

## 10-Q 1 f10q0320\_dataseainc.htm QUARTERLY REPORT

**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 March 31, 2020

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

Commission file number 333-202071

**DATASEA INC.**

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of  
incorporation or organization)

45-2019013

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

20th Floor, Tower B, Guorui Plaza  
1 Ronghua South Road, Technological Development Zone  
Beijing, People's Republic of China

(Address of principal executive offices)

100176

(Zip Code)

+86 10-56145240

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, \$0.001 par value	DTSS	NASDAQ Capital Market

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.

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

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

Securities registered pursuant to Section 12(b) of the Act: **None.**

As of May 12, 2020, the Company had 20,943,846 shares of its common stock, \$0.001 par value per share, issued and outstanding.

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**PART I – FINANCIAL INFORMATION****DATASEA INC.****CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)****DATASEA INC.  
CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2020</b>	<b>June 30, 2019</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	\$ 2,010,811	\$ 6,072,637
Restricted cash	600,000	600,000
Inventory	272,749	73,294
Value-added tax prepayment	70,534	-
Prepaid expenses and other current assets	491,913	105,932
	<u>3,446,007</u>	<u>6,851,863</u>
Total current assets	3,446,007	6,851,863
<b>NONCURRENT ASSETS</b>		
Fixed assets, net	252,315	41,116
Intangible assets, net	1,948,882	555,811
Right-of-use assets, net	758,162	-
	<u>2,959,359</u>	<u>596,927</u>
Total noncurrent assets	2,959,359	596,927
<b>TOTAL ASSETS</b>	<b><u>\$ 6,405,366</u></b>	<b><u>\$ 7,448,790</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 46,768	\$ 13,088
Advances from customers	1,361,134	1,318,897
Accrued expenses and other payables	178,779	264,684
Loan payable to shareholder	-	86,733
Operating lease liabilities	348,401	-
	<u>1,935,082</u>	<u>1,683,402</u>
Total current liabilities	1,935,082	1,683,402
<b>NONCURRENT LIABILITIES</b>		
Operating lease liabilities	421,558	-
	<u>421,558</u>	<u>-</u>
Total noncurrent assets	421,558	-
<b>TOTAL LIABILITIES</b>	<b>2,356,640</b>	<b>1,683,402</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$0.001 par value, 375,000,000 shares authorized, 20,943,846 shares issued and outstanding at March 31, 2020 and June 30, 2019	20,944	20,944
Additional paid-in capital	11,104,666	11,104,666
Accumulated comprehensive income	179,000	189,906
Accumulated deficit	(7,255,884)	(5,550,128)
	<u>4,048,726</u>	<u>5,765,388</u>
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>4,048,726</b>	<b>5,765,388</b>

**TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY**

**\$ 6,405,366**   **\$ 7,448,790**

**DATASEA INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
**(Unaudited)**

	<u>NINE MONTHS ENDED</u>		<u>THREE MONTHS ENDED</u>	
	<u>March 31, 2020</u>	<u>March 31, 2019</u>	<u>March 31, 2020</u>	<u>March 31, 2019</u>
Revenues	\$ -	\$ -	\$ -	\$ -
Cost of goods sold	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Gross profit	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Operating expenses				
Selling	142,605	183,240	33,284	34,388
General and administrative	1,373,837	1,013,136	428,227	510,983
Research and development	<u>229,511</u>	<u>133,103</u>	<u>109,146</u>	<u>29,218</u>
Total operating expenses	1,745,953	1,329,479	570,657	574,589
Loss from operations	(1,745,953)	(1,329,479)	(570,657)	(574,589)
Non-operating income				
Other (expense) income, net	(3,632)	(2,571)	2,784	894
Interest income	<u>43,828</u>	<u>47,114</u>	<u>10,134</u>	<u>32,696</u>
Total non-operating income, net	40,196	44,543	12,918	33,590
Loss before income tax	(1,705,757)	(1,284,936)	(557,739)	(540,999)
Income tax	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net loss	(1,705,757)	(1,284,936)	(557,739)	(540,999)
Other comprehensive item				
Foreign currency translation gain (loss)	<u>(10,906)</u>	<u>222,332</u>	<u>719</u>	<u>198,209</u>
Total comprehensive loss	<u>\$ (1,716,663)</u>	<u>\$ (1,062,604)</u>	<u>\$ (557,020)</u>	<u>\$ (342,790)</u>
Net loss per share				
Basic and diluted	<u>\$ (0.08)</u>	<u>\$ (0.06)</u>	<u>\$ (0.03)</u>	<u>\$ (0.03)</u>
Weighted average shares outstanding				
Basic and diluted	<u>20,943,846</u>	<u>19,845,627</u>	<u>20,943,846</u>	<u>20,943,846</u>

