

Surna Inc.
Form 10-Q
May 21, 2013

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

FORM 10-Q

- QUARTERLY REPORT UNDER TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended MARCH 31, 2013
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 333-164578

SURNA INC.

(Exact name of registrant as specified in its charter)

Nevada
*(State or other jurisdiction of
incorporation or organization)*

27-3911608
(I.R.S. Employer Identification No.)

**Suite S3, 414 Block B, Goldway Industrial Centre
2 Wing Kin Road, Kwai Tsing**

N/A

Hong Kong

(Address of principal executive offices)

(ZIP Code)

+852.3721.3668

(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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). **YES** **NO**

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. (Check one):

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). **YES** **NO**

SURNA INC.

Quarterly Report on Form 10-Q

For the Quarter ended 31 March, 2013

TABLE OF CONTENTS

PART I

<u>ITEM 1. FINANCIAL STATEMENTS.</u>	1
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.</u>	13

PART II

<u>ITEM 1. LEGAL PROCEEDINGS.</u>	20
<u>ITEM 1A. RISK FACTORS.</u>	20
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.</u>	20
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES.</u>	20
<u>ITEM 4. MINE SAFETY DISCLOSURES.</u>	20
<u>ITEM 5. OTHER INFORMATION.</u>	20
<u>ITEM 6. EXHIBITS.</u>	20

<u>Signatures</u>	21
-------------------	----

<u>Exhibit Index</u>	22
----------------------	----

AVAILABLE INFORMATION

Surna Inc. files annual, quarterly and current reports and other information with the Securities and Exchange Commission (the "SEC"). You may read and copy any document we file with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including Morgan Stanley) file electronically with the SEC. Surna's electronic SEC filings are available to the public at the SEC's internet site, www.sec.gov.

Surna's internet site is surna.com. You can access the Company's Investor Relations webpage at surna.com/index/investors and Corporate Governance webpage at governance.surna.com. Surna posts the following on its Corporate Governance webpage:

.
Code of Ethics

.
Charter for our Audit Committee

.
Charter for our Disclosure Committee

Surna's Code of Ethics applies to all directors, officers and employees, including its Chief Executive Officer, its Chief Financial Officer and its Controller and Principal Accounting Officer. Surna will post any amendments to the Code of Ethics on its internet site. The information on Surna's internet site is not incorporated by reference into this report.

CERTAIN CONVENTIONS

Except where the context otherwise requires and for purposes of this quarterly report only:

.
China or PRC refers to the People's Republic of China, and excludes Hong Kong, Macau and Taiwan;

we, us, our company and our refer to Surna Inc., and, unless the context requires otherwise, its wholly-owned subsidiaries, including Surna Media Inc., a British Virgin Islands company, Surna Hongkong Limited, a Hong Kong company, and Flying Cloud Information Technology Co. Ltd., a PRC company.

FORWARD-LOOKING INFORMATION

This quarterly report contains statements of a forward-looking nature. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. These statements are made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by terminology such as may, will, expects, anticipates, future, intend, plan, estimate, is/are likely to or other similar expressions. The accuracy of these statements may be impacted by a number of risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, the following:

We have limited financial resources and accordingly may not be able to continue to operate as a going concern unless we obtain additional financing;

Our lack of resources may make it difficult or impossible to stabilize and strengthen our position as an online game developer in China;

We may not be successful in our efforts to develop and launch additional online games;

Our various initiatives to implement our business strategies may not prove successful despite the costs incurred to pursue them;

Our competitors have significantly more resources than we do, and as a result we might not be able to compete successfully;

The regulatory environment in China and other countries relating to the Internet and Internet content providers, including online game developers and operators, may hinder or impair our ability to conduct our online gaming business as we intend; and

These risks are not exhaustive. We operate in an emerging and evolving environment. New risk factors emerge from time to time and it is impossible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results of this annual report to differ materially from those contained in any forward-looking statement.

We would like to caution you not to place undue reliance on forward-looking statements and you should read these statements in conjunction with the risk factors disclosed under Item 1A. Risk Factors of our last annual report. We do not undertake any obligation to update or revise the forward-looking statements except as required under applicable law.

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

Surna Inc.

Condensed Consolidated Balance Sheets

	March 31, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current Assets		
Cash	\$ 1,203	\$ 1,197
Accounts receivable	22	-
Prepaid expenses	-	250
Total Current Assets	1,225	1,447
Equipment, net of accumulated depreciation	13,335	16,668
TOTAL ASSETS	\$ 14,560	\$ 18,115
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Accrued liabilities	\$ 80,893	\$ 83,509
Amounts due to related parties	2,466,224	2,371,861
Total Current Liabilities	2,547,117	2,455,370
TOTAL LIABILITIES	2,547,117	2,455,370
STOCKHOLDERS DEFICIT		
Preferred stock, \$0.00001 par value; 150,000,000 shares authorized;	-	-
0 shares issued and outstanding		
Common stock, \$0.00001 par value; 350,000,000 shares authorized;	994	994
99,375,000 issued and outstanding		
Paid in capital	148,507	148,507
Accumulated other comprehensive loss	(7,438)	(4,304)
Accumulated deficit	(2,674,620)	(2,582,452)

Total Stockholders' Deficit		(2,532,557)		(2,437,255)
TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT	\$	14,560	\$	18,115

Please see accompanying notes to these unaudited condensed consolidated financial statements

F1

Surna Inc.

