

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

OR

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

For the transition period from _____ to _____

Commission file number **001-37797**

MONSTER DIGITAL, INC.

(Exact name of registrant as specified in its charter)

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

27-3948465
*(I.R.S. Employer
Identification No.)*

2655 First Street, Suite 250
Simi Valley, California 93065
(Address of principal executive offices, including zip code)

(805) 915-4775
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 small reporting company. See the definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
(Do not check if smaller reporting company)		Emerging Growth Company	<input checked="" type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

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

As of July 31, 2017, the registrant had 9,343,202 shares of common stock, par value \$.0001 per share, issued and outstanding.

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Item 1. Financial Statements

PART I – FINANCIAL INFORMATION
MONSTER DIGITAL, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except par value)

	June 30, 2017 (unaudited)	December 31, 2016 (Note 1)
ASSETS		
Current assets		
Cash	\$ 39	\$ 1,453
Accounts receivable, net of allowances of \$271 and \$253, respectively	214	856
Inventories	607	1,105
Prepaid expenses and other	325	619
Total current assets	<u>1,185</u>	<u>4,033</u>
Trademark, net of amortization of \$251 and \$185, respectively	2,351	2,417
Deposits and other assets	14	14
Total assets	<u>\$ 3,550</u>	<u>\$ 6,464</u>
LIABILITIES AND SHAREHOLDERS' (DEFICIT) EQUITY		
Current liabilities		
Accounts payable	\$ 599	\$ 268
Accrued expenses	1,416	1,786
Customer refund	1,336	1,840
Due to related parties	34	44
Notes payable	378	38
Total current liabilities	<u>3,763</u>	<u>3,976</u>
Commitments and contingencies		
Shareholders' (deficit) equity		
Preferred stock; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock; \$.0001 par value; 100,000,000 shares authorized; 9,343,202 and 7,785,011 shares issued and outstanding, respectively	1	1
Additional paid-in capital	35,753	34,575
Accumulated deficit	(35,967)	(32,088)
Total shareholders' (deficit) equity	<u>(213)</u>	<u>2,488</u>
Total liabilities and shareholders' (deficit) equity	<u>\$ 3,550</u>	<u>\$ 6,464</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

MONSTER DIGITAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, except per share)
(unaudited)

	For the Three Months Ended		For the Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2017	2016	2017	2016
Net sales	\$ 187	\$ 1,683	\$ 1,138	\$ 2,220
Cost of goods sold	226	1,253	1,224	1,743
Gross profit (loss)	(39)	430	(86)	477
Operating expenses				
Research and development	81	65	150	114
Selling and marketing	327	591	1,027	1,227
General and administrative	1,191	675	2,683	1,470
Total operating expenses	1,599	1,331	3,860	2,811
Operating loss	(1,638)	(901)	(3,946)	(2,334)
Other (income) expense, net				
Interest and finance expense	—	339	1	787
Gain on settlement of customer refund	—	—	(68)	—
Total other (income) expense	—	339	(67)	787
Loss before income taxes	(1,638)	(1,240)	(3,879)	(3,121)
Provision for income taxes	—	—	—	—
Net Loss	<u>\$ (1,638)</u>	<u>\$ (1,240)</u>	<u>\$ (3,879)</u>	<u>\$ (3,121)</u>
Loss Per Share				
Basic and Diluted	<u>\$ (0.19)</u>	<u>\$ (0.33)</u>	<u>\$ (0.47)</u>	<u>\$ (0.83)</u>
Number of Shares used in Computation				
Basic and Diluted	<u>8,446</u>	<u>3,750</u>	<u>8,323</u>	<u>3,749</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

MONSTER DIGITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF SHAREHOLDERS' (DEFICIT) EQUITY
(Dollars in thousands)
(unaudited)

	Common Stock		Preferred	Stock	Additional	Accumulated	Shareholders'
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	(Deficit) Equity
Balance December 31, 2016	7,785,011	\$ 1	—	\$ —	\$ 34,575	\$ (32,088)	\$ 2,488
Issuance of common stock, net of issuance costs	469,478	—	—	—	419	—	419
Issuance of common stock pursuant to stock option plan	795,610	—	—	—	—	—	—
Issuance of common stock pursuant to consulting arrangements	82,500	—	—	—	—	—	—
Warrant exercise	38,189	—	—	—	—	—	—
Conversion of related party debt into equity	172,414	—	—	—	100	—	100
Amortization of non-cash stock-based compensation	—	—	—	—	659	—	659
Net loss	—	—	—	—	—	(3,879)	(3,879)
Balance June 30, 2017	<u>9,343,202</u>	<u>\$ 1</u>	<u>—</u>	<u>\$ —</u>	<u>\$ 35,753</u>	<u>\$ (35,967)</u>	<u>\$ (213)</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

MONSTER DIGITAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(unaudited)

	Six Months Ended June 30,	
	2017	2016
<i>Cash flows from operating activities</i>		
Net loss	\$ (3,879)	\$ (3,121)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	659	179
Amortization of deferred debt issuance costs and debt discount	—	691
Amortization of trademark	66	65
Gain on settlement of customer refund	(68)	—
Provision for doubtful accounts	20	119
Changes in operating assets and liabilities:		
Accounts receivable	622	(513)
Inventories	498	(396)
Prepaid expenses and other	294	87
Accounts payable	331	445
Accrued expenses	(302)	317
Customer refund	(504)	(25)
Due to related parties	(10)	—
Net cash used in operating activities	<u>(2,273)</u>	<u>(2,152)</u>
<i>Cash flows from financing activities</i>		
Proceeds from issuance of preferred stock, net	—	2,393
Issuance of common stock, net of issuance cost	419	—
Proceeds from issuance of convertible notes	340	—
Short-term loan – related party	100	24
Proceeds from issuance of bridge financing	—	406
Payments on trademark note payable	—	(75)
Proceeds from credit facility	—	581
Payments on credit facility	—	(474)
Prepaid IPO costs	—	(613)
Deferred financing costs	—	(57)
Net cash provided by financing activities	<u>859</u>	<u>2,185</u>
Net (decrease) increase in cash	<u>(1,414)</u>	<u>33</u>
Cash, beginning of the period	<u>1,453</u>	<u>119</u>
Cash, end of the period	<u>\$ 39</u>	<u>\$ 152</u>
<i>Supplemental disclosure of cash flow information</i>		
Cash paid during the period for:		
Interest	<u>\$ 1</u>	<u>\$ 29</u>
<i>Non-cash investing and financing activities:</i>		
Conversion of related party debt into equity	<u>\$ 100</u>	<u>\$ —</u>
Deferred IPO costs	<u>\$ —</u>	<u>\$ 356</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

MONSTER DIGITAL, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — BUSINESS ACTIVITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization: Monster Digital, Inc. (“MDI”), a Delaware corporation (formed in November 2010), and its subsidiary, SDJ Technologies, Inc. (“SDJ”) (collectively referred to as the “Company”), is an importer of high-end memory storage products, flash memory and action sports cameras marketed and sold under the Monster Digital brand name acquired under a long-term licensing agreement with Monster, Inc. The Company sources its products from China, Taiwan and Hong Kong.

Public Offering: The Company closed its initial public offering (the “Offering”) on July 13, 2016 and its common stock and warrants are now listed on the Nasdaq Capital Market under the symbols “MSDI” and “MSDIW”, respectively. The Offering generated gross proceeds of \$9,132,750 on the sale of 2,025,000 common shares at \$4.50 per share and 2,025,000 warrants at \$0.01 per warrant.

Basis of Presentation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and with the SEC’s instructions for interim financial information. They do not include all information and footnotes necessary for a fair presentation of financial position, operating results and cash flows in conformity with U.S. GAAP for complete financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2016 which are included in Form 10-K filed by the Company that on March 31, 2017. In the opinion of management, all adjustments (consisting of normal recurring adjustments and accruals) considered necessary for a fair presentation of the operating results for the periods presented have been included in the interim periods. Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for other interim periods or the year ending December 31, 2017. For interim financial reporting purposes, income taxes are recorded based upon estimated annual effective income tax rates taking into consideration discrete items occurring in a quarter. The consolidated balance sheet as of December 31, 2016 is derived from the 2016 audited financial statements.

Principles of Consolidation: The consolidated financial statements include the accounts of MDI and SDJ. All significant intercompany transactions have been eliminated in consolidation.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities (including sales returns, price protection allowances, bad debts, inventory reserves, warranty reserves, and asset impairments), disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates

Concentration of Cash: The Company maintains its cash in bank accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. Management believes the Company is not exposed to any significant credit risk on its cash balances.

Accounts Receivable: Accounts receivable are carried at original invoice amount less allowance for doubtful accounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Accounts receivable are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received. Accounts receivable are considered to be past due if any portion of the receivable balance is outstanding for more than 90 days past the customer’s granted terms. The Company does not charge interest on past due balances or require collateral on its accounts receivable. As of June 30, 2017 and December 31, 2016, the allowance for doubtful accounts was approximately \$271,000 and \$253,000, respectively.