**DATASEA INC.**  
**STATEMENTS OF CHANGES IN CONSOLIDATED STOCKHOLDERS' EQUITY**  
**NINE MONTHS ENDED MARCH 31, 2020 AND 2019**  
**(UNAUDITED)**

	<u>Common Stock</u>		<u>Additional paid-in capital</u>	<u>Accumulated deficit</u>	<u>Accumulated other comprehensive income</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at July 1, 2019	20,943,846	\$ 20,944	\$ 11,104,666	\$ (5,550,128)	\$ 189,906	\$ 5,765,388
Net loss	-	-	-	(396,985)	-	(396,985)
Foreign currency translation gain	-	-	-	-	6,613	6,613
Balance at September 30, 2019	20,943,846	20,944	11,104,666	(5,947,113)	196,519	5,375,016
Net loss	-	-	-	(751,032)	-	(751,032)
Foreign currency translation loss	-	-	-	-	(18,238)	(18,238)
Balance at December 31, 2019	20,943,846	20,944	11,104,666	(6,698,145)	178,281	4,605,746
Net loss	-	-	-	(557,739)	-	(557,739)
Foreign currency translation gain	-	-	-	-	719	719
Balance at March 31, 2020	<u>20,943,846</u>	<u>\$ 20,944</u>	<u>\$ 11,104,666</u>	<u>\$ (7,255,884)</u>	<u>\$ 179,000</u>	<u>\$ 4,048,726</u>
	<u>Common Stock</u>		<u>Additional paid-in capital</u>	<u>Accumulated deficit</u>	<u>Accumulated other comprehensive income</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at July 1, 2018	19,170,846	\$ 19,171	\$ 5,121,102	(4,124,947)	\$ 170,795	\$ 1,186,121
Sale of common stock	84,000	84	244,581	-	-	244,665
Net loss	-	-	-	(371,659)	-	(371,659)
Foreign currency translation gain	-	-	-	-	31,573	31,573
Balance at September 30, 2018	19,254,846	19,255	5,365,683	(4,496,606)	202,368	1,090,700
Sale of common stock	21,500	22	62,759	-	-	62,781
Sale of common stock - offering	1,667,500	1,668	5,676,224	-	-	5,677,892
Net loss	-	-	-	(372,278)	-	(372,278)
Foreign currency translation loss	-	-	-	-	(7,450)	(7,450)
Balance at December 31, 2018	20,943,846	20,945	11,104,666	(4,868,884)	194,918	6,451,645
Net loss	-	-	-	(540,999)	-	(540,999)
Foreign currency translation gain	-	-	-	-	198,209	198,209
Balance at March 31, 2019	<u>20,943,846</u>	<u>\$ 20,945</u>	<u>\$ 11,104,666</u>	<u>\$ (5,409,883)</u>	<u>\$ 393,127</u>	<u>\$ 6,108,855</u>



**DATASEA INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>March 31, 2020</b>	<b>March 31, 2019</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (1,705,757)	\$ (1,284,936)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	38,536	28,285
Operating lease expense	113,211	-
Changes in assets and liabilities:		
Inventory	(204,186)	279
Prepaid expenses and other current assets	(394,017)	12,099
Accounts payable	34,500	-
Advance from customers	83,889	-
Accrued expenses and other payables	(13,338)	(44,790)
Taxes payable	(105,098)	-
Payment on operating lease liabilities	(132,953)	-
Net cash used in operating activities	(2,285,214)	(1,289,063)
<b>Cash flows from investing activities:</b>		
Acquisition of fixed assets	(248,333)	(64,531)
Acquisition of intangible assets	(1,400,000)	-
Net cash used in investing activities	(1,648,333)	(64,531)
<b>Cash flows from financing activities:</b>		
Payment of loan payable - shareholder, net	(85,091)	(15,392)
Net proceeds from sale of common stock - offering	-	5,240,889
Net proceeds from issuance of common stock	-	308,858
Net cash provided by (used in) financing activities	(85,091)	5,534,355
<b>Effect of exchange rate changes on cash</b>	<b>(43,189)</b>	<b>129,722</b>
<b>Net (decrease) increase in cash and restricted cash</b>	<b>(4,061,826)</b>	<b>4,310,483</b>
<b>Cash and restricted cash, beginning of period</b>	<b>6,672,637</b>	<b>1,031,486</b>
<b>Cash and restricted cash, end of period</b>	<b>\$ 2,610,811</b>	<b>\$ 5,341,969</b>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	\$ -	\$ -
Cash paid for income tax	\$ -	\$ -
<b>Supplemental disclosures of non-cash investing and financing activities:</b>		
Right-of-use assets obtained in exchange for new operating lease liabilities	\$ 875,366	\$ -

**DATASEA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2020 (UNAUDITED) AND JUNE 30, 2019****NOTE 1 – ORGANIZATION AND DESCRIPTION OF BUSINESS**

Datasea Inc. (the “Company”, or “we”, “us”, “our” or similar terminology) was incorporated in the State of Nevada on September 26, 2014 under the name Rose Rock Inc. and changed its name to Datasea Inc. on May 27, 2015 by amending its articles of incorporation. On May 26, 2015, the Company’s founder, Xingzhong Sun, sold 6,666,667 shares of common stock, par value \$0.001 per share, of the Company (the “Common Stock”) to Zhixin Liu, one of the owners of Shuhai Skill (HK) as defined below. On October 27, 2016, Mr. Sun sold his remaining 1,666,667 shares of Common Stock of the Company to Ms. Liu.

