

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

FORM 10-Q

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

For the quarterly period ended **September 30, 2019**

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: 001-38037

SG BLOCKS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

95-4463937

(I.R.S. Employer
Identification No.)

195 Montague Street, 14th Floor, Brooklyn, NY

(Address of principal executive offices)

11201

(Zip Code)

(646) 240-4235

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01	SGBX	The Nasdaq Stock Market LLC

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Emerging growth company	<input type="checkbox"/>
Smaller reporting 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 or 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

APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes No

As of November 12, 2019, there were 6,007,791 shares of the registrant's common stock, \$0.01 par value, outstanding.

SG BLOCKS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2019

TABLE OF CONTENTS

	<u>Page</u>	
PART I. FINANCIAL INFORMATION		
ITEM 1.	Financial Statements	2
	Condensed Consolidated Balance Sheets as of September 30, 2019 (Unaudited) and December 31, 2018	2
	Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2019 and 2018 (Unaudited)	3
	Condensed Consolidated Statements of Changes in Stockholders' Equity for the Three and Nine Months Ended September 30, 2019 and 2018 (Unaudited)	4
	Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2019 and 2018 (Unaudited)	5
	Notes to Condensed Consolidated Financial Statements	6
ITEM 2.	Management's Discussion and Analysis of Financial Condition and Result of Operations	27
ITEM 3.	Quantitative and Qualitative Disclosures About Market Risk	34
ITEM 4.	Controls and Procedures	34
PART II. OTHER INFORMATION		
ITEM 1.	Legal Proceedings	35
ITEM 1A.	Risk Factors	35
ITEM 2.	Unregistered Sales of Equity Securities and Use of Proceeds	42
ITEM 3.	Defaults Upon Senior Securities	42
ITEM 4.	Mine Safety Disclosures	42
ITEM 5.	Other Information	42
ITEM 6.	Exhibits	42
SIGNATURE		43

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

SG BLOCKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2019 (Unaudited)	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,953	\$ 1,368,395
Accounts receivable, net	1,436,339	1,746,326
Costs and estimated earnings in excess of billings on uncompleted contracts	8,689	260,325
Prepaid expenses and other current assets	164,885	986,687
Total current assets	<u>1,611,866</u>	<u>4,361,733</u>
Property, plant and equipment, net	12,671	71,337
Goodwill	4,162,173	4,162,173
Intangible assets, net	2,335,086	2,443,929
Total Assets	<u>\$ 8,121,796</u>	<u>\$ 11,039,172</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 1,807,456	\$ 2,624,218
Billings in excess of costs and estimated earnings on uncompleted contracts	241,091	1,334,887
Total current liabilities	<u>2,048,547</u>	<u>3,959,105</u>
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, \$1.00 par value, 5,405,010 shares authorized; none issued or outstanding	—	—
Common stock, \$0.01 par value, 25,000,000 shares authorized as of September 30, 2019 and 300,000,000 shares authorized as of December 31, 2018; 6,007,791 issued and outstanding as of September 30, 2019 and 4,260,041 issued and outstanding as of December 31, 2018	60,079	42,601
Additional paid-in capital	19,464,360	17,700,743
Accumulated deficit	(13,451,190)	(10,663,277)
Total stockholders' equity	<u>6,073,249</u>	<u>7,080,067</u>
Total Liabilities and Stockholders' Equity	<u>\$ 8,121,796</u>	<u>\$ 11,039,172</u>

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

SG BLOCKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	<i>For the Three Months Ended September 30, 2019</i>	<i>For the Three Months Ended September 30, 2018</i>	<i>For the Nine Months Ended September 30, 2019</i>	<i>For the Nine Months Ended September 30, 2018</i>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue:				
Block sales	\$ —	\$ —	\$ —	\$ 42,799
Construction services	187,895	2,033,769	2,521,139	5,307,168
Engineering services	(3,369)	49,056	126,419	582,183
Total	<u>184,526</u>	<u>2,082,825</u>	<u>2,647,558</u>	<u>5,932,150</u>
Cost of revenue:				
Block sales	—	—	—	33,084
Construction services	391,494	1,764,030	1,986,394	5,056,971
Engineering services	(24,711)	93,955	31,998	422,085
Total	<u>366,783</u>	<u>1,857,985</u>	<u>2,018,392</u>	<u>5,512,140</u>
Gross profit (loss)	(182,257)	224,840	629,166	420,010
Operating expenses:				
Payroll and related expenses	548,156	611,906	1,832,333	1,589,935
General and administrative expenses	478,726	557,078	1,318,390	1,538,441
Marketing and business development expense	63,016	133,378	194,591	311,965
Pre-project expenses	1,275	—	19,726	49,964
Total	<u>1,091,173</u>	<u>1,302,362</u>	<u>3,365,040</u>	<u>3,490,305</u>
Operating loss	(1,273,430)	(1,077,522)	(2,735,874)	(3,070,295)
Other income (expense):				
Other income	—	—	—	5,768
Loss on asset disposal	(52,039)	—	(52,039)	—
Loss from equity affiliates	—	(960)	—	(960)
Total	<u>(52,039)</u>	<u>(960)</u>	<u>(52,039)</u>	<u>4,808</u>
Loss before income taxes	(1,325,469)	(1,078,482)	(2,787,913)	(3,065,487)
Income tax expense	—	—	—	—
Net loss	(1,325,469)	(1,078,482)	(2,787,913)	(3,065,487)
Less: Net loss attributable to non-controlling interest	—	(52,445)	—	(52,445)
Net loss attributable to common stockholders of SG Blocks, Inc.	<u>\$ (1,325,469)</u>	<u>\$ (1,026,037)</u>	<u>\$ (2,787,913)</u>	<u>\$ (3,013,042)</u>
Net loss per share - basic and diluted:				
Basic and diluted	<u>\$ (0.23)</u>	<u>\$ (0.24)</u>	<u>\$ (0.56)</u>	<u>\$ (0.71)</u>
Weighted average shares outstanding:				
Basic and diluted	<u>5,694,748</u>	<u>4,260,041</u>	<u>4,938,547</u>	<u>4,260,041</u>

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

SG BLOCKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)

	<i>\$0.01 Par Value Common Stock</i>		<i>Additional Paid-in Capital</i>	<i>Accumulated Deficit</i>	<i>Non-controlling Interest</i>	<i>Total Stockholders' Equity</i>
	<i>Shares</i>	<i>Amount</i>				
<i>Balance – June 30, 2019</i>	5,107,791	\$ 51,079	\$ 18,692,964	\$ (12,125,721)	\$ —	\$ 6,618,322
Stock-based compensation	—	—	197,090	—	—	197,090
Issuance of common stock, net of issuance costs	900,000	9,000	574,306	—	—	583,306
Net loss	—	—	—	(1,325,469)	—	(1,325,469)
<i>Balance – September 30, 2019</i>	<u>6,007,791</u>	<u>\$ 60,079</u>	<u>\$ 19,464,360</u>	<u>\$ (13,451,190)</u>	<u>\$ —</u>	<u>\$ 6,073,249</u>
<i>Balance – December 31, 2018</i>	4,260,041	\$ 42,601	\$ 17,700,743	\$ (10,663,277)	\$ —	\$ 7,080,067
Stock-based compensation	—	—	645,080	—	—	645,080
Issuance of common stock, net of issuance costs	1,747,750	17,478	1,118,537	—	—	1,136,015
Net loss	—	—	—	(2,787,913)	—	(2,787,913)
<i>Balance – September 30, 2019</i>	<u>6,007,791</u>	<u>\$ 60,079</u>	<u>\$ 19,464,360</u>	<u>\$ (13,451,190)</u>	<u>\$ —</u>	<u>\$ 6,073,249</u>

	<i>\$0.01 Par Value Common Stock</i>		<i>Additional Paid-in Capital</i>	<i>Accumulated Deficit</i>	<i>Non- controlling Interest</i>	<i>Total Stockholders' Equity</i>
	<i>Shares</i>	<i>Amount</i>				
<i>Balance – June 30, 2018</i>	4,260,041	\$ 42,601	\$ 17,469,843	\$ (7,806,261)	\$ —	\$ 9,706,183
Stock-based compensation	—	—	117,102	—	—	117,102
Net loss	—	—	—	(1,026,037)	(52,445)	(1,078,482)
<i>Balance – September 30, 2018</i>	<u>4,260,041</u>	<u>\$ 42,601</u>	<u>\$ 17,586,945</u>	<u>\$ (8,832,298)</u>	<u>\$ (52,445)</u>	<u>\$ 8,744,803</u>
<i>Balance – December 31, 2017</i>	4,260,041	\$ 42,601	\$ 17,304,529	\$ (5,819,256)	\$ —	\$ 11,527,874
Stock-based compensation	—	—	282,416	—	—	282,416
Net loss	—	—	—	(3,013,042)	(52,445)	(3,065,487)
<i>Balance – September 30, 2018</i>	<u>4,260,041</u>	<u>\$ 42,601</u>	<u>\$ 17,586,945</u>	<u>\$ (8,832,298)</u>	<u>\$ (52,445)</u>	<u>\$ 8,744,803</u>

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

SG BLOCKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	<i>For the Nine Months Ended September 30, 2019</i>	<i>For the Nine Months Ended September 30, 2018</i>
	<u>(Unaudited)</u>	<u>(Unaudited)</u>
Cash flows from operating activities:		
Net loss	\$ (2,787,913)	\$ (3,065,487)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	8,697	3,227
Amortization of intangible assets	108,843	442,031
Bad debt expense (benefit)	(54,000)	—
Interest income on short-term investment	—	(4)
Stock-based compensation	482,139	282,416
Loss on asset disposal	52,039	—
Loss on equity affiliates	—	960
Changes in operating assets and liabilities:		
Accounts receivable	363,987	247,670
Costs and estimated earnings in excess of billings on uncompleted contracts	251,636	(46,514)
Prepaid expenses and other current assets	821,802	(17,922)
Accounts payable and accrued expenses	(653,821)	(160,480)
Billings in excess of costs and estimated earnings on uncompleted contracts	(1,093,796)	408,692
Net cash used in operating activities	<u>(2,500,387)</u>	<u>(1,905,411)</u>
Cash flows from investing activities:		
Proceeds from short-term investment	—	30,037
Purchase of property, plant and equipment	(2,070)	(69,137)
Purchase of intangible asset	—	(5,000)
Investment in and advances to equity affiliates	—	(7,916)
Net cash used in investing activities	<u>(2,070)</u>	<u>(52,016)</u>
Cash flows from financing activities:		
Proceeds from public stock offering, net of issuance costs	1,136,015	—
Net cash provided by financing activities	<u>1,136,015</u>	<u>—</u>
Net decrease in cash and cash equivalents	(1,366,442)	(1,957,427)
Cash and cash equivalents - beginning of period	1,368,395	4,870,824
Cash and cash equivalents - end of period	\$ 1,953	\$ 2,913,397
Supplemental disclosure of non-cash operating activities:		
Non cash conversion of accrued salary to restricted stock units	<u>\$ 162,941</u>	<u>\$ —</u>

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

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

1. Description of Business

SG Blocks, Inc. (collectively with its subsidiaries, the “Company,” “we”, “us” or “our”) was previously known as CDSI Holdings, Inc., a Delaware corporation incorporated on December 29, 1993. On November 4, 2011, CDSI Merger Sub, Inc., the Company’s wholly-owned subsidiary, was merged with and into SG Building Blocks, Inc. (“SG Building,” formerly SG Blocks Inc.) (the “Merger”), with SG Building surviving the Merger and becoming a wholly-owned subsidiary of the Company. The Merger was a reverse merger that was accounted for as a recapitalization of SG Building, as SG Building was the accounting acquirer. Accordingly, the historical financial statements presented are the financial statements of SG Building.

The Company provides two main products, both of which are used to meet the growing demand for safe and greencommercial, industrial and residential building construction. The Company provides SGBlocks™, code engineered cargo shipping containers that the Company modifies for use in construction. Rather than consuming new steel and lumber, SGBlocks™ capitalize on the structural engineering and design parameters a shipping container must meet and repurposes them for use in building. They offer the construction industry a safer, greener, faster, longer lasting and more economical alternative to conventional construction methods. The Company also provides purpose-built modules (“SGPBMs” and, together with SGBlocks™, “Modules”), which are prefabricated steel modular units created specifically for use in modular construction, unlike the shipping containers used to create SGBlocks™.

The Company also provides engineering and project management services related to the use and modification of Modules in construction.

The Company is now focusing on entering into licensing agreements across the Company’s construction opportunity verticals that should enable it to further its sales and marketing efforts on qualified lead generation for its licensees.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

2. Liquidity

The Company has prepared its condensed consolidated financial statements on a going concern basis, which assumes that the Company will realize its assets and satisfy its liabilities in the normal course of business. However, the Company has incurred net losses since its inception and has negative operating cash flows, which raise substantial doubt about its ability to continue as a going concern. The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of the uncertainty concerning the Company's ability to continue as a going concern.

As of September 30, 2019, the Company had cash and cash equivalents of \$1,953 and a backlog of \$17.8 million. See Note 8 for a discussion of construction backlog. Based on the Company's conversations with key customers, the Company anticipates its backlog to convert to revenue over the following period:

	<u>2019</u>
Within 1 year	\$ 4,250,770
1 to 2 years	13,536,400
Thereafter	—
Total Backlog	<u>\$ 17,787,170</u>

The Company completed an equity offering in April 2019 and in August 2019, which resulted in net proceeds of approximately \$1,136,015. See Note 9 for a discussion of these offerings. The Company completed a Securities Purchase Agreement in November 2019, which resulted in net proceeds of approximately \$326,000. See Note 13 for a discussion on this purchase agreement. The Company believes that it will have sufficient cash balances to meet obligations and further intends to meet its capital needs by containing costs and entering into strategic alliances, as well as exploring other options, including the possibility of raising additional debt or equity capital as necessary. There is, however, no assurance the Company will be successful in meeting its capital requirements prior to becoming cash flow positive. The Company does not have any additional sources secured for future funding, and if it is unable to raise the necessary capital at the times it requires such funding, it may need to materially change its business plan, including delaying implementation of aspects of such business plan or curtailing or abandoning such business plan altogether.

On July 1, 2019, the Company received a letter from The Nasdaq Stock Market LLC ("Nasdaq") notifying the Company that, because the closing bid price for the Company's common stock listed on Nasdaq was below \$1.00 for 30 consecutive business days, the Company no longer meets the minimum bid price requirement for continued listing on Nasdaq under Nasdaq Listing Rule 5550(a)(2), which requires a minimum bid price of \$1.00 per share.

Pursuant to Nasdaq Listing Rule 5810(c)(3)(A), the Company has been granted a grace period of 180 calendar days, or until December 30, 2019, to regain compliance with the minimum closing bid price requirement for continued listing. To regain compliance, the closing bid price of the Company's shares of common stock must meet or exceed \$1.00 per share for at least ten consecutive business days during this 180-day grace period.