Condensed Consolidated Statement of Operations and Comprehensive Income

(Unaudited)

	Three months ended	
	March 31,	March 31,
	2013	2012
Revenue	\$ 22	\$ 47,831
Cost of revenue	-	-
Gross margin	22	47,831
Operating Expenses:		
Depreciation expenses	3,333	3,333
Product development cost	-	17,433
General and administrative expenses	88,858	188,984
Total operating expenses	92,191	209,750
Operating loss	(92,168)	(161,919)
Other income (expenses):		
Other expense	-	-
Loss from continuing operations before provision for income taxes	(92,168)	(161,919)
Provision for income taxes	-	-
Loss from continuing operations	(92,168)	(161,919)
Income from discontinued operations	-	11,607
Net loss	(92,168)	(150,312)
Comprehensive loss:		
Net loss	(92,168)	(150,312)
Foreign currency translation loss	(3,134)	(50)
Comprehensive loss	\$ (95,302)	\$ (150,362)
Loss per common share from continuing operations - basic and diluted	(\$0.00)	(\$0.00)
Income per common share from discontinued operations - basic and diluted	\$0.00	\$0.00
Net loss per common share - basic and diluted	(\$0.00)	(\$0.00)
Weighted average number of common shares outstanding, basic and diluted	99,375,000	99,375,000

Please see accompanying notes to these unaudited condensed consolidated financial statements.

Surna Inc.

Condensed Consolidated Statement of Cash Flows

(Unaudited)

	For the three months ended March 31, 2013	For the three months ended March 31, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (92,168)	\$ (150,312)
Income from discontinued operations	-	11,607
Loss from continuing operations	(92,168)	(161,919)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation expense	3,333	3,333
Changes in operating assets and liabilities:		
Accounts receivable	(22)	(47,906)
Prepaid expenses	250	565
Accrued liabilities	(2,616)	(4,237)
Amount due to related parties	94,363	200,981
Cash provided by (used in) operating activities of continuing operations	3,139	(709)
Cash (used in) operating activities of discontinued operations	-	(53)
Net cash provided by (used in) operating activities	3,139	(762)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash flow used in investing activities	-	-
CASH FLOWS FROM FINANCING ACTIVITIES		
Net cash provided by financing activities	-	-
Effect of exchange rate changes on cash	(3,133)	(50)
Net increase (decrease) in cash	6	(812)
Cash, beginning of period	1,197	2,798
Cash, end of period	\$ 1,203	\$ 1,986
Supplementary disclosure of cash flow information		
Cash paid for interest	\$ -	\$ -
Cash paid of income tax	\$ -	\$ -

Please see accompanying notes to these unaudited condensed consolidated financial statements.

F3

Surna Inc.

Notes to Condensed Consolidated Financial Statements

March 31, 2013 and 2012

(Unaudited)

NOTE 1 - NATURE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Company

Surna Inc. was incorporated in the State of Nevada on October 15, 2009. From September through November 2010, the company placed 4,175,000 shares to 51 individuals at \$0.02 per shares and raised \$83,500 excluding expenses. On May 16, 2011 a stock dividend of 4 new shares for each 1 share held was declared, with a record date of May 18, 2011. On May 18, 2011 authorized capital was increased from 100,000,000 common shares to 350,000,000 common shares. On September 1, 2011, Surna Inc. entered the online game development business by acquiring Surna Media Inc. and its operating subsidiaries Surna Hongkong Limited and Flying Cloud Information Technology Co. Ltd. through the issuance of 20,000,000 common shares.

Qoo Games Limited was incorporated in Hong Kong on February 21, 2012. It was intended that this company operate as the publisher of mobile games, including for the iOS and Android operating systems, but to-date it has not commenced operations.

Basis of presentation

The accounting policies and methods followed in preparing these unaudited condensed consolidated financial statements are those used by Surna Inc. (the Company) as described in Note 1 of the notes to consolidated financial statements included in the Annual Report on Form 10-K. The unaudited condensed consolidated financial statements for the three-months ended March 31, 2013 and 2012 have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission and do not conform in all respects to the disclosure and information that is required for annual consolidated financial statements. Operating results for the three month period presented are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The balance sheet at December 31, 2012 has been derived from audited financial statements. These interim consolidated financial statements should be read in conjunction with the most recent 10-K form of the Company filed on April 16, 2013.