On October 29, 2015, the Company entered into a share exchange agreement (the “Exchange Agreement”) with the shareholders (the “Shareholders”) of Shuhai Information Skill (HK) Limited (“Shuhai Skill (HK)”), a limited liability company incorporated on May 15, 2015 under the laws of the Hong Kong Special Administrative Region of the People’s Republic of China (the “PRC”). Pursuant to the terms of the Exchange Agreement, the Shareholders, who together own 100% of the ownership rights in Shuhai Skill (HK), transferred all of the issued and outstanding ordinary shares of Shuhai Skill (HK) to the Company in exchange for the issuance of an aggregate of 6,666,667 shares of Common Stock, thereby causing Shuhai Skill (HK) and its wholly owned subsidiaries, Tianjin Information Sea Information Technology Co., Ltd. (“Tianjin Information”), a limited liability company incorporated under the laws of the PRC, and Harbin Information Sea Information Technology Co., Ltd., a limited liability company incorporated under the laws of the PRC, to become wholly-owned subsidiaries of the Company; and Shuhai Information Technology Co., Ltd., also a limited liability company incorporated under the laws of the PRC (“Shuhai Beijing”), to become a variable interest entity (“VIE”) of the Company through a series of contractual agreements between Shuhai Beijing and Tianjin Information. The transaction was accounted for as a reverse merger, with Shuhai Skill (HK) and its subsidiaries being the accounting survivor. Accordingly, the historical financial statements presented are those of Shuhai Skill (HK) and its consolidated subsidiaries and VIE.

Following the Share Exchange, the Shareholders, being Zhixin Liu and her father, Fu Liu, owned approximately 82% of the outstanding shares of Common Stock. As of October 29, 2015, there were 18,333,333 shares of Common Stock issued and outstanding, 15,000,000 of which were beneficially owned by Zhixin Liu and Fu Liu.

On May 1, 2018, the Company implemented a 1 for 3 reverse stock split decreasing the shares outstanding from 57,511,711 to 19,170,846. The unaudited condensed consolidated financial statements have been retroactively adjusted to reflect the reverse split.

After the Share Exchange, the Company, through its consolidated subsidiaries and VIE is engaged in providing smart security solutions primarily to schools, tourist or scenic attractions and public communities in China.

On October 16, 2019, Shuhai Beijing incorporated a wholly owned subsidiary, Heilongjiang Xunrui Technology Co. Ltd. (“Xunrui”), which is engaged in developing and marketing the Company’s smart security system products.

On December 3, 2019, Shuhai Beijing formed Nanjing Shuhai Equity Investment Fund Management Co. Ltd. (“Shuhai Nanjing”), a joint venture in PRC, in which Shuhai Beijing holds a 99% ownership interest with the remaining 1% ownership held by Nanjing Fanhan Zhineng Technology Institute Co. Ltd, an unrelated party that was supported by both Nanjing Municipal Government and Beijing University of Posts and Telecommunications. Shuhai Nanjing was formed for purposes of easy access of government funding and private financing in new technology development and project incubation. As of this report date, Shuhai Nanjing has no operations yet.

In January 2020, as described below, to expeditiously establish new subsidiaries to further expand the business and operation, the Company acquired ownerships in three entities for no consideration from the Company’s management who set up such entities on the Company’s behalf.

On January 3, 2020, Shuhai Beijing entered into two equity transfer agreements (the “Transfer Agreements”) with President of the Company, and a Director of the Company. Pursuant to the Transfer Agreements, the Director and the President, each agreed, for no consideration, to (i) transfer their 51% and 49% ownership interest, respectively, in Guozhong Times (Beijing) Technology Ltd. (“Guozhong Times”) to Shuhai Beijing; and (ii) transfer their 51% and 49% ownership interest, respectively, in Guohao Century (Beijing) Technology Ltd. (“Guohao Century”) to Shuhai Beijing. Guozhong Times and Guohao Century were established for developing technology for electronic products, intelligence equipment and accessories, and providing software and information system consulting, installation and maintenance services. Guozhong Times started operation since January 2020, Guohao Century has not yet commenced operation as of this report date.

