which approximated the quoted market price on the acquisition date. The
4 contingent equity consideration was also calculated based on the negotiated
5 price per share of common stock of the Company of \$2.50, which
6 approximated the quoted market price.

7 29. With regard to KushCo's acquisition of CMP Wellness and the Company's
8 subsequent contingent consideration liability, the 3Q 2017 10-Q stated, in relevant part:

9 The Company has a contingent consideration liability of \$1,785,375, which
10 consists of contingent cash consideration of \$1,735,375 resulting from the
11 acquisition of CMP The contingent consideration liability is calculated
12 based on the weighted average probability of meeting certain milestones.
13 This liability is remeasured at each reporting period. The Company had no
14 financial assets or liabilities that are measured at fair value on a recurring
15 basis as of August 31, 2016.

16 * * *

17 During the three months ended May 31, 2017, the Company did not recognize
18 any change in the fair value of its contingent consideration liability of
19 \$1,785,375 from its inception date of May 1, 2017 and May 3, 2017.

20 30. Additionally, while the 3Q 2017 10-Q noted that KushCo's internal control
21 over financial reporting was not effective for that period because of, *inter alia*, missing
22 policies and levels of supervision, it nonetheless minimized current and future risks
23 associated with those weaknesses. For example, the 3Q 2017 10-Q assured investors that
24 KushCo "believe[s] that the weaknesses identified . . . have not had any material effect on
25 our financial results," and that "[m]anagement believes that despite our material
26 weaknesses . . . our financial statements for the three and nine month periods ended May
27 31, 2017 are fairly stated, in all material respects, in accordance with U.S. GAAP." The
28

1 3Q 2017 10-Q also stressed that KushCo was “currently reviewing our disclosure controls
2 and procedures related to these material weaknesses” and expected “to implement changes
3 in the current fiscal year, including identifying specific areas within our governance,
4 accounting and financial reporting processes to add adequate resources to potentially
5 mitigate these material weaknesses.” The 3Q 2017 10-Q also reassured investors that its
6 management would “continue to monitor and evaluate the effectiveness of our internal
7 controls and procedures and our internal controls over financial reporting on an ongoing
8 basis,” and that management was “committed to taking further action and implementing
9 additional enhancements or improvements, as necessary and as funds allow.”
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13 31. As part of “Management’s Remediation Plan,” the 3Q 2017 10-Q
14 highlighted that KushCo would: (i) “appoint additional qualified personnel to address
15 inadequate segregation of duties and implement modifications to our financial controls to
16 address such inadequacies”; (ii) “adopt a written whistleblower policy and code of ethics”;
17 and (iii) “appoint an independent board of directors, including board committees related
18 to financial controls and reporting.” The 3Q 2017 10-Q promised that “[t]he remediation
19 efforts set out herein *will* be implemented in the current 2017 fiscal year” (emphasis
20 added).
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24 32. The 3Q 2017 10-Q also contained merely generic, boilerplate warnings that
25 an error in financial reporting could occur despite KushCo’s implementation of internal
26 controls, stating, in relevant part:
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1 Because of its inherent limitations, internal controls over financial reporting
2 may not prevent or detect misstatements. Projections of any evaluation of
3 effectiveness to future periods are subject to the risk that controls may
4 become inadequate because of changes in conditions, or that the degree of
5 compliance with the policies or procedures may deteriorate. All internal
6 control systems, no matter how well designed, have inherent
7 limitations. Therefore, even those systems determined to be effective can
8 provide only reasonable assurance with respect to financial statement
9 preparation and presentation.

10 33. Appended as exhibits to the 3Q 2017 10-Q were signed certifications
11 pursuant to the Sarbanes-Oxley Act of 2002 (“SOX”) wherein Defendants Kovacevich
12 and Martin certified that “[t]he [3Q 2017 10-Q] fully complies with the requirements of
13 Section 13(a) or 15(d) of the Securities Exchange Act of 1934,” and that “[t]he information
14 contained in the [3Q 2017 10-Q] fully presents, in all material respects, the financial
15 condition and results of operations or the Company.”

16 34. On November 28, 2017, KushCo filed its Annual Report on Form 10-K with
17 the SEC, reporting the Company’s financial and operating results for the fiscal year ended
18 August 31, 2017 (the “2017 10-K”). For fiscal year 2017, KushCo reported a net income
19 of \$0.07 million, or \$0.00 per diluted share, on net revenue of \$18.80 million, compared
20 to a net income of \$0.07 million, or \$0.00 per diluted share, on net revenue of \$8.22 million
21 for fiscal year 2016.

22 35. With regard to KushCo’s acquisition of CMP Wellness and the Company’s
23 subsequent contingent consideration equity, the 2017 10-K stated, in relevant part:

24 In accordance with ASC 805, management has evaluated the estimated fair
25 value of the contingent consideration based a probability-weighted
26 assessment of the occurrence of CMP reaching certain gross profit earnout
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1 targets. The Company initially recorded a contingent liability for the
contingent cash consideration of \$1,735,375 \$1,905,000 and recorded
2 contingent equity consideration of \$10,763,760. Based on information
3 obtained during the fourth fiscal quarter, the Company revised its estimate of
the contingent cash consideration from \$1,735,375 to \$1,905,000, and its
4 estimate of the contingent equity consideration from \$10,763,760 to
5 \$11,852,400. The fair value of the contingent equity consideration is recorded
6 in additional paid in capital.

7 * * *

8 The results of operations of CMP were consolidated beginning on the date of
9 the merger. Acquisition-related transaction costs are not included as a
10 component of consideration transferred, but are accounted for as an expense
11 in the period in which the costs are incurred. Any excess of the acquisition
12 consideration over the fair value of tangible and intangible assets acquired
and liabilities assumed is allocated to goodwill. The amount of contingent
13 consideration was recorded at its estimated fair value as of the acquisition
14 date. The subsequent accounting for contingent consideration depends on
whether the contingent consideration is classified as a liability or equity. The
15 portion of contingent consideration classified as equity is not remeasured in
16 subsequent accounting periods. However, contingent consideration classified
17 as a liability is remeasured to its fair value at the end of each reporting period
and the change in fair value is reflected in income or expense during that
18 period. Any changes within the measurement period resulting from facts and
19 circumstances that existed as of the acquisition date may result in
retrospective adjustments to the provisional amounts recorded at the
20 acquisition date.