In opinion of management, all adjustments, all of which are of a normal recurring nature, considered necessary for fair statement have been included in these interim consolidated financial statements.

Basis of Consolidation

The unaudited condensed consolidation financial statements include the accounts of the Company and its subsidiaries, including Surna Media Inc, Surna Hongkong Limited, and Flying Cloud InfoTech Co. Ltd. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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

Reclassifications

Certain reclassifications have been made to amounts in prior periods to conform with the current period presentation. All reclassifications have been applied consistently to the periods presented.

Cash and Cash Equivalents

All highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents.

Property and Equipment

Property and equipment are stated at cost. When retired or otherwise disposed, the related carrying value and accumulated depreciation are removed from the respective accounts and the net difference less any amount realized from disposition, is reflected in earnings. For financial statement purposes, property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives.

Revenue Recognition

The Company provides software development services related to online games in current fiscal year. Based on ASC 985-605-25-3 Software Not Requiring Significant Production, Modification, or Customization, revenue is recognized when persuasive evidence of an arrangement exists, delivery of services has occurred, the service fee is fixed or determinable and the collectability is reasonably assured.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at invoiced amount and generally do not bear interest. An allowance for doubtful accounts is established, as necessary, based on past experience and other factors which, in management's judgment, deserve current recognition in estimating bad debts. Such factors include growth and composition of accounts receivable, the relationship of the allowance for doubtful accounts to accounts receivable and current economic conditions. The determination of the collectability of amounts due from customer accounts requires the Company to

make judgments regarding future events and trends. Allowances for doubtful accounts are determined based on assessing the Company's portfolio on an individual customer and on an overall basis. This process consists of a review of historical collection experience, current aging status of the customer accounts, and the financial condition of Surna Inc.'s customers. Based on a review of these factors, the Company establishes or adjusts the allowance for specific customers and the accounts receivable portfolio as a whole. At March 31, 2013 and December 31, 2012, an allowance for doubtful accounts was not considered necessary as all accounts receivable were deemed collectible.

Concentration of Credit Risk

Financial instruments that potentially subject Surna Inc. to concentration of credit risk consist of cash and accounts receivable. Under Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, for the two-year period of January 1, 2011 through December 31, 2012, cash balances in noninterest-bearing transaction accounts at all FDIC-insured depository institutions are provided temporary unlimited deposit insurance coverage. At March 31, 2013, cash balances in interest-bearing accounts are zero.

Sales to customers via Apple's AppStore comprised 100% of Surna Inc.'s revenues of \$22 for the three months ended March 31, 2013. At March 31, 2013, Surna Inc.'s accounts receivable from its primary customer was \$22. Surna Inc. believes that, in the event that its primary customer is unable or unwilling to continue to purchase Surna Inc.'s production, there are a substantial number of alternative buyers for its production at comparable prices.

Foreign Currency Translation

The Company translates the foreign currency financial statements into US Dollars using the year or reporting period end or average exchange rates in accordance with the requirements of Accounting Standards Codification subtopic 830-10, Foreign Currency Matters (ASC 830-10). Assets and liabilities of these subsidiaries were translated at exchange rates as of the balance sheet date. Revenues and expenses are translated at average rates in effect for the periods presented. The cumulative translation adjustment is included in the accumulated other comprehensive gain (loss) within shareholders' equity (deficit). Foreign currency transaction gains and losses arising from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the unaudited condensed consolidated results of operations.

Functional Currency

The functional currency of the Company is the United States Dollars (USD). The functional currency of the Company's operating subsidiary, Surna HK, is the Hong Kong Dollar (HKD). The functional currency of the Surna HK's operating subsidiary in PRC, Flying Cloud, is the Renminbi (RMB), the PRC's currency. Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency at rates of exchange prevailing at the balance sheet dates. Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transaction. Exchange gains or losses arising from foreign currency transactions are included in the determination of net income (loss) for the respective periods.

For financial reporting purposes, the consolidated financial statements of the Company are translated into the Company's reporting currency, United States Dollars (USD). Balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using the average exchange rate prevailing during the reporting period.

The exchange rates used to translate amounts in HKD and RMB into USD for the purposes of preparing the consolidated financial statements were as follows:

	March 31, 2013	March 31, 2012
Period-end HKD: USD exchange rate	\$ 7.80	\$ 7.80
Average Period HKD: USD exchange rate	\$ 7.80	\$ 7.80
Period-end RMB: USD exchange rate	\$ 6.27	\$ 6.31
Average Period RMB: USD exchange rate	\$ 6.28	\$ 6.30

Comprehensive Income (Loss)

The Company adopted Accounting Standards Codification subtopic 220-10, Comprehensive Income (ASC 220-10) which establishes standards for the reporting and displaying of comprehensive income (loss) and its components. Comprehensive income (loss) is defined as the change in stockholders' equity (deficit) of a business during a period from transactions and other events and circumstances from non-owners sources. It includes all changes in stockholders' equity (deficit) during a period except those resulting from investments by owners and distributions to owners. ASC 220-10 requires other comprehensive income (loss) to include foreign currency translation adjustments and unrealized gains and losses on available for sale securities.