On January 7, 2020, Shuhai Beijing entered into another equity transfer agreement with the President, the same Director described above and an unrelated individual. Pursuant to this equity transfer agreement, the Director, the President and the unrelated each agreed to transfer their 51%, 16%, 33% ownership interests, respectively, in Guozhong Haoze (Beijing) Technology Ltd. (“Guozhong Haoze”) to Shuhai Beijing for no consideration. Guozhong Haoze was formed to further develop and market the smart security system products. Guozhong Haoze has not yet commenced operation as of this report date

In December 2019, a novel strain of coronavirus (COVID-19) was reported in China, upon which the World Health Organization has declared the outbreak to constitute a “Public Health Emergency of International Concern.” Based on the epidemic prevention and control system embedded in our intelligent security platform, the company was able to promptly organize our employees at home to develop and upgrade the body temperature measurement and administration backend of the epidemic prevention and control system, which could meet the needs of schools and public communities for epidemic prevention, and well addressed the problem of how to integrate our security platform and epidemic prevention system. Ever since April, the company has resumed normal work, and the impact of COVID-19 outbreak on our marketing efforts from January to March of 2020 has been minimized.

## **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **GOING CONCERN**

The accompanying unaudited condensed consolidated financial statements were prepared assuming the Company will continue as a going concern, which contemplates continuity of operations, realization of assets, and liquidation of liabilities in the normal course of business. For the nine months ended March 31, 2020 and 2019, the Company had a net loss of \$1.71 million and \$1.28 million, respectively. The Company has an accumulated deficit of \$7.26 million as of March 31, 2020. This raises substantial doubt about the Company’s ability to continue as a going concern. There can be no assurance that the Company will become profitable or obtain necessary financing for its business or that it will be able to continue in business.

The Company is currently seeking to modify its products and software to assist schools and communities in addressing the coronavirus outbreak, providing possible remedy and prevention for the future outbreak after school resumes and public community reverts to social activities by promoting Epidemic Prevention and Control Systems. Management also intends to raise additional funds by way of a private or public offering, or by obtaining loans from banks or others which are planned to be used altogether with operating turnover to support Company’s R&D, procurement, marketing and daily operation, while the Company believes in the viability of its strategy to generate sufficient revenue and in its ability to raise additional funds on reasonable terms and conditions, there can be no assurances to that effect. The ability of the Company to continue as a going concern is dependent upon the Company’s ability to further implement its business plan and generate sufficient revenue and its ability to raise additional funds by way of a public or private offering.

The unaudited condensed consolidated financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary if the Company is unable to continue as a going concern.

### **BASIS OF PRESENTATION AND CONSOLIDATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. The accompanying unaudited condensed consolidated financial statements include the financial statements of the Company and its 100% owned subsidiaries of Shuhai Skill (HK), Tianjin Information and its VIE, Shuhai Beijing, and its subsidiaries – Xunrui and Guozhong Times. All significant inter-company transactions and balances have been eliminated in consolidation.

The accompanying unaudited interim condensed consolidated financial statements (“CFS”) have been prepared pursuant to the rules and regulations of the SEC. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments and elimination of intercompany transactions upon consolidation) which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in the annual consolidated financial statements prepared in accordance with US GAAP have been omitted pursuant to such rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended June 30, 2019. The results for the three and nine months ended March 31, 2020 are not necessarily indicative of the results to be expected for the full year ending June 30, 2020.

## **VARIABLE INTEREST ENTITY**

Pursuant to Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Section 810, “Consolidation” (“ASC 810”), the Company is required to include in its consolidated financial statements, the financial statements of Shuhai Beijing, its VIE. ASC 810 requires a VIE to be consolidated if the company is subject to a majority of the risk of loss for the VIE or is entitled to receive a majority of the VIE’s residual returns. A VIE is an entity in which a company, through contractual arrangements, bears the risk of, and enjoys the rewards normally associated with ownership of the entity, and therefore the company is the primary beneficiary of the entity.

Under ASC 810, a reporting entity has a controlling financial interest in a VIE, and must consolidate that VIE, if the reporting entity has both of the following characteristics: (a) the power to direct the activities of the VIE that most significantly affect the VIE’s economic performance; and (b) the obligation to absorb losses, or the right to receive benefits, that could potentially be significant to the VIE. The reporting entity’s determination of whether it has this power is not affected by the existence of kick-out rights or participating rights, unless a single enterprise, including its related parties and de - facto agents, have the unilateral ability to exercise those rights. Shuhai Beijing’s actual stockholders do not hold any kick-out rights that affect the consolidation determination.

Through the VIE agreements, the Company is deemed the primary beneficiary of Shuhai Beijing and its subsidiaries. Accordingly, the results of Shuhai Beijing and its subsidiaries have been included in the accompanying unaudited condensed consolidated financial statements. Shuhai Beijing has no assets that are collateral for or restricted solely to settle their obligations. The creditors of Shuhai Beijing do not have recourse to the Company’s general credit.