Inventories: Inventories are stated at the lower of cost or market, with cost being determined on the weighted average cost method of accounting. The Company purchases finished goods and materials to assemble kits in quantities that it anticipates will be fully used in the near term. Changes in operating strategy, customer demand, and fluctuations in market values can limit the Company's ability to effectively utilize all products purchased and can result in finished goods with above-market carrying costs which may cause a write-down of inventory. The Company's policy is to closely monitor inventory levels, obsolescence and lower market values compared to costs and, when necessary, reduce the carrying amount of its inventory to its market value. As of June 30, 2017 and December 31, 2016, inventory on hand was comprised primarily of finished goods ready for sale and packaging and supplies.

Fair Value of Financial Instruments: Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. Fair value is based on a hierarchy of valuation techniques, which is determined on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's own market assumptions. These two types of inputs create a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1: Quoted prices for identical instruments in active markets.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The carrying amount for other financial instruments, which include cash, accounts receivable and accounts payable, approximate fair value based upon their short-term nature and maturity.

Revenue Recognition: Revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) the sales price is fixed or determinable, (3) collectability is reasonably assured, and (4) products have been shipped and the customer has taken ownership and assumed the risk of loss. Distributors and retailers take full ownership of their product upon delivery and sales are fully recognized at that time.

Revenue is reduced by reserves for price protection, sales returns, allowances and rebates. The Company's reserve estimates are based upon historical data as well as projections of sales, customer inventories, market conditions and current contractual sales terms. If the Company reduces the list price of its products, certain customers may receive a credit from the Company (i.e., price protection). The Company estimates the impact of such pricing changes on a regular basis and adjusts its allowances accordingly. Amounts charged to operations for price protection are calculated based on actual price changes on individual products and customer inventory levels. The reserve is then reduced by actual credits given to these customers at the time the credits are issued. We calculate the allowance for doubtful accounts and provision for sales returns and rebates based on management's estimate of the amount expected to be uncollectible or returned on specific accounts. We provide for future returns, price protection and rebates at the time the products are sold. We calculate an estimate of future returns of product by analyzing units shipped, units returned and point of sale data to ascertain consumer purchases and inventory remaining with retail to establish anticipated returns. Price protection is calculated on a product by product basis. The objective of price protection is to mitigate returns by providing retailers with credits to ensure maximum consumer sales. Price protection is granted to retailers after they have presented the Company an affidavit of existing inventory.

The Company also offers market development credits (“MDF credits”) to certain of its customers. These credits are also charged against revenue.

Shipping and Handling Costs: Historically, the Company has not charged its customers for shipping and handling costs, which is a component of marketing and selling expenses. These costs totaled approximately \$22,000 and \$59,000 in the three months ended June 30, 2017 and 2016, respectively, and approximately \$53,000 and \$94,000 in the six months ended June 30, 2017 and 2016, respectively.

Income Taxes: Deferred tax assets and liabilities are determined based on the temporary differences between the financial reporting and tax basis of assets and liabilities and net operating loss carryforwards, applying enacted statutory tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recorded when it is more likely than not that some or all of the deferred tax assets will not be realized.

The Company uses a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more likely than not to be realized upon settlement. As of June 30, 2017 and December 31, 2016, there are no known uncertain tax positions.

The Company’s policy is to classify the liability for unrecognized tax benefits as current to the extent that it is more likely than not to be realized upon settlement and to the extent that the Company anticipates payment (or receipt) of cash within one year. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in the tax provision.

Product Warranty: The Company’s memory products are sold under various limited warranty arrangements ranging from three years to five years on solid state drives and a limited lifetime warranty on all other products. Company policy is to establish reserves for estimated product warranty costs in the period when the related revenue is recognized. The Company has the right to return defective products to the manufacturer. As of June 30, 2017 and December 31, 2016, the Company has established a warranty reserve of \$101,000 and \$118,000, respectively. The warranty reserve is included in accrued expenses in the accompanying consolidated balance sheets.

Research and Development: The Company incurs costs to improve the appeal and functionality of its products. Research and development costs are charged to expense when incurred.

Earnings (Loss) per Share: Basic earnings (loss) per share is calculated by dividing net earnings (loss) attributable to common stockholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings (loss) per share is calculated similarly but includes potential dilution from the exercise of common stock warrants and options and conversion of debt to equity, except when the effect would be anti-dilutive. Earnings (loss) per share are computed using the “treasury stock method.” At June 30, 2017, outstanding warrants to acquire 4,224,664 shares of common stock (2,025,000 issued further to the Offering, 1,405,007 issued in connection with the conversion of preferred stock and bridge loans upon closing of the Offering and 794,657 other warrants), 16,834 stock options, and \$378,000 in convertible notes payable have been excluded from the computation of diluted loss per share because their effect was anti-dilutive. At June 30, 2016, warrants outstanding for 325,093 shares of common stock, 19,528 stock options, 2,802,430 convertible preferred shares and \$378,000 in convertible notes payable have been excluded from the computation of diluted loss per share because their effect was anti-dilutive.

Recently Issued Accounting Pronouncements — In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective in the first quarter of 2018 and requires either a retrospective or a modified retrospective approach to adoption. We have not yet selected a transition method and are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

In July 2015, the FASB issued ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. The standard requires entities to measure most inventory “at the lower of cost and net realizable value,” thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market (market in this context is defined as one of three different measures, one of which is net realizable value). The standard is effective for the Company prospectively beginning January 1, 2017. The adoption of this standard has not had a material impact to the Company.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes*, which includes amendments that require deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. The amendments in this ASU are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Earlier application is permitted as of the beginning of an interim or annual reporting period. The amendments may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The adoption of this ASU is not expected to have a material impact on the Company’s consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires lessees to recognize assets and liabilities for the rights and obligations created by most leases on their balance sheet. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. ASU 2016-02 requires modified retrospective adoption for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company is currently evaluating the impact the standard may have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting (Topic 718)*, which provides for simplification of certain aspects of employee share-based payment accounting including income taxes, classification of awards as either equity or liabilities, accounting for forfeitures and classification on the statement of cash flows. ASU 2016-09 will be effective for the Company in the first quarter of 2017 and will be applied either prospectively, retrospectively or using a modified retrospective transition approach depending on the area covered in this update. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations – Clarifying the Definition of a Business*, which clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The standard introduces a screen for determining when assets acquired are not a business and clarifies that a business must include, at a minimum, an input and a substantive process that contribute to an output to be considered a business. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company does not expect this new guidance to have a material impact on its consolidated financial statements.

Other pronouncements issued by the FASB with future effective dates are either not applicable or not significant to the consolidated financial statements of the Company.

NOTE 2 — GOING CONCERN

As of June 30, 2017, the Company has incurred cumulative net losses from its inception of approximately \$36 million, has incurred a year to date loss of approximately \$3.9 million, and has negative operating cash flows, a working capital deficit and shareholders’ deficit. These circumstances raise substantial doubt as to the Company’s ability to continue as a going concern. In response to this uncertainty, Management has taken certain measures in 2016 and to date in 2017 and has plans for the remainder of 2017 and beyond, with the objective of alleviating this concern. They include the following:

- In the six months ended June 30, 2017, the Company raised approximately \$419,000, net of offering costs, upon the issuance of restricted stock, \$340,000 upon the issuance of convertible debt and has raised an additional \$200,000 subsequent to June 30, 2017. The Company continues to seek funding in order to support its operations.
- The Company has entered into an agreement that is intended to culminate in a merger as well as a spin-off of its camera business (see Note 3). This potential transaction is expected to result in a surviving entity that would be better capitalized.
- In order to meet customers' needs for consumer products, the Company is continuing to develop new products to complement existing products and expand overall product offerings, with the objective of increasing revenue and gross profit percentages. The Company plans on introducing additional new action sports cameras in the fourth quarter of 2017.

While the Company believes it will be successful in obtaining the necessary financing to fund its operations, there are no assurances that such additional funding will be achieved and that it will succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts of liabilities that might be necessary should the Company be unable to continue in existence as a going concern.

NOTE 3 — POTENTIAL MERGER

On July 3, 2017, the Company entered into an Agreement and Plan of Merger with Innovate Biopharmaceuticals, Inc. ("Innovate"). The Merger Agreement is filed as Exhibit 2.1 to the Company's Form 8K filed with the Securities and Exchange Commission on July 6, 2017 and this discussion regarding the potential merger should be read in conjunction with the Merger Agreement. Under the terms of the Merger Agreement, pending stockholder approval of the transaction, the Company will merge into Innovate with Innovate surviving the merger and becoming a wholly-owned subsidiary of the Company. Subject to the terms of the Merger Agreement, at the effective time of the Merger, Innovate stockholders will receive a number of newly issued shares of the Company's common stock determined using an exchange ratio defined in the Merger Agreement. The exchange ratio will be based on a pre-transaction valuation of \$60 million for Innovate's business and \$6 million for the Company's business. As a result, current securityholders of the Company would collectively own approximately 9% and Innovate securityholders would collectively own approximately 91% of the combined company on a pro-forma basis, subject to adjustment based on the Company's net cash balance and the relative capitalization of the two companies at closing, as described more fully in the Merger Agreement. Following the Merger, stockholders of Innovate will become the majority owners of the Company.