If the Company does not regain compliance with Rule 5550(a)(2) by December 30, 2019, the Company may be eligible for an additional 180-calendar day compliance period. To qualify, the Company would be required to meet the continued listing requirement for market value of publicly held shares and all other initial listing standards for The Nasdaq Capital Market, except for the minimum bid price, and provide written notice to Nasdaq of its intent to cure the deficiency during this second compliance period, by effecting a reverse stock split, if necessary. However, if it appears to the Nasdaq staff that the Company will not be able to cure the deficiency, or if the Company is otherwise not eligible, Nasdaq will provide notice to the Company that its common stock will be subject to delisting.

The Company intends to monitor the closing bid price of its common stock and consider its available options in the event that the closing bid price of its common stock remains below \$1.00 per share. There can be no assurance that the Company will be able to regain compliance with the minimum bid price requirement or maintain compliance with the other listing requirements.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

3. Summary of Significant Accounting Policies

Basis of presentation and principals of consolidation— The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. The condensed consolidated financial statements and notes should be read in conjunction with the financial statements and notes for the year ended December 31, 2018 included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the Securities and Exchange Commission on March 29, 2019. In the opinion of management, all adjustments, consisting of normal accruals, considered necessary for a fair presentation of the interim financial statements have been included. Results for the nine months ended September 30, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, SG Building Blocks, Inc., SG Residential, Inc., and SG Blocks Puerto Rico, Inc. All significant intercompany accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period’s presentation.

Recently adopted accounting pronouncements— New accounting pronouncements implemented by the Company are discussed below or in the related notes, where appropriate.

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No.2016-02, “Leases (Topic 842)” (“ASU 2016-02”). The update’s principal objective is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet. ASU 2016-02 continues to retain a distinction between finance and operating leases but requires lessees to recognize a right-of-use asset representing their right to use the underlying asset for the lease term and a corresponding lease liability on the balance sheet for all leases with terms greater than twelve months. The update is effective for fiscal years beginning after December 15, 2018. In July 2018, the FASB issued ASU No. 2018-11, “Leases (Topic 842): Targeted Improvements” (“ASU 2018-11”), which provides entities with an additional transition method. Under ASU 2018-11, entities have the option of recognizing the cumulative effect of applying the new standard as an adjustment to beginning retained earnings in the year of adoption while continuing to present all prior periods under previous lease accounting guidance. In July 2018, the FASB also issued ASU No. 2018-10, “Codification Improvements to Topic 842, Leases” (“ASU 2018-10”), which clarifies how to apply certain aspects of ASU2016-02. The Company adopted ASU 2016-02, ASU 2018-10 and ASU 2018-11 effective January 1, 2019. The Company had no operating or finance lease agreements as of September 30, 2019. The adoption of ASU No.2016-02 did not have a material impact on the Company’s financial statements and disclosures.

In June 2018, the FASB issued ASU No.2018-07, “Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting” (“ASU 2018-07”), which expands the scope of Topic 718 to include all share-based payment transactions for acquiring goods and services from nonemployees. ASU 2018-07 specifies that Topic 718 applies to all share-based payment transactions in which the grantor acquires goods and services to be used or consumed in its own operations by issuing share-based payment awards. Under ASC 718, the measurement date for equity-classified, share-based awards is generally the grant date of the award. ASU 2018-07 also clarifies that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under ASC 606. The Company adopted ASU 2018-07 effective January 1, 2019. The adoption provides administrative relief by fixing the remaining unamortized expense of the award and eliminating the requirement to quarterly re-measure the Company’s nonemployee awards. The adoption of ASU No. 2018-07 did not have a material impact on the Company’s financial statements and disclosures.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

3. Summary of Significant Accounting Policies (continued)

Recently issued accounting pronouncements not yet adopted— New accounting pronouncements requiring implementation in future periods are discussed below.

In January 2017, the FASB issued ASU No.2017-04, “Simplifying the Test for Goodwill Impairment” (“ASU2017-04”), to simplify the test for goodwill impairment by removing Step 2. An entity will, therefore, perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognizing an impairment charge for the amount by which the carrying amount exceeds the fair value, not to exceed the total amount of goodwill allocated to the reporting unit. An entity still has the option to perform a qualitative assessment to determine if the quantitative impairment test is necessary. The ASU is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted. Adoption of the ASU is on a prospective basis. Based on current evaluation, the Company does not expect that ASU No. 2017-04 will have a material impact on the Company’s financial statements.

In August 2018, the FASB issued ASU No.2018-13, “Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement” (“ASU 2018-13”). This ASU amends ASC 820 to add, remove and modify certain disclosure requirements for fair value measurements. For example, public companies will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. Management does not expect the adoption of ASU 2018-13 to have a material impact on the Company’s financial position, results of operations or cash flow.

Accounting estimates – The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Significant areas that require the Company to make estimates include revenue recognition, stock-based compensation and allowance for doubtful accounts. Actual results could differ from those estimates.

Operating cycle – The length of the Company’s contracts varies, but is typically between six to twelve months. In some instances, the length of the contract may exceed twelve months. Assets and liabilities relating to current and long-term contracts are included in current assets and current liabilities, respectively, in the accompanying balance sheets as they will be liquidated in the normal course of contract completion, which at times could exceed one year.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

3. Summary of Significant Accounting Policies (continued)

Revenue recognition – The Company applies recognition of revenue over time, which is similar to the method the Company applied under previous guidance (i.e., percentage of completion). The Company determines, at contract inception, whether it will transfer control of a promised good or service over time or at a point in time—regardless of the length of contract or other factors. The recognition of revenue aligns with the timing of when promised goods or services are transferred to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. To achieve this core principle, the Company applies the following five steps in accordance with its revenue policy:

- 1) Identify the contract with a customer;
- 2) Identify the performance obligations in the contract;
- 3) Determine the transaction price;
- 4) Allocate the transaction price to performance obligations in the contract; and
- 5) Recognize revenue as performance obligations are satisfied.

Due to uncertainties inherent in the estimation process, it is possible that estimates of costs to complete a performance obligation will be revised in the near-term. For those performance obligations for which revenue is recognized using a cost-to-cost input method, changes in total estimated costs, and related progress toward complete satisfaction of the performance obligation, are recognized on a cumulative catch-up basis in the period in which the revisions to the estimates are made. When the current estimate of total costs for a performance obligation indicate a loss, a provision for the entire estimated loss on the unsatisfied performance obligation is made in the period in which the loss becomes evident.

On October 3 2019, the Company entered into an Exclusive License Agreement (“ELA”) pursuant to which it granted an exclusive license for its technology as outlined in the ELA. See Note 13 for a discussion on the ELA. Under the ELA, the Company will receive royalty payments based upon gross revenues earned by the licensee for commercialize products within the field of design and project management platforms for residential use, including single-family residences and multi-family residences, but excluding military housing. The Company has determined that the ELA grants the licensee a right to access the Company’s intellectual property throughout the license period (or its remaining economic life, if shorter), and thus recognizes revenue over time as the licensee recognizes revenue and the Company has the right to payment of royalties. No revenue has been recognized under the ELA for the nine months ended September 30, 2019.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

3. Summary of Significant Accounting Policies (continued)

Disaggregation of Revenues

The Company's revenues are principally derived from construction and engineering contracts related to Modules. The Company's contracts are with many different customers in numerous industries.

The following tables provide further disaggregation of the Company's revenues by categories:

Revenue by Customer Type	Three Months Ended September 30,			
	2019		2018	
Multi-Family	\$ (18,013)	— %	\$ 47,026	2 %
Office	4,424	2 %	445,992	22 %
Retail	195,421	97 %	955,667	46 %
School	—	— %	602,641	29 %
Special Use	—	— %	30,990	1 %
Other	2,694	1 %	509	— %
Total revenue by customer type	\$ 184,526	100 %	\$ 2,082,825	100 %

Revenue by Customer Type	Nine Months Ended September 30,			
	2019		2018	
Multi-Family	\$ 94,178	4 %	\$ 257,840	4 %
Office	1,212,321	46 %	1,039,348	18 %
Retail	1,332,805	50 %	1,487,587	25 %
School	—	— %	2,462,880	42 %
Special Use	6,812	— %	667,074	11 %
Other	1,442	— %	17,421	— %
Total revenue by customer type	\$ 2,647,558	100 %	\$ 5,932,150	100 %

Contract Assets and Contract Liabilities

Accounts receivable are recognized in the period when the Company's right to consideration is unconditional. Accounts receivable are recognized net of an allowance for doubtful accounts. A considerable amount of judgment is required in assessing the likelihood of realization of receivables.

The timing of revenue recognition may differ from the timing of invoicing to customers.

Contract assets include unbilled amounts from long-term construction services when revenue recognized under the cost-to-cost measure of progress exceeds the amounts invoiced to customers, as the amounts cannot be billed under the terms of our contracts. Such amounts are recoverable from customers based upon various measures of performance, including achievement of certain milestones, completion of specified units or completion of a contract. Contract assets are generally classified as current within the condensed consolidated balance sheets and labeled as "costs and estimated earnings in excess of billings on uncompleted contracts".

Contract liabilities from construction and engineering contracts occur when amounts invoiced to customers exceed revenues recognized under the cost-to-cost measure of progress. Contract liabilities additionally include advanced payments from customers on certain contracts. Contract liabilities decrease as the Company recognizes revenue from the satisfaction of the related performance obligation. Contract liabilities are generally classified as current within the condensed consolidated balance sheet and labeled as "billings in excess of costs and estimated earnings on uncompleted contracts".

Although the Company believes it has established adequate procedures for estimating costs to complete on open contracts, it is at least reasonably possible that additional significant costs could occur on contracts prior to completion. The Company periodically evaluates and revises its estimates and makes adjustments when they are considered necessary.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

3. Summary of Significant Accounting Policies (continued)

Cash and cash equivalents – The Company considers cash and cash equivalents to include all short-term, highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less upon acquisition. Cash and cash equivalents totaled \$1,953 as of September 30, 2019 and \$1,368,395 as of December 31, 2018.

Short-term investment – The Company classifies any investment with a maturity greater than six months but less than one year as a short-term investment. The Company had no short-term investments as of September 30, 2019 or December 31, 2018.

Accounts receivable and allowance for doubtful accounts – Accounts receivable are receivables generated from sales to customers and progress billings on performance type contracts. Amounts included in accounts receivable are deemed to be collectible within the Company's operating cycle. The Company recognizes account receivable at invoiced amounts.

The allowance for doubtful accounts reflects the Company's best estimate of probable losses inherent in the accounts receivable balances. Management provides an allowance for doubtful accounts based on the Company's historical losses, specific customer circumstances, and general economic conditions. Periodically, management reviews accounts receivable and adjusts the allowance based on current circumstances and charges off uncollectible receivables when all attempts to collect have been exhausted and the prospects for recovery are remote. Recoveries are recognized when they are received. Actual collection losses may differ from the Company's estimates and could be material to its consolidated financial position, result of operations, and cash flows.

Inventory – Raw construction materials (primarily shipping containers) are valued at the lower of cost (first-in, first-out method) or net realizable value. Finished goods and work-in-process inventories are valued at the lower of cost or net realizable value, using the specific identification method. There was no inventory as of September 30, 2019 or December 31, 2018.

Goodwill – The Company performs its impairment test of goodwill at the reporting unit level each fiscal year, or more frequently if events or circumstances change that would more likely than not reduce the fair value of its reporting unit below its carrying values. The Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount, including goodwill. If management concludes that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, management conducts a two-step quantitative goodwill impairment test. The first step of the impairment test involves comparing the fair value of the applicable reporting unit with its carrying value. If the carrying amount of the reporting unit exceeds the reporting unit's fair value, management performs the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill. The amount by which the carrying value of the goodwill exceeds its implied fair value, if any, is recognized as an impairment loss. The Company's evaluation of goodwill completed during the year ended December 31, 2018 resulted in no impairment losses.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

3. Summary of Significant Accounting Policies (continued)

Intangible assets – Intangible assets represent the preliminary assets identified upon emergence from bankruptcy and consist of \$2,766,000 of proprietary knowledge and technology which is being amortized over 20 years and \$1,113,000 of customer contracts which was being amortized over 2.5 years. In addition, intangible assets include \$28,820 of trademarks and \$5,300 of website costs which are being amortized over 5 years. The Company evaluated intangible assets for impairment during the year ended December 31, 2018, and determined that there were no impairment losses. The accumulated amortization as of September 30, 2019 and 2018 was \$1,578,034 and \$1,321,604, respectively. The amortization expense for the three months ended September 30, 2019 and 2018 was \$36,281 and \$147,399, respectively. The amortization expense for the nine months ended September 30, 2019 and 2018 was \$108,843 and \$442,031, respectively. The estimated amortization expense for the successive five years is as follows:

For the year ended December 31,

2019	\$ 36,281
2020	145,124
2021	145,124
2022	140,801
2023	139,007
Thereafter	1,728,749
	<u>\$ 2,335,086</u>

Property, plant and equipment – Property, plant and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated lives of each asset. Estimated useful life for significant classes of assets are as follows: computer and software 3 to 5 years and equipment 5 to 7 years. Repairs and maintenance are charged to expense when incurred.

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

Fair value measurements – Financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, are carried at cost, which the Company believes approximates fair value due to the short-term nature of these instruments.

The Company measures the fair value of financial assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

3. Summary of Significant Accounting Policies (continued)

The Company uses three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Quoted prices for similar assets and liabilities in active markets or inputs that are observable.
- Level 3 Inputs that are unobservable (for example, cash flow modeling inputs based on assumptions).

Share-based payments – The Company measures the cost of services received in exchange for an award of equity instruments based on the fair value of the award. For employees and directors, including non-employee directors, the fair value of a stock option award is measured on the grant date. The fair value amount is then recognized over the period services are required to be provided in exchange for the award, usually the vesting period. The Company recognizes stock-based compensation expense on a graded-vesting basis over the requisite service period for each separately vesting tranche of each award. Stock-based compensation expense to employees and all directors is reported within payroll and related expenses in the consolidated statements of operations. Stock-based compensation expense to non-employees is reported within marketing and business development expense in the consolidated statements of operations.

Income taxes – The Company accounts for income taxes utilizing the asset and liability approach. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes generally represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from the differences between the financial and tax bases of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted.

The calculation of tax liabilities involves dealing with uncertainties in the application of complex tax regulations. The Company recognizes liabilities for anticipated tax audit issues based on the Company's estimate of whether, and the extent to which, additional taxes will be due. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when the liabilities are no longer determined to be necessary. If the estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

Concentrations of credit risk – Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents. The Company places its cash with high credit quality institutions. At times, such amounts may be in excess of the FDIC insurance limits. The Company has not experienced any losses in its account and believes that it is not exposed to any significant credit risk on the account.

With respect to receivables, concentrations of credit risk are limited to a few customers in the construction industry. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers other than normal lien rights. At September 30, 2019 and December 31, 2018, 92% and 76%, respectively, of the Company's gross accounts receivable were due from two customers.