F6

Recent Accounting Pronouncements

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

NOTE 2 - GOING CONCERN

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company currently has \$2,545,892 working capital deficit (current liabilities exceeds current assets), minimal sources of recurring revenue and has generated cumulative net losses of \$2,674,620 during the period from inception through March 31, 2013.

In the course of its development activities, the Company has sustained and continues to sustain losses. The Company cannot predict if and when the Company will generate profits. The Company expects to finance its operations primarily through debt or equity financing.

These conditions raise substantial doubt about the Company's ability to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to meet its obligations, to obtain additional financing as may be required until such time as it can generate sources of recurring revenues and to ultimately attain profitability. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 3 - CHANGE IN FISCAL YEAR-END

On March 19, 2012, the Board of Directors approved a change to our fiscal year end from November 30 to December 31 of each year. With the change effective this 2012 fiscal year, which will now end December 31, 2012, there is a one fiscal month transition period covering the fiscal month of December 2011. Results for this transition period are reported in the Quarterly Report commencing the first fiscal quarter ended March 31, 2012 along with the results for the new fiscal quarters in 2012. Notice of the Company's election of a change in fiscal year was made on Form 8-K, which was filed on March 20, 2012.

NOTE 4 - DISCONTINUED OPERATIONS

Edgar Filing: Surna Inc. - Form 10-Q

On March 27, 2012, Surna Inc. sold Surna Networks Inc. and Surna Networks Limited to CHAN Kam Ming for a total sales price of US\$1. Surna Inc. assumed liabilities of Surna Networks Inc. and Surna Networks Limited of US\$9,286. Surna Networks Inc. was incorporated on July 19, 2011 and Surna Networks Limited was incorporated on August 2, 2011.

The results of discontinued operations of Surna Networks for the three month ended March 31, 2013 and 2012 are summarized as below:

	Surna Networks, Inc. (USD)		Surna Networks Limited (USD)	
	Three Months Ended	Three Months Ended	Three Months Ended	Three Month Ended
	03/31/2013	03/31/2012	03/31/2013	03/31/2012
Revenue	\$ -	\$ -	\$ -	\$ 44,433
Cost of Revenue	-	-	-	(31,323)
General & Administrative	-	-	-	(1,503)
Net (Loss) Income	\$ -	\$ -	\$ -	\$ 11,607

F7

NOTE 5 - SIGNIFICANT CONCENTRATIONS, RISKS AND UNCERTAINTIES

The majority of the Company's operations are carried out in the PRC. Due to this the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, and by the general state of the PRC's economy.

The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in the North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

NOTE 6 - RELATED PARTY TRANSACTIONS

As of March, 2013 and December 31, 2012, the Company had a balance due to related parties of \$2,466,224 and \$2,371,861, respectively. This balance is from various advances from the Company's directors for working capital purposes and expenses incurred on behalf of Company and salary due to them and which are non-interest bearing, unsecured and due on demand.

NOTE 7 - COMMITMENTS AND CONTINGENCIES

Settlement Payments

On March 7 2013, the Company entered into settlement agreement with a former employee for outstanding dues. In accordance with the terms of the agreement, the Company is obligated to make payments totaling HK\$80,000 (US\$10,257). An initial payment of HK\$10,000 (US\$1,282) was made on April 7, 2013 and monthly payments of HK\$10,000 (US\$1,282) are due through August 2013 and then HK\$15,000 (US\$1,923) is due for next two months. A final payment of HK\$15,000 (US\$1,923) will be due in October 2013. As of March 31, 2013, the Company has accrued of this settlement of HK\$80,000 (US\$10,257) under accrued liabilities on its balance sheet.

Service agreement

During March, 2012, the Company entered into an agent agreement with Jurun Information Technology (Shanghai) Co. Ltd. (Jurun), and Jurun entered into a technical service agreement with Kunlun Wanwei Information Technology Company Ltd (Kunlun). Under the agreements, the Company provided the license of the online game to Jurun and on the same date the license was transferred from Jurun to Kunlun for a period of five years. The Company will receive upfront fees of RMB 1 million (US\$158,730) payable in the following installments: 1) 30% after the first closed-beta testing; 2) 50% after the second closed-beta testing and 3) 20% after the first open-beta testing. In addition, the Company will receive 20% of game-related revenue from Kunlun during the agreement term. All amounts due from Kunlun will be transferred to Jurun and Jurun will return 100% of the fees back to the Company.

Therefore, the Company recognized the RMB 1 million (US\$158,730) fee as revenue during the year 2012 in accordance with ASC 985-605-25-3 Software Not Requiring Significant Production, Modification, or Customization. As of the date the Company was unable to collect the revenue amounts and therefore, as of balance sheet date, the Company had reversed the whole revenue.