21 The equity consideration received by CMP members was calculated based on
the negotiated price per share of common stock of the Company of \$2.50,
22 which approximated the quoted market price on the acquisition date. The
contingent equity consideration (number of common shares) was also
23 calculated based on the negotiated price per share of common stock of the
Company of \$2.50, which approximated the quoted market price.
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26 36. With regard to KushCo's acquisition of CMP Wellness and the Company's
27 subsequent contingent consideration liability, the 2017 10-K stated, in relevant part:
28

1 The Company has a contingent consideration liability of \$1,820,000, which
2 consists of contingent cash consideration of \$1,820,000 resulting from the
3 acquisition of CMP The contingent consideration liability is calculated
4 based on the weighted average probability of meeting certain milestones.
5 This liability is remeasured at each reporting period. The Company had no
6 other financial assets or liabilities that are measured at fair value on a
7 recurring basis as of August 31, 2017 and 2016.

8 * * *

9 During the year ended August 31, 2017, the Company recognized a change
10 in the fair value of its contingent consideration liability of \$169,625, which
11 increased liability from \$1,735,375 to \$1,905,000. A payment of \$85,000 was
12 made towards this liability during the year ended August 31, 2017, resulting
13 in a net liability of \$1,820,000.

14 37. Additionally, the 2017 10-K contained substantively the same warnings and
15 reassurances as in ¶¶ 30- 32 above regarding its still-ineffective internal control over
16 financial reporting, including the assurance that KushCo “believe[s] that the weaknesses
17 identified . . . have not had any material effect on our financial results,” and that
18 “[m]anagement believes that despite our material weaknesses . . . our financial statements
19 for the year ended August 31, 2017 are fairly stated, in all material respects, in accordance
20 with U.S. GAAP.” However, where the 3Q 2017 10-Q repeatedly asserted that KushCo
21 would make its remedial changes in the Company’s 2017 fiscal year, the 2017 10-K now
22 promised that KushCo would implement these changes in the Company’s 2018 fiscal year.

23 38. Appended as exhibits to the 2017 10-K were signed SOX certifications
24 wherein Defendants Kovacevich and McCormick “certifie[d] to [their] knowledge that the
25 [2017 10-K] . . . fully complies with the requirements of Section 13(a) or 15(d), as
26 applicable, of the Securities Exchange Act of 1934, as amended . . . and that the
27
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1 information contained in the [2017 10-K] fairly presents, in all material respects, the
2 financial condition and results of operations of the Company.”

3
4 39. On January 16, 2018, KushCo filed its Quarterly Report on Form 10-Q with
5 the SEC, reporting the Company’s financial and operating results for the quarterly period
6 ended November 30, 2017 (the “1Q 2018 10-Q”). For the period, KushCo reported a net
7 income of \$0.10 million, or \$0.00 per diluted share, on net revenue of \$8.85 million,
8 compared to a net loss of \$0.16 million, or \$0.00 per diluted share, on net revenue of \$2.47
9 million for the same period the prior fiscal year.
10

11
12 40. With regard to KushCo’s acquisition of CMP Wellness and the Company’s
13 subsequent contingent consideration equity, the 1Q 2018 10-Q stated, in relevant part:

14
15 In accordance with ASC 805, management has evaluated the estimated fair
16 value of the contingent consideration based a probability-weighted
17 assessment of the occurrence of CMP reaching certain gross profit earnout
18 targets. The Company initially recorded a contingent liability for the
19 contingent cash consideration of \$1,735,375 \$1,905,000 and recorded
20 contingent equity consideration of \$10,763,760. Based on information
21 obtained during the fourth fiscal quarter, the Company revised its estimate of
22 the contingent cash consideration from \$1,735,375 to \$1,905,000, and its
23 estimate of the contingent equity consideration from \$10,763,760 to
24 \$11,852,400. The fair value of the contingent equity consideration is recorded
25 in additional paid in capital.

26
27 * * *

28
The results of operations of CMP were consolidated beginning on the date of
the merger. Acquisition-related transaction costs are not included as a
component of consideration transferred, but are accounted for as an expense
in the period in which the costs are incurred. Any excess of the acquisition
consideration over the fair value of tangible and intangible assets acquired
and liabilities assumed is allocated to goodwill. The amount of contingent
consideration was recorded at its estimated fair value as of the acquisition

1 date. The subsequent accounting for contingent consideration depends on
2 whether the contingent consideration is classified as a liability or equity. The
3 portion of contingent consideration classified as equity is not remeasured in
4 subsequent accounting periods. However, contingent consideration classified
5 as a liability is remeasured to its fair value at the end of each reporting period
6 and the change in fair value is reflected in income or expense during that
7 period. Any changes within the measurement period resulting from facts and
8 circumstances that existed as of the acquisition date may result in
9 retrospective adjustments to the provisional amounts recorded at the
10 acquisition date.

11 The equity consideration received by CMP members was calculated based on
12 the negotiated price per share of common stock of the Company of \$2.50,
13 which approximated the quoted market price on the acquisition date. The
14 contingent equity consideration (number of common shares) was also
15 calculated based on the negotiated price per share of common stock of the
16 Company of \$2.50, which approximated the quoted market price.

17 41. With regard to KushCo's acquisition of CMP Wellness and the Company's
18 subsequent contingent consideration liability, the 1Q 2018 10-Q stated, in relevant part:

19 The Company has a contingent consideration liability of \$1,820,000, which
20 consists of contingent cash consideration of \$1,820,000 resulting from the
21 acquisition of CMP The contingent consideration liability is calculated
22 based on the weighted average probability of meeting certain milestones.
23 This liability is remeasured at each reporting period. The Company had no
24 other financial assets or liabilities that are measured at fair value on a
25 recurring basis as of November 30, 2017.

26 * * *

27 During the three months ended November 30, 2017, the Company did not
28 recognize any change in the fair value of its contingent consideration liability
of \$1,820,000.

42. As with the 3Q 2017 10-Q and 2017 10-K, the 1Q 2018 10-Q once again
noted that KushCo's internal control over financial reporting was not effective. Unlike
the 3Q 2017 10-Q and 2017 10-K, however, the 1Q 2018 10-Q did not promise to address

1 the material weaknesses in its financial reporting within the current fiscal year, stating, in
2 relevant part:

3
4 The material weaknesses that existed on August 31, 2017 are described in
5 Part II, Item 9A – Controls and Procedures in our most recent Annual Report
6 on Form 10-K, filed on November 29, 2017. Due to a lack of financial
7 resources and size, we are not able to, and do not intend to, immediately take
8 any action to remediate these material weaknesses. We will not be able to do
9 so until we acquire sufficient financing to do so. We will implement further
10 controls as circumstances, cash flow, and working capital permit.

11
12 43. Nonetheless, as with the 3Q 2017 10-Q and 2017 10-K, the 1Q 2018 10-Q
13 once again reassured investors that their financial statements could be relied upon,
14 minimizing both present and future risks associated with their financial reporting:

15 Notwithstanding the assessment that our disclosure controls and procedures
16 were not effective and that there were material weaknesses as identified in
17 this report, we believe that our financial statements fairly present our
18 financial position, results of operations and cash flows for the periods covered
19 thereby in all material respects.