### ***VIE Agreements***

***Operation and Intellectual Property Service Agreement*** – This agreement allows Tianjin Information to manage and operate Shuhai Beijing and collect 100% of their net profits. Under the terms of the Operation and Intellectual Property Service Agreement, Shuhai Beijing entrusts Tianjin Information to manage its operations, manage and control its assets and financial matters, and provide intellectual property services, purchasing management services, marketing management services and inventory management services to Shuhai Beijing. Shuhai Beijing and its shareholders shall not make any decisions nor direct the activities of Shuhai Beijing without Tianjin Information’s consent.

***Shareholders’ Voting Rights Entrustment Agreement*** – Tianjin Information has entered into a shareholders’ voting rights entrustment agreement (the “Entrustment Agreement”) under which Zhixin Liu and Fu Liu (collectively the “Shuhai Beijing Shareholders”) have vested their voting power in Shuhai Beijing to Tianjin Information or its designee(s). The Entrustment Agreement does not have an expiration date.

**Equity Option Agreement** – the Shuhai Beijing Shareholders and Tianjin Information entered into an equity option agreement (the “Option Agreement”), pursuant to which the Shuhai Beijing Shareholders have granted Tianjin

Information or its designee(s) the irrevocable right and option to acquire all or a portion of Shuhai Beijing Shareholders’ equity interests in Shuhai Beijing for an option price of RMB 0.001 for each capital contribution of RMB1.00. Pursuant to the terms of the Option Agreement, Tianjin Information and the Shuhai Beijing shareholders have agreed to certain restrictive covenants to safeguard the rights of Tianjin Information under the option Agreement. Tianjin Information agreed to pay RMB1.00 annually to Shuhai Beijing Shareholders to maintain the option rights. Tianjin Information may terminate the Option Agreement upon prior written notice. The Option Agreement is valid for a period of 10 years from the effective date and renewable at Tianjin Information’s option.

**Equity Pledge Agreement** – Tianjin Information and the Shuhai Beijing Shareholders entered into an equity pledge agreement on October 27, 2015 (the “Equity Pledge Agreement”). The Equity Pledge Agreement serves to guarantee the performance by Shuhai Beijing of its obligations under the Operation and Intellectual Property Service Agreement and the Option Agreement. Pursuant to the Equity Pledge Agreement, Shuhai Beijing Shareholders have agreed to pledge all of their equity interests in Shuhai Beijing to Tianjin Information. Tianjin Information has the right to collect any and all dividends paid on the pledged equity interests during the pledge period. Pursuant to the terms of the Equity Pledge Agreement, the Shuhai Beijing Shareholders have agreed to certain restrictive covenants to safeguard the rights of Tianjin Information. Upon an event of default or certain other agreed events under the Operation and Intellectual Property Service Agreement, the Option Agreement and the Equity Pledge Agreement, Tianjin Information may exercise the right to enforce the pledge.

The following financial statement amounts and balances of the VIE were included in the accompanying condensed consolidated financial statements as of March 31, 2020 and June 30, 2019 and for the nine and three months ended March 31, 2020 and 2019, respectively:

	<b>March 31, 2020 (Unaudited)</b>	<b>June 30, 2019</b>
Current assets	\$ 546,373	\$ 1,573,413
Non-current assets	990,548	96,927
Total assets	<u>\$ 1,536,921</u>	<u>\$ 1,670,340</u>
Current liabilities	\$ 1,863,810	\$ 6,232,836
Non-current liabilities	421,558	-
Total liabilities	<u>\$ 2,285,368</u>	<u>\$ 6,232,836</u>
	<b>For the Three Months Ended March 31, 2020 (Unaudited)</b>	<b>For the Nine Months Ended March 31, 2020 (Unaudited)</b>
Revenues	<u>\$ -</u>	<u>\$ -</u>
Gross profit	<u>\$ -</u>	<u>\$ -</u>
Net loss	<u>\$ 235,541</u>	<u>\$ 944,617</u>
	<b>For the Three Months Ended March 31, 2019 (Unaudited)</b>	<b>For the Nine Months Ended March 31, 2019 (Unaudited)</b>
Revenues	<u>\$ -</u>	<u>\$ -</u>
Gross profit	<u>\$ -</u>	<u>\$ -</u>

Net loss

\$ 291,011    \$ 1,107,119

## **USE OF ESTIMATES**

The preparation of unaudited condensed consolidated financial statements in conformity with US GAPP 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 amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. The significant areas requiring the use of management estimates include, but are not limited to, the estimated useful life and residual value of property, plant and equipment, provision for staff benefits, recognition and measurement of deferred income taxes and the valuation allowance for deferred tax assets. Although these estimates are based on management's knowledge of current events and actions management may undertake in the future, actual results may ultimately differ from those estimates and such differences may be material to our unaudited condensed consolidated financial statements.