In addition, prior to the closing of the Merger, the Company currently intends to transfer all of its businesses, assets and certain liabilities not assumed by Innovate further to the Merger to a new corporation, which will be either wholly owned or substantially owned by the Company.

The Company is in the process of drafting a preliminary Schedule 14A, Information Required in a Proxy Statement, to obtain the required stockholder approval for the merger transaction. There can be no assurance that such stockholder approval will be attained or that, if such stockholder approval is attained, that the merger transaction will be completed.

NOTE 4 — DEBT AND EQUITY FINANCING

Credit Facility

In June 2015, the Company secured an accounts receivable financing facility with Bay View Funding. The contract provides for maximum funding of \$4 million and a factoring fee of 1.35% for the first 30 days and .45% for each 10-day period thereafter that the financed receivable remains outstanding. Upon the execution of this contract, the balance owed under a prior credit facility was repaid and that contract was terminated. There was no amount outstanding under this facility as of June 30, 2017 and December 31, 2016. There are no financial or similar covenants associated with this facility.

Notes Payable

During the three and six months ended June 30, 2017, the Company issued \$340,000 in convertible Notes payable; the notes are due and payable the earlier of March 31, 2018 or at the closing of the Company's potential merger transaction at which time they would convert, along with accrued interest, to common stock concurrent with the merger. The notes are convertible at the lesser of \$0.75 or 75% of the average market price of the Company's common stock during the five days prior to the merger closing and bear an interest rate of 15%. The Company has agreed to give one-year warrant coverage at 25% of the number of shares issued upon conversion. As of June 30, 2017, a total of \$340,000 in principal of the convertible Notes remains outstanding. Subsequent to June 30, 2017, the Company issued \$200,000 of additional convertible Notes under the same terms.

As of June 30, 2017 and December 31, 2016, a total of \$38,000 in principal of convertible Notes payable that matured in the second quarter of 2015 remains outstanding.

Promissory notes

From October 2015 through March 7, 2016, the Company issued promissory notes; the notes were due and payable at the earlier of one year from the date of issuance or the closing date of the Company's initial public offering, bore an interest rate of 15% that was accrued upon issuance, irrespective of whether the promissory note was outstanding for part or full term until maturity, and had a loan origination fee of \$.225 for each dollar loaned. The loan origination fee associated with the notes as of September 30, 2016 was \$756,000 and was recorded as accrued interest and debt discount to the notes payable and is being amortized over the life of the notes. Debt discount amortized as interest expense in the three and nine months ended September 30, 2016 was approximately \$25,000 and \$389,000, respectively. All principal, fees and interest were payable on the due date. In July 2016, the Company completed the Offering whereby 90% of the outstanding promissory notes totaling \$3,024,000 were converted to 672,000 shares of common stock and 672,000 warrants at the offering price of \$4.50 per share. The 15% accrued interest and the 22.5% origination fee were waived as part of the conversion. The remaining, unconverted \$336,000 of promissory notes were paid out of the proceeds of the Offering along with the accrued interest and origination fee attributable to those notes. No balance is due as of June 30, 2017 and December 31, 2016.

Due to Monster, Inc.

In addition to the issuance of shares of common stock and common stock purchase warrants, the Company agreed to pay Monster, Inc. \$500,000 as consideration for use of the name Monster Digital, Inc. pursuant to Amendment No. 3 to the Trademark License Agreement between the Company and Monster, Inc. Of this total balance, the Company agreed to pay \$125,000 in December 2015 and the balance from the proceeds of the planned IPO. The Company paid \$50,000 of the \$125,000 in December 2015 and the balance in January 2016. The remaining \$375,000 was paid in September 2016.

Notes payable consists of the following (in thousands):

	June 30, 2017	December 31, 2016
Notes payable, convertible debt	\$ 38	\$ 38
Convertible notes payable	340	—
Total	\$ 378	\$ 38

NOTE 5 — ACCRUED EXPENSES

Accrued expenses consist of the following (in thousands):

	June 30, 2017	December 31, 2016
Royalties	\$ 250	\$ 125
Reserve for charges against sales	174	334
Accrued purchase orders	113	158
Deferred gain	273	—
Due to customer for promotional credits	59	445
Others	547	724
Total	\$ 1,416	\$ 1,786

NOTE 6 — STOCKHOLDERS' EQUITY

Common Stock Purchase Warrants: In 2016, the Company issued warrants to acquire 3,755,100 shares of common stock, 2,025,000 issued further to the Offering and 1,405,007 issued in connection with the conversion of preferred stock and bridge loans upon closing of the Offering. In March and April 2016, the Company issued 171,000 warrants to purchase shares of common stock at \$2.00 per share in connection with the issuance of restricted stock. In May 2017, 39,392 warrants to purchase common stock at \$0.0052 were exercised, in a cashless exercise, in exchange for the net equivalent shares of common stock. In June 2017, 102,041 warrants to purchase shares of common stock at \$2.00 per share were issued in connection with the conversion of debt to equity. As of June 30, 2017 and December 31, 2016, warrants to purchase 4,224,664 and 3,991,015 shares of common stock, respectively, are outstanding. Unexercised warrants will expire from 2017 to 2025.

Restricted Shares: In August 2015, the Company issued 84,170 shares of restricted common stock to the Company's Chairman of the Board pursuant to a consulting agreement. The consulting agreement was effective in May 2015.

In August 2015, the Company issued 382,575 shares of restricted common stock in connection with the Trademark License Agreement with Monster, Inc. The fair value of the 382,575 shares approximating \$2,103,000 were recorded as part of the Trademark in August 2015. In regards to the valuation of the Company's common stock, the Board of Directors engaged an independent third party valuation of the Company.

In August 2016, the Company authorized the issuance of 40,000 shares of restricted common stock pursuant to a services agreement with an investment relations firm and recognized \$7,000 and \$14,000 of compensation expense related to restricted shares in the three and six months ended June 30, 2017, respectively. In addition, the Company authorized the issuance of 125,000 shares of restricted common stock to Jawahar Tandon pursuant to a consulting agreement and recognized the full \$563,000 of compensation expense related to the restricted shares during the year ended December 31, 2016.

In November 2016, the Company entered into a securities purchase agreement with the selling stockholder providing for the issuance and sale to such investor of 333,333 shares of our common stock. The shares issued in the Private Placement were sold at a purchase price per share of \$1.50, for aggregate gross proceeds to us of approximately \$500,000 and aggregate net proceeds to us, after deducting for placement agent fees and expenses, of approximately \$446,000. The investor was issued an additional 80,000 shares in May 2017 in a non-cash transaction. The additional share issuance was intended to adjust the aggregate shares awarded to the investor in relation to future investment rounds that were transacted at \$1.15 per share. Under the same Private Placement Memorandum, the Company issued 151,515 shares of restricted common stock to its Chairman of the Board at a purchase price of \$1.65 per share for gross proceeds of \$250,000 and net proceeds of approximately \$226,000.

In March 2017, the Company issued 226,000 shares of common stock at \$1.50 per share pursuant to a Private Placement Memorandum for aggregate gross proceeds of \$339,000 and net proceeds, after deducting for commission and placement agent fees and expenses, of approximately \$307,000. In April 2017, the Company issued an additional 116,000 shares at \$1.15 for aggregate gross proceeds of \$133,400 and net proceeds, after deducting for commission, of approximately \$112,000.

On June 23, 2017, the Company issued 172,414 shares of common stock at \$0.58 per share in exchange for a \$100,000 promissory note dated June 7, 2017 due to GSB Holdings, Inc., a family owned company of David Clarke, the Company's CEO and Chairman of the Board. The issuance price was \$0.05 greater than the closing price of the Company's common stock on the issuance date.

During the three months ended June 30, 2017, the Company issued 87,500 fully vested shares of restricted common stock and recognized \$56,150 of non-cash, stock-based compensation at the time of issuance. The Company issued 15,000 of the 87,500 shares for product marketing, 12,500 shares pursuant to an employee severance agreement, 25,000 additional shares to its investor relations firm and 35,000 shares as compensation for the activities of a special committee of its board of directors.

Also during the three months ended June 30, 2017, the Company issued 95,000 shares of restricted common stock to certain employees and recognized \$4,000 of non-cash, stock-based compensation during the period. Another \$43,000 of stock-based compensation remains to be amortized over 22 months.

Preferred Stock: In March 2016, the Company issued a confidential Private Placement Memorandum ("PPM") for a maximum of 3,000,000 shares of Series A Convertible Preferred Stock, with a purchase price of \$1.00 per share and convertible into one share of the Company's common stock and having an 8%, noncumulative dividend. Pursuant to the PPM, as of June 30, 2016, 2,802,430 shares of Series A Preferred Stock were subscribed for net proceeds of approximately \$2.4 million. In July 2016, the Company completed the Offering in which all shares of Series A Preferred Stock was converted into 622,762 shares of common stock and 622,762 warrants at the public offering price of \$4.50 per share and the issuance of 134,044 shares of common stock further to the conversion.