Revenue relating to two and four customers represented approximately 94% and 80% of the Company's total revenue for the three months ended September 30, 2019 and 2018, respectively. Revenue relating to two and one customers represented approximately 87% and 41% of the Company's total revenue for the nine months ended September 30, 2019 and 2018, respectively.

Cost of revenue relating to two and four vendors represented approximately 93% and 85% of the Company's total cost of revenue for the three months ended September 30, 2019 and 2018, respectively. Cost of revenue relating to four and one vendors represented approximately 94% and 52% of the Company's total cost of revenue for the nine months ended September 30, 2019 and 2018, respectively. The Company believes it has access to alternative suppliers, with limited disruption to the business, should circumstances change with its existing suppliers.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

4. Accounts Receivable

At September 30, 2019 and December 31, 2018, the Company's accounts receivable consisted of the following:

	September 30, 2019	December 31, 2018
Billed:		
Block sales	\$ —	\$ 14,723
Construction services	1,306,567	1,619,498
Engineering services	333,230	400,877
Retainage receivable	544,911	543,417
Other receivable	37,526	7,706
Total gross receivables	2,222,234	2,586,221
Less: allowance for doubtful accounts ⁽¹⁾	(785,895)	(839,895)
Total net receivables	<u>\$ 1,436,339</u>	<u>\$ 1,746,326</u>

⁽¹⁾ The allowance for doubtful accounts is primarily due to unpaid billings on a contract that is currently in dispute.

Receivables are evaluated for collectability and allowances for potential losses are established or maintained on applicable receivables. The allowance for doubtful accounts was \$785,895 as of September 30, 2019. There was no provision for doubtful accounts, \$54,000 collected for doubtful accounts and no write offs for the nine months ended September 30, 2019. The provision for doubtful accounts was \$810,580 and write offs were \$4,920 for the year ended December 31, 2018.

5. Contract Assets and Contract Liabilities

Costs and estimated earnings on uncompleted contracts consisted of the following at September 30, 2019 and December 31, 2018:

	September 30, 2019	December 31, 2018
Costs incurred on uncompleted contracts	\$ 228,461	\$ 11,307,975
Estimated earnings to date on uncompleted contracts	79,852	838,615
Gross contract assets	308,313	12,146,590
Less: billings to date	(540,715)	(13,221,152)
Net contract assets (liabilities)	<u>\$ (232,402)</u>	<u>\$ (1,074,562)</u>

The above amounts are included in the accompanying consolidated balance sheets under the following captions at September 30, 2019 and 2018:

	September 30, 2019	December 31, 2018
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 8,689	\$ 260,325
Billings in excess of costs and estimated earnings on uncompleted contracts	(241,091)	(1,334,887)
Net contract assets (liabilities)	<u>\$ (232,402)</u>	<u>\$ (1,074,562)</u>

Although management believes it has established adequate procedures for estimating costs to complete on open contracts, it is at least reasonably possible that additional significant costs could occur on contracts prior to completion. The Company periodically evaluates and revises its estimates and makes adjustments when they are considered necessary.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

6. **Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and amortization and depreciated using the straight-line method over their useful lives. At September 30, 2019 and December 31, 2018, the Company's property, plant and equipment, net consisted of the following:

	September 30, 2019	December 31, 2018
Computer equipment and software	\$ 18,862	\$ 39,193
Furniture and other equipment	1,885	63,479
Property, plant and equipment	20,747	102,672
Less: accumulated depreciation	(8,076)	(31,335)
Property, plant and equipment, net	<u>\$ 12,671</u>	<u>\$ 71,337</u>

Depreciation expense for the nine months ended September 30, 2019 and 2018 amounted to \$8,697 and \$3,227, respectively.

7. **Net Income (Loss) Per Share**

Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of the common shares issuable upon the exercise of stock options and warrants. Potentially dilutive common shares are excluded from the calculation if their effect is antidilutive.

At September 30, 2019, there were options, including options granted to non-employees and non-directors, restricted stock units and warrants to purchase 1,080,059, 473,933 and 1,063,775 shares of common stock, respectively, outstanding that could potentially dilute future net income (loss) per share. Because the Company had a net loss for the three and nine months ended September 30, 2019, it is prohibited from including potential common shares in the computation of diluted per share amounts. Accordingly, the Company has used the same number of shares outstanding to calculate both the basic and diluted loss per share. At September 30, 2018, there were options, including options to non-employees and non-directors, and warrants to purchase 1,188,392 and 86,250 shares of common stock, respectively, outstanding that could potentially dilute future net income (loss) per share.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

8. Construction Backlog

The following represents the backlog of signed construction and engineering contracts in existence at September 30, 2019 and December 31, 2018, which represents the amount of revenue the Company expects to realize from work to be performed on uncompleted contracts in progress and from contractual agreements in effect at September 30, 2019 and December 31, 2018, respectively, on which work has not yet begun:

	September 30, 2019	December 31, 2018
Balance - beginning of period	\$ 97,657,379	\$ 76,659,029
New contracts and change orders during the period, net	17,474,684	58,805,877
Adjustments and cancellations, net	(94,697,335)	(29,616,815)
Subtotal	20,434,728	105,848,091
Less: contract revenue earned during the period	(2,647,558)	(8,190,712)
Balance - end of period	<u>\$ 17,787,170</u>	<u>\$ 97,657,379</u>

Backlog at September 30, 2019 included one large contract entered into by the Company during the third quarter of 2019 in the amounts of approximately \$17 million. The Company expects that all of this revenue will be realized by September 30, 2021. During the fourth quarter of 2018, the Company moved a contract of \$27.5 million out of backlog and into its pipeline until the customer completes a highest and best use analysis of the land. During the second quarter of 2019, the Company moved a \$25.0 million contract out of backlog after receiving a cancellation notice from the customer. The customer has requested arbitration to resolve contractual issues related to pricing and scope of work performed on the contract. During the third quarter of 2019, the Company removed two contracts in the amount of \$55 million and \$15 million out of backlog due to the fact that these projects now fall under the ELA. Under the ELA the Company expects to receive approximately \$2.4 million for one such project. The Company expects to receive these royalties through June 30, 2022. Backlog does not include expected royalty fees to the Company under the ELA from projects to be delivered by our licensee.

The Company's remaining backlog as of September 30, 2019 represents the remaining transaction price of firm contracts for which work has not been performed and excludes unexercised contract options. As of September 30, 2019, the aggregate amount of the transaction price allocated to backlog was \$17,787,170.

The Company expects to satisfy its backlog which represents the remaining unsatisfied performance obligation on contracts as of September 30, 2019 over the following period:

	2019
Within 1 year	\$ 4,250,770
1 to 2 years	13,536,400
Thereafter	—
Total Backlog	<u>\$ 17,787,170</u>

Although backlog reflects business that is considered to be firm, cancellations, deferrals or scope adjustments may occur. Backlog is adjusted to reflect any known project cancellations, revisions to project scope and cost and project deferrals, as appropriate.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

9. Stockholders' Equity

Public Offering – In June 2017, the Company issued 1,500,000 shares of its common stock at \$5.00 per share through a public offering (the “Public Offering”). The Company incurred \$1,388,615 in issuance costs from the Public Offering and issued warrants to purchase 75,000 shares of common stock valued at \$55,475 to the underwriters (as discussed in Note 10).

In July 2017, as permitted by the underwriting agreement entered into in connection with the Public Offering, the underwriters exercised their option to purchase an additional 225,000 shares of common stock at \$5.00 per share. The Company incurred \$176,771 in issuance costs from this issuance. In connection with this exercise, certain affiliates of the underwriters were granted additional warrants to purchase 11,250 shares of common stock in the aggregate valued at \$8,321 (as discussed in Note 10).

In connection with and prior to the Public Offering, the Company issued 1,801,670 shares of its common stock upon conversion of all outstanding preferred stock and 516,667 shares of its common stock upon conversion of the previously outstanding convertible debentures.

Securities Purchase Agreement – In April 2019, the Company issued 847,750 shares of its common stock at \$1.10 per share pursuant to the terms of a Securities Purchase Agreement (the “Purchase Agreement”) with certain institutional investors and accredited investors. Concurrently with the sale of the common stock, pursuant to the Purchase Agreement, the Company also sold common stock purchase warrants to such investors to purchase up to an aggregate of 847,750 shares of common stock. The Company incurred \$379,816 in issuance costs from the offering and issued warrants to purchase 84,775 shares of common stock to the underwriters. The warrants are further discussed in Note 10.

Underwriting Agreement – In August 2019, the Company issued 900,000 shares of its common stock at \$0.85 per share pursuant to the terms of an Underwriting Agreement (the “Underwriting Agreement”) to the public. The Company incurred \$181,695 in issuance costs from the offering and issued warrants to purchase 45,000 shares of common stock to the underwriter. The warrants are further discussed in Note 10.

Decrease in Authorized Shares – On June 5, 2019, at the Company’s annual meeting of stockholders, the stockholders approved an amendment to the Company’s amended and restated certificate of incorporation to decrease the number of authorized shares of common stock from 300,000,000 to 25,000,000 shares. Following the meeting, on June 5, 2019, the Company filed a certificate of amendment to the amended and restated certificate of incorporation to decrease its authorized shares of common stock accordingly. There was no change to the number of authorized shares of preferred stock.

10. Warrants

In conjunction with the Public Offering, the Company issued to certain affiliates of the underwriters, as compensation, warrants to purchase an aggregate of 86,250 shares of common stock at an exercise price of \$6.25 per share. The warrants are exercisable at the option of the holder on or after June 21, 2018 and expire June 21, 2023. The fair value of warrants was calculated utilizing a Black-Scholes model and amounted to \$63,796. The fair market value of the warrants as of the date of issuance has been included in issuance costs in additional paid-in capital.

In conjunction with the Purchase Agreement in April 2019, the Company also sold warrants to purchase up to an aggregate of 847,750 shares of common stock at an initial exercise price of \$1.375 per share. The warrants are exercisable at the option of the holder on or after October 29, 2019 and expire October 29, 2024. The Company issued to certain affiliates of the underwriters, as compensation, warrants to purchase an aggregate of 84,775 shares of common stock at an initial exercise price of \$1.375 per share. The warrants are exercisable at the option of the holder on or after October 29, 2019 and expire April 24, 2024.

In conjunction with the Underwriting Agreement in August 2019, the Company issued to the underwriter, as compensation, warrants to purchase an aggregate of 45,000 shares of common stock at an initial exercise price of \$1.0625 per share. The warrants are exercisable at the option of the holder on or after February 1, 2020 and expire August 29, 2024.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

11. Share-based Compensation

On October 26, 2016, the Company’s Board of Directors approved the issuance of up to 500,000 shares of the Company’s common stock in the form of restricted stock or options (“2016 Stock Plan”). Effective January 20, 2017, the 2016 Stock Plan was amended and restated as the SG Blocks, Inc. Stock Incentive Plan, as further amended effective June 1, 2018 (the “Incentive Plan”). The Incentive Plan authorizes the issuance of up to 2,500,000 shares of common stock. It authorizes the issuance of equity-based awards in the form of stock options, stock appreciation rights, restricted shares, restricted share units, other share-based awards and cash-based awards to non-employee directors and to officers, employees and consultants of the Company and its subsidiaries, except that incentive stock options may only be granted to the Company’s employees and its subsidiary’s employees. The Incentive Plan expires on October 26, 2026, and is administered by the Compensation Committee of the Board of Directors of the Company. Each of the Company’s employees, directors, and consultants are eligible to participate in the Incentive Plan. As of September 30, 2019, there were 893,205 shares of common stock available for issuance under the Incentive Plan.

Stock-Based Compensation Expense

Stock-based compensation expense is included in the consolidated statements of operations as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Payroll and related expenses	\$ 139,402	\$ 117,102	\$ 472,014	\$ 282,416
Marketing and business development expenses	3,375	—	10,125	—
Total	\$ 142,777	\$ 117,102	\$ 482,139	\$ 282,416

The following table presents total stock-based compensation expense by security type included in the consolidated statements of operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Stock options	\$ 40,098	\$ 117,102	\$ 112,293	\$ 282,416
Restricted stock units	102,679	—	369,846	—
Total	\$ 142,777	\$ 117,102	\$ 482,139	\$ 282,416

Stock-Based Option Awards

The fair value of the stock-based option awards granted during the nine months ended September 30, 2019 and 2018, were estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

	2019	2018
Expected dividend yield	—%	—%
Expected stock volatility	68.35%	25.70%
Risk-free interest rate	2.44%	2.56%
Expected life (in years)	3	5

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

11. Share-based Compensation (continued)

Because the Company does not have significant historical data on employee exercise behavior, the Company uses the “Simplified Method” to calculate the expected life of the stock-based option awards granted to employees. The simplified method is calculated by averaging the vesting period and contractual term of the options.

The following table summarizes stock-based option activities and changes during the nine months ended September 30, 2019. The table includes options granted to employees and directors of the Company, as described below:

	Shares	Weighted Average Fair Value Per Share	Weighted Average Exercise Price Per Share	Weighted Average Remaining Terms (in years)	Aggregate Intrinsic Value
Outstanding – December 31, 2018	1,105,059	\$ 1.24	\$ 4.06	8.41	\$ —
Granted	—	—	—	—	—
Exercised	—	—	—	—	—
Cancelled	(25,000)	—	—	—	—
Outstanding – September 30, 2019	1,080,059	1.24	4.05	7.64	\$ —
Exercisable – December 31, 2018	949,355	1.23	4.00	8.30	—
Exercisable – September 30, 2019	1,024,356	\$ 1.24	\$ 4.04	7.62	\$ —

For the three months ended September 30, 2019 and 2018, the Company recognized stock-based compensation expense of \$40,098 and \$117,102, respectively, related to stock options. For the nine months ended June 30, 2019 and 2018, the Company recognized stock-based compensation expense of \$112,293 and \$282,416, respectively, related to stock options. This expense is included in payroll and related expenses in the accompanying consolidated statements of operations.

As of September 30, 2019, there was \$51,619 of total unrecognized compensation costs related to non-vested stock options, which will be expensed over a weighted average period of less than one year. The intrinsic value is calculated as the difference between the fair value of the stock price at year end and the exercise price of each of the outstanding stock options. The fair value of the stock price at September 30, 2019 was \$0.42 per share.

In March 2018, the Company granted Mr. Galvin, Mr. Shetty and six employees of the Company options to purchase 82,154, 81,342 and an aggregate of 86,504, respectively, shares of the Company’s common stock with an exercise price of \$4.61 per share. These options vest in equal quarterly installments over either a two-year and three-year period and will fully vest by the end of March 31, 2021. The options with a two-year period, which includes those granted to Mr. Galvin and Mr. Shetty, will vest in full by December 31, 2019; the options with a three-year vesting period will vest in full by March 31, 2021. The fair value of these options upon issuance amounted to \$320,000.