20 We have taken steps to enhance our internal control over financial reporting
21 and plan to take additional steps to remediate the material weaknesses.
22 Specifically:

23 (i) We appointed additional independent members with public
24 company board experience to our board of directors,

25 (ii) We added staff to our finance team, and outsourced to third party
26 the assessment of certain complex transactions under US GAAP

27 (iii) On January 2018, we hired a controller with public company
28 experience

We believe that the measures described above will strengthen our internal
control over financial reporting. We expect that our efforts, including design,
implementation and testing will continue throughout fiscal year 2018.

1 44. Appended as exhibits to the 1Q 2018 10-Q were signed SOX certifications
2 wherein Defendants Kovacevich and McCormick “certifie[d] to [their] knowledge that the
3 Company’s [1Q 2018 10-Q] . . . fully complies with the requirements of Section 13(a) or
4 15(d), as applicable, of the Securities Exchange Act of 1934, as amended . . . and that the
5 information contained in the [1Q 2018 10-Q] fairly presents, in all material respects, the
6 financial condition and results of operations of the Company.”
7

8 45. On April 13, 2018, KushCo filed its Quarterly Report on Form 10-Q with
9 the SEC, reporting the Company’s financial and operating results for the quarterly period
10 ended February 28, 2018 (the “2Q 2018 10-Q”). For the period, KushCo reported a net
11 loss of \$7.61 million, or \$0.12 per diluted share, on net revenue of \$10.36 million,
12 compared to a net income of \$0.00 million, or \$0.00 per diluted share, on net revenue of
13 \$2.97 million for the same period the prior fiscal year.
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16 46. With regard to KushCo’s acquisition of CMP Wellness and the Company’s
17 subsequent contingent consideration equity, the 2Q 2018 10-Q stated, in relevant part:
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20 In accordance with ASC 805, management has evaluated the estimated fair
21 value of the contingent consideration based a probability-weighted
22 assessment of the occurrence of CMP reaching certain gross profit earnout
23 targets. The Company initially recorded a contingent liability for the
24 contingent cash consideration of \$1,735,375 and recorded contingent equity
25 consideration of \$10,763,760. Based on information obtained during the
26 fourth fiscal quarter, the Company revised its estimate of the contingent cash
27 consideration from \$1,735,375 to \$1,905,000, and its estimate of the
28 contingent equity consideration from \$10,763,760 to \$11,852,400. A
payment of \$85,000 was made towards this liability during the year ended
August 31, 2017, resulting in a net liability of \$1,820,000. During the six
months ended February, a payment of \$170,000 was made towards this
liability, resulting in a net liability of \$1,650,000. During the three months

1 ended February 28, 2018, the Company did not recognize any change in the
2 fair value of its contingent consideration liability of \$1,650,000.

3 * * *

4 The results of operations of CMP were consolidated beginning on the date of
5 the merger. Acquisition-related transaction costs are not included as a
6 component of consideration transferred, but are accounted for as an expense
7 in the period in which the costs are incurred. Any excess of the acquisition
8 consideration over the fair value of tangible and intangible assets acquired
9 and liabilities assumed is allocated to goodwill. The amount of contingent
10 consideration was recorded at its estimated fair value as of the acquisition
11 date. The subsequent accounting for contingent consideration depends on
12 whether the contingent consideration is classified as a liability or equity. The
13 portion of contingent consideration classified as equity is not remeasured in
14 subsequent accounting periods. However, contingent consideration classified
15 as a liability is remeasured to its fair value at the end of each reporting period
16 and the change in fair value is reflected in income or expense during that
17 period. Any changes within the measurement period resulting from facts and
18 circumstances that existed as of the acquisition date may result in
19 retrospective adjustments to the provisional amounts recorded at the
20 acquisition date.

21 The equity consideration received by CMP members was calculated based on
22 the negotiated price per share of common stock of the Company of \$2.50,
23 which approximated the quoted market price on the acquisition date. The
24 contingent equity consideration (number of common shares) was also
25 calculated based on the negotiated price per share of common stock of the
26 Company of \$2.50, which approximated the quoted market price.

27 47. With regard to KushCo's acquisition of CMP Wellness and the Company's
28 subsequent contingent consideration liability, the 2Q 2018 10-Q stated, in relevant part:

24 The Company has a contingent consideration liability of \$1,650,000 which
25 consists of contingent cash consideration of \$1,650,000 resulting from the
26 acquisition of CMP The contingent consideration liability is calculated
27 based on the weighted average probability of meeting certain milestones.
28 This liability is remeasured at each reporting period. The Company had no
other financial assets or liabilities that are measured at fair value on a
recurring basis as of February 28, 2018.

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During the year ended August 31, 2017, the Company recognized a change in the fair value of its contingent consideration liability of \$169,625, which increased liability from \$1,735,375 to \$1,905,000. A payment of \$85,000 was made towards this liability during the year ended August 31, 2017, resulting in a net liability of \$1,820,000. During the six months ended February, a payment of \$170,000 was made towards this liability, resulting in a net liability of \$1,650,000. During the three months ended February 28, 2018, the Company did not recognize any change in the fair value of its contingent consideration liability of \$1,650,000.

48. Additionally, the 2Q 2018 10-Q contained substantively the same warnings and reassurances as in ¶¶ 30-32 above regarding its still-ineffective internal control over financial reporting, including the assurance that “[n]otwithstanding the assessment that our disclosure controls and procedures were not effective and that there were material weaknesses as identified” in the 2017 10-K, “we believe that our financial statements fairly present our financial position, results of operations and cash flows for the periods covered thereby in all material respects.”

49. The 2Q 2018 10-Q also touted KushCo’s enhanced remedial efforts since the 1Q 2018 10-Q, stating, in relevant part:

We have taken steps to enhance our internal control over financial reporting and plan to take additional steps to remediate the material weaknesses.

Specifically:

- (i) We appointed additional independent members with public company board experience to our board of directors, such that our board of directors is now composed of a majority of independent directors;

1 (ii) On March 9, 2018, our board of directors formed an Audit
2 Committee composed entirely of independent directors that will,
3 among other things, assist the board of directors in its oversight of the
4 integrity of our financial statements and our financing reporting
5 processes and systems of internal control;

6 (iii) We have adopted a Code of Business Conduct and Ethics and a
7 whistleblower policy;

8 (iv) We added staff to our finance team, and outsourced to third party
9 the assessment of certain complex transactions under US GAAP; and

10 (v) On January 2018, we hired a controller with public company
11 experience

12 We believe that the measures described above will strengthen our internal
13 control over financial reporting. We expect that our efforts, including design,
14 implementation and testing will continue throughout fiscal year 2018.