## **CONTINGENCIES**

Certain conditions may exist as of the date the unaudited condensed consolidated financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought. If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, the estimated liability would be accrued in the Company's unaudited condensed consolidated financial statements.

If the assessment indicates that a potential material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed. As of March 31, 2020 and June 30, 2019, the Company has no such contingencies.

## **CASH AND CASH EQUIVALENTS**

Cash and cash equivalents include cash on hand, demand deposits and short-term cash investments that are highly liquid in nature and have original maturities of three months or less.

## **RESTRICTED CASH**

Restricted cash represents cash held in an indemnification escrow account related to requirements of the financing agreement signed with the underwriter of the Company's initial public offering for a period of 18 months or longer subsequent to the closing of the initial public offering on December 21, 2018.

## **INVENTORY**

Inventory comprised principally of smart student identification cards related to the Company's "Safe Campus" security products, as well as products associated therewith comprised of routers to be used in installations, is valued at the lower of cost or net realizable value. The value of inventory is determined using the first-in, first-out method. The Company periodically estimates an inventory allowance for estimated unmarketable inventories when necessary. Inventory amounts are reported net of such allowances. There were no allowances for inventory as of March 31, 2020 and June 30, 2019.

## PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, less accumulated depreciation. Major repairs and improvements that significantly extend original useful lives or improve productivity are capitalized and depreciated over the period benefited. Maintenance and repairs are expensed as incurred. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method over estimated useful lives as follows:

Furniture and fixtures	5-10 years
Office equipment	3-5 years
Vehicles	5 years
Lease improvement	3 years

Leasehold improvements are depreciated utilizing the straight-line method over the shorter of their estimated useful lives or remaining lease term.

## INTANGIBLE ASSETS

Intangible assets with finite lives are amortized using the straight-line method over their estimated period of benefit. Evaluation of the recoverability of intangible assets is made to take into account events or circumstances that warrant revised estimates of useful lives or that indicate that impairment exists. All of the Company's intangible assets are subject to amortization. No impairment of intangible assets has been identified as of the balance sheet date.

Intangible assets include licenses, certificates, patents and other technology and are amortized over their useful life of five to ten years.

## FAIR VALUE ("FV") OF FINANCIAL INSTRUMENTS

Certain of the Company's financial instruments, including cash and equivalents, accrued liabilities and accounts payable, carrying amounts approximate their FV due to their short maturities. FASB ASC Topic 825, "Financial Instruments," requires disclosure of the FV of financial instruments held by the Company. The carrying amounts reported in the balance sheets for current liabilities each qualify as financial instruments and are a reasonable estimate of their FV because of the short period of time between the origination of such instruments and their expected realization and the current market rate of interest.

## FAIR VALUE MEASUREMENTS AND DISCLOSURES

FASB ASC Topic 820, "Fair Value Measurements," defines fair value, and establishes a three-level valuation hierarchy for disclosures that enhances disclosure requirements for fair value measures. The three levels are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include other than those in level 1 quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The carrying value of the Company's short-term financial instruments, such as accounts payable, approximate their fair values due to their short maturities.

As of March 31, 2020 and June 30, 2019, the Company did not identify any assets and liabilities that are required to be presented on the balance sheet at fair value on a recurring basis.

## IMPAIRMENT OF LONG-LIVED ASSETS

In accordance with FASB ASC 360-10, Accounting for the Impairment or Disposal of Long-Lived Assets, long-lived assets such as property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable, or it is reasonably possible that these assets could become impaired as a result of technological or other changes. The determination of recoverability of assets to be held and used is made by comparing the carrying amount of an asset to future undiscounted cash flows to be generated by the asset.

If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value. Fair value generally is determined using the asset's expected future discounted cash flows or market value, if readily determinable. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell. During the reporting periods there was no impairment loss recognized on long-lived assets.

## LEASES

On July 1, 2019, the Company adopted Topic 842 using the modified retrospective transition approach by applying the new standard to all leases existing at the date of initial application. Results and disclosure requirements for reporting periods beginning after July 1, 2019 are presented under Topic 842, while prior period amounts have not been adjusted and continue to be reported in accordance with its historical accounting under Topic 840.

The Company elected the package of practical expedients permitted under the transition guidance, which allowed it to carry forward its historical lease classification, its assessment on whether a contract was or contains a lease, and its initial direct costs for any leases that existed prior to July 1, 2019. The Company also elected to combine its lease and non-lease components and to keep leases with an initial term of 12 months or less off the balance sheet and recognize the associated lease payments in the condensed consolidated statements of income on a straight-line basis over the lease term.