Non-Employee Stock Options

In September 2017, in connection with an advisory agreement entered into by the Company (the “Advisory Agreement”), a consultant was granted options to purchase 50,000 shares of the Company’s common stock, with an exercise price of \$6.25. The options were scheduled to vest when certain performance conditions were met. These performance conditions consisted of the purchase of fifty modular units from the Company by qualified customers. As of March 31, 2019, the required performance conditions were not met, and the options expired.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

11. Share-based Compensation (continued)

Restricted Stock Units

Effective July 26, 2018, a total of 27,955 of restricted stock units were granted to the Company's non-employee directors, under the Company's stock-based compensation plan, at the calculated fair value of \$5.36 per share, which represents the average closing price of the Company's common stock for the ten trading days immediately preceding and including the grant date. Restricted stock units granted to directors in 2018 vested on June 5, 2019 as the earlier of (A) the first anniversary of the date of the grant or (B) the date of the annual meeting of the Company's stockholders that occurs in the year immediately following the date of the grant; and are payable six months after the termination of the director from the Board or death or disability.

On March 22, 2019, a total of 314,058 of restricted stock units were granted to Mr. Galvin, Mr. Armstrong, Mr. Shetty, six employees and one consultant of the Company, under the Company's stock-based compensation plan, at the fair value of \$2.70 per share, which represents the closing price of the Company's common stock on February 26, 2019. Restricted stock units granted to Mr. Galvin, Mr. Armstrong, Mr. Shetty, and an aggregate of six employees and one consultant of 122,785, 15,432, 114,575 and an aggregate of 61,266, respectively, vest in installments over either a one-year, two-year, three-year and four-year period and will fully vest by the end of December 31, 2022. The fair value of these units upon issuance amounted to \$847,957.

On January 15, 2019 and February 26, 2019, a total of 10,514 of restricted stock units were granted to two of the Company's non-employee directors, under the Incentive Plan, at the calculated fair value of \$2.94 and \$2.76 per share, respectively, which represents the average closing price of the Company's common stock for the ten trading days immediately preceding and including the grant date. The restricted stock units granted on January 15, 2019 will vest on January 15, 2020, subject to each individual's continued service as a director of the Company through such date, and are payable six months after the termination of the director from the Company's Board of Directors or death or disability. The restricted stock units granted on February 26, 2019 vest on the earlier of (A) the first anniversary of the date of the grant or (B) the date of the 2019 annual meeting of the Company's stockholders subject to each individual's continued service as a director of the Company through such date, and are payable six months after the termination of the director from the Board of Directors or death or disability.

Effective June 5, 2019, a total of 183,780 of restricted stock units were granted to the Company's non-employee directors, under the Company's stock-based compensation plan, at the calculated fair value of \$0.82 per share, which represents the average closing price of the Company's common stock for the ten trading days immediately preceding and including the grant date. Restricted stock units granted to directors on June 5, 2019 vest on the earlier of (A) the first anniversary of the date of the grant or (B) the date of the annual meeting of the Company's stockholders that occurs in the year immediately following the date of the grant; and are payable six months after the termination of the director from the Board or death or disability.

For the three months ended September 30, 2019 and 2018, the Company recognized stock-based compensation expense of \$102,679 and \$0 related to restricted stock units. For the nine months ended September 30, 2019 and 2018, the Company recognized stock-based compensation expense of \$369,846 and \$0 related to restricted stock units. This expense is included in the payroll and related expenses and marketing and business development expenses in the accompanying condensed consolidated statement of operations. For the nine months ended September 30, 2019 and 2018, the Company recognized \$162,941 and \$0, respectively, related to restricted stock units in lieu of accrued compensation.

The following table summarizes restricted stock unit activities during the nine months ended September 30, 2019:

	Number of Shares
Non-vested balance at January 1, 2019	22,364
Granted	508,349
Vested	(27,792)
Forfeited/Expired	(56,779)
Non-vested balance at September 30, 2019	<u>446,142</u>

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

12. Commitments and Contingencies

Legal Proceedings

The Company is subject to certain claims and lawsuits arising in the normal course of business. The Company assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. Where it is probable that the Company will incur a loss and the amount of the loss can be reasonably estimated, the Company records a liability in its consolidated financial statements. These legal accruals may be increased or decreased to reflect any relevant developments on a quarterly basis. Where a loss is not probable or the amount of the loss is not estimable, the Company does not record an accrual, consistent with applicable accounting guidance. Based on information currently available to the Company, advice of counsel, and available insurance coverage, the Company believes that its established accruals are adequate and the liabilities arising from the legal proceedings will not have a material adverse effect on its consolidated financial condition. The Company notes, however, that in light of the inherent uncertainty in legal proceedings there can be no assurance that the ultimate resolution of a matter will not exceed established accruals. As a result, the outcome of a particular matter or a combination of matters may be material to the Company's results of operations for a particular period, depending upon the size of the loss or the Company's income for that particular period.

Pizzarotti Litigation – On or about August 10, 2018, Pizzarotti, LLC filed a complaint against the Company and Mahesh Shetty, the Company's President, and others seeking unspecified damages for an alleged breach of contract by the Company and another entity named Phipps & Co. ("Phipps"). The lawsuit was filed as Pizzarotti, LLC v. Phipps & Co., et al., Index No. 653996/2018 and commenced in the Supreme Court of the State of New York for the County of New York. On or about April 1, 2019, Phipps filed cross-claims against the Company and Mr. Shetty asserting claims for indemnification, contribution, fraud, negligence, negligent misrepresentation, and breach of contract. SG Blocks has likewise cross claimed against Phipps for indemnification and contribution, claiming that any damages to the Plaintiff were the result of the acts or omissions of Phipps and its principals.

The claims against the Company arise from a purported assignment agreement dated August 10, 2018, whereby Pizzarotti claims that the Company agreed to assume certain obligations under a certain trade contract between Pizzarotti and Phipps & Co. The Company has moved to dismiss both the Pizzarotti claims and Phipps cross claims asserting that the purported assignment is void and unenforceable as a matter of law for lack of consideration. That motion is currently pending before the court. The Company intends to vigorously defend the litigation.

Litigation is subject to many uncertainties, and the outcome of this action is not predicted with assurance. The Company is currently unable to predict the possible loss or range of loss, if any, associated with the resolution of this litigation, and, accordingly, the Company has made no provision related to this matter in the condensed consolidated financial statements.

Vendor Litigation – On January 1, 2019, SG Blocks filed a suit against Teton Buildings, LLC ("Teton") to recover breach of contract damages of approximately \$2,100,000 plus attorneys' fees related to the HOLA Community Partners construction project in Los Angeles, California (the "HOLA Project"), for which Teton was engaged by the Company to supply modular units in early 2017. The Company's complaint alleged that Teton failed to comply with specific product requirements with respect to the modular units for the HOLA Project and that Teton's delay and product quality resulted in damages. The Company's claims include breach of contract, negligence, and breach of express warranty. The lawsuit was filed as *SG Blocks, Inc. v. Teton Buildings, LLC*, Case Number 2019-02827 in the United States District Court for the Southern District of Texas.

SG Blocks believes it will prevail on the merits of the case. As with any litigation at this early stage, the cost of litigating and the outcome remain uncertain. On October 16, 2019, Teton Buildings, LLC filed a voluntary petition for relief under chapter 11, title 11, of the United States Code, in the United States Bankruptcy Court for Southern District of Texas, Houston Division (the "Bankruptcy Court"). The case in the Bankruptcy Court is styled In re: Teton Buildings, LLC and bears the case number 19-35811. As a result of the bankruptcy filing the litigation against stayed. The Company is pursuing its rights and remedies in the Teton bankruptcy case. Although the Company believes it will prevail on the merits of its claims, as with any litigation, particularly litigation within bankruptcy, the cost of litigation and the outcome are uncertain, and now subject to the United States Bankruptcy Code and Rules.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

12. Commitments and Contingencies (continued)

HOLA Community Partners Matter— There is an ongoing dispute between the Company and HOLA Community Partners, a California non-profit corporation, in connection with the parties' Construction and Delivery Agreement, dated June 1, 2017, pursuant to which HOLA Community Partners hired the Company for design, engineering, fabrication, and installation services for the construction of the HOLA Project. The Company claims that HOLA Community Partners owes the Company certain amounts due for work performed on the HOLA Project and extra costs incurred due to delays and impacts caused by HOLA Community Partners. HOLA Community Partners disputes the amounts owed, and claims that the Company failed to meet its contractual obligations. The parties are in ongoing settlement discussions. Neither party has commenced litigation as of the date of these condensed consolidated financial statements.

In addition, the Company is subject to other routine legal proceedings, claims, and litigation in the ordinary course of its business. Defending lawsuits requires significant management attention and financial resources and the outcome of any litigation, including the matters described above, is inherently uncertain. The Company does not, however, currently expect that the costs to resolve these routine matters will have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Vendor Litigation— On June 21, 2019, SG Blocks filed suit against EDI International, PC ("EDI") arising out of EDI's interference with SG Blocks' contractual and economic relations with HOLA Community Partners and the Heart of Los Angeles Youth, Inc., related to the HOLA Project, for which EDI was engaged to provide certain design and engineering services to SG Blocks. In the lawsuit, SG Blocks asserts claims for intentional interference with economic advantage, negligent interference with economic advantage, and intentional interference with contractual relations and seeks to recover from EDI damages in excess of \$1,274,752. The lawsuit was filed as SG Blocks, Inc. v. EDI International, PC Which Will Do Business In California As EDI International California et al., Case No. 19STCV21725, in the Superior Court of California, County of Los Angeles.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

13. Subsequent Events

Exclusive License Agreement – On October 3, 2019, as amended on October 17, 2019, the Company entered into an Exclusive License Agreement (the “*License Agreement*”) with CPF GP 2019-1 LLC (the “*Licensee*”), pursuant to which the Company granted the Licensee an exclusive license (the “*License*”) solely within the United States and its legal territories to the Company’s technology, intellectual property, any improvements thereto, and any related permits, in order to develop and commercialize products within the field of design and project management platforms for residential use, including single-family residences and multi-family residences, but excluding military housing. The License Agreement has an initial term of five (5) years and will automatically renew for subsequent five (5) year periods. The License Agreement provides for customary terminating provisions, including the right by the Company to terminate if the Licensee fails to make minimum royalty payments (as described below).

In consideration for the License, during the initial term, the Licensee agreed to pay the Company a royalty of (x) five percent (5%) on the first \$20,000,000 of gross revenues derived from the Licensee’s commercialization of the License (net of customary discounts, sales taxes, delivery charges, and amounts for returns) (the “*Gross Revenues*”), (y) four and one-half percent (4.5%) on the next \$30,000,000 of Gross Revenues, and (z) five percent (5%) on all Gross Revenues thereafter (collectively, the “*Royalty*”), subject to the following minimum royalty payments determined on a cumulative basis during the initial term: \$500,000 in year 1, \$750,000 in year 2, \$1,500,000 in year 3, \$2,000,000 in year 4, and \$2,500,000 in year 5. If the License Agreement is extended beyond the initial term, then the parties will negotiate in good faith the royalty rate and the minimum royalty payments for the renewal term(s). In addition, to the extent the Licensee sublicenses any aspect of the License to a sublicensee, the Licensee will pay to the Company fifty percent (50%) of all payments received by the Licensee from such sublicensee. The Company may also provide the Licensee with professional services with respect to the License, and the Licensee will reimburse the Company for employees’ time, materials, and expenses incurred in providing such professional services. The Licensee also separately agreed to reimburse the Company for any third-party expenses incurred by the Company in developing the Company’s remaining and future residential projects.

The License Agreement provides for customary indemnification obligations between the parties and further provides that the Licensee will indemnify the Company for any claims arising out of the commercialization of the License by the Licensee or any of its subsidiaries, contractors, or sublicensees. In addition, the License Agreement provides that the Company will provide the Licensee with cost estimates for the fabrication and manufacturing of residential projects in the Company’s existing pipeline as of the date of the License Agreement, and if such projects cannot be reasonably constructed and installed at or below such estimates, then the Licensee may withhold payment of any royalty due to the Company under the License Agreement on a dollar-for-dollar basis to offset the costs above the originally estimated amounts.

The Company previously disclosed, its membership interest in CPF GP 2019-1 LLC (“*CPF GP*”), which is the managing member of the Licensee, which in turn owns the land on, and intends to develop the 302-unit multifamily project in, Sullivan County, New York, known as the “Monticello Project.” Under the License Agreement, the Company agreed to withdraw as a member of CPF GP. As a result, the Company’s membership interest in CPF GP was forfeited and the Company no longer has any obligation to contribute \$1,300,000 of cash to CPF GP. In addition, as a result of the License Agreement, the Licensee (rather than the Company) will supply products for the construction of the Monticello Project. As a result of the transactions under the License Agreement, the Company anticipates that its construction backlog will be reduced, perhaps materially.

Loan Agreement – On October 3, 2019, the Company entered into a Loan Agreement and Promissory Note (the “*Loan Agreement*”) with CPF GP, pursuant to which the Company agreed to loan CPF GP a principal amount of \$750,000 at an annual interest rate of five percent (5%), with a maturity date of July 31, 2023. Under the Loan Agreement, the Company will advance to CPF GP the first installment of the principal amount, equal to \$500,000, no later than October 15, 2019 and will advance to CPF GP the second installment of the principal amount, equal to \$250,000, no later than February 28, 2020. As security for this loan, the Company will receive a security interest in all of CPF GP’s membership interests in the Licensee. The Company is considering its options in funding the first principal installment under the Loan Agreement, including but not limited to raising equity capital or assigning its rights and obligations under the Loan Agreement to another party. If the Company fails to fund either principal installment, such failure will constitute a default under the Loan Agreement and a cross default under the License Agreement.

Notes to Condensed Consolidated Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

13. Subsequent events (continued)

On October 15, 2019, the Company and CPF GP 2019-1 LLC (“*CPF GP*”) entered into an Amendment to Loan Agreement and Promissory Note (the “*Amendment*”), pursuant to which the parties amended that certain Loan Agreement and Promissory Note, dated October 3, 2019 (the “*Loan Agreement*”). Under the Amendment, the parties agreed to extend the date by which the Company is obligated to make the first installment of the principal amount of the loan (which such installment amount is equal to \$500,000) to CPF GP under the Loan Agreement from October 15, 2019 to October 25, 2019.

On November 7, 2019, the Company and CPF GP 2019-1 LLC (“*CPF GP*”) entered into Second Amendment to Loan Agreement and Promissory Note (the “*Second Amendment*”), pursuant to which the parties amended that certain Loan Agreement and Promissory Note, dated October 3, 2019 (the “*Loan Agreement*”), as amended on October 15, 2019. Under the Second Amendment, the parties agreed to extend the date by which the Company is obligated to make the first installment of the principal amount of the loan (which such installment amount is equal to \$500,000) to CPF GP under the Loan Agreement from October 25, 2019 to January 31, 2020 and the second installment from February 28, 2020 to April 15, 2020.