NOTE 7 — STOCK OPTIONS

In 2012, the Company's Board of Directors approved the 2012 Omnibus Incentive Plan (the "Plan") which allows for the granting of stock options, stock appreciation rights, awards of restricted stock and restricted stock Units, stock bonuses and other cash and stock-based performance awards. A total of 970,350 shares of common stock have been approved and reserved for issuance under the Plan, which includes a 600,000 share increase approved by the Company's stockholders in May 2016. During the six months ended June 30, 2017 and 2016, no options were granted under the Plan. In addition, during the six months ended June 30, 2017 and 2016, 46,100 and 51,512 options, respectively, were forfeited for employees who were no longer with the Company and were returned to the pool of available options. There were 145,049 and 778,949 shares of common stock available to grant as options or restricted stock at June 30, 2017 and December 31, 2016, respectively.

On December 23, 2015, the Company authorized restricted stock grants under its 2012 Omnibus Incentive Plan of 47,135 to two executives of the Company, the grants accepted and effective January 4, 2016. In August 2016, 33,688 shares were forfeited and returned to the option pool.

On the effective date of the Offering, 111,332 shares of restricted stock were granted to four executives of the Company. In January 2017, an additional 30,000 shares were granted to two of the same executives. Subsequent to the granting of the restricted stock, 101,332 shares were forfeited and returned to the option pool. Also concurrent to the Offering, 10,000 shares of restricted stock were granted to each of the Company's four outside directors. In January 2017, an additional 5,000 shares were granted to three of the directors. Since 45,000 of these shares were issued during the quarter fully vested, the Company recognized \$29,000 of stock-based compensation at grant. Also in January 2017, 175,000 shares of restricted stock were issued to the Company's CEO fully vested and the Company recognized \$266,000 of stock-based compensation at the time of the grant.

Also granted on the effective date of the Offering were previously approved options to acquire 86,502 common shares at an exercise price per share of \$4.50 to four executives of the Company. Subsequent to the granting of the stock options, 69,668 options were forfeited and returned to the option pool.

In August 2016, pursuant to a services agreement and outside of the Plan, the Company granted options to acquire 38,143 shares of common stock to an investor relations firm.

The Company follows the provision of ASC Topic 718, *Compensations – Stock Compensation* which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and non-employee directors, including employee stock options. Stock compensation expense based on the grant date fair value estimated in accordance with the provisions of ASC 718 is generally recognized as an expense over the requisite service period.

In 2016, the following stock option grants were made:

Option Date	Options Granted	Exercise Price	Estimated Fair Value of Underlying Stock	Intrinsic Value
August 2016	6,004	\$ 5.00	\$ 3.00	None
August 2016	7,230	\$ 7.00	\$ 3.00	None
August 2016	9,986	\$ 9.00	\$ 3.00	None
August 2016	14,923	\$ 11.00	\$ 3.00	None

No stock options were granted during the six months ended June 30, 2017.

The Company utilizes the Black-Scholes valuation method to value stock options and recognizes compensation expense over the vesting period. The expected life represents the period that the Company's stock-based compensation awards are expected to be outstanding. The Company uses a simplified method provided in Securities and Exchange Commission release Staff Accounting Bulletin No. 110 which averages an awards weighted average vesting period and contractual term for "plain vanilla" share options. The expected volatility was estimated by analyzing the historic volatility of similar public companies. No dividend payouts were assumed as the Company has not historically paid, and is not anticipating to pay, dividends in the foreseeable future. The risk-free rate of return reflects the weighted average interest rate offered for U.S. treasury rates over the expected life of the options.

A summary of significant assumptions used to estimate the fair value of the stock options granted in 2016 are as follows:

Weighted average fair value of options granted	\$1.70
Expected term (years)	6.0 to 10.0
Risk-free interest rate	1.21% to 1.51%
Volatility	45.4%
Dividend yield	None

A summary of option activity for the Plan as of June 30, 2017 and changes for the six months then ended are represented as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contract Term (Years)	Aggregate Intrinsic Value
Options outstanding January 1, 2017	62,934	\$ 4.50	9.50	\$ —
Granted	—	—	—	—
Forfeited	(46,100)	—	—	—
Outstanding at June 30, 2017	<u>16,834</u>	\$ 4.50	9.00	\$ —

The following table summarizes restricted share activity for the six months ended June 30, 2017:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding January 1, 2017	128,467	\$ 3.87
Granted	1,094,103	1.18
Vested	(622,570)	1.21
Forfeited	(70,000)	3.06
Outstanding at June 30, 2017	<u>530,000</u>	\$ 1.48

The Company recorded non-cash stock-based compensation related to stock options and restricted stock of \$226,000 and \$659,000 during the three and six months ended June 30, 2017, respectively. The Company recorded \$179,000 non-cash stock-based compensation in the six months ended June 30, 2016.

As of June 30, 2017, the total compensation expense related to unvested options and restricted stock not yet recognized totaled approximately \$547,000. The weighted average vesting period over which the total compensation expense will be recorded related to unvested options and restricted stock not yet recognized at June 30, 2017 was approximately 13 months.

NOTE 8 — RELATED PARTY TRANSACTIONS

Borrowings: From time to time, the Company receives short-term, non-interest bearing loans from Tandon Enterprises, Inc. for the purpose of funding temporary working capital needs. For the six months ended June 30, 2016, the Company borrowed \$24,000, net of repayments. The \$346,100 owed to Tandon Enterprises at June 30, 2016 was converted into 76,911 shares of common stock and warrants at the effective date of the Offering.

In September 2015, David Clarke, the Company's Chairman of the Board and a significant stockholder of the Company, loaned the Company \$100,000 further to a promissory note bearing interest at 5% per annum, principal and unpaid interest payable on demand. In addition, Mr. Clarke incurred expenses on behalf of the Company totaling approximately \$50,000. Concurrent with the closing of the Offering, the loan and liability related to the expenses were converted into 33,333 shares of common stock and 33,333 warrants at the public offering price of \$4.50.

On June 7, 2017, GSB Holdings, Inc., a family owned company of David Clarke, the Company's CEO and Chairman of the Board, loaned the Company \$100,000 further to a promissory note and issued 102,041 three-year warrants at an exercise price of \$2.00 in lieu of interest. On June 23, 2017, the Company issued 172,414 shares of common stock at \$0.58 per share in exchange for the promissory note. The issuance price was \$0.05 greater than the closing price of the Company's common stock on the issuance date.

Restricted Shares: In November 2016, the Company issued 151,515 shares of restricted common stock to its Chairman of the Board at a purchase price of \$1.65 per share pursuant to a Private Placement Memorandum. In March 2017, the Company issued 70,000 shares of restricted stock to its Chairman of the Board at a purchase price of \$1.50 per share pursuant to a Private Placement Memorandum.

NOTE 9 — INCOME TAXES

For the six months ended June 30, 2017 and 2016, there was no income tax provision recorded. The Company's income tax provision generally consists of state income taxes currently paid or payable.

The ultimate realization of the deferred tax asset is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Due to the uncertainty surrounding the realization of these deferred tax assets, the Company has recorded a 100% valuation allowance. Net operating loss carryforwards expire between the years 2029 and 2036. Tax years ended December 31, 2016, 2015, 2014 and 2013 are open and subject to audit.

The effective income tax provision as a percentage of pre-tax loss differs from expected combined federal and state income tax of 40% as a result of the full valuation allowance.

Management is not aware of any uncertain tax positions and does not expect the total amount of recognized tax benefits to change significantly in the next twelve months.

NOTE 10 — CUSTOMER AND VENDOR CONCENTRATIONS

Customers:

Approximately 22%, 19%, 16% and 11% of the Company's gross sales were made to four customers for the six months ended June 30, 2017. At June 30, 2017, the amount included in outstanding accounts receivable related to these customers was approximately \$323,000. Approximately 41% and 18% of the Company's gross sales were made to two customers for the six months ended June 30, 2016.

Vendors:

Approximately 99% of the Company's purchases were provided by three vendors for the six months ended June 30, 2017. At June 30, 2017, the amount in accounts payable related to these vendors was approximately \$6,000. Approximately 94% of the Company's purchases were provided by three vendors for the six months ended June 30, 2016.

NOTE 11 — COMMITMENTS AND CONTINGENCIES

Royalty

The Company entered into the initial trademark license agreement with Monster, Inc. (formerly Monster Cable Products, Inc.) effective July 7, 2010. In 2012, the agreement was amended giving the Company exclusive rights to utilize the name "Monster Digital" on memory products for a period of 25 years (expires July 7, 2035) under the following payment schedule of royalties to Monster, Inc. This license agreement contains various termination clauses that include (i) change in control, (ii) breach of contract and (iii) insolvency, among others. The Company is required to remit royalty payments to Monster, Inc. on or before the 30th day following the end of each calendar quarter. At any time during the term of the agreement, a permanent license may be negotiated.

The royalty schedule became effective in August 2011 and was further amended in April 2012. As amended, royalties under this contract are as follows:

- Years 1 (2012) and 2: Royalties on all sales excluding sales to Monster, Inc. at a rate of four (4) percent, with no minimum.
- Years 3 through 6: Minimum royalty payments of \$50,000 per quarter up to a maximum of four (4) percent of all sales excluding sales to Monster, Inc.
- Years 7 through 10: Minimum royalty payments of \$125,000 per quarter up to a maximum of four (4) percent of all sales excluding sales to Monster, Inc.
- Years 11 through 15: Minimum royalty payments of \$187,500 per quarter up to a maximum of four (4) percent of all sales excluding sales to Monster, Inc.
- Years 16 through 25: Minimum royalty payments of \$250,000 per quarter up to a maximum of four (4) percent of all sales excluding sales to Monster, Inc.