15 50. Appended as exhibits to the 2Q 2018 10-Q were signed SOX certifications
16 wherein Defendants Kovacevich and McCormick “certifie[d] to [their] knowledge that the
17 Company’s [2Q 2018 10-Q] . . . fully complies with the requirements of Section 13(a) or
18 15(d), as applicable, of the Securities Exchange Act of 1934, as amended . . . and that the
19 information contained in the [2Q 2018 10-Q] fairly presents, in all material respects, the
20 financial condition and results of operations of the Company.”

21 51. On July 13, 2018, KushCo filed its Quarterly Report on Form 10-Q with the
22 SEC, reporting the Company’s financial and operating results for the quarterly period
23 ended May 31, 2018 (the “3Q 2018 10-Q”). For the period, KushCo reported a net loss of
24 \$2.17 million, or \$0.03 per diluted share, on net revenue of \$12.91 million, compared to a
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1 net income of \$0.01 million, or \$0.00 per diluted EPS, on net revenue of \$4.72 million for
2 the same period the prior fiscal year.

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4 52. With regard to KushCo's acquisition of CMP Wellness and the Company's
5 subsequent contingent consideration equity, the 3Q 2018 10-Q stated, in relevant part:

6 In accordance with ASC 805, management has evaluated the estimated fair
7 value of the contingent consideration based a probability-weighted
8 assessment of the occurrence of CMP reaching certain gross profit earnout
9 targets. The Company initially recorded a contingent liability for the
10 contingent cash consideration of \$1,735,375 and recorded contingent equity
11 consideration of \$10,763,760. Based on information obtained during the
12 fourth fiscal quarter, the Company revised its estimate of the contingent cash
13 consideration from \$1,735,375 to \$1,905,000, and its estimate of the
14 contingent equity consideration from \$10,763,760 to \$11,852,400. A
15 payment of \$85,000 was made towards this liability during the year ended
16 August 31, 2017, resulting in a net liability of \$1,820,000. During the six
17 months ended February, a payment of \$170,000 was made towards this
18 liability, resulting in a net liability of \$1,650,000. During the three months
19 ended May 31, 2018, the Company did not recognize any change in the fair
20 value of its contingent consideration liability of \$1,650,000.

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22 * * *

23 The results of operations of CMP were consolidated beginning on the date of
24 the merger. Acquisition-related transaction costs are not included as a
25 component of consideration transferred, but are accounted for as an expense
26 in the period in which the costs are incurred. Any excess of the acquisition
27 consideration over the fair value of tangible and intangible assets acquired
28 and liabilities assumed is allocated to goodwill. The amount of contingent
consideration was recorded at its estimated fair value as of the acquisition
date. The subsequent accounting for contingent consideration depends on
whether the contingent consideration is classified as a liability or equity. The
portion of contingent consideration classified as equity is not remeasured in
subsequent accounting periods. However, contingent consideration classified
as a liability is remeasured to its fair value at the end of each reporting period
and the change in fair value is reflected in income or expense during that
period. Any changes within the measurement period resulting from facts and
circumstances that existed as of the acquisition date may result in

1 retrospective adjustments to the provisional amounts recorded at the
2 acquisition date.

3 The equity consideration received by CMP members was calculated based on
4 the negotiated price per share of common stock of the Company of \$2.50,
5 which approximated the quoted market price on the acquisition date. The
6 contingent equity consideration (number of common shares) was also
7 calculated based on the negotiated price per share of common stock of the
8 Company of \$2.50, which approximated the quoted market price.

9 53. With regard to KushCo's acquisition of Summit and the Company's
10 subsequent contingent consideration, the 3Q 2018 10-Q stated, in relevant part:

11 The [Summit] acquisition was accounted for using the acquisition method of
12 accounting in accordance with ASC 805, Business Combinations. The
13 consideration paid to the Members of Summit at the closing included the
14 Cash Consideration, consisting of an aggregate of \$1.4 million in cash, net of
15 cash received and the Share Consideration, consisting of an aggregate of
16 1,280,000 shares common stock. \$500,000 of the Cash Consideration and
17 approximately 640,000 shares of common stock from the Share
18 Consideration were held back by the Company for a period of 15 months for
19 potential post-closing working capital and/or indemnification claims relating
20 to, among other things, breaches of representations, warranties and covenants
21 contained in the Merger Agreement. The Members may become entitled to
22 receive earn-out consideration of up to an additional 1,280,000 shares of
23 common stock, in the aggregate, based on the net revenue performance of the
24 Summit business during a one-year period following the closing.

25 The Company estimated the probability of the contingent consideration at
26 100% and recorded the earn-out consideration of the additional 1,280,000
27 shares of common stock in stockholders' equity.

28 54. With regard to KushCo's acquisition of CMP Wellness and Summit, and the
Company's subsequent contingent consideration liability, the 3Q 2018 10-Q stated, in
relevant part:

The Company has a contingent consideration liability of \$2,150,000 which
consists of contingent cash consideration of \$1,650,000 resulting from the

1 acquisition of CMP and \$500,000 resulting from the acquisition of Summit.
2 The contingent consideration liability is calculated based on the weighted
3 average probability of meeting certain milestones. This liability is
4 remeasured at each reporting period. The Company had no other financial
5 assets or liabilities that are measured at fair value on a recurring basis as of
6 May 31, 2018.

7 * * *

8 During the nine months ended May 31, 2018, a payment of \$170,000 was
9 made towards this liability, an increase of \$500,000 resulted from the Summit
10 acquisition, resulting in a net liability of \$2,150,000. During the three months
11 ended May 31, 2018, the Company did not recognize any change in the fair
12 value of its contingent consideration liability of \$2,150,000.

13 55. The 3Q 2018 10-Q also contained substantively the same warnings and
14 reassurances as in ¶¶ 30-32 above regarding its still-ineffective internal control over
15 financial reporting, including the assurance that “[n]otwithstanding the assessment that
16 our disclosure controls and procedures were not effective and that there were material
17 weaknesses as identified” in the 2017 10-K, “we believe that our financial statements fairly
18 present our financial position, results of operations and cash flows for the periods covered
19 thereby in all material respects.” Additionally, the 3Q 2018 10-Q also touted the same
20 enhanced remedial measures as the 2Q 2018 10-Q, quoted in ¶ 49 above.