CMC Right of First Refusal Agreement— On October 9, 2019, the Company entered into a Right of First Refusal Agreement (the “*Agreement*”) with CMC Development LLC (“*CMC*”), which has a term of two (2) years. Under the Agreement, the Company has a right of first refusal with respect to being engaged as a designer and builder of any real estate projects for which CMC has secured the rights to develop and in which CMC has a greater than fifty percent (50%) interest in the owner or developer entity and has the right to select the builder for such real estate project (the “*ROFR Rights*”). In exchange for such ROFR Rights, the Company agreed to issue to CMC 50,000 shares of restricted stock of the Company’s common stock, of which 25,000 shares will vest and be issued on September 30, 2020 and the remaining 25,000 shares will vest and be issued on September 30, 2021, unless the Agreement is earlier terminated. In the event that the Agreement is earlier terminated, CMC will still be entitled to receive the entire amount of such restricted stock that has vested as of such earlier termination date, but in no event less than 25,000 shares of such restricted stock. The Agreement also provides for customary indemnification and confidentiality obligations between the parties.

The Agreement also provides that CMC has engaged the Company to build and design, in the aggregate, approximately 100 residential and commercial units at 1100 Ridge Avenue, Atlanta, Georgia, which is known as the “Ridge Avenue, Atlanta Project.” The total cost of the project is \$5,000,000. The project is a residential project subject to the Company’s Exclusive License Agreement, dated October 3, 2019. As a result, the licensee under the Exclusive License Agreement will arrange for the design build of the container-based modular building for the project and SG Blocks will be entitled to the related fees under such Exclusive License Agreement.

Securities Purchase Agreement— On November 12, 2019, the Company entered into a Securities Purchase Agreement (the “*Purchase Agreement*”) with an investor, pursuant to which the Company issued to the investor a senior secured convertible debenture in the principal amount of \$480,770 (the “*Debenture*”) for proceeds of \$375,000 (representing an original issue discount of 22%). We received net proceeds of approximately \$326,250 after deducting certain fees due to the placement agent and certain transaction expenses. The Debenture is due 110 days after issuance and is secured under a Security Agreement, dated November 12, 2019, entered into with the investor (the “*Security Agreement*”) by a security interest in all of the Company’s existing and future assets, subject to existing security interests and exceptions. The Company has the right to redeem all or a portion of the outstanding principal of the Debenture (i) prior to the maturity date without interest and with no conversion by the investor and (ii) after the maturity date at a premium of 120%, and with interest accruing at 24% from the maturity date.

SG BLOCKS, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements For the Nine Months Ended September 30, 2019 and 2018 (Unaudited)

13. Subsequent events (continued)

The Debenture is convertible into shares of the Company's common stock only upon (i) the occurrence of an Event of Default (as defined in the Debenture) or (ii) at maturity in the event any principal remains outstanding, at a conversion price equal to the lower of (x) 67.5% of the lowest daily VWAPs of the common stock during the five consecutive trading days immediately preceding the Event of Default or date of maturity or (y) if the Debenture is not fully paid as of the Maturity, the lowest daily VWAP during the ten (10) consecutive trading days immediately preceding the date of the applicable Conversion, and based on a conversion amount determined by the product of (x) the portion of the principal and accrued interest to be converted and (y) 120% or (y) if the Debenture is not fully paid as of the Maturity Date and no conversions have been effected under the Debenture, the lowest daily VWAP during the ten (10) consecutive Trading Days immediately preceding the date of the applicable Conversion; provided, however, that the Company will not issue any shares of common stock upon conversion of the Debenture if the investor would exceed the aggregate number of shares of common stock which the Company may issue upon conversion or exercise (as the case may be) of the Debenture without breaching the Company's obligations under the rules or regulations of the Nasdaq Stock Market, including rules related to the aggregate of offerings under NASDAQ Listing Rule 5635(d) (which currently limit such issuance to 1,200,957 shares, which is 19.99% of the Company's outstanding shares as of the date hereof). In addition, subject to limited exceptions, the investor will not have the right to convert any portion of the Debenture if the investor, together with its affiliates, would beneficially own in excess of 4.99% of the number of shares of the Company's common stock outstanding immediately after giving effect to its conversion and under no circumstances may convert the Debenture if the investor, together with its affiliates, would beneficially own in excess of 9.99% of the number of shares of the Company's common stock outstanding immediately after giving effect to its conversion.

In connection with this transaction, the Company entered into a Placement Agency Agreement (the "**Placement Agency Agreement**") with ThinkEquity, a division of Fordham Financial Management, Inc. (the "**Placement Agent**"), pursuant to which the Company has agreed to pay the Placement Agent a cash fee equal to 9% of the gross proceeds received by the Company from the investor in this transaction, as well as a one-time expense fee of \$15,000 for aggregate out-of-pocket expenses incurred collectively in this transaction. Pursuant to the Placement Agency Agreement, the Company also agreed to grant to the Placement Agent or its designees warrants to purchase up to 9% of the aggregate number of shares of common stock underlying the Debenture, which equals 108,086 shares of common stock, at an exercise price of 110% of the closing price of the Company's common stock on the closing date (the "**Placement Agent Warrants**").

The Placement Agent Warrants are exercisable, in whole or in part, commencing on the issuance date and have an exercise period of five years. In the event that there is not an effective registration statement permitting for the resale of the shares underlying the Placement Agent Warrants, the Placement Agent Warrant's shall be exercisable on a cashless basis. There are significant restrictions pursuant to FINRA Rule 5110 against transferring the Placement Agent's Warrants and the shares issuable upon exercise of the Placement Agent Warrants during the one hundred eighty (180) days after the closing date.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Result of Operations

Introduction and Certain Cautionary Statements

As used in this Quarterly Report, unless the context requires otherwise, references to the "Company," "we," "us," and "our" refer to SG Blocks, Inc. and its subsidiaries. The following discussion and analysis of the financial condition and results of our operations should be read in conjunction with our condensed consolidated financial statements and related notes and schedules included elsewhere in this Quarterly Report on Form 10-Q. The unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with our audited consolidated financial statements and notes for the year ended December 31, 2018, which were included in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the Securities and Exchange Commission on March 29, 2019 (the "2018 Form 10-K"). Statements contained in this Quarterly Report on Form 10-Q may use forward-looking terminology, such as "anticipates," "believes," "could," "would," "estimates," "may," "might," "plan," "expect," "intend," "should," "will," or other variations on these terms or their negatives. All statements other than statements of historical facts are statements that could potentially be forward-looking. The Company cautions that forward-looking statements involve risks and uncertainties and actual results could differ materially from those expressed or implied in these forward-looking statements or could affect the extent to which a particular objective, projection, estimate or prediction is realized. Factors that could cause or contribute to such differences include, but are not limited to: general economic, political and financial conditions, both in the United States and internationally; our ability to obtain additional financing on acceptable terms, if at all, or to obtain additional capital in other ways; our ability to increase sales, generate income, effectively manage our growth and realize our backlog; competition in the markets in which we operate, including the consolidation of our industry, our ability to expand into and compete in new geographic markets and our ability to compete by protecting our proprietary manufacturing process; a disruption or cybersecurity breach in our or third-party suppliers' information technology systems; our ability to adapt our products and services to industry standards and consumer preferences and obtain general market acceptance of our products; product shortages and the availability of raw materials, and potential loss of relationships with key vendors, suppliers or subcontractors; the seasonality of the construction industry in general, and the commercial and residential construction markets in particular; a disruption or limited availability with our third party transportation vendors; the loss or potential loss of any significant customers; exposure to product liability, including the possibility that our liability for estimated warranties may be inadequate, and various other claims and litigation; our ability to attract and retain key employees; our ability to attract private investment for sales of product; the credit risk from our customers and our customers' ability to obtaining third-party financing if and as needed; an impairment of goodwill; the impact of federal, state and local regulations, including changes to international trade and tariff policies, and the impact of any failure of any person acting on our behalf to comply with applicable regulations and guidelines; costs incurred relating to current and future legal proceedings or investigations; the cost of compliance with environmental, health and safety laws and other local building regulations; our ability to utilize our net operating loss carryforwards and the impact of changes in the United States' tax rules and regulations; dangers inherent in our operations, such as natural or man-made disruptions to our facilities and project sites, and the adequacy of our insurance coverage; our ability to comply with the requirements of being a public company, including Nasdaq Capital Market listing requirements; fluctuations in the price of our common stock, including decreases in price due to sales of significant amounts of stock; potential dilution of the ownership of our current stockholders due to, among other things, public offerings or private placements by the Company or issuances upon the exercise of outstanding options or warrants and the vesting of restricted stock units; the ability of our principal stockholders, management and directors to potentially exert control due to their ownership interest; any ability to pay dividends in the future; potential negative reports by securities or industry analysts regarding our business or the construction industry in general; Delaware law provisions discouraging, delaying or preventing a merger or acquisition at a premium price; our ability to remain listed on the Nasdaq Capital Market and the possibility that our stock will be subject to penny stock rules; our classification as a smaller reporting company resulting in, among other things, a potential reduction in active trading of our common stock or increased volatility in our stock price; and any factors discussed in "Part II—Item 1 A. Risk Factors" to this Quarterly Report on Form 10-Q as well as our 2018 Form 10-K and other filings with the Securities and Exchange Commission. In addition, certain information presented below is based on unaudited financial information. There can be no assurance that there will be no changes to this information once audited financial information is available. As a result, readers are cautioned not to place undue reliance on forward-looking statements. The Company will not undertake to update any forward-looking statement herein or that may be made from time to time on behalf of the Company.

Background

Using our proprietary technology and design and engineering expertise, we modify code-engineered cargo shipping containers and purpose-built modules for use for safe and sustainable commercial, industrial and residential building construction. Rather than consuming new steel and lumber, our proprietary technology and engineering expertise allows for the redesign, repurpose and conversion of heavy-gauge steel cargo shipping containers into SGBlocks™, which are safe green building blocks for commercial, industrial, and residential building construction. Our technology and expertise is also used to purpose-build modules, or prefabricated steel modular units customized for use in modular construction (“Modules”), primarily to augment or complement a SGBlocks structure.

Prior to October 2019, our business model was solely a project-based construction model pursuant to which we were responsible for the design and construction of finished products that incorporated our technology primarily to customers in the multi-family housing, restaurant, military and education industries throughout the United States. On October 3, 2019, we changed our business model for our residential building construction to a royalty fee model when we entered into a five year exclusive license agreement with CPF GP 2019-1 LLC (“CPF”) pursuant to which CPF licensed, on an exclusive basis, our proprietary technology for residential use, including single-family residences and multi-family residences, but excluding military housing. CPF, at the time the License Agreement was entered into, was already a significant customer for the Company’s Modules and had completed a \$5.0 million equity financing to develop a 302-unit multifamily project in Sullivan County, New York. Now, in the United States with respect to residential construction (other than residential construction for the military) we are no longer responsible for constructing the Modules that are based on our technology or the related costs and instead that service is performed by CPF and its subcontractors and our revenue for such residential construction is no longer generated from sales of products direct to the end customer but instead is generated from royalties received from CPF based on the gross revenue that CPF receives from sales of products that are based upon our technology. Depending upon the success of this new business model, we may expand the licensing business model to commercial and industrial construction. We also are continuing to seek opportunities and potential projects in other target markets, which may develop into licensing opportunities in the future.

Results of Operations

Nine Months Ended September 30, 2019 and 2018:

	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
Revenue	\$ 2,647,558	\$ 5,932,150
Cost of revenue	(2,018,392)	(5,512,140)
Operating expenses	(3,365,040)	(3,490,305)
Operating loss	(2,735,874)	(3,070,295)
Other income (expense)	(52,039)	4,808
Net loss	\$ (2,787,913)	\$ (3,013,042)

Revenue

Total revenue for the nine months ended September 30, 2019 was \$2,647,558 compared to \$5,932,150 for the nine months ended September 30, 2018. This decrease of \$3,284,592 or 55% was mainly driven by a decline in revenue resulting from the Company’s school, multi-family, retail and special use contracts for the nine months ended September 30, 2019 as compared to September 30, 2018. Revenue resulting from the Company’s office contracts increased by approximately \$72,973, which was offset by a decrease in revenue from the Company’s school, multi-family, retail, other and special use contracts of \$3,457,565.

Cost of Revenue and Gross Profit

Cost of revenue was \$2,018,392 for the nine months ended September 30, 2019 compared to \$5,512,140 for the nine months ended September 30, 2018. The decrease of \$3,493,748 is primarily related to the lower revenues and the lower procurement and manufacturing costs of modifying containers.

Gross profit was \$629,166 and \$420,010 for the nine months ended September 30, 2019 and 2018, respectively.

Gross profit percentage increased to 24% for the nine months ended September 30, 2019 compared to 7% for the nine months ended September 30, 2018 primarily due to lower margins in the nine months ended September 30, 2018 from a legacy contract.

Payroll and Related Expenses

Payroll and related expenses for the nine months ended September 30, 2019 were \$1,832,333 compared to \$1,589,935 for the nine months ended September 30, 2018. This increase was primarily caused by an increase in salaries and additional head count of \$100,932 and an increase in stock-based compensation expense of \$189,595 recognized during the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018. We recognized \$472,013 in stock-based compensation expense for the nine months ended September 30, 2019, compared to \$282,418 for the nine months ended September 30, 2018.

Other Operating Expenses

Other operating expenses include professional fees, marketing and business development, pre-project and depreciation and amortization expenses. During the nine months ended September 30, 2019, other operating expenses were \$1,532,707 compared to \$1,900,370 for the nine months ended September 30, 2018. The decrease resulted primarily from a decrease in marketing and business development costs of approximately \$117,373, a decrease in pre-project expenses of approximately \$30,237 and a decrease of approximately \$333,188 in amortization expense caused by customer contracts being fully amortized at the end of 2018, offset by an increase of approximately \$130,781 in legal fees for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018.

Other Income (Expense)

For the nine months ended September 30, 2019, we recognized no other income compared to \$5,768 during the nine months ended September 30, 2018. For the nine months ended September 30, 2019, there was a loss on asset disposal of \$52,039 compared to \$960 for a loss from equity affiliates during the nine months ended September 30, 2018.

Three Months Ended September 30, 2019 and 2018:

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018
Revenue	\$ 184,526	\$ 2,082,825
Cost of revenue	(366,783)	(1,857,985)
Operating expenses	(1,091,173)	(1,302,362)
Operating loss	(1,273,430)	(1,077,522)
Other income (expense)	(52,039)	(960)
Net loss	\$ (1,325,469)	\$ (1,078,482)

Revenue

Total revenue for the three months ended September 30, 2019 was \$184,526 compared to \$2,082,825 for the three months ended September 30, 2018. This decrease of \$1,898,299 or 91% was mainly driven by a decline in all of the Company's customer types for the three months ended September 30, 2019 as compared to three months ended September 30, 2018.

Cost of Revenue and Gross Profit

Cost of revenue was \$366,783 for the three months ended September 30, 2019 compared to \$1,857,985 for the three months ended September 30, 2018. The decrease of \$1,491,202 is primarily related to the lower revenues and the lower procurement and manufacturing costs of modifying containers.