Effective July 1, 2014, the royalty rate on certain products was reduced from 4% to 2% for a period of 12 months, based on a mutual understanding between the Company and the licensor.

For the three months ended June 30, 2017 and 2016, royalty expense amounted to approximately \$125,000 and \$71,000, respectively. For the six months ended June 30, 2017 and 2016, royalty expense amounted to approximately \$250,000 and \$121,000, respectively, and is included as a component of selling and marketing expenses in the accompanying consolidated statements of operations. At June 30, 2017, \$250,000 is due for royalties and the Company is not in compliance with the royalty payment schedule.

Operating Lease

The Company occupied executive offices in Simi Valley, CA pursuant to a lease through January 31, 2018. Effective as of March 31, 2017, the Company terminated the lease by mutually accepted and favorable terms with the lessor. Effective April 1, 2017, the Company entered into a one year lease for warehouse space in Ontario, CA.

Customer Payment Agreement

In July 2015, the Company entered into an agreement with a customer under which the Company will pay the customer a total of \$835,000 owed to the customer for promotional and other credits related to sales that occurred in 2014. The credits were accrued as contra-sales in 2014. Under the terms of the agreement, there is no interest and the Company will make 12 monthly payments of \$65,000 beginning in August 2015, and one final payment of \$65,000 in August 2016. The Company is not in compliance with the payment agreement and the balance owed is \$57,000 at June 30, 2017.

In January 2017, the Company entered into an agreement with a customer under which the Company settled an amount due of \$1.84 million for \$1.5 million, recording a \$341,000 deferred gain and recognizing a current period gain of \$68,000. The settlement included an initial payment of \$250,000 with the remaining balance to be paid in monthly installments through December 2018. The Company is not in compliance with the payment agreement and the balance owed is \$1.2 million at June 30, 2017.

Legal Matters

The Company is subject to certain legal proceedings and claims arising in connection with the normal course of its business. In the opinion of management, the reserve established for the three cases noted below is adequate so that the claims will have no material adverse effect on its consolidated financial position, results of operations or cash flows.

On February 16, 2016, the Company received a letter from GoPro, Inc., or GoPro, alleging that the Company infringes on at least five U.S. patents held by GoPro, and requesting that the Company confirm in writing that it will permanently cease the sale and distribution of its Villain camera, along with any camera accessories, including the waterproof camera case and standard housing. The five patents specifically identified by GoPro in the letter were U.S. Patent No. D710,921: camera housing design, U.S. Patent No. D702,747: camera housing design, U.S. Patent No. D740,875: camera housing design, U.S. Patent No. D737,879: camera design and U.S. Patent No. 721,935: camera design. Based upon our preliminary review of these patents, the Company believes it has some defenses to GoPro's allegations, although there can be no assurance that the Company will be successful in defending against these allegations or reaching a business resolution that is satisfactory to us. In addition, we have begun marketing and selling the camera under the name "Monster Vision" and phasing out the "Villain" name. We have had no correspondence from GoPro since instituting the name change.

The supplier of the Company's Villain camera has contractually represented and warranted that it owns or has paid royalties to any and all intellectual property, designs, software, hardware, packaging, components, manuals and any other portion, part or element that is or may be subject to the Villain name and the parts and accessories thereof sourced by the supplier. This supplier has contractually agreed to pay any claims, damages, or costs that the Company suffers as a result of the patent infringement or a violation of international, U.S. or state laws or regulations as detailed in the prior sentence.

NOTE 12 — SUBSEQUENT EVENTS

Convertible Debt Financing

On July 24, 2017, the Company entered into a Private Placement Engagement Agreement with WestPark Capital, Inc. for the purpose of raising up to \$1,150,000 in convertible debt. The Promissory Notes will bear interest at 15% and be convertible to common stock concurrent with a potential merger (see Note 3) at the lesser of \$0.75 per share or 75% of the average market value of the Company's common stock for the five days preceding the consummation of such merger. Otherwise, the Notes become due March 31, 2019. For every \$2.50 in Note principal purchased, investors will receive one Warrant, exercisable for five years, to purchase shares of common stock at \$2.00. As of August 18, 2017, \$308,500 has been raised under this arrangement.

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

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited condensed interim financial statements and the notes to those financial statements appearing elsewhere in this Report.

Certain statements in this Report constitute forward-looking statements. These forward-looking statements include statements, which involve risks and uncertainties, regarding, among other things, (a) our projected sales, profitability, and cash flows, (b) our growth strategy, (c) anticipated trends in our industry, (d) our future financing plans, and (e) our anticipated needs for, and use of, working capital. They are generally identifiable by use of the words "may," "will," "should," "anticipate," "estimate," "plan," "potential," "project," "continuing," "ongoing," "expects," "management believes," "we believe," "we intend," or the negative of these words or other variations on these words or comparable terminology. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur. You should not place undue reliance on these forward-looking statements.

The forward-looking statements speak only as of the date on which they are made and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which the statements are made or to reflect the occurrence of unanticipated events.

The "Company," "we," "us," and "our," refer to Monster Digital, Inc. and its wholly-owned subsidiary SDJ Technologies, Inc.

Overview

General

Our primary business focus is the design, development and marketing of premium products under the "Monster Digital" brand for use in high-performance computing and consumer and mobile product applications. We have invested significantly in building a broad distribution channel for the sale of products bearing the "Monster Digital" brand. Our current focus is to leverage our distribution network through cooperating with Monster, Inc. to identify and market additional specialty and consumer electronics products.

Our primary product offering is a line of action sports cameras used in adventure sport, adventure photography and extreme-action videography.

Our license with Monster, Inc. allows us to manufacture and sell certain high-end products, utilizing the Monster premium brand name which is highly recognized by consumers for its high quality audio-video products. We work with our subcontract manufacturers and suppliers to offer new and enhanced products that use existing technology and adopt new technologies to satisfy existing and emerging consumer demands and preferences. On the marketing side, we partner with Monster, Inc. to support the sales and marketing of these products on a global basis.

Historically, memory has been the most significant part of our business and it is a commodity that tends to be subject to price erosion. Using the Monster branding to quickly introduce new technologies to the market is designed to bring about the introduction of products that are not subject to the same level of downward pressure on pricing as is common with memory products. In addition, we intend to expand and continue to invest in our international operations, which we believe will be an important factor in our continued growth.

We expect to continue to incur operating losses and negative cash flows from operations in the near future and will require additional capital resources to execute strategic initiatives that include a potential merger and a spin-off of our camera business pursuant to the Agreement and Plan of Merger dated July 3, 2017 between the Company and Innovate Biopharmaceuticals, Inc. which, if consummated, would involve fundamental changes in the Company's business. (see Note 3.)

Net sales

The principal factors that have affected or could affect our net sales from period to period are:

- The condition of the economy in general and of the memory storage products industry in particular,
- Our customers' adjustments in their order levels,
- Changes in our pricing policies or the pricing policies of our competitors or suppliers,
- The addition or termination of key supplier relationships,
- The rate of introduction and acceptance by our customers of new products,
- Our ability to compete effectively with our current and future competitors,
- Our ability to enter into and renew key corporate and strategic relationships with our customers, vendors and strategic alliances,
- Changes in foreign currency exchange rates,
- A major disruption of our information technology infrastructure,
- Unforeseen catastrophic events, such as armed conflict, terrorism, fires, typhoons and earthquakes, and
- Any other disruptions, such as labor shortages, unplanned maintenance or other manufacturing problems.

Cost of goods sold

Cost of goods sold primarily includes the cost of products that we purchase from third party manufacturers and sell to our customers. Additional packaging and assembly (labor) costs for certain product orders is also a component of costs of goods sold. Cost of goods sold is also affected by inventory obsolescence if our inventory management is not effective or efficient. We mitigate the risk of inventory obsolescence by stocking relatively small amounts of inventory at any given time, and relying instead on a strategy of manufacturing or acquiring products based on orders placed by our customers.

General and administrative expenses

General and administrative expenses relate primarily to compensation and associated expenses for personnel in general management, information technology, human resources, procurement, planning and finance, as well as outside legal, investor relations, accounting, consulting and other operating expenses.

Selling and marketing expenses

Selling and marketing expenses relate primarily to salary and other compensation and associated expenses for internal sales and customer relations personnel, advertising, outbound shipping and freight costs, tradeshow, royalties under a brand license, and selling commissions.

Research and development expenses

Research and development expenses consist of compensation and associated costs of employees engaged in research and development projects, as well as materials and equipment used for these projects, and third party compensation for research and development services. We do not engage in any long-term research and development contracts, and all research and development costs are expensed as incurred.

Other expenses

Interest and finance expense includes interest paid or payable to a finance company for outstanding borrowings, bank fees, purchase order finance fees, interest accrued on convertible debt, amortization of a debt discount that arose as a result of the issuance of warrants with convertible debt, and amortization of debt issuance costs. Debt conversion expense is a non-cash charge for the effect of an induced conversion of debt to equity

Three Months ended June 30, 2017 Compared to Three Months ended June 30, 2016

Results of Operations

The following discussion explains in greater detail our consolidated operating results and financial condition. This discussion should be read in conjunction with the consolidated financial statements and notes herein.