21 56. Appended as exhibits to the 3Q 2018 10-Q were signed SOX certifications
22 wherein Defendants Kovacevich and McCormick “certifie[d] to [their] knowledge that the
23 Company’s [3Q 2018 10-Q] . . . fully complies with the requirements of Section 13(a) or
24 15(d), as applicable, of the Securities Exchange Act of 1934, as amended . . . and that the
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1 information contained in the [3Q 2018 10-Q] fairly presents, in all material respects, the
2 financial condition and results of operations of the Company. ”

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4 57. On November 29, 2018, KushCo filed its Annual Report on Form 10-K with
5 the SEC, reporting the Company’s financial and operating results for the fiscal year ended
6 August 31, 2018 (the “2018 10-K”). For fiscal year 2018, KushCo reported a net loss of
7 \$10.20 million, or \$0.16 per diluted share, on net revenue of \$52.08 million, compared to
8 a net income of \$0.07 million, or \$0.00 per diluted share, on net revenue of \$18.80 for
9 fiscal year 2017.
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12 58. With regard to KushCo’s acquisition of CMP Wellness and the Company’s
13 subsequent contingent consideration equity, the 2018 10-K stated, in relevant part:

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15 In accordance with ASC 805, management has evaluated the estimated fair
16 value of the contingent consideration based a probability-weighted
17 assessment of the occurrence of CMP reaching certain gross profit earnout
18 targets. The Company initially recorded a contingent liability for the
19 contingent cash consideration of \$1,735,375 \$1,905,000 and recorded
20 contingent equity consideration of \$10,763,760. Based on information
21 obtained during the fourth fiscal quarter, the Company revised its estimate of
22 the contingent cash consideration from \$1,735,375 to \$1,905,000, and its
23 estimate of the contingent equity consideration from \$10,763,760 to
24 \$11,852,400. The fair value of the contingent equity consideration is recorded
25 in additional paid in capital.

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The results of operations of CMP were consolidated beginning on the date of
the merger. Acquisition-related transaction costs are not included as a
component of consideration transferred, but are accounted for as an expense
in the period in which the costs are incurred. Any excess of the acquisition
consideration over the fair value of tangible and intangible assets acquired
and liabilities assumed is allocated to goodwill. The amount of contingent
consideration was recorded at its estimated fair value as of the acquisition

1 date. The subsequent accounting for contingent consideration depends on
2 whether the contingent consideration is classified as a liability or equity. The
3 portion of contingent consideration classified as equity is not remeasured in
4 subsequent accounting periods. However, contingent consideration classified
5 as a liability is remeasured to its fair value at the end of each reporting period
6 and the change in fair value is reflected in income or expense during that
7 period. Any changes within the measurement period resulting from facts and
8 circumstances that existed as of the acquisition date may result in
9 retrospective adjustments to the provisional amounts recorded at the
10 acquisition date.

11 * * *

12 The equity consideration received by CMP members was calculated based on
13 the negotiated price per share of common stock of the Company of \$2.50,
14 which approximated the quoted market price on the acquisition date. The
15 contingent equity consideration (number of common shares) was also
16 calculated based on the negotiated price per share of common stock of the
17 Company of \$2.50, which approximated the quoted market price.

18 59. With regard to KushCo's acquisition of Summit, the 2018 10-K noted an
19 estimated fair value contingent equity consideration of \$3,193,907, and a total fair value
20 of consideration and total estimated acquisition consideration of \$10,680,666, as adjusted
21 for August 31, 2018, compared to an estimated fair value contingent equity consideration
22 of \$7,155,200, and a total fair value of consideration and total estimated acquisition
23 consideration of \$15,755,618, as initially reported May 2, 2018.¹ The 2018 10-K also
24 stated, in relevant part:

25 The [Summit] acquisition was accounted for using the acquisition method of
26 accounting in accordance with ASC 805, Business Combinations. The

27 ¹ For the Summit acquisition, the 3Q 2018 10-Q did not explicitly list an estimated fair value contingent
28 equity consideration of \$7,155,200, nor a total fair value of consideration and total estimated acquisition
consideration of \$15,755,618, as initially reported May 2, 2018. Instead, the 3Q 2018 10-Q listed these
two values as KushCo's contingent company stock consideration and total purchase price, respectively,
from the Summit acquisition.

1 consideration paid to the Members of Summit at the closing included the
2 Cash Consideration, consisting of an aggregate of \$905,231 in cash, net of
3 cash received, \$187,849 in cash held back and the Share Consideration,
4 consisting of an aggregate of 1,280,000 shares common stock. \$187,849 of
5 the Cash Consideration and approximately 640,000 shares of common stock
6 from the Share Consideration were held back by the Company for a period of
7 15 months for potential post-closing working capital and/or indemnification
8 claims relating to, among other things, breaches of representations,
9 warranties and covenants contained in the Merger Agreement. The Members
10 may become entitled to receive earn-out consideration of up to an additional
11 1,280,000 shares of common stock, in the aggregate, based on the net revenue
12 performance of the Summit business during a one-year period following the
13 closing.

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15 60. With regard to KushCo's acquisition of Hybrid, the 2018 10-K noted an
16 estimated fair value contingent equity consideration of \$920,000, and a total fair value of
17 consideration and total estimated acquisition consideration of \$4,178,492. The 2018 10-
18 K also stated, in relevant part:

19 The [Hybrid] acquisition was accounted for using the acquisition method of
20 accounting in accordance with ASC 805, Business Combinations. The
21 consideration paid to the Members of Hybrid at the closing included the Cash
22 Consideration, consisting of an aggregate of \$847,187 in cash, net of cash
23 received, \$82,106 in cash held back and the Share Consideration, consisting
24 of an aggregate of 360,000 shares common stock. \$82,106 of the Cash
25 Consideration and 162,000 shares of common stock from the Share
26 Consideration were held back by the Company issuable on January 1, 2019.
27 The Members may become entitled to receive earn-out payments of up to
28 \$1.37 million, through a combination of cash and stock payments, based on
the net revenue performance of the Hybrid business during the period
September 1, 2018 through August 31, 2019.

61. Additionally, the 2018 10-K noted that KushCo's internal control over
financial reporting was still ineffective, but that it suffered from fewer material
weaknesses, now including only "inadequate segregation of duties consistent with control