The adoption did not impact its beginning retained earnings, or its prior year consolidated statements of income and statements of cash flows.

Under Topic 842, the Company determines if an arrangement is a lease at inception. Right of Use Assets ("ROU") and lease liabilities are recognized at commencement date based on the present value of remaining lease payments over the lease term. For this purpose, the Company considers only payments that are fixed and determinable at the time of commencement. As most of its leases do not provide an implicit rate, it uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The Company's incremental borrowing rate is a hypothetical rate based on its understanding of what its credit rating would be. The ROU assets include adjustments for prepayments and accrued lease payments. The ROU asset also includes any lease payments made prior to commencement and is recorded net of any lease incentives received. The Company's lease terms may include options to extend or terminate the lease when it is reasonably certain that it will exercise such options.

Operating leases are included in operating lease right-of-use assets and operating lease liabilities (current and non-current), on the condensed consolidated balance sheets. At March 31, 2020, the net ROU was \$758,162, and total operating lease liabilities (includes current and noncurrent) was \$769,956.

## REVENUE RECOGNITION

On July 1, 2018, the Company adopted Accounting Standards Update ("ASU") 2014-09 (and related amendments subsequently issued in 2016), Revenue from Contracts with Customers (ASC 606), by using the modified retrospective method for contracts that were not completed as of July 1, 2018. This did not result in an adjustment to retained earnings upon adoption of this new guidance, as the Company's revenue was recognized based on the amount of consideration, we expect to receive in exchange for satisfying the performance obligations.

The core principle underlying the ASC 606 is that the Company will recognize revenue to represent the transfer of goods and services to customers in an amount that reflects the consideration to which the Company expects to be entitled in such exchange. This will require the Company to identify contractual performance obligations and determine whether revenue should be recognized at a point in time or over time, based on when control of goods and services transfers to a customer. The Company's revenue streams are recognized at a point in time, based on when control of goods and services transfers to a customer.

ASC 606 requires the use of a new five-step model to recognize revenue from customer contracts. The five-step model requires that the Company (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, including variable consideration to the extent that it is probable that a significant future reversal will not occur, (iv) allocate the transaction price to the respective performance obligations in the contract, and (v) recognize revenue when (or as) the Company satisfies each performance obligation. The application of the five-step model to the revenue streams compared to the prior guidance did not result in significant changes in the way the Company records its revenue. Upon adoption, the Company evaluated its revenue recognition policy for all revenue streams within the scope of the ASC 606 under previous standards and using the five-step model under the new guidance and confirmed that there were no differences in the pattern of revenue recognition.

The Company is seeking to derive its revenues from professional service contracts with its customers, with revenues being recognized upon delivery of services and products. Persuasive evidence of an arrangement is demonstrated via professional service contracts and invoices; and the service price to the customer is fixed upon acceptance of the professional services contract. The Company will recognize revenue when professional service is rendered to the customer by the Company and collectability of payment is reasonably assured. These revenues will be recognized at a point in time after all performance obligations are satisfied.

## **INCOME TAXES**

The Company uses the asset and liability method of accounting for income taxes in accordance with ASC Topic 740, "Income Taxes." Under this method, income tax expense is recognized for the amount of: (i) taxes payable or refundable for the current period and (ii) deferred tax consequences of temporary differences resulting from matters that have been recognized in an entity's financial statements or tax returns. Deferred tax assets also include the prior years' net operating losses carried forward. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is provided to reduce the deferred tax assets reported if based on the weight of the available positive and negative evidence, it is more likely than not some portion or all of the deferred tax assets will not be realized.

The Company follows ASC Topic 740, which prescribes a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC Topic 740 also provides guidance on recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures.

Under the provisions of ASC Topic 740, when tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest associated with unrecognized tax benefits is classified as interest expense and penalties are classified in selling, general and administrative expenses in the statement of income. At March 31, 2020 and June 30, 2019, the Company did not take any uncertain positions that would necessitate recording a tax related liability.

## RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses are expensed in the period when they are incurred. For the three and nine months ended March 31, 2020, the Company incurred research and development expenses of \$109,146 and \$229,511, respectively. For the three and nine months ended March 31, 2019, the Company incurred research and development expenses of \$29,218 and \$133,103, respectively.

## CONCENTRATION OF CREDIT RISK

The Company maintains cash in accounts with state-owned banks within the PRC. Cash in state-owned banks less than RMB500,000 (\$71,806) is covered by insurance. Should any of these institutions holding the Company's cash become insolvent, or if the Company is unable to withdraw funds for any reason, the Company could lose the cash on deposit with that institution. The Company has not experienced any losses in such accounts and believes it is not exposed to any risks on its cash in these bank accounts.