Gross loss was \$182,257 for the three months ended September 30, 2019 and gross profit was \$224,840 for the three months ended September 30, 2018.

Gross loss percentage increased to 99% for the three months ended September 30, 2019 compared to gross profit percentage of 11% for the three months ended September 30, 2018 primarily due to higher site installation costs in the three months ended September 30, 2019 from a retail contract.

Payroll and Related Expenses

Payroll and related expenses for the three months ended September 30, 2019 were \$548,156 compared to \$611,906 for the three months ended September 30, 2018. This decrease was primarily caused by a decrease in salaries and head count of \$68,680 offset by an increase in stock-based compensation expense of \$22,300 recognized during the three months ended September 30, 2019 compared to the three months ended September 30, 2018. We recognized \$139,402 in stock-based compensation expense for the three months ended September 30, 2019, compared to \$117,102 for the three months ended September 30, 2018.

Other Operating Expenses

Other operating expenses include professional fees, marketing and business development, pre-project and depreciation and amortization expenses. Other operating expenses for the three months ended September 30, 2019 were \$543,017 compared to \$690,456 for the three months ended September 30, 2018. The decrease resulted primarily from a decrease in marketing and business development costs of approximately \$73,736 and a decrease of approximately \$111,118 in amortization expense caused by customer contracts being fully amortized at the end of 2018, offset by an increase of approximately \$41,728 in legal fee expense for the three months ended September 30, 2019 compared to the three months ended September 30, 2018.

Other Income (Expense)

We recognized \$52,039 for a loss on asset disposal during the three months ended September 30, 2019 compared to \$960 for a loss on equity affiliates during the three months ended September 30, 2018.

Income Tax Provision

A 100% valuation allowance was provided against the deferred tax asset consisting of available net operating loss carryforwards and, accordingly, no income tax benefit was provided.

Liquidity and Capital Resources

As of September 30, 2019 and December 31, 2018, we had an aggregate of \$1,953 and \$1,368,395, respectively, of cash and cash equivalents. Our condensed consolidated financial statements have been prepared assuming we will continue as a going concern, which contemplates, among other things, the realization of assets and satisfaction of liabilities in the normal course of business.

Historically, our operations have primarily been funded through proceeds from equity and debt financings, as well as revenue from operations. In June and July 2017, we sold 1,725,000 shares of our common stock in a public offering, including an over-allotment option exercised by the underwriters. We received net proceeds of approximately \$7,900,000 after deducting underwriting discounts and commissions and related expenses. We incurred a total of \$1,565,386 in issuance costs in connection with the Public Offering.

In April 2019, we closed a follow-on offering, pursuant to which we sold 847,750 shares of our common stock. In connection with the follow-on offering, we also sold common stock purchase warrants to purchase up to an aggregate of 847,750 shares of common stock. Such warrants were sold in a private placement pursuant to Section 4(a)(2) and Rule 506(b) under the Securities Act of 1933, as amended. We received net proceeds of approximately \$552,709 after deducting certain fees due to the placement agent and certain transaction expenses.

In addition, in August 2019, we closed a follow-on offering, pursuant to which we sold 900,000 shares of our common stock. In connection with the follow-on offering, we also sold common stock purchase warrants to purchase up to an aggregate of 45,000 shares of common stock. Such warrants were sold in a private placement pursuant to Section 4(a)(2) and Rule 506(b) under the Securities Act of 1933, as amended. We received net proceeds of approximately \$583,000 after deducting certain underwriting discounts and commissions and non-accountable expenses due to the underwriter and certain transaction expenses.

In addition, in November 2019, we entered into a securities purchase agreement with an investor, pursuant to which the Company issued to the investor a senior secured convertible debenture in the principal amount of \$480,770 for proceeds of \$375,000 (representing an original issue discount of 22%). We received net proceeds of approximately \$326,250 after deducting certain fees due to the placement agent and certain transaction expenses.

We anticipate that we will continue to generate losses from operations for the foreseeable future. As of September 30, 2019, our stockholders' equity was \$6,073,249, compared to \$7,080,067 as of December 31, 2018. Our net loss from operations for the nine months ended September 30, 2019 was \$2,787,913 and net cash used in operating activities was \$2,500,387.

We are attempting to generate sufficient revenues, and may need to secure additional financing sources, such as debt or equity capital, to support our daily operations and fund future growth, which financing may not be available on favorable terms or at all. We currently have a Form S-3 shelf registration statement on file with the Securities and Exchange Commission, under which we currently have limited capacity to issue additional shares. If we issue additional equity securities to raise funds, our existing stockholders may experience further dilution, and the new equity securities may have rights, preferences and privileges senior to those of our existing stockholders. If we issue debt securities to raise additional funds, we may incur debt service obligations, become subject to additional restrictions that limit or restrict our ability to operate our business or be required to encumber our assets. There can be no assurance that we will be able to raise any such capital on terms acceptable to us, if at all. We do not have any additional sources secured for future funding and if we are unable to raise the necessary capital at the times we require such funding, we may need to materially change our business plan, including delaying implementation of aspects of such business plan or curtailing or abandoning such business plan altogether.

Management believes that the actions presently being taken to further implement its business plan and generate sufficient revenues provide the opportunity for us to continue as a going concern. While we believe in the viability of our strategy to increase revenues and in our ability to raise additional funds, we cannot provide any assurances to that effect. Our ability to continue as a going concern is dependent upon our ability to further implement our business plan and generate sufficient revenues.

The condensed consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Additionally, as previously announced, on July 1, 2019, we received a letter from the Nasdaq Stock Market LLC ("Nasdaq") that, because the closing bid price for our common stock was below \$1.00 for 30 consecutive business days, we no longer met the minimum bid price requirement for continued listing on Nasdaq. In accordance with Nasdaq listing rules, we were granted a 180-calendar day grace period, or until December 30, 2019, to regain compliance with the minimum bid price requirement. To regain compliance, the closing bid price of our common stock must meet or exceed \$1.00 per share for at least ten consecutive business days during this 180-day grace period. We intend to monitor the closing bid price of our common stock and consider our available options in the event that the closing bid price of our common stock remains below \$1.00 per share. There can be no assurance that we will be able to regain compliance with the minimum bid price requirement or maintain compliance with the other listing requirements.

Cash Flow Summary

	Nine Months Ended September 30,	
	2019	2018
Net cash provided by (used in):		
Operating activities	\$ (2,500,387)	\$ (1,905,411)
Investing activities	(2,070)	(52,016)
Financing activities	1,136,015	—
Net increase (decrease) in cash and cash equivalents	<u>\$ (1,366,442)</u>	<u>\$ (1,957,427)</u>

Operating activities used net cash of \$2,500,387 in the nine months ended September 30, 2019, and \$1,905,411 in the nine months ended September 30, 2018. Generally, our net operating cash flows fluctuate primarily based on changes in our profitability and working capital. Cash used in operating activities decreased by \$594,976, primarily due to a decrease in working capital of \$741,636 and a net decrease of \$333,188 in amortization, offset by a decrease in net loss of \$277,574 and a net increase of \$199,723 in stock compensation expense in the nine months ended September 30, 2019 compared to nine months ended September 30, 2018.

Investing activities used net cash of \$2,070 in the nine months ended September 30, 2019, and net cash of \$52,016 in the nine months ended September 30, 2018. Cash used in investing activities decreased by \$49,946 from the corresponding period of the prior year primarily due to a decrease in purchases in property, plant and equipment of \$67,067.

Financing activities provided net cash of \$1,136,015 in the nine months ended September 30, 2019, and no net cash in nine months ended September 30, 2018. Cash provided by financing activities increased by \$1,136,015 due to an increase in proceeds from the issuance of common stock.

We provide services to our customers in three separate phases: the design phase, the architectural and engineering phase and the construction phase. Each phase is independent of the other, but builds through a progression of concept through delivery of a completed structure. These phases may be embodied in a single contract or in separate contracts, which is typical of a design build process model. As of September 30, 2019, we had eight projects totaling \$17,787,170 under contract, which, if they all proceed to construction, will result in our constructing approximately 113,850 square feet of container space. Of these contracts, alleight projects combine all three phases or parts thereof and including construction. We expect that all of this revenue will be realized by September 30, 2021.

Backlog may fluctuate significantly due to the timing of orders or awards for large projects and is not necessarily indicative of future backlog levels or the rate at which backlog will be recognized as revenue. The decrease in backlog at September 30, 2019 from the prior year is primarily attributable to the Company moving a contract of approximately \$25,000,000 out of backlog after receiving a cancellation notice from the customer and moving two contracts of approximately \$70,000,000 out of backlog due to the exclusive license agreement. The Company had work in progress or completed contracts during the first nine months of 2019 for approximately \$2,647,000.

There can be no assurance that our customers will decide to and/or be able to proceed with these construction projects, or that we will ultimately recognize revenue from these projects in a timely manner or at all.

Off-Balance Sheet Arrangements

As of September 30, 2019 and December 31, 2018, we had no material off-balance sheet arrangements to which we are a party.

Critical Accounting Policies

Our condensed consolidated financial statements have been prepared using generally accepted accounting principles in the United States of America (“GAAP”), which require management to make estimates and assumptions that affect reported amounts. The estimates and assumptions are based on historical experience and on other factors that management believes to be reasonable. Actual results may differ from those estimates. Critical accounting policies represent the areas where more significant judgments and estimates are used in the preparation of our condensed consolidated financial statements. A discussion of such critical accounting policies, which include share-based payments, derivative instruments, goodwill, intangible assets and revenue recognition, can be found in our 2018 Form 10-K. There have been no material changes in critical accounting policies from those disclosed in the 2018 Form 10-K.

Non-GAAP Financial Information

In addition to our results under GAAP, we also present EBITDA and Adjusted EBITDA for historical periods. EBITDA and Adjusted EBITDA are non-GAAP financial measures and have been presented as supplemental measures of financial performance that are not required by, or presented in accordance with, GAAP. We calculate EBITDA as net income (loss) before interest expense, income tax benefit (expense), depreciation and amortization. We calculate Adjusted EBITDA as EBITDA before certain non-recurring adjustments such as stock-based compensation expense.

EBITDA and Adjusted EBITDA are presented because they are important metrics used by management as one of the means by which it assesses our financial performance. EBITDA and Adjusted EBITDA are also frequently used by analysts, investors and other interested parties to evaluate companies in our industry. These measures, when used in conjunction with related GAAP financial measures, provide investors with an additional financial analytical framework that may be useful in assessing us and our results of operations.

EBITDA and Adjusted EBITDA have certain limitations. EBITDA and Adjusted EBITDA should not be considered as alternatives to net income (loss), or any other measures of financial performance derived in accordance with GAAP. These measures also should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items for which these non-GAAP measures make adjustments. Additionally, EBITDA and Adjusted EBITDA are not intended to be liquidity measures because of certain limitations, including, but not limited to:

- They do not reflect our cash outlays for capital expenditures;
- They do not reflect changes in, or cash requirements for, working capital; and
- Although depreciation and amortization are non-cash charges, the assets are being depreciated and amortized and may have to be replaced in the future, and these non-GAAP measures do not reflect cash requirements for such replacements.

Other companies, including other companies in our industry, may not use such measures or may calculate one or more of the measures differently than as presented in this Quarterly Report on Form 10-Q, limiting their usefulness as a comparative measure.

In evaluating EBITDA and Adjusted EBITDA, you should be aware that in the future we will incur expenses that are the same or similar to some of the adjustments made in our calculations, and our presentation of EBITDA and Adjusted EBITDA should not be construed to mean that our future results will be unaffected by such adjustment. Management compensates for these limitations by using EBITDA and Adjusted EBITDA as supplemental financial metrics and in conjunction with our results prepared in accordance with GAAP. The non-GAAP information should be read in conjunction with our consolidated financial statements and related notes.

The following is a reconciliation of EBITDA and Adjusted EBITDA to the nearest GAAP measure, net loss:

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
Net loss attributable to common stockholders of SG Blocks, Inc.	\$ (1,325,469)	\$ (1,026,037)	\$ (2,787,913)	\$ (3,013,042)
Addback depreciation and amortization	38,677	148,747	117,540	445,258
EBITDA (non-GAAP)	(1,286,792)	(877,290)	(2,670,373)	(2,567,784)
Addback loss on asset disposal	52,039	—	52,039	—
Addback stock compensation expense	142,777	117,102	482,139	282,416
Adjusted EBITDA (non-GAAP)	\$ (1,091,976)	\$ (760,188)	\$ (2,136,195)	\$ (2,285,368)

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Management of SG Blocks, Inc., with the participation of our Principal Executive Officer and Principal Financial Officer, carried out an evaluation of the effectiveness of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934, as amended (the “Exchange Act”), Rules 13a-15(e) or 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q (the “Evaluation Date”). Based upon that evaluation, our Principal Executive Officer and Principal Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

The Principal Executive Officer and the Principal Financial Officer believe that the condensed consolidated financial statements and other information contained in this Quarterly Report on Form 10-Q present fairly, in all material respects, our business, financial condition and results of operations.

Changes in Internal Control over Financial Reporting

We have a limited number of employees with accounting and reporting responsibilities. During the three months ended September 30, 2019, we appointed a new Acting Chief Executive Officer upon Mahesh Shetty’s resignation from his positions as our President and Chief Financial Officer and we experienced changes in other accounting personnel with roles in our accounting and financial reporting processes that included allocation of work to outside vendors. Other than such personnel changes, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) occurred during the quarter ended September 30, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

The information included in "Note 12 - Commitments and Contingencies" of the Company's condensed consolidated financial statements included elsewhere in this Form 10-Q is incorporated by reference into this Item.

ITEM 1A. Risk Factors

There have been no material changes from the risk factors disclosed in "Part I—Item 1A. Risk Factors" in our 2018 Form 10-K, except as follows:

Our operating results will be subject to fluctuations and are inherently unpredictable.

In order to return to profitability, we will need to generate and sustain higher revenue while maintaining reasonable cost and expense levels. In our most recent quarter we experienced a loss. We do not know if our revenue will grow, or if it will grow sufficiently to outpace our expenses, which we expect to increase as we expand our operational capacity. We may not be able to become profitable on a quarterly or an annual basis. Our quarterly revenue and operating results will be difficult to predict and have in the past fluctuated from quarter to quarter. The amount, timing and mix of project sales, often for a single medium or large-scale project, may cause large fluctuations in our revenue and other financial results. Further, our revenue mix of high margin materials sales versus lower margin projects can fluctuate dramatically quarter to quarter, which may adversely affect our revenue and financial results in any given period. Finally, our ability to meet project completion schedules for an individual project and the corresponding revenue impact under the percentage-of-completion method of recognizing revenue, may similarly cause large fluctuations in our revenue and other financial results. This may cause us to miss any future guidance announced by us.

We base our planned operating expenses in part on our expectations of future revenue, and a significant portion of our expenses are fixed in the short-term. If revenue for a particular quarter is lower than we expect, we likely will be unable to proportionately reduce our operating expenses for that quarter, which would harm our operating results for that quarter. This may cause us to miss any guidance announced by us.