	Three months ended June 30,	
	2017	2016
	(in thousands)	
Net sales	\$ 187	\$ 1,683

Net sales for the three months ended June 30, 2017 decreased approximately 89% to \$187,000 from \$1.7 million for the three months ended June 30, 2016. We began to rapidly transition away from memory product sales beginning in the third quarter of 2016. In the three months ended June 30, 2017, gross sales of memory product totaled approximately \$64,000. In the three months ended June 30, 2016, gross sales of memory product totaled approximately \$1.4 million. In addition, working capital constraints continue to limit our ability to build traction with our action sports camera line.

	Three months ended June 30,	
	2017	2016
	(in thousands)	
Cost of goods sold	\$ 226	\$ 1,253
Gross profit (loss)	\$ (39)	\$ 430
Gross profit margin	(20.9)%	25.5%

Cost of goods decreased approximately 82%, which was less than the decrease in sales. As a percent of net sales, cost of goods sold was 120.9% in the three months ended June 30, 2017 as compared to 74.5% for the three months ended June 30, 2016. Gross profit (loss) in the three months ended June 30, 2017 decreased to (\$39,000) from \$430,000 in the three months ended June 30, 2016. Gross profit (loss) as a percentage of net sales was (20.9%) in the three months ended June 30, 2017, compared to 25.5% in the three months ended June 30, 2016. In general, gross profit as a percentage of net sales is a result of a combination of factors, including product mix, customer mix, and specific pricing decisions. These factors can affect a significant change in gross profit as a percentage of net sales from one period to the next, particularly when sales are relatively low. Specific to the current quarter ended June 30, 2017, we right-priced our product to be more competitive in the action sports camera space, selling at a lower margin, in the first quarter of 2017. In addition, semi variable and fixed indirect costs became a higher percentage of sales at this significantly lower sales volume.

	Three months ended June 30,	
	2017	2016
	(in thousands)	
Selling and marketing	\$ 327	\$ 591
General and administrative	\$ 1,191	\$ 675

Sales and marketing for the three months ended June 30, 2017 decreased approximately 45%, to \$327,000, compared to \$591,000 for the three months ended June 30, 2016. The decrease in sales and marketing expense was significantly attributable to a decrease in sales department headcount and to the decrease in costs that vary directly with sales.

General and administrative expenses for the three months ended June 30, 2017 increased by approximately 76% to \$1.2 million compared to \$675,000 in the three months ended June 30, 2016. There were increases in cost related to being a public company that included increases in stock-based compensation, professional services and the new cost of directors' and officers' insurance. In addition, during the three months ended June 30, 2017, we wrote off \$216,000 to bad debt expense, a component of general and administrative expenses as compare to \$101,000 in the three months ended June 30, 2016 and recorded non-cash, stock-based compensation of \$226,000 in the current period as compared to \$85,000 in the three months ended June 30, 2016.

	Three months ended June 30,	
	2017	2016
	(in thousands)	
Research and development ("R&D")	\$ 81	\$ 65

R&D for the three months ended June 30, 2017 increased approximately 25% to \$81,000, compared to \$65,000 for the three months ended June 30, 2016. The increase is most significantly related to the hiring of an employee who is working on new product procurement and design. With respect to our products, the basic functional technology we use has changed very little over time, therefore, our R&D spending has primarily related to enhancing existing functionality, introducing new functions within existing products, and designing and engineering new products largely with existing proven technology. Though we are in the process of product redesign, we do not expect that R&D costs as a percentage of sales will be significant for the foreseeable future.

	Three months ended June,	
	2017	2016
	(in thousands)	
Interest and finance expense	\$ -	\$ 339

Interest expense for the three months ended June 30, 2016 included \$319,000 of interest expense related to bridge financing that was converted to equity as part of the initial public offering in July 2016. Also during that period, we incurred interest expense related to accounts receivable factoring that is not being used during the current three months ended June 30, 2017.

	Three months ended June 30,	
	2017	2016
	(in thousands)	
Income tax provision	\$	-
	-	-

Income tax expense generally consists of state income taxes due or paid in the states in which we operate. We have not recognized a deferred tax benefit for the operating losses generated during the periods due to the uncertainty that we will generate taxable income in the future that will allow us to utilize the benefit.

Six Months ended June 30, 2017 Compared to Six Months ended June 30, 2016

Results of Operations

The following discussion explains in greater detail our consolidated operating results and financial condition. This discussion should be read in conjunction with the consolidated financial statements and notes herein.

	Six months ended June 30,	
	2017	2016
	(in thousands)	
Net sales	\$ 1,138	\$ 2,220

Net sales for the six months ended June 30, 2017 decreased approximately 49% to \$1.1 million from \$2.2 million for the six months ended June 30, 2016. We began to rapidly transition away from memory product sales beginning in the third quarter of 2016. In the six months ended June 30, 2017, gross sales of memory product totaled approximately \$197,000. In the six months ended June 30, 2016, gross sales of memory product totaled approximately \$1.7 million. In addition, working capital constraints continue to limit our ability to build traction with our action sports camera line.

	Six months ended June 30,	
	2017	2016
	(in thousands)	
Cost of goods sold	\$ 1,224	\$ 1,743
Gross profit (loss)	\$ (86)	\$ 477
Gross profit margin	(7.6)%	21.5%

Cost of goods sold decreased approximately \$519,000 for the six months ended June 30, 2017 to \$1.2 million, compared to \$1.7 million for the six months ended June 30, 2016. As a percent of net sales, cost of goods sold increased to 107.6% in the six months ended June 30, 2017 from 78.5% for the six months ended June 30, 2016. Gross profit (loss) in the six months ended June 30, 2017 decreased to \$(86,000) from \$477,000 in the six months ended June 30, 2016. Gross profit (loss) as a percentage of net sales was (7.6%) in the six months ended June 30, 2017, compared to 21.5% in the six months ended June 30, 2016. In general, gross profit as a percentage of net sales is a result of a combination of factors, including product mix, customer mix, and specific pricing decisions. These factors can affect a significant change in gross profit as a percentage of net sales from one period to the next, particularly when sales are relatively low. Specific to the current six months ended June 30, 2017, we right-priced our product to be more competitive in the action sports camera space, selling at lower margins in the first quarter of 2017. In addition, in the first quarter of 2017, we sold certain memory products, for which we no longer had a customer base, below cost.

	Six months ended	
	June 30,	
	2017	2016
	(in thousands)	
<u>Selling and marketing</u>	\$ 1,027	\$ 1,227
<u>General and administrative</u>	\$ 2,683	\$ 1,470

Sales and marketing for the six months ended June 30, 2017 decreased approximately 16%, to \$1.0 million, compared to \$1.2 million for the six months ended June 30, 2016. The decrease in sales and marketing expense was significantly attributable to the decrease in headcount in our sales department as well as a decrease in expenses that vary directly with sales.

General and administrative expenses for the six months ended June 30, 2017 increased by approximately 82% to \$2.7 million compared to \$1.5 million in the six months ended June 30, 2016. There were increases in cost related to being a public company that included increases in non-cash, stock-based compensation, professional services and the new cost of directors' and officers' insurance. Stock-based compensation was \$659,000 in the six months ended June 30, 2017 as compared to \$179,000 in the six months ended June 30, 2016.

	Six months ended	
	June 30,	
	2017	2016
	(in thousands)	
<u>Research and development ("R&D")</u>	\$ 150	\$ 114

R&D for the six months ended June 30, 2017 increased approximately 32% to \$150,000, compared to \$114,000 for the six months ended June 30, 2016. The increase is most significantly related to the hiring of an employee who is working on new product procurement and design. With respect to our products, the basic functional technology we use has changed very little over time, therefore, our R&D spending has primarily related to enhancing existing functionality, introducing new functions within existing products, and designing and engineering new products largely with existing proven technology. Though we are in the process of product redesign, we do not expect that R&D costs as a percentage of sales will be significant for the foreseeable future.

	Six months ended	
	June 30,	
	2017	2016
	(in thousands)	
<u>Interest and finance expense</u>	\$ 1	\$ 787
<u>Gain on settlement of customer refund</u>	\$ (68)	\$ —

For the six months ended June 30, 2016 we incurred approximately \$691,000 in amortization of debt discount and deferred financing costs related to bridge loan financing. Also during that period, we incurred interest expense related to accounts receivable factoring that is not being used during the six months ended June 30, 2017. Gain on settlement of customer refund of \$68,000 is the amortization of a \$340,000 deferred gain that resulted from a settlement agreement on a customer refund from fiscal 2012.

	Six months ended	
	June 30,	
	2017	2016
	(in thousands)	
Income tax provision	\$ —	\$ —

No income tax expense was recognized in the six-month periods ended June 30, 2017 and 2016. We have not recognized a deferred tax benefit for the operating losses generated during the periods due to the uncertainty that we will generate taxable income in the future that will allow us to utilize the benefit.