1 objectives” and a “lack of multiple levels of supervision and review.” The 2018 10-K also
2 assured investors that while “[c]ertain of the material weaknesses in internal control over
3 financial reporting as of August 31, 2018 . . . remain unchanged from August 31, 2017,”
4 KushCo’s nonetheless “believe[s] that the weaknesses identified . . . have not had any
5 material effect on our financial results,” and that “[m]anagement believes that despite our
6 material weaknesses set forth above, our financial statements for the fiscal year ended
7 August 31, 2018 are fairly stated, in all material respects, in accordance with U.S. GAAP.”
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10 62. Moreover, the 2018 10-K contained substantively the same merely generic,
11 boilerplate warnings that an error in financial reporting could occur despite KushCo’s
12 implementation of internal controls, as quoted in ¶ 32 above. The 2018 10-K also noted
13 that it would continue management’s remediation plan for its remaining material
14 weaknesses in internal control over financial reporting in KushCo’s 2019 fiscal year.
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17 63. Appended as exhibits to the 2018 10-K were signed SOX certifications
18 wherein Defendants Kovacevich and Tedford “certifie[d] to [their] knowledge that the
19 Company’s [2018 10-K] . . . fully complies with the requirements of Section 13(a) or
20 15(d), as applicable, of the Securities Exchange Act of 1934, as amended . . . and that the
21 information contained in the [2018 10-K] fairly presents, in all material respects, the
22 financial condition and results of operations of the Company.”
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25 64. Finally, on January 8, 2019, KushCo filed its Quarterly Report on Form 10-
26 Q with the SEC, reporting the Company’s financial and operating results for the quarterly
27 period ended November 30, 2018 (the “1Q 2019 10-Q”). For the period, KushCo reported
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1 a loss of \$8.19 million, or \$0.10 per diluted share, on net revenue of \$25.32 million,
2 compared to a net income of \$0.10 million, or \$0.00 per diluted share, on net revenue of
3 \$8.85 million for the same period the prior fiscal year.
4

5 65. With regard to KushCo's contingent consideration from its acquisition of
6 CMP Wellness, Summit, and Hybrid, the 1Q 2019 10-Q stated, in relevant part:
7

8 The Company has contingent consideration outstanding associated with its
9 prior business combinations. The Company accounts for business
10 combinations under the acquisition method and allocates the total purchase
11 price for acquired businesses to the tangible and identified intangible assets
12 acquired and liabilities assumed, based on their estimated fair values as of the
13 acquisition date. A liability for contingent consideration, if applicable, is
14 recorded at fair value as of the acquisition date and, evaluated each period for
15 changes in the fair value and adjusted as appropriate.

16 The Company's contingent consideration as of November 30, 2018 was
17 \$672,849, consisting of \$187,849 from the Summit acquisition and \$485,000
18 from the Hybrid acquisition.

19 The Company's contingent consideration as of August 31, 2018 was
20 \$754,955, consisting of \$187,849 from the Summit acquisition and \$532,106
21 from the Hybrid acquisition.

22 66. Additionally, the 1Q 2019 10-Q noted that KushCo's internal control over
23 financial reporting was still ineffective because it suffered from the same material
24 weaknesses identified in the 2018 10-K, as quoted in ¶ 61 above. The 1Q 2019 10-Q
25 nonetheless continued to tout KushCo's remediation measures, which included the same
26 measures identified in KushCo's 2Q 2018 10-Q and 3Q 2018 10-Q, as quoted in ¶ 49
27 above, with the addition of KushCo's "hiring of [the Company's] new Chief Financial
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1 Officer, Christopher Tedford, with significant sales and distribution experience who will
2 focus on the development of the finance and accounting function.”

3
4 67. Additionally, while the 1Q 2019 10-Q did not contain the same assurances
5 as its previous reports, quoted above, that KushCo and its management believed their
6 financial statements and representations were accurate and fairly presented despite
7 material weaknesses in KushCo’s internal controls, the 1Q 2019 10-Q nonetheless assured
8 investors that “[t]here ha[d] been no change in [KushCo’s] internal control over financial
9 reporting” regarding “the effectiveness of [KushCo’s] internal control over financial
10 reporting” that occurred during the period, “that has materially affected, or is reasonably
11 likely to materially affect, our internal control over financial reporting.”
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14 68. Appended as exhibits to the 1Q 2019 10-Q were signed SOX certifications
15 wherein Defendants Kovacevich and Tedford “certifie[d] to [their] knowledge that the
16 Company’s [1Q 2019 10-Q] . . . fully complies with the requirements of Section 13(a) or
17 15(d), as applicable, of the Securities Exchange Act of 1934, as amended . . . and that the
18 information contained in the [1Q 2019 10-Q] fairly presents, in all material respects, the
19 financial condition and results of operations of the Company.”
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23 69. The statements referenced in ¶¶ 27-68 were materially false and misleading
24 because Defendants made false and/or misleading statements, as well as failed to disclose
25 material adverse facts about the Company’s business, operational and compliance policies.
26 Specifically, Defendants made false and/or misleading statements and/or failed to disclose
27 that: (i) KushCo made material accounting errors in connection with its acquisitions of
28

1 CMP Wellness, Summit, and Hybrid; (ii) as a result, KushCo's previously issued financial
2 statements as of and for the fiscal years ended August 31, 2018 and August 31, 2017,
3 included in the Company's Annual Reports on Form 10-K for such periods, and financial
4 statements as of and for the quarterly periods ended May 31, 2017, November 30, 2017,
5 February 28, 2018, May 31, 2018 and November 30, 2018, included in the Company's
6 Quarterly Reports on Form 10-Q for such periods, could not be relied upon; (iii) KushCo's
7 net loss for the fiscal year ended August 31, 2018, was more than twice as high than
8 previously reported; (iv) KushCo and its management's assurances that its financial
9 statements for those fiscal years and periods were accurate and fairly reported could not
10 be relied upon; and (v) as a result, the Company's public statements were materially false
11 and misleading at all relevant times.
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16 **The Truth Begins to Emerge**

17 70. On April 9, 2019, KushCo issued a press release, attached as an exhibit to
18 the Company's Current Report on Form 8-K, announcing the Company's decision to
19 restate prior period financial statements for fiscal years 2017 and 2018 for non-cash items
20 related to acquisitions of CMP Wellness, Summit, and Hybrid.
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23 71. Specifically, the April 2019 8-K disclosed that KushCo had inaccurately
24 accounted for certain shared-settled contingent consideration relating to its CMP
25 Wellness, Summit, and Hybrid acquisitions, by recording their respective earnout
26 arrangements as equity rather than as liabilities, stating, in relevant part:
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1 On April 8, 2019, the Audit Committee of the Board of Directors (the “Audit
2 Committee”) of KushCo Holdings, Inc. (the “Company”), after discussion
3 with management of the Company and the Company’s independent
4 registered public accounting firm, RBSM LLP (“RBSM”), concluded that *the*
5 *Company’s previously issued audited consolidated financial statements as*
6 *of and for the fiscal years ended August 31, 2018 and 2017 included in the*
7 *Company’s Annual Reports on Form 10-K for such periods and unaudited*
8 *condensed consolidated interim financial statements as of and for the fiscal*
9 *periods ended May 31, 2017, November 30, 2017, February 28, 2018, May*
10 *31, 2018 and November 30, 2018 included in the Company’s Quarterly*
11 *Reports on Form 10-Q for such periods should no longer be relied upon.*
12 *Similarly, management’s reports on the effectiveness of internal controls*
13 *over financial reporting, earnings releases, and investor communications*
14 *describing the financial statements for the periods described above should*
15 *no longer be relied upon.*