Litigation

The Company is subject to certain legal proceedings and claims, which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity. There was no outstanding litigation as of March 31, 2013.

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

You should read the following discussion and analysis of our financial condition and results of operations together with the information in our consolidated financial statements (unaudited) for the current period and our consolidated annual audited financial statements for the last fiscal year as filed on Form 10-K, and the notes thereto and other financial information incorporated by reference. Some of the information contained in this discussion and analysis includes forward-looking statements that involve risks and uncertainties. You should review the Risk Factors section of our last annual report for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

Liquidity and Capital resources

We are a start-up company and have not yet generated significant revenues from our business operations. Our auditors have issued a going concern opinion; this means that our auditors believe there is substantial doubt that we can continue as an on-going business for the next twelve months unless we obtain additional capital. Accordingly, we must raise cash from sources other than operations. Our only other source of funds at this time is further investment in our company by existing shareholders or others. If we need additional funds and cannot raise them, we will either have to suspend operations until we raise sufficient capital, or cease operations entirely.

Since inception, we have sold 75,000,000 shares of common stock to 7bridge Capital Management Limited for \$15,000. From September through November 2010, the company placed 4,175,000 shares to 51 individuals at \$0.02 per shares and raised \$83,500 excluding expenses.

We issued 79,175,000 shares of common stock, 75,000,000 shares pursuant to the exemption from registration contained in Regulation S of the Securities Act of 1933 and 4,175,000 shares pursuant to our public offering. Both were accounted for as sales of common stock. On May 16, 2011 we declared a stock dividend of 4 new shares for each 1 share held, with a record date of May 18, 2011. On May 18, 2011 our Board of Directors approved an increase in authorized capital from 100,000,000 common shares to 350,000,000 common shares.

There is limited historical financial information about us upon which to base an evaluation of our performance. We are in a start-up stage of operations and have not generated significant revenues and are subject to risks inherent in the establishment of a new business enterprise, including limited capital resources. We have no assurance that future financing will be available to us on acceptable terms. If financing is not available on satisfactory terms, we may be unable to continue, develop or expand our operations. Equity financing could result in additional dilution to existing shareholders.

Edgar Filing: Surna Inc. - Form 10-Q

As of December 31, 2012, our total current assets were \$1,447 and our total current liabilities were \$2,455,370, hence a working capital deficit of \$2,453,923.

As of March 31, 2013, our total assets were \$1,225 and our total liabilities were \$2,547,117, hence a working capital deficit of \$2,545,892.

Results of Operations

We are a start-up stage corporation and have not generated or realized significant revenues from our business operations. To meet our initial need for cash we raised money from our public offering. Our only other source for cash at this time is investments by others in our company, and if we can not rely on loans from our officers, shareholders or others in order for us to maintain our operations we may need to find alternative sources, like a second public offering or a private placement of securities. At present, if we cannot generate sufficient revenues to continue operations or if we do not secure any additional funding we may either have to suspend operations until we do raise funds, or cease operations entirely.

Sale of a subsidiary and change in operating segments

Previously Surna Inc. had two direct operating subsidiaries: Surna Media Inc. (Surna Media) and Surna Networks, Inc. (Surna Networks). Surna Media 's principal business is the development of web and mobile games and social networks. Surna Network 's principal business is telecommunications services, IT support services and open-source software development.

Surna Networks had been established to develop and provide a range of information technology and network services for potential customers, including game companies inside and outside of the PRC, but its business had focused solely on wholesale carrier services utilizing VoIP telecommunications, which is also referred to as International Simple Resale (ISR). Results of the ISR business were disappointing, and we did not foresee it being self-supporting or profitable without further significant investment. Upon further review we determined that it is not relevant to our core business or future plans, and that the best strategy was the sale or winding-up of this business line. On 27 March 2012 we entered into an agreement for the sale of all of the issued and outstanding shares of Surna Networks. The Board of Directors determined that there was no intrinsic value in the current operations of Surna Networks, and therefore accepted an offer to purchase the company for the par value of the issued shares of US\$1.00.

With the sale of Surna Networks we now operate in only one distinct segment, that being Surna Media 's online and mobile games and social networks development business.

Sales of mobile games

Sales to customers via Apple 's AppStore comprised 100% of our revenues of \$22 for the three months ended March 31, 2013. At March 31, 2013, our accounts receivable from its primary customer was \$22. We believe that, in the event that its primary customer is unable or unwilling to continue to purchase Surna Inc. 's production, there are a

substantial number of alternative buyers for its production at comparable prices.