Financial Condition

Liquidity and Capital Resources

Our primary sources of liquidity throughout the six months ended June 30, 2017 and 2016 have been our initial public offering, cash raised in private placements of common stock and accounts receivable.

In June 2015, we secured an accounts receivable financing facility with Bay View Funding. The contract provides for maximum funding of \$4.0 million and a factoring fee of 1.35% for the first 30 days and .45% for each 10-day period thereafter that the financed receivable remains outstanding. As of June 30, 2017, there was no balance owed on this facility. The facility automatically renews annually at year-end unless terminated with 30 days notice.

On July 13, 2016, we closed an initial public offering and received net proceeds of \$8,151,000.

In November 2016, we issued 484,848 shares of common stock in a Private Placement receiving net proceeds of approximately \$672,000.

In March and April 2017, the Company issued additional shares pursuant to a Private Placement Memorandum, issuing 342,000 shares receiving net proceeds of approximately \$419,000. In May and June 2017, the Company issued convertible promissory notes for total proceeds of \$340,000.

Discussion of Cash Flows

	Six months ended June 30,		
	2017	2016	Change
	(in thousands)		
Net cash used in operating activities	\$ (2,273)	\$ (2,152)	\$ (121)
Net cash used in investing activities	—	—	—
Net cash provided by financing activities	859	2,185	(1,326)
Net increase (decrease) in cash	<u>\$ (1,414)</u>	<u>\$ 33</u>	<u>\$ (1,447)</u>

Operating Activities

Net cash used in operating activities in the six months ended June 30, 2017 was approximately \$2.3 million, due primarily to the net loss of \$3.9 million. The loss as a use of cash was partially offset by using existing inventory for sales during the quarter, by collections of accounts receivable related to first quarter sales and by a \$331,000 increase in accounts payable. One other significant use of cash was a net \$504,000 reduction in amounts due to customers. Net cash used in operating activities in the six months ended June 30, 2016 was approximately \$2.2 million, due primarily to the net loss of \$3.1 million, partially offset by certain non-cash expense items that include \$691,000 of amortization of deferred debt issuance costs and debt discount. An increase in accounts receivable of \$513,000 as a use of cash was attributable to sales at the end of the quarter and was offset by an increase in accounts payable of \$445,000 as a source of cash. There was also a \$396,000 increase in inventory as a use of cash and an increase in accrued expenses of \$317,000 as a source of cash that was largely attributable to the accrual of inventory in transit at June 30, 2016.

Investing Activities

Our current operating structure does not depend upon a significant investment in capital equipment or operating facilities. Substantially all of our manufacturing is conducted offshore by third party manufacturers. Our warehouse is leased under a one-year operating lease. For the six months ended June 30, 2017 and 2016, we used no cash in investing activities.

Financing Activities

Net cash provided by financing activities for the six months ended June 30, 2017 was \$859,000 and was attributable to issuance of common stock pursuant to a private placement memorandum and the issuance of convertible promissory notes. Net cash provided by financing activities for the six months ended June 30, 2016 was approximately \$2.2 million and was attributable to the bridge loan financing and preferred stock issuances during the first six months of 2016.

Debt Instruments

As of June 30, 2017, debt instruments include two convertible notes payable with a total principal amount of \$38,000 due in 2015 that remain unpaid and \$340,000 in convertible promissory notes.

Operating and Capital Expenditure Requirements

We have not achieved profitability since our inception and we expect to continue to incur net losses for the foreseeable future. We expect our cash expenditures to increase in the near term as we fund our future growth. As a publicly traded company we will incur significant legal, accounting and other expenses that we were not required to incur as a private company. In addition, the Sarbanes-Oxley Act, as well as rules adopted by the Securities and Exchange Commission, or SEC, and the Nasdaq Stock Market, requires public companies to implement specified corporate governance practices that are currently inapplicable to us as a private company. We expect these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly.

Our current cash balance is not sufficient to fund the operation for the remainder of 2017. As such, the Company believes that there is substantial doubt about the Company's ability to continue as a going concern. We will need to raise substantial additional financing in the future to fund our operations. In order to meet these additional cash requirements, we would likely need to sell additional equity or convertible securities that may result in dilution to our stockholders. If we raise additional funds through the issuance of convertible securities, these securities could have rights senior to those of our common stock and could contain covenants that restrict our operations. There can be no assurance that we will be able to obtain additional equity or debt financing on terms acceptable to us, if at all. If we raise additional funds through collaboration and licensing agreements with third parties, it may be necessary to relinquish valuable rights to our product candidates, technologies or future revenue streams or to grant licenses on terms that may not be favorable to us. For additional risks associated with our substantial capital requirement, please see "Risk Factors" in our annual report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2017.

We have entered into an agreement that is intended to culminate in a merger as well as a spin-off of our camera business (see Note 3). This potential transaction is expected to result in a surviving entity that would be better capitalized. The transaction requires shareholder approval and there can be no assurance that shareholder approval will be obtained or that, if approved by shareholders, the proposed transaction will be completed.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, as defined by applicable SEC rules and regulations.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with U.S. GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. On an on-going basis, we evaluate our estimates, which are based upon historical experiences, market trends and financial forecasts and projections, and upon various other assumptions that management believes to be reasonable under the circumstances at that certain point in time. Actual results may differ, significantly at times, from these estimates under different assumptions or conditions.

We believe the following critical accounting policies and estimates affect the significant estimates and judgments we use in the preparation of our consolidated financial statements, and may involve a higher degree of judgment and complexity than others.

Revenue recognition

Net sales (revenue) are recognized when there is persuasive evidence that an arrangement exists, when delivery has occurred, when the price to the buyer is fixed or determinable and when collectability of the receivable is reasonably assured. These elements are met when title to the products is passed to the buyers, which is generally when product is delivered to the customer and the customer has accepted delivery.

Certain customers have limited rights of return and/or are entitled to price adjustments on products held in their inventory. We reduce net sales in the period of sale for estimates of product returns, price adjustments and other allowances. Our reserve estimates are based upon historical data as well as projections of sales, customer inventories, price adjustments, average selling prices and market conditions. Price protection is calculated on a product by product basis. The objective of price protection is to mitigate returns by providing retailers with credits to ensure maximum consumer sales. Price protection is granted to retailers after they have presented the company an affidavit of existing inventory. Actual returns and adjustments could be significantly different from our estimates and provisions, resulting in an adjustment to net sales.

Inventories

Inventory is stated at the lower of cost or market, with cost being determined on the weighted average cost method of accounting. We purchase finished goods and materials to assemble kits in quantities that we anticipate will be fully used in the near term. Changes in operating strategy, customer demand, and fluctuations in market values can limit our ability to effectively utilize all products purchased and can result in finished goods with above-market carrying costs which may cause losses on sales to customers. Our policy is to closely monitor inventory levels, obsolescence and lower market values compared to costs and, when necessary, reduce the carrying amount of inventory to market value. As of June 30, 2017 and December 31, 2016, inventory on hand was comprised primarily of finished goods ready for sale and packaging materials.

Share-based compensation/Warrants valuation

We use the Black-Scholes model to determine the fair value of stock options and stock purchase warrants on the date of grant. The amount of compensation or other expense recognized using the Black-Scholes model requires us to exercise judgment and make assumptions relating to the factors that determine the fair value of our share-based grants. The fair value calculated by this model is a function of several factors, including the grant price, the expected future volatility, the expected term of the option or warrant and the risk-free interest rate correlating to the term of the option or warrant. The expected term is derived using the simplified method provided in Securities and Exchange Commission release Staff Accounting Bulletin No. 110 which averages an award's weighted average vesting period and contractual term for "plain vanilla" share options. The expected volatility is estimated by analyzing the historic volatility of similar public companies. The risk-free rate of return reflects the weighted average interest rate offered for US treasury rates over the expected life of options or warrants. The expected term and expected future volatility requires our judgment. In addition, we are required to estimate the expected forfeiture rate and only recognize a cost or expense for those stock options or warrants expected to vest.

Fair value measurements

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. Fair value is based on a hierarchy of valuation techniques, which is determined on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1: Quoted prices for identical instruments in active markets.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The carrying amount for other financial instruments, which include cash, accounts receivable, accounts payable, and line of credit, approximate fair value based upon their short-term nature and maturity.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 1 of Notes to Consolidated Financial Statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Pursuant to Item 305(e) of Regulation S-K (§ 229.305(e)), we are not required to provide the information required by this Item as it is a "smaller reporting company," as defined by Rule 229.10(f)(1).

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As required by Rules 13a-15(e) and 15d-15(e) under the Exchange Act, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report. This evaluation was carried out under the supervision and with the participation of our management.

We maintain a set of disclosure controls and procedures designed to ensure that information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rule and forms. Disclosure controls are also designed with the objective of ensuring that this information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decision regarding required disclosure.

Based upon their evaluation as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are not effective to ensure that information required to be included in our periodic Securities and Exchange Commission filing is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

Our management has determined that we had a material weakness in our internal control over financial reporting as of June 30, 2017 and December 31, 2016 relating to the design and operation of our closing and financial reporting processes. We have concluded that this material weakness in our internal control over financial reporting is due to the fact that we do not yet have the appropriate resources with the appropriate level of experience and technical expertise to oversee our closing and financial reporting processes.