16 As part of preparing its condensed consolidated interim financial statements
17 as of and for the fiscal period ended February 28, 2019, *the Company*
18 *identified inadvertent errors in the accounting for certain shared-settled*
19 *contingent consideration (“Contingent Consideration”) relating to the*
20 *Company’s acquisition of CMP Wellness in May 2017, Summit*
21 *Innovations in May 2018, and Hybrid Creative in July 2018. In connection*
22 *with those acquisitions, Contingent Consideration relating to the respective*
23 *earnout arrangements were recorded as equity. Upon further evaluation,*
24 *the Company determined that the Contingent Consideration should have*
25 *been accounted for as liabilities with changes in the fair value recorded in*
26 *the Company’s consolidated statements of operations.*

27 * * *

28 The Company expects the corrected misstatements to have the following
impact on its restated annual consolidated financial statements:

- *Increase net loss from \$10.2 million to \$24.3 million during its fiscal year ended August 31, 2018;*
- Increase net income from \$0.1 million to \$1.7 million during its fiscal year ended August 31, 2017;
- No impact on its net revenue or gross profit for any of the restated fiscal periods; and
- No impact on its cash flows from operations for any of the restated fiscal periods.

1 The Company intends to file such amended reports as soon as practicable.

2
3 ***Management has concluded that the Company's internal control over***
4 ***financial reporting and its disclosure controls and procedures were not***
5 ***effective as of the end of the respective restatement periods.*** The Company
6 will amend any disclosures pertaining to its evaluation of such internal
7 controls and procedures, as appropriate, in connection with the amended 10-
8 K and 10-Q filings. In February 2019, the Company engaged a national
9 accounting advisory firm to assist with the design and implementation of its
10 internal controls over financial reporting based on the criteria established
11 in *Internal Control - Integrated Framework (2013)* issued by the Committee
12 of Sponsoring Organizations of the Treadway Commission.

13 (Emphases added).

14 72. On this news, KushCo's stock price fell \$0.45 per share, or 7.76%, to close
15 at \$5.35 on April 10, 2019.

16 73. As a result of Defendants' wrongful acts and omissions, and the precipitous
17 decline in the market value of KushCo' securities, Plaintiff and other Class members have
18 suffered significant losses and damages.

19 **PLAINTIFF'S CLASS ACTION ALLEGATIONS**

20 74. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil
21 Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those who purchased or
22 otherwise acquired KushCo securities during the Class Period (the "Class"); and were
23 damaged upon the revelation of the alleged corrective disclosures. Excluded from the
24 Class are Defendants herein, the officers and directors of the Company, at all relevant
25 times, members of their immediate families and their legal representatives, heirs,
26 successors or assigns and any entity in which Defendants have or had a controlling interest.
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1 75. The members of the Class are so numerous that joinder of all members is
2 impracticable. Throughout the Class Period, KushCo securities were actively traded on
3 the OTCQB. While the exact number of Class members is unknown to Plaintiff at this
4 time and can be ascertained only through appropriate discovery, Plaintiff believes that
5 there are hundreds or thousands of members in the proposed Class. Record owners and
6 other members of the Class may be identified from records maintained by KushCo or its
7 transfer agent and may be notified of the pendency of this action by mail, using the form
8 of notice similar to that customarily used in securities class actions.
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11 76. Plaintiff's claims are typical of the claims of the members of the Class as all
12 members of the Class are similarly affected by Defendants' wrongful conduct in violation
13 of federal law that is complained of herein.
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16 77. Plaintiff will fairly and adequately protect the interests of the members of the
17 Class and has retained counsel competent and experienced in class and securities litigation.
18 Plaintiff has no interests antagonistic to or in conflict with those of the Class.
19

20 78. Common questions of law and fact exist as to all members of the Class and
21 predominate over any questions solely affecting individual members of the Class. Among
22 the questions of law and fact common to the Class are:
23

- 24 • whether the federal securities laws were violated by Defendants' acts as
25 alleged herein;
- 26 • whether statements made by Defendants to the investing public during the
27 Class Period misrepresented material facts about the business, operations and
28 management of KushCo;

- 1 • whether the Individual Defendants caused KushCo to issue false and
2 misleading financial statements during the Class Period;
- 3 • whether Defendants acted knowingly or recklessly in issuing false and
4 misleading financial statements;
- 5 • whether the prices of KushCo securities during the Class Period were
6 artificially inflated because of the Defendants' conduct complained of herein;
7 and
- 8 • whether the members of the Class have sustained damages and, if so, what is
9 the proper measure of damages.

10 79. A class action is superior to all other available methods for the fair and
11 efficient adjudication of this controversy since joinder of all members is impracticable.
12 Furthermore, as the damages suffered by individual Class members may be relatively
13 small, the expense and burden of individual litigation make it impossible for members of
14 the Class to individually redress the wrongs done to them. There will be no difficulty in
15 the management of this action as a class action.
16
17

18 80. Plaintiff will rely, in part, upon the presumption of reliance established by the
19 fraud-on-the-market doctrine in that:
20

- 21 • Defendants made public misrepresentations or failed to disclose material
22 facts during the Class Period;
- 23 • the omissions and misrepresentations were material;
- 24 • KushCo securities are traded in an efficient market;
- 25 • the Company's shares were liquid and traded with moderate to heavy volume
26 during the Class Period;
- 27 • the Company traded on the OTCQB and was covered by multiple analysts;
- 28

- the misrepresentations and omissions alleged would tend to induce a reasonable investor to misjudge the value of the Company's securities; and
- Plaintiff and members of the Class purchased, acquired and/or sold KushCo securities between the time the Defendants failed to disclose or misrepresented material facts and the time the true facts were disclosed, without knowledge of the omitted or misrepresented facts.

81. Based upon the foregoing, Plaintiff and the members of the Class are entitled to a presumption of reliance upon the integrity of the market.

82. Alternatively, Plaintiff and the members of the Class are entitled to the presumption of reliance established by the Supreme Court in *Affiliated Ute Citizens of the State of Utah v. United States*, 406 U.S. 128, 92 S. Ct. 2430 (1972), as Defendants omitted material information in their Class Period statements in violation of a duty to disclose such information, as detailed above.

COUNT I

(Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder Against All Defendants)

83. Plaintiff repeats and re-alleges each and every allegation contained above as if fully set forth herein.

84. This Count is asserted against Defendants and is based upon Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder by the SEC.