Strategy

Our development efforts have focused on two main areas that span both the web and mobile platforms: firstly, games developed in conjunction with animated television series; and secondly, more traditional products targeted at a teenage and young-adult male audience. Results from our game development business in the PRC have to-date been disappointing but it is our intention to continue to pursue opportunities in game publishing, focusing at present on mobile games and then on opportunities in web-game publishing in other markets. In summary, the current status of our game development projects is:

Ori-Princess: Spring Cleaning: Development of the iPhone version was completed in October 2012 and it was published on the Apple Appstore from 25 October, 2012. Sales from release through March 31, 2013 totaled \$22. We have had discussions with third-party mobile publishers in the PRC about publishing an advertising supported version of the game, but to date these have not resulted in any final contracts.

Ori-Princess: Development work on the Ori-Princess role-playing game was suspended indefinitely on November 9, 2012. It is our intention to explore options for either working with other game developers to complete this project or engaging new development personnel to restart the development program, but so far we have not reached any arrangements for this.

Serica: Publishing rights for the Simplified Chinese version of the game were licensed to Kunlun (through Jurun) in March 2012, with the first payment of RMB 300,000 due on April 1, 2012, and with subsequent payments of RMB 500,000 in May and RMB 200,000 in July, 2012. Kunlun commenced charging for the game on July 12, 2012, which constituted the start of commercial operations. To-date no payment has been received from Kunlun for any part of the licensing of the game. On January 7, 2013 Jurun, as the official licensor, engaged Receivables Management Services (HK), Limited (RMS) to attempt to recover all or some of the amounts owed. RMS' s collection efforts have to-date not met with success, and we are still evaluating what further actions it would be beneficial for us to pursue regarding this project.

Qia Ke Zhong Shi (Legend of the Kung-Fu Masters): As of August 2012 development work on this game had largely been completed, however YouQu refused to continue any further with its contracted development work or provide the game or agree to support the finished product. Flying Cloud requested from YouQu delivery or return of all the contracted work product, including up-to-date source code, documentation and art work on September 25, 2012; but to date this has not been forthcoming. We are still evaluating what further actions it would be beneficial for us to pursue, including its continued development, and licensing or selling it to a third-party developer or publisher.

Contractual arrangements for character licensing and game development

Development work on *Serica* and *Qia Ke Zhong Shi* was contracted by Flying Cloud to YouQu Interactive (Beijing) Technology Co. Ltd., a company controlled by Yeah YE, a consultant to Flying Cloud (YouQu). The completion date to beta-test stage for *Serica* was April 2012 and for *Qia Ke Zhong Shi* in August 2012. Development work on *Ori-Princess: Spring Cleaning* was contracted by Flying Cloud to Guangzhou Nine Leaf Network Technology Co. Ltd.

Online Game publishing in the PRC

As the copyright ownership of online games that are to be distributed in the PRC is restricted to domestic PRC entities (that is, a natural person who is a citizen or corporations that are not foreign-invested), commercial distribution of any products that are the copyright of our subsidiary corporation in the PRC, Flying Cloud Information Technology Co. Ltd. (Flying Cloud) as a foreign-owned entity, would not be possible. Accordingly, the copyright, for the PRC only, for our online games is held in-trust for Flying Cloud by Jurun Information Technology (Shanghai) Co. Ltd. (Jurun). Jurun is incorporated in Shanghai and its equity interest is owned by two PRC citizens, who hold the company in-trust for a British Virgin Islands (BVI) corporation, Evident Games Limited (Evident), through a series of contractual arrangements that make Jurun a Variable Interest Entity (VIE) of Evident. Evident is in turn controlled by Lim Clarke & Co, the majority shareholder of Surna Inc.

Publishing rights for the Simplified Chinese versions of the game were licensed by Jurun to Beijing Kunlun World Wide Technology Share Co., Ltd., an enterprise organized under the laws of the PRC (Kunlun). On March 19, 2012, Flying Cloud entered into a Technical Services agreement (the Technical Services Contract) with Jurun, in a transaction that is effectively a licensing of the Simplified Chinese version of the game. An exclusive, global license to publish the Simplified Chinese version of the game has been granted by Jurun to Kunlun for a term of 5 years from date of the commencement of commercial operations, which was July 12, 2012. The terms of the Technical Services Contract between Jurun and Flying Cloud mirror the terms of Jurun's licensing agreement with Kunlun, and provide for Flying Cloud to receive the full economic benefit of the licensing of the Simplified Chinese version of the game. Under the terms of the contract for development work that was undertaken on the game, 20% of the income derived from the game by Surna is due to YouQu. It was expected at the time that licenses for the Traditional Chinese and Korean versions of the game would be granted to Kunlun as well, but in the end Jurun did not proceed with finalizing these agreements.

Mobile game publishing in the PRC

There are no similar restrictions in the PRC on the publishing of games for mobile devices, and therefore these games are the copyright of Surna Inc. worldwide, including in China, and will be published on the Apple Appstore and Google Play and other Android app markets by Surna. It is our intention to transition these operations to our newly incorporated subsidiary Qoo Games Limited in 2013.