If we are not successful in our efforts to increase sales or raise capital, we could experience a shortfall in cash over the next twelve months, and our ability to obtain additional financing on acceptable terms, if at all, may be limited.

On December 31, 2018 and 2017, we had cash and cash equivalents of \$1,368,395 and \$4,900,857, respectively. However, during the fiscal years ended December 31, 2018 and 2017, we reported a net loss of \$4,844,021 and \$4,512,680, respectively, and used \$3,452,234 and \$1,242,107 of cash for operations, respectively. On September 30, 2019, we had cash and cash equivalents of \$1,953. However, during the nine months ended September 30, 2019 and 2018, respectively, we reported a net loss of \$2,787,913 and \$3,013,042, respectively, and used \$2,500,387 and \$1,905,411 of cash for operations, respectively. If we are not successful with our efforts to increase revenue, we could experience a shortfall in cash over the next twelve months. If there is a shortfall, we may be forced to reduce operating expenses, among other steps, all of which would have a material adverse effect on our operations going forward.

We may also seek to obtain debt or additional equity financing to meet any cash shortfalls. The type, timing and terms of any financing we may select will depend on, among other things, our cash needs, the availability of other financing sources and prevailing conditions in the financial markets. However, there can be no assurance that we will be able to secure additional funds if needed and that, if such funds are available, the terms or conditions would be acceptable to us. If we are unable to secure additional financing, further reduction in operating expenses might need to be substantial in order for us to ensure enough liquidity to sustain our operations. Any equity financing would be dilutive to our stockholders. If we incur debt, we will likely be subject to restrictive covenants that significantly limit our operating flexibility and require us to encumber our assets. If we fail to raise sufficient funds and continue to incur losses, our ability to fund our operations, take advantage of strategic opportunities, or otherwise respond to competitive pressures will be significantly limited. Any of the above limitations could force us to significantly curtail or cease our operations, and you could lose all of your investment in our common stock. These circumstances have, in the past, raised substantial doubt about our ability to continue as a going concern, and continued cash losses may risk our status as a going concern. Our consolidated financial statements do not include any adjustments that might be necessary should we be unable to continue as a going concern.

We have incurred net losses in prior periods, and there can be no assurance that we will generate income in the future, or that we will be able to successfully achieve or maintain our growth strategy.

Our ability to achieve profitability will depend upon our ability to generate and sustain substantially increased revenues. We may continue to incur operating losses in the future as we execute our growth strategy. Although we expect that our expenses will decline due to our new business model, there can be no assurance that our revenue from royalties will exceed our expenses, especially since we anticipate that most of our expenses will be fixed expenses that we will not be dependent upon revenue generated. The likelihood that we will generate net income in the future must be considered in light of the difficulties facing the construction industry as a whole, economic conditions and the competitive environment in which we operate. Our operating results for future periods are subject to numerous uncertainties, and we may not achieve sufficient revenues to sustain or increase profitability. In addition, we may be unable to successfully achieve or maintain our growth strategy, including our ability to expand into new geographic markets.

The failure to comply with the terms of the Secured Convertible Debenture could potentially result in action against our pledged assets and/or the issuance of a significant number of shares of our common stock.

In our November 2019 debt financing, we received a cash payment in the aggregate amount of \$375,000 (the "Loan") pursuant to a Securities Purchase Agreement that we entered into with RedDiamond Partners LLC (the "Lender"), and we issued to the Lender a debenture in the aggregate principal amount of \$480,770 (representing an original issue discount of 22%), which debenture is secured by a security interest in all of our existing and future assets, subject to existing security interests and exceptions. The debenture requires that we repay the loan in 110 days and that we meet various covenants. If we fail to comply with the terms of the debenture and/or the related agreements, the Lender could declare a note default and if the default were to remain uncured, the Lender have the right to proceed against any or all of the collateral securing debenture. Any action by the Lender to proceed against our assets would likely have a serious disruptive effect on our business operations. In addition, the debenture is convertible into shares of our common stock upon (i) the occurrence of an Event of Default (as defined in the debenture) and (ii) maturity in the event any principal remains outstanding, which could result in the issuance of up to 19.99% of our issued and outstanding shares of common stock as of the date of the issuance of the debenture.

We have entered into an exclusive license agreement with CPF for rights to develop and commercialize products for use in residential construction that utilize our core technology, which agreement is expected to have a material impact on our business.

We entered into an exclusive license agreement with CPF, pursuant to which we granted CPF an exclusive license solely within the United States and its legal territories to commercialize our technology, intellectual property, any improvements thereto, and any related permits, in order to develop and commercialize products within the field of design and project management platforms for residential use, including single-family residences and multi-family residences, but excluding military housing. Under the terms of the License Agreement, CPF is to provide us with royalties based upon its sale of products that utilize the licensed technology. In as much as CPF has an exclusive license in the United States, which is the only territory to date where we have been retained to construct products for use for residences, unless we were to either expand residential construction product sales to territories outside of the United States or enter into licensing arrangements similar to that with CPF for sales of products that utilize our technology outside of the United States for residential use or in the United States for business not cover by the License, such as military residences and commercial and industrial construction, we will be totally dependent upon CPF for our revenue for residential construction. Upon certain extraordinary events, CPF is entitled to terminate the license agreement in which case we would be forced to incur the costs to commercialize products for residential construction unless another licensee were found.

Our residential construction business model depends upon a third-party licensee who is outside our control.

We are dependent upon CPF to commercialize products for residential construction that utilize our technology under the License Agreement with us. CPF is an independent entity and we cannot control the amount or timing of resources that it devotes to such commercialization efforts. CPF may not assign as great a priority to such commercialization efforts or pursue them as diligently as we would if we were undertaking such commercialization ourselves. If CPF or any other licensee fails to devote sufficient time and resources to such commercialization efforts, or if its performance is substandard our ability to generate revenue may be adversely affected. CPF may also have relationships with other commercial entities, some of whom may compete with us. If CPF assists our competitors at our expense, our competitive position would be harmed.

Our residential construction business is difficult to evaluate because we are currently focused on a new business model and have very limited operating history and limited information.

We recently engaged in a new licensing business model for our residential construction business in the United States. We have entered into one license agreement for use of our technology for construction of residences in the United States and if successful, we intend to expand our model and enter into additional similar agreements. There is a risk that we will be unable to successfully generate revenue from this new business model and that we will be unable to enter into additional licensing agreements or that any additional agreements that we enter into will be on favorable terms. Although we believe that we will experience cost savings from this new business model resulting in greater net income since we will no longer require the same level of capital, personnel and equipment as was required from our prior residential construction business model, there can be no assurance that we will experience the level of cost savings that we anticipate or generate the income that we anticipate. We are subject to many risks associated with this new business model such as our dependence upon licensees to commercialize products that utilize our technology. There is no assurance that CPF's activities will be successful or will result in any revenues or profit. Even if we generate revenue, there can be no assurance that we will be profitable. We are subject to the risks inherent to the operation of a new business enterprise, and cannot assure you that we will be able to successfully address these risks.

The issuance of shares of our common stock upon the exercise of outstanding options, warrants and restricted stock units may dilute the percentage ownership of the then-existing stockholders and may make it more difficult to raise additional equity capital.

As of September 30, 2019, there are outstanding options and warrants to purchase 1,080,059 and 1,063,775 shares of common stock, respectively, in addition to 446,142 unvested restricted stock units. The exercise of such options and warrants and the vesting of restricted stock units would dilute the then-existing stockholders' percentage ownership of our stock, and any sales in the public market of common stock underlying such securities could adversely affect prevailing market prices for the common stock. Moreover, the terms upon which we would be able to obtain additional equity capital could be adversely affected because the holders of our options and warrants can be expected to exercise them at a time when we would, in all likelihood, be able to obtain any needed capital on terms more favorable to us than those provided by such securities.

We are dependent on the services of key personnel, and the unexpected loss of their services may adversely affect our operations.

Our success depends highly upon the personal efforts and abilities of our senior management team, specifically the efforts of Paul M. Galvin, our Chief Executive Officer, Gerald Sheeran, our Acting Chief Financial Officer, Stevan Armstrong, our Chief Technology Officer, and Rockey Butler, our Vice President of Operations. The Company has entered into employment agreements with Messrs. Galvin and Armstrong. The employment agreements with Messrs. Galvin and Armstrong each provide for two-year terms, with automatic renewal after the end of such term. The loss of the services of one or more of these individuals could have a material adverse effect on our business. Our ability to achieve profitability and generate increased revenue will depend upon our ability to retain, and, if necessary, attract experienced management personnel.

Risks Relating to our Business and Industry

We and CPF are dependent on the availability and skill of subcontractors, their willingness to work with them, and their selection of, and ability to obtain, suitable and quality building materials.

We and CPF will rely on subcontractors to perform the actual construction of our building projects and, in many cases, to select and obtain raw materials. Despite detailed specifications and quality control procedures, in some cases, improper construction processes or defective materials may be used to finish construction of our building projects. We and CPF may need to spend money to remediate such problems when they are discovered. Defective products can result in the need to perform extensive repairs to large numbers of buildings. Though subcontracts are written to protect from substandard performance or materials, pervasive problems could adversely affect CPF's business and therefore our ability to generate royalty income. Our revenue from our CPF is based upon the gross revenue it receives from product sales which is exclusive of amounts repaid or credited by reason of rejection or returns. The inability to contract with skilled subcontractors or general contractors at reasonable costs and on a timely basis could limit our or CPF's ability to construct and deliver buildings and could erode our profit margins and adversely affect our results of operations and cash flows.

Our clients may adjust, cancel or suspend the contracts in our backlog; as such, our backlog is not necessarily indicative of our future revenues or earnings. In addition, even if fully performed, our backlog is not a good indicator of our future gross margins.

Backlog represents the total dollar amount of revenues we expect to record in the future as a result of performing work under contracts we have been awarded. We include in backlog only those contracts for which we have reasonable assurance that the customer can obtain the permits for construction and can fund the construction. As of December 31, 2018, our backlog totaled approximately \$97.7 million and as of September 30, 2019, our backlog totaled approximately \$17.8 million. The decrease in backlog at September 30, 2019 from December 31, 2018 is primarily attributable to us moving a contract of approximately \$25 million out of backlog after receiving a cancellation notice from the customer and moving two contracts of approximately \$70 million out of backlog due to the exclusive License Agreement. We cannot provide assurance that our backlog will be realized as revenues in the amounts reported or, if realized, will result in profits. In accordance with industry practice, substantially all of our contracts are subject to cancellation, termination or suspension at our customer's discretion. In the event of a project cancellation, we generally would not have a contractual right to the total revenue reflected in our backlog. Projects can remain in backlog for extended periods of time because of the nature of the project and the timing of the particular services required by the project. In addition, the risk of contracts in backlog being cancelled or suspended generally increases during periods of widespread economic slowdowns or in response to changes in commodity prices.

The contracts in our backlog are subject to changes in the scope of services to be provided and adjustments to the costs relating to the contracts. The revenue for certain contracts included in backlog is based on estimates. Additionally, our performance of our individual contracts can affect greatly our gross margins and, therefore, our future profitability. We can provide no assurance that the contracts in backlog, assuming they produce revenues in the amounts currently estimated, will generate gross margins at the rates we have realized in the past.

Our liability for estimated warranties for services performed under our prior business model may be inadequate, which could materially adversely affect our business, financial condition and results of operations.

We are subject to construction defect and warranty claims arising in the ordinary course of business. These claims are common in the construction industry and can be costly. At this time, our third-party providers offer guarantees and warranties in accordance with industry standards that flow through to our clients. A large number of warranty claims could have a material adverse effect on our results of operations.

The cyclical and seasonal nature of the construction industry causes our revenues and operating results to fluctuate, and we expect this cyclicity and seasonality to continue in the future.

The construction industry is highly cyclical and seasonal and is influenced by many international, national and regional economic factors, including the availability of consumer and wholesale financing, seasonality of demand, consumer confidence, interest rates, income levels and general economic conditions, including inflation and recessions. As a result of the foregoing factors, the revenues and operating results we derive from customers and CPF will fluctuate, and we currently expect them to continue to fluctuate in the future. Moreover, we have experienced, and may continue to experience, operating losses during cyclical downturns in the construction market. These and other economic factors could have a material adverse effect on demand for our products and our financial condition and operating results.

Cybersecurity risks related to the technology used in our operations and other business processes, as well as security breaches of company, customer, employee and vendor information, could adversely affect our business.

We rely on various information technology systems to capture, process, store and report data and interact with licensees and employees. Despite careful security and controls design, as the prevalence of cyber-attacks continues to increase, our information technology systems, and those of our third-party providers, could become subject to increased security threats, such as phishing and malware incidents. Our security measures may be unable to prevent certain security breaches, and any such network, system, data or other breaches could result in misappropriation of sensitive data, transactional errors, theft of funds, business disruptions, loss of or damage to intellectual property, loss of customers and business opportunities, unauthorized access to or disclosure of confidential or personal information (which could cause a breach of applicable data protection legislation), regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensatory costs and additional compliance costs, any of which could have a material adverse effect on our reputation, business, financial condition, results of operations and cash flows.

Because the techniques used to obtain unauthorized access to, or disable, degrade or sabotage, information technologies systems change frequently, and may not be recognized until after they have been launched against a target, we may be unable to anticipate these techniques, implement adequate preventative measures or remediate any breach in a timely or effective manner. In addition, the development and maintenance of preventative or detective measures is costly, and requires ongoing monitoring and updating as technologies change and efforts to circumvent security measures become more sophisticated. As well as incurring additional costs, sophisticated hardware and operating system software and applications that we procure from third parties may contain defects in design or manufacture, including “bugs” and other problems that could unexpectedly interfere with the operation of the systems, or we may be unable to successfully integrate and launch new systems as planned without disruptions to our operations. Misuse of internal applications, theft of intellectual property, trade secrets, funds or other corporate assets and inappropriate disclosure of confidential information could stem from such incidents.

Despite our efforts, we remain potentially vulnerable to cyber-attacks and security breaches, and any such attack or breach could adversely affect our reputation, business, financial condition or results of operations.

Our business depends on the construction industry and general business, financial market and economic conditions.

The construction industry is cyclical and significantly affected by changes in general and local economic and real estate conditions, such as employment levels, consumer confidence, demographic trends, housing demand, inflation, deflation, interest rates and credit availability. Changes in these general and local economic conditions or deterioration in the broader economy could negatively impact the level of purchases, capital expenditures and creditworthiness of our indirect customers and suppliers to CPF, and, therefore, our royalty income and financial condition, results of operations and cash flows. Changes in these economic conditions may affect some of our regions or markets more than others. If adverse conditions affect our larger markets, they could have a proportionately greater impact on us than on some other companies. In addition, any uncertainty regarding global economic conditions may have an adverse effect on the results of operations and financial condition of us or our customers, distributors and suppliers, such as negative effects of currency exchange fluctuations. A shortage of labor in the construction industry could also have an impact on our financial results.