85. During the Class Period, Defendants engaged in a plan, scheme, conspiracy and course of conduct, pursuant to which they knowingly or recklessly engaged in acts, transactions, practices and courses of business which operated as a fraud and deceit upon Plaintiff and the other members of the Class; made various untrue statements of material

1 facts and omitted to state material facts necessary in order to make the statements made,
2 in light of the circumstances under which they were made, not misleading; and employed
3 devices, schemes and artifices to defraud in connection with the purchase and sale of
4 securities. Such scheme was intended to, and, throughout the Class Period, did: (i)
5 deceive the investing public, including Plaintiff and other Class members, as alleged
6 herein; (ii) artificially inflate and maintain the market price of KushCo securities; and (iii)
7 cause Plaintiff and other members of the Class to purchase or otherwise acquire KushCo
8 securities and options at artificially inflated prices. In furtherance of this unlawful scheme,
9 plan and course of conduct, Defendants, and each of them, took the actions set forth herein.
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13 86. Pursuant to the above plan, scheme, conspiracy and course of conduct, each
14 of the Defendants participated directly or indirectly in the preparation and/or issuance of
15 the quarterly and annual reports, SEC filings, press releases and other statements and
16 documents described above, including statements made to securities analysts and the
17 media that were designed to influence the market for KushCo securities. Such reports,
18 filings, releases and statements were materially false and misleading in that they failed to
19 disclose material adverse information and misrepresented the truth about KushCo's
20 finances and business prospects.
21
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24 87. By virtue of their positions at KushCo, Defendants had actual knowledge of
25 the materially false and misleading statements and material omissions alleged herein and
26 intended thereby to deceive Plaintiff and the other members of the Class, or, in the
27 alternative, Defendants acted with reckless disregard for the truth in that they failed or
28

1 refused to ascertain and disclose such facts as would reveal the materially false and
2 misleading nature of the statements made, although such facts were readily available to
3 Defendants. Said acts and omissions of Defendants were committed willfully or with
4 reckless disregard for the truth. In addition, each Defendant knew or recklessly
5 disregarded that material facts were being misrepresented or omitted as described above.
6
7

8 88. Information showing that Defendants acted knowingly or with reckless
9 disregard for the truth is peculiarly within Defendants' knowledge and control. As the
10 senior managers and/or directors of KushCo, the Individual Defendants had knowledge of
11 the details of KushCo's internal affairs.
12

13 89. The Individual Defendants are liable both directly and indirectly for the
14 wrongs complained of herein. Because of their positions of control and authority, the
15 Individual Defendants were able to and did, directly or indirectly, control the content of
16 the statements of KushCo. As officers and/or directors of a publicly-held Company, the
17 Individual Defendants had a duty to disseminate timely, accurate, and truthful information
18 with respect to KushCo's businesses, operations, future financial condition and future
19 prospects. As a result of the dissemination of the aforementioned false and misleading
20 reports, releases and public statements, the market price of KushCo securities was
21 artificially inflated throughout the Class Period. In ignorance of the adverse facts
22 concerning KushCo's business and financial condition which were concealed by
23 Defendants, Plaintiff and the other members of the Class purchased or otherwise acquired
24 KushCo securities at artificially inflated prices and relied upon the price of the securities,
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1 the integrity of the market for the securities and/or upon statements disseminated by
2 Defendants, and were damaged thereby.

3
4 90. During the Class Period, KushCo securities were traded on an active and
5 efficient market. Plaintiff and the other members of the Class, relying on the materially
6 false and misleading statements described herein, which the Defendants made, issued or
7 caused to be disseminated, or relying upon the integrity of the market, purchased or
8 otherwise acquired shares of KushCo securities at prices artificially inflated by
9 Defendants' wrongful conduct. Had Plaintiff and the other members of the Class known
10 the truth, they would not have purchased or otherwise acquired said securities, or would
11 not have purchased or otherwise acquired them at the inflated prices that were paid. At
12 the time of the purchases and/or acquisitions by Plaintiff and the Class, the true value of
13 KushCo securities was substantially lower than the prices paid by Plaintiff and the other
14 members of the Class. The market price of KushCo securities declined sharply upon
15 public disclosure of the facts alleged herein to the injury of Plaintiff and Class members.

16
17 91. By reason of the conduct alleged herein, Defendants knowingly or recklessly,
18 directly or indirectly, have violated Section 10(b) of the Exchange Act and Rule 10b-5
19 promulgated thereunder.

20
21 92. As a direct and proximate result of Defendants' wrongful conduct, Plaintiff
22 and the other members of the Class suffered damages in connection with their respective
23 purchases, acquisitions and sales of the Company's securities during the Class Period,
24
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1 upon the disclosure that the Company had been disseminating misrepresented financial
2 statements to the investing public.
3
4

5 **COUNT II**

6 **(Violations of Section 20(a) of the Exchange Act Against The Individual**
7 **Defendants)**

8 93. Plaintiff repeats and re-alleges each and every allegation contained in the
9
10 foregoing paragraphs as if fully set forth herein.

11 94. During the Class Period, the Individual Defendants participated in the
12 operation and management of KushCo, and conducted and participated, directly and
13 indirectly, in the conduct of KushCo's business affairs. Because of their senior positions,
14 they knew the adverse non-public information about KushCo's misstatement of income
15 and expenses and false financial statements.
16
17

18 95. As officers and/or directors of a publicly owned Company, the Individual
19 Defendants had a duty to disseminate accurate and truthful information with respect to
20 KushCo's financial condition and results of operations, and to correct promptly any public
21 statements issued by KushCo which had become materially false or misleading.
22
23

24 96. Because of their positions of control and authority as senior officers, the
25 Individual Defendants were able to, and did, control the contents of the various reports,
26 press releases and public filings which KushCo disseminated in the marketplace during
27 the Class Period concerning KushCo's results of operations. Throughout the Class Period,
28

1 the Individual Defendants exercised their power and authority to cause KushCo to engage
2 in the wrongful acts complained of herein. The Individual Defendants therefore, were
3 “controlling persons” of KushCo within the meaning of Section 20(a) of the Exchange
4 Act. In this capacity, they participated in the unlawful conduct alleged which artificially
5 inflated the market price of KushCo securities.
6

7
8 97. Each of the Individual Defendants, therefore, acted as a controlling person of
9 KushCo. By reason of their senior management positions and/or being directors of
10 KushCo, each of the Individual Defendants had the power to direct the actions of, and
11 exercised the same to cause, KushCo to engage in the unlawful acts and conduct
12 complained of herein. Each of the Individual Defendants exercised control over the
13 general operations of KushCo and possessed the power to control the specific activities
14 which comprise the primary violations about which Plaintiff and the other members of the
15 Class complain.
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19 98. By reason of the above conduct, the Individual Defendants are liable pursuant
20 to Section 20(a) of the Exchange Act for the violations committed by KushCo.
21

22 **PRAYER FOR RELIEF**

23 **WHEREFORE**, Plaintiff demands judgment against Defendants as follows:

24 A. Determining that the instant action may be maintained as a class action under
25 Rule 23 of the Federal Rules of Civil Procedure, and certifying Plaintiff as the Class
26 representative;
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