Target Markets

We plan to develop further games for children, pre-teens and teens, female players and young-adults over the next two years. These will include online and mobile games and we intend, whenever possible, to work with the producers of cartoon TV-series and movies in the PRC on licensing and product tie-ins. At present we have limited financial resources and this may restrict or render ineffective the marketing and advertising program that we will need to undertake, which may materially effect our operations. Our primary target for online gaming customers are children and young adults, female game players, students and office workers. As game developers we intend to reach the end-user through the licensing of our products to independent publishers, however we may at some point choose to supplement there efforts with online advertising, including display ads, paid search ads, and social media marketing campaigns.

Factors affecting results of our operations in China

The majority of our operations are carried out in the PRC and the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments, and by the general state of the PRC's economy and of the online games industry there. For example, we benefit from the overall economic growth in

China in the past several years, which has resulted in increases in disposable income and discretionary consumer spending; the increasing use of the Internet; the growing popularity of online games in comparison with other forms of entertainment; and favorable demographic trends. Our results of operations may be adversely affected by an economic slowdown in China and other countries and regions where our games are operated, or the arrival of additional competition in the markets where we operate. They may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things. Regulation imposed by the government of China and other countries on the online game industries may also have significant impact on our results of operations in the future.

Our operating results are more directly affected by company-specific factors including the following:

- .
our cost of developing and marketing online games;
- .
the speed at which we develop and launch new online games and related in-game items;
- .
the popularity of our games and in-game items compared with those of our competitors;
- .
the amount of our licensing revenues inside of China; and
- .
the success of investments and merger and acquisition activities.

Our future growth will depend significantly upon our ability to continually and successfully develop and market additional online games that are attractive to players and to increase the monetization of our existing and future games in China.

Taxation

Nevada

Surna Inc. and Surna Networks, Inc. are each required to pay an annual fee to the Nevada Secretary of State of \$165. Nevada has no corporate income taxes. Although the majority of our operations are outside the United States, we may be subject to federal or other U.S. taxation in the future.

British Virgin Islands

Surna Media is incorporated in the BVI. Under current laws, it is not subject to income or capital gains tax. In addition, payment of dividends to its shareholder, Surna Inc., is not subject to withholding tax.

Hong Kong

Our subsidiary in Hong Kong is subject to a profit tax at the rate of 16.5% on assessable profit determined under relevant Hong Kong tax regulations.

According to the *Mainland and Hong Kong Special Administrative Region Arrangement on the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, or the Tax Agreement, dividends paid by a foreign-invested enterprise in mainland China to its corporate shareholder in Hong Kong will be subject to withholding tax at a maximum rate of 5.0%, provided however that such Hong Kong company directly owns at least 25.0% of the equity interest in the mainland foreign-invested enterprise. However, under the new *Enterprise Income Tax Law* (EIT) and its implementation rules, as well as *Circular No. 601* issued by SAT in October 2009 (or *Circular 601*), dividends from our PRC subsidiary paid to us through Surna HK may be subject to withholding tax at a rate of 10.0% if Surna HK is not considered to be the beneficial owner of the dividends distributed by a resident enterprise of the PRC.

Surna HK currently holds all the equity interest in our PRC operating company Flying Cloud. To the extent that Surna HK is considered a non-resident enterprise of the PRC under the Tax Agreement, dividends paid by Flying Cloud may be subject to a maximum withholding tax rate of 10.0%. Dividends paid by Surna HK to its shareholder will not be subject to any Hong Kong withholding tax.

China - PRC Enterprise Income Tax

Prior to January 1, 2008, companies established in China were generally subject to state and local EIT at statutory rates of 30% and 3% respectively. On March 16, 2007, the National People's Congress of China enacted a new regulation, the *PRC Enterprise Income Tax Law*, which took effect beginning January 1, 2008. On December 6, 2007, the State Council also adopted the *Implementing Rules for the Enterprise Income Tax Law*, or the *Implementing Rules*, which also took effect beginning January 1, 2008. Under the PRC EIT Law, foreign invested enterprises (or FIEs), and Chinese domestic companies are subject to EIT at a uniform rate of 25%. On February 22, 2008, the Ministry of Finance and the State Administration of Taxation, or the SAT, promulgated the *Notice on Several Preferential Policies in Respect of Enterprise Income Tax* (or Notice No. 1 2008), reiterating the policy that a software enterprise newly established within China may, upon determination, be exempted from income taxes for its first two profit-making years and shall be subject to the income tax at half the standard rate for the next three years.

Qualification as a software enterprise is however subject to an annual assessment by the relevant government authorities in China. We may be classified as a resident enterprise for PRC enterprise income tax purposes, which could result in our global income becoming subject to 25% PRC enterprise income tax. Under the PRC EIT Law and the *Implementing Rules*, dividends generated from the business of our PRC subsidiary and payable to us may be subject to a withholding tax rate of 10% if we are considered a non-resident enterprise incorporated outside of the PRC unless there is an applicable tax treaty with China that provides for a different withholding arrangement and we are deemed to be entitled to such favorable treatment. If we were to be classified as a resident enterprise for PRC enterprise income tax purposes, this would result in our global income becoming subject to 25% PRC enterprise income tax.