Our business relies on private investment and a slower than expected economy may adversely affect our results.

A significant portion of our sales and those of CPF are for projects with non-public owners, such as non-residential builders and home builders who make investments with private funds into their projects. Construction spending is affected by their customers’ ability to finance projects. Residential and nonresidential construction could decline if companies and consumers are unable to finance construction projects or if the economy slows or is stalled, which could result in delays or cancellations of capital projects. If the economy slows, or if housing starts and nonresidential projects do not increase, sales of our products directly by us to consumers or by CPF and related services may decline, and our financial position, results of operations and liquidity could be materially adversely affected.

Risks Relating to the Construction Sector

We and CPF may be dependent upon third-party financing, and our financial condition and results of operations could be negatively affected if additional third-party financing for our customers does not become available.

Our business and earnings depend substantially on our ability and the ability of CPF to obtain financing for the development of their construction projects. The availability and cost of such financing is further dependent on the number of financial institutions participating in the industry, the departure of financial institutions from the industry, the financial institutions’ lending practices, the strength of the domestic and international credit markets generally, governmental policies and other conditions, all of which are beyond our control. In light of the current economic climate, some of our projects and those of CPF may not be successful in obtaining additional funds in a timely manner, on favorable terms or at all. The availability of borrowed funds, especially for construction financing, has been greatly reduced, and lenders may require project developers to invest increased amounts of equity in a project in connection with both new loans and the extension of existing loans. Unfavorable changes in the availability and terms of financing in the industry will have a material adverse effect on certain privately financed projects.

Our results of operations also depend on the ability of any potential privately financed licensees to obtain loans for the purchase of new buildings. Over the past few years, lenders have tightened the credit underwriting standards, which have reduced lending volumes. If this trend continues, it would negatively impact CPF’s sales and revenue and our royalty income, which depend in large part on the availability and cost of financing. In addition, where our potential customers must sell their existing buildings or real estate in order to develop new buildings, increases in mortgage costs and/or lack of availability of mortgages could prevent buyers of potential customers’ existing buildings from obtaining the mortgages they need to complete their purchases, which would result in our potential customers’ inability to make purchases from us. If our potential customers cannot obtain suitable financing, our sales and results of operations would be adversely affected.

The construction industry is highly competitive, and such competition may increase the adverse effects of industry conditions, including the consolidation of the industry.

We operate in a very competitive environment characterized by competition from numerous local, regional and national builders. We and CPF may compete for financing, raw materials and skilled management and labor resources. A decline in construction starts could adversely affect demand for products that utilize our technology and expertise and our results of operations. Increased competition could require us to further increase CPF's selling incentives and/or reduce our prices, which could negatively affect our royalty income. We may be unable to successfully expand into or compete in the markets in new geographic areas. In addition, while we believe our ESR may improve our competitive position by potentially expediting reviews and approvals by state and local building departments and certifying our specific quality control and design acceptance criteria, there is no assurance that it will have the desired impact.

There can be no assurance that Modules or modular construction techniques that utilize our technology and expertise will achieve market acceptance and grow; thus, the future of our business and the modular construction industry as a whole is uncertain.

There can be no assurance that we will achieve market acceptance for our technology and expertise or that the modular construction market will grow. Our business may be disrupted by the introduction of new products and services and is subject to changing consumer preferences and industry trends, which may adversely affect our ability to plan for the future development and marketing of our products. Although Modules have particular applications in a wide variety of market segments, there is no assurance that we will be able to expand our relationship within such market segments or, even if we do, that general market acceptance for our technology and expertise or Modules will continue to increase.

Government regulations and legal challenges may delay the start or completion of our projects, increase our expenses or limit our building activities, which could have a negative impact on our operations.

Various domestic and international rules and regulations concerning building, zoning, sales and similar matters apply to and/or affect the construction industry. Governmental regulation affects construction activities, as well as sales activities, mortgage lending activities and other dealings with consumers. These industries also have experienced an increase in state and local legislation in the United States and regulations that limit the availability or use of land. Municipalities may also restrict or place moratoriums on the availability of utilities, such as water and sewer taps. In some areas, municipalities may enact growth control initiatives, which restrict the number of building permits available in a given year. In addition, we may be required to apply for additional approvals or modify our existing approvals because of changes in local circumstances or applicable law. If governments in locations in which we operate take actions like the ones described, they could adversely affect our business by causing delays, increasing our licensees' costs or limiting our licensees' ability to operate in those areas. Further, we may experience delays and increased expenses as a result of legal challenges to our proposed projects, whether brought by governmental authorities or private parties. Failure to comply with laws or regulations applicable to or affecting us or our licensees, or the passage in the future of new and more stringent laws affecting us or our licensees, may adversely affect our financial condition or results of operations.

The dangers inherent in our operations, such as disruptions to our facilities and project sites, and the limits on insurance coverage could expose us to potentially significant liability costs and materially interfere with the performance of our operations.

While we believe our insurance coverage is adequate and in line with our industry's standards, all construction, including modular construction, involves operating hazards that can cause personal injury or loss of life, severe damage to and destruction of property and equipment and suspension of operations, including, but not limited to, natural or man-made disruptions to our facilities and project sites. We may be sued for such injuries based on the use of our technology. The failure of such structures during and after installation can result in similar injuries and damages. Although we believe that our insurance coverage is adequate, there can be no assurance that we will be able to maintain adequate insurance in the future at rates we consider reasonable, or that our insurance coverage will be adequate to cover future claims that may arise. Claims for which we are not fully insured may adversely affect our working capital and profitability. In addition, changes in the insurance industry have generally led to higher insurance costs and decreased availability of coverage. The availability of insurance that covers risks we and our competitors typically insure against may decrease, and the insurance that we are able to obtain may have higher deductibles, higher premiums and more restrictive policy terms.

Risks Relating to our Common Stock

Our failure to meet the continued listing requirements of the Nasdaq Capital Market could result in a delisting of our common stock.

Our common stock is listed on the Nasdaq Capital Market, which imposes, among other requirements, a minimum bid requirement. On July 1, 2019, we received a letter from Nasdaq that, because the closing bid price for our common stock was below \$1.00 for 30 consecutive business days, we no longer met the minimum bid price requirement for continued listing on Nasdaq. Under Nasdaq Listing Rule 5810(c)(3)(A), we were granted a 180-calendar day grace period, or until December 30, 2019, to regain compliance with the minimum bid price requirement. To regain compliance, the closing bid price of our common stock must meet or exceed \$1.00 per share for at least ten consecutive business days during this 180-day grace period. There can be no assurance that we will be able to regain compliance or that Nasdaq will grant us a further extension of time to regain compliance, if necessary.

The delisting of our common stock from Nasdaq may make it more difficult for us to raise capital on favorable terms in the future, or at all. Such a delisting would likely have a negative effect on the price of our common stock and would impair your ability to sell or purchase our common stock when you wish to do so. Further, if our common stock were to be delisted from the Nasdaq Capital Market, our common stock would cease to be recognized as a covered security, and we would be subject to additional regulation in each state in which we offer our securities. Moreover, there is no assurance that any actions that we take to restore our compliance with the Nasdaq minimum bid requirement would stabilize the market price or improve the liquidity of our common stock, prevent our common stock from falling below the Nasdaq minimum bid price required for continued listing again or prevent future non-compliance with Nasdaq's listing requirements.

There can be no assurance that we will continue to meet the minimum bid price requirement, or any other requirement in the future. If we fail to meet the minimum bid price requirement, or other applicable Nasdaq listing requirements, including maintaining minimum levels of stockholders' equity or market values of our common stock, our common stock could be delisted. Delisting from the Nasdaq Capital Market would cause us to pursue eligibility for trading of our common stock on other markets or exchanges, or on an over-the-counter market. In such case, our stockholders' ability to trade or obtain quotations of the market value of our common stock would be severely limited because of lower trading volumes and transaction delays. These factors could contribute to lower prices and larger spreads in the bid and ask prices of these securities. There can be no assurance that our common stock, if delisted from the Nasdaq Capital Market, would be listed on a national securities exchange, a national quotation service or the over-the-counter markets. Delisting from the Nasdaq Capital Market could also result in negative publicity, make it more difficult for us to raise additional capital, adversely affect the market liquidity of our common stock, decrease securities analysts' coverage of us or diminish investor, supplier and employee confidence. In addition, our stock could become a "penny stock," which would make trading of our common stock more difficult.

Our shares of common stock are from time to time thinly traded, so stockholders may be unable to sell at or near ask prices or at all if they need to sell shares to raise money or otherwise desire to liquidate their shares.

Our common stock has from time to time been "thinly-traded," meaning that the number of persons interested in purchasing our common stock at or near ask prices at any given time may be relatively small or non-existent. This situation is attributable to a number of factors, including the fact that we are a small company that is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer that has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. We cannot give stockholders any assurance that a broader or more active public trading market for our common shares will develop or be sustained, or that current trading levels will be sustained.

The trading in our stock has in the past and may continue to be very volatile.

Our stock price and the trading volume of our stock continue to be very volatile. As such, investors may find it difficult to obtain accurate stock price quotations and holders of our stock may be unable to resell their stock at desirable prices. Sales of substantial amounts of our common stock, or the perception that such sales might occur, could adversely affect prevailing market prices of our common stock and our stock price may decline substantially in a short period of time. As a result, our stockholders could suffer losses or be unable to liquidate holdings.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

EXHIBIT INDEX
Description

Exhibit Number	Description
1.1	<u>Underwriting Agreement between SG Blocks, Inc. and ThinkEquity, a division of Fordham Financial Management, Inc., dated July 29, 2019 (incorporated herein by reference to Exhibit 1.1 of the Current Report on Form 8-K filed by SG Blocks, Inc. with the Securities and Exchange Commission on July 31, 2019).</u>
4.1	<u>Form of Representative's Warrant Agreement (incorporated herein by reference to Exhibit 4.1 of the Current Report on Form 8-K filed by SG Blocks, Inc. with the Securities and Exchange Commission on July 31, 2019).</u>
10.1+	<u>Amendment No. 1, dated October 17, 2019, to the Exclusive License Agreement by and between SG Blocks, Inc., and CPF GP 2019-1 LLC, dated October 3, 2019</u>
31.1+	<u>Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2+	<u>Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1*	<u>Certification by Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS+	XBRL Instance Document - the instance document does not appear in the Interactive Data File as the XBRL tags are embedded within the Inline XBRL document.
101.SCH+	XBRL Taxonomy Extension Schema Document.
101.CAL+	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF+	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB+	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE+	XBRL Taxonomy Extension Presentation Linkbase Document.
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

+ **Filed herewith.**

* **Furnished herewith.**

SIGNATURE

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.

SG BLOCKS, INC.
(Registrant)

Date: November 14, 2019

By: /s/ Gerald A. Sheeran
Gerald A. Sheeran
Acting Chief Financial Officer
(Principal Financial and Accounting Officer)

**Amendment No. 1 to
Exclusive License Agreement**

Amendment Effective Date: **October 17, 2019**

THIS AMENDMENT NO. 1 TO THE EXCLUSIVE LICENSE AGREEMENT (the "Amendment" to the "Agreement"), is made by and among SG Blocks, Inc., a Delaware corporation ("Licensor"), and CPF GP 2019-1 LLC, a Delaware limited liability company ("Licensee" and collectively, the "Parties"). Capitalized terms used but not defined herein shall have the meaning assigned to them in the Amended Purchase Agreement (as defined below).

WHEREAS, Licensor and Licensee entered into the Agreement on October 3, 2019 (the "Commencement Date"); and

WHEREAS, Licensee's name in the Agreement was erroneously written as *CPF MF 2019-1 LLC* ("CPF MF"); and

WHEREAS, the Parties acknowledge and agree that the correct name of Licensee is *CPF GP 2019-1 LLC* ("CPF GP"); and

WHEREAS, CPF MF acknowledges and agrees that it is not a party to the Agreement; and

WHEREAS, the Parties desire to correct the name of the Licensee in the Agreement;

NOW, THEREFORE, in consideration of the foregoing recitals, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties, intending to be legally bound, hereby agree as follows:

1. The reference in the Agreement's introductory paragraph to *CPF MF 2019-1 LLC* shall be replaced with a reference to *CPF GP 2019-1 LLC*.
 2. The reference in the Agreement's signature block to *CPF MF 2019-1 LLC* shall be replaced with a reference to *CPF GP 2019-1 LLC*.
 3. The Parties and CPF MF affirm that (a) CPF GP is a party to the Agreement and should be deemed to have been a party to the Agreement as of the Commencement Date; and (b) CPF MF is not a party to the Agreement and should not be deemed to have been a party to the Agreement as of the Commencement Date.
 4. **No other changes.** Except to the extent modified herein, the Agreement shall remain in full force and effect, unchanged and binding upon the Parties in all other material respects. In the event of any conflict between the Agreement and this Amendment, this Amendment shall prevail.
-

5. Each of the parties hereto hereby irrevocably waives and releases the other parties hereto (and their respective affiliates, officers, directors and consultants) from any and all types of damages or penalties and/or any liability or responsibility related thereto, which might arise in connection with the error corrected hereby.
6. **Counterparts.** This Amendment may be executed in any number of counterparts, each of which shall be deemed an original, but all of which taken together, shall constitute one and the same instrument.
7. **E-Signature.** If this Amendment is executed electronically, the Parties agree that the electronic signature will be legally binding. Neither party will contest the enforceability of this Amendment on the basis that it was executed electronically.

IN WITNESS WHEREOF, the Parties hereto have executed this Amendment by their duly authorised representatives as of the Amendment Effective Date hereof:

PARTIES TO THE AGREEMENT:

SG BLOCKS, INC.

By: /s/ Paul Galvin

Name: Paul Galvin

Title: Chairman and CEO

CPF GP 2019-1 LLC

By: /s/ Greg Jacobson

Name: Greg Jacobson

Title: Managing Partner

ACKNOWLEDED AND AGREED:

CPF MF 2019-1 LLC

By: /s/ Greg Jacobson

Name: Greg Jacobson

Title: Managing Partner of the Managing Member

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Paul M. Galvin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SG Blocks, 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; and
 - 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 the 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.

Date: November 14, 2019

/s/ Paul M. Galvin

Paul M. Galvin
Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Gerald A. Sheeran, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SG Blocks, 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; and
 - 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 the 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.

Date: November 14, 2019

/s/ Gerald A. Sheeran

Gerald A. Sheeran
Acting Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. §1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of SG Blocks, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul M. Galvin, the Chief Executive Officer of the Company, and I, Gerald A. Sheeran, the Acting Chief Financial Officer of the Company, do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief that:

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.

November 14, 2019

/s/ Paul M. Galvin

Name: Paul M. Galvin
Title: Chairman and Chief Executive Officer
(Principal Executive Officer)

November 14, 2019

/s/ Gerald A. Sheeran

Name: Gerald A. Sheeran
Title: Acting Chief Financial Officer
(Principal Financial Officer)

This certification accompanies each Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 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.