In order to remediate this material weakness, we have taken the following actions:

- we have hired and are continuing to actively seek additional accounting and finance staff members to augment our current staff and to improve the effectiveness of our closing and financial reporting processes; and
- we are formalizing our accounting policies and internal controls documentation and strengthening supervisory reviews by our management.

Notwithstanding the material weakness that existed as of June 30, 2017 and December 31, 2016, our management has concluded that the consolidated financial statements presented in this filing present fairly, in all material respects, our financial position, results of operation and cash flows in conformity with GAAP.

Changes in Internal Control Over Financial Reporting

There were no material changes in our internal control over financial reporting during the period ended June 30, 2017 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On February 16, 2016, the Company received a letter from GoPro, Inc., or GoPro, alleging that the Company infringes on at least five U.S. patents held by GoPro, and requesting to confirm in writing that the Company will permanently cease the sale and distribution of its Villain camera, along with any camera accessories, including the waterproof camera case and standard housing. The five patents specifically identified by GoPro in the letter were U.S. Patent No. D710,921: camera housing design, U.S. Patent No. D702,747: camera housing design, U.S. Patent No. D740,875: camera housing design, U.S. Patent No. D737,879: camera design and U.S. Patent No. 721,935: camera design. Based upon our preliminary review of these patents, the Company believes it has some defenses to GoPro's allegations, although there can be no assurance that the Company will be successful in defending against these allegations or reaching a business resolution that is satisfactory to us. In addition, we have begun marketing and selling the camera under the name "Monster Vision" and phasing out the "Villain" name. We have had no correspondence from GoPro since instituting the name change.

The supplier of the Company's Villain camera has contractually represented and warranted that it owns or has paid royalties to any and all intellectual property, designs, software, hardware, packaging, components, manuals and any other portion, part or element that is or may be subject to the Villain and the parts and accessories thereof sourced by the supplier. This supplier has contractually agreed to pay any claims, damages, or costs that the Company suffers as a result of the patent infringement or a violation of international, U.S. or state laws or regulations as detailed in the prior sentence.

ITEM 1A. RISK FACTORS.

Our results of operations and financial condition are subject to numerous risks and uncertainties described in our Annual Report on Form 10-K filed on March 31, 2017. You should carefully consider these risk factors in conjunction with the other information contained in this Quarterly Report. Should any of these risks materialize, our business, financial condition and future prospects could be negatively impacted. Material changes to the risk factors set forth in that Form 10-K are stated below.

We need substantial additional capital to continue to fund our operations and we may not be able to obtain the amount of capital required, particularly when the credit and capital markets are unstable. If we are unable to raise substantial additional capital, we would have to modify our business plan, seek to sell assets or explore a transaction a merger partner or curtail some or all of our operations.

We currently have minimal cash on hand and an accounts receivable factoring facility limited to \$4.0 million. Our existing financial resources are not sufficient to satisfy our future minimum capital requirements. We need substantial additional funding to fund our operations. We do not know whether substantial additional financing is available, or, if available, whether the terms of any financing will be favorable to us. The current worldwide financing environment is challenging, which could make it more difficult for us to raise funds on reasonable terms, or at all. To the extent we raise additional capital by issuing equity securities, our stockholders will likely experience substantial dilution and the new equity securities may have rights, preferences or privileges senior to those of our common stock. If we are unable to raise substantial additional capital, or cannot raise substantial capital on acceptable terms, we will not have sufficient capital to operate our business and would have to modify our business plan, seek to sell assets, explore a transaction with a merger partner or curtail some or all of our operations.

If we fail to meet all applicable continued listing requirements of the Nasdaq Capital Market and Nasdaq determines to delist our common stock, the delisting could adversely affect the market liquidity of our common stock, impair the value of your investment, adversely affect our ability to raise needed funds and subject us to additional trading restrictions and regulations.

Companies listed on The NASDAQ Stock Market, or NASDAQ, are subject to delisting for, among other things, failure to maintain a minimum stockholders' equity of \$2.5 million. On April 17, 2017, we received a deficiency notice from NASDAQ notifying us that, based on our Form 10-K for the year ended December 31, 2016, NASDAQ determined that our stockholders' equity does not comply with the minimum \$2.5 million stockholders' equity requirement for continued listing on The NASDAQ Capital Market. NASDAQ provided us with 45 calendar days, or until June 1, 2017, to submit a plan to regain compliance with the minimum stockholders' equity standard. The plan to regain compliance was accepted and NASDAQ granted an extension until October 14, 2017 to evidence compliance. If we do not regain compliance by October 14, 2017, or if we fail to satisfy another NASDAQ requirement for continued listing, NASDAQ staff could provide notice that our common stock will become subject to delisting. In such event, NASDAQ rules permit us to appeal the decision to reject its proposed compliance plan or any delisting determination to a NASDAQ Hearings Panel.

On June 15, 2017, we received a letter from NASDAQ notifying the Company that it is not in compliance with NASDAQ Listing Rule 5810(b) that requires us to maintain a minimum bid price of One Dollar (\$1.00) per share. This determination was based upon the closing bid price of the Company's common stock for the preceding thirty (30) consecutive business days. NASDAQ has provided the Company with 180 calendar days, or until December 12, 2017, to regain compliance by maintaining a closing bid price of One Dollar (\$1.00) for at least Ten (10) consecutive business days. The Company is presently evaluating various courses of action to regain compliance. In the event the Company does not regain compliance, the Company may be eligible for additional time, however, there can be no assurance that the Company will regain compliance by December 12, 2017, or that, if it does not, will be granted further time to regain compliance. If the Company fails to satisfy this listing requirement, or any other NASDAQ requirement for continued listing, NASDAQ staff could provide notice that the Company's common stock will become subject to delisting.

The NASDAQ notices have no immediate effect on the listing of our common stock on the NASDAQ Capital Market. However, we cannot assure you that we will be able to meet these or other continued listing requirements of NASDAQ. If our common stock loses its status on the NASDAQ Capital Market, our common stock would likely trade in the over-the-counter market. If our shares were to trade on the over-the-counter market, selling our common stock could be more difficult because smaller quantities of shares would likely be bought and sold, transactions could be delayed, and any security analysts' coverage of us may be reduced. In addition, in the event our common stock is delisted, broker-dealers have certain regulatory burdens imposed upon them, which may discourage broker-dealers from effecting transactions in our common stock, further limiting the liquidity of our common stock. These factors could result in lower prices and larger spreads in the bid and ask prices for our common stock. Such delisting from the NASDAQ Capital Market and continued or further declines in our share price could also greatly impair our ability to raise additional necessary capital through equity or debt financing and could significantly increase the ownership dilution to shareholders caused by our issuing equity in financing or other transactions.

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

In February 2017, the Company issued a Private Placement Memorandum ("PPM") to raise up to total of \$2,000,000. In March 2017, the Company issued 70,000 shares at \$1.50 per share and 203,478 shares at \$1.15 per share pursuant to the PPM for aggregate gross proceeds of \$339,000 and net proceeds, after deducting for commission and placement agent fees and expenses, of approximately \$307,000. In April 2017, the Company issued an additional 116,000 shares at \$1.15 for aggregate gross proceeds of \$133,400 and net proceeds, after deducting for commission, of approximately \$112,000.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not Applicable.

ITEM 5. OTHER INFORMATION.

None

ITEM 6. EXHIBITS.

Exhibit Number	Description of Exhibit
31.1	Rule 13(a)-14(a)/15(d)-14(a) Certification of principal executive officer
31.2	Rule 13(a)-14(a)/15(d)-14(a) Certification of principal financial and accounting officer
32.1*	Section 1350 Certification of principal executive officer and principal financial and accounting officer
101	XBRL data files of Financial Statements and Notes contained in this Quarterly Report on Form 10-Q.

* This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

MONSTER DIGITAL, INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 21, 2017

Monster Digital, Inc.

By: /s/ DAVID OLERT
Name: David Olert
Title: Chief Financial Officer (Principal Financial and Accounting Officer)

By: /s/ DAVID H. CLARKE
Name: David H. Clarke
Title: Chief Executive Officer (Principal Executive Officer and duly authorized officer)

CERTIFICATION

I, David H. Clarke, certify that:

1. I have reviewed this report on Form 10-Q of Monster Digital, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DAVID H. CLARKE

David H. Clarke

Chief Executive Officer (Principal Executive Officer)

August 21, 2017

CERTIFICATION

I, David Olert, certify that:

1. I have reviewed this report on Form 10-Q of Monster Digital, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DAVID OLERT

David Olert

Chief Financial Officer (Principal Financial and Accounting Officer)

August 21, 2017

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the report of Monster Digital, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned, in the capacities and on the dates indicated below, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ DAVID H. CLARKE

David H. Clarke

Chief Executive Officer (Principal Executive Officer)

August 21, 2017

/s/ DAVID OLERT

David Olert

Chief Financial Officer (Principal Financial and Accounting Officer)

August 21, 2017

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and is not filed with the Securities and Exchange Commission as part of the Form 10-Q or as a separate disclosure document and is not incorporated by reference into any filing of Monster Digital, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, irrespective of any general incorporation language contained in such filing. A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