Foreign currency and foreign currency translation

Foreign currency may have a major impact on our financial results. The functional currency of the Company is the United States Dollars (USD). The functional currency of the Company's operating subsidiary, Surna HK, is the Hong Kong Dollar (HKD). The functional currency of the Surna HK's operating subsidiary in PRC, Flying Cloud, is the Renminbi (RMB), the PRC's currency. Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency at rates of exchange prevailing at the balance sheet dates. Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transaction. Exchange gains or losses arising from foreign currency transactions are included in the determination of net income (loss) for the respective periods.

For financial reporting purposes, the consolidated financial statements of the Company are translated into the Company's reporting currency, United States Dollars (USD). Balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using the average exchange rate prevailing during the reporting period.

Adjustments resulting from the translation, if any, are included in accumulated other comprehensive income (loss) in stockholders' equity.

Going Concern

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company currently has \$2,545,892 working capital deficit (current liabilities exceeds current assets), minimal sources of recurring revenue and has generated cumulative net losses of \$2,674,620 during the period from inception through March 31, 2013.

In the course of its development activities, the Company has sustained and continues to sustain losses. The Company cannot predict if and when the Company will generate profits. The Company expects to finance its operations primarily through debt or equity financing.

These conditions raise substantial doubt about the Company's ability to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to meet its obligations, to obtain additional financing as may be required until such time as it can generate sources of recurring revenues and to ultimately attain profitability. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The report of the Company's independent registered public accounting firm relating to the December 31, 2012 consolidated financial statements states that there is substantial doubt about the Company's ability to continue as a going concern.

Period Ended March 31, 2013 and March 31, 2012

Our revenues from Continuing Operation for the period ended March 31, 2013 were \$22 which was from our online games. The net loss from continuing operations for the period ended March 31, 2013 was \$92,168 of which includes \$63,231 for Salaries, and \$28,960 for general and administration expense. The gross profit from continuing operations was \$47,831 and the net loss was \$161,919 for the three months period ended March 31, 2012. In which, it includes \$143,331 for Salaries, \$17,433 for product development and \$48,986 for general and administration expense.

Income from discontinued operation for the three month period ended March 31, 2012 is \$11,607, with no such comparative figure for three months period ended March 31, 2013.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information under this item.

ITEM 4. CONTROLS AND PROCEDURES.

a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including the Principal Executive Officer and Principal Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Principal Executive Officer and Principal Financial Officer have concluded that these disclosure controls and procedures are not effective because of the identification of a material weakness in our internal control over financial reporting which is identified below, which we view as an integral part of our disclosure controls and procedures.

.

The Company lacks proper segregation of duties. We believe that the lack of proper segregation of duties is due to our limited resources.

.

The Company does not have a comprehensive and formalized accounting and procedures manual.

Our management does not expect that our disclosure controls and internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by individual acts or collusion between two or more people, or by management or board override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

(b) Changes in internal control over financial reporting.

There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are not presently a party to any litigation.

ITEM 1A. RISK FACTORS.

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

Incorporated by reference to the Exhibit index attached hereto.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing of this Form 10-Q and has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 21st day of May, 2013.

SURNA INC.

(the Registrant)

BY: /s/ Cherry Lim

Cherry Ping-Wai Lim

CEO (Principal Executive Officer) and a member of the Board of Directors

BY: /s/ Poon Manchor

Man-Chor POON

Chief Financial Officer (Principal Financial Officer, Principal Accounting Officer), Treasurer

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

Signature	Title	Date
<u>/s/ Cherry Lim</u> Cherry Ping-Wai Lim	CEO (Principal Executive Officer) and a member of the Board of Directors	May 21, 2013
<u>/s/ Richard Clarke</u> Richard Clarke	Member of the Board of Directors	May 21, 2013

EXHIBIT INDEX

Exhibit	Document Description	Incorporated by reference			Filed herein
		Form	Date	Number	
3.1	Articles of Incorporation	S-1	1/28/10	3.1	
3.2	Bylaws	S-1	1/28/10	3.2	
3.3	Amended Articles of Incorporation	8K	6/16/11	33	
4.1	Specimen Stock Certificate	S-1	1/28/10	4.1	
10.1	Asset purchase agreement with Kopere Limited	8-K	4/28/11	10.1	
10.2	Debt conversion agreement with Kopere Limited	8-K	6/23/11	10.1	
10.3	Share exchange agreement for Surna Media Inc.	8-K	11/8/11	10.1	
10.4	Technical Services Agreement with Jurun Information Technology (Shanghai) Co. Ltd.	10-Q	5/21/12	10.4	
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X