Cash denominated in RMB with a U.S. dollar equivalent of \$1,584,380 and \$1,395,104 at March 31, 2020 and June 30, 2019, respectively, were held in accounts at financial institutions located in the PRC, which is not freely convertible into foreign currencies. The Company, its subsidiaries and VIE have not experienced any losses in such accounts and do not believe the cash is exposed to any significant risk. Cash held in accounts at U.S. financial institutions are insured by the Federal Deposit Insurance Corporation or other programs subject to certain limitations up to \$250,000 per depositor. As of March 31, 2020, the cash balance of approximately \$410,138 was maintained at U.S. financial institutions, of which approximately \$160,000 was not insured. Cash was maintained at financial institutions in Hong Kong, and were insured by the Hong Kong Deposit Protection Board up to a limit of HK \$500,000 (approximately \$64,000). As of March 31, 2020, the cash balance of approximately \$16,293 was maintained at financial institutions in Hong Kong.

## FOREIGN CURRENCY TRANSLATION AND COMPREHENSIVE INCOME (LOSS)

The accounts of the Company's Chinese entities are maintained in RMB and the accounts of the U.S. parent company are maintained in United States dollars("USD") The accounts of the Chinese entities were translated into USD in accordance with ASC Topic 830 "Foreign Currency Matters." All assets and liabilities were translated at the exchange rate on the balance sheet date; stockholders' equity is translated at historical rates and the statements of operations and cash flows are translated at the weighted average exchange rate for the period. The resulting translation adjustments are reported under other comprehensive income (loss) in accordance with ASC Topic 220, "Comprehensive Income." Gains and losses resulting from foreign currency transactions are reflected in the statements of operations.

The Company follows FASB ASC Topic 220-10, "Comprehensive Income (loss)." Comprehensive income(loss) comprises net income(loss) and all changes to the statements of changes in stockholders' equity, except those due to investments by stockholders, changes in additional paid-in capital and distributions to stockholders.

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

	<b>March 31, 2020</b>	<b>March 31, 2019</b>	<b>June 30, 2019</b>
Period end USD: RMB exchange rate	7.0851	6.7121	6.8668
Average USD: RMB exchange rate	6.9993	6.8271	6.8263

## BASIC AND DILUTED EARNINGS (LOSS) PER SHARE (EPS)

Basic EPS is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed similarly, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Diluted EPS are based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to have been exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

## STATEMENT OF CASH FLOWS

In accordance with FASB ASC Topic 230, "Statement of Cash Flows," cash flows from the Company's operations are calculated based upon the local currencies. As a result, amounts shown on the statement of cash flows may not necessarily agree with changes in the corresponding asset and liability on the balance sheet.

## RECENT ACCOUNTING PRONOUNCEMENTS

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement, which modifies the disclosure requirements for Level 1, Level 2 and Level 3 instruments in the fair value hierarchy. The guidance is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted for any eliminated or modified disclosures. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

In December 2019, the FASB issued ASU 2019-12, Simplifying the Accounting for Income Taxes, which simplifies the accounting for income taxes, eliminates certain exceptions within ASC 740, Income Taxes, and clarifies certain aspects of the current guidance to promote consistent application among reporting entities. The guidance is effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years, with early adoption permitted. Upon adoption, the Company must apply certain aspects of this standard retrospectively for all periods presented while other aspects are applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. The Company is evaluating the impact this update will have on its Consolidated Financial Statements.

## NOTE 3 – FIXED ASSETS

Fixed assets are summarized as follows:

	<b>March 31, 2020 (Unaudited)</b>	<b>June 30, 2019</b>
Furniture and fixtures	\$ 89,439	\$ 83,437
Vehicle	2,823	2,913
Leasehold improvement	137,826	-
Office equipment	151,885	54,641
Subtotal	<u>381,973</u>	<u>140,991</u>
Less: accumulated depreciation	129,658	99,875
Total	<u>\$ 252,315</u>	<u>\$ 41,116</u>

Depreciation expense for the three months ended March 31, 2020 and 2019 was \$23,556 and \$7,156 respectively.

Depreciation expense for the nine months ended March 31, 2020 and 2019 was \$33,263 and \$24,787 respectively.

**NOTE 4 – INTANGIBLE ASSETS**

Intangible assets are summarized as follows:

	<b>March 31, 2020 (Unaudited)</b>	<b>June 30, 2019</b>
Software registration right	\$ 36,677	\$ 37,843
Patent	11,318	15,286
Technology development	1,900,000	500,000
Value-added telecommunications business license	14,815	11,678
Subtotal	<u>1,962,810</u>	<u>564,807</u>
Less: Accumulated amortization	<u>13,928</u>	<u>8,996</u>
Total	<u>\$ 1,948,882</u>	<u>\$ 555,811</u>

On May 28, 2019, the Company entered into an agreement with SDT Trade Co., Ltd., an unaffiliated party (“SDT”). SDT will assist the Company with technical development work related to the Company’s security-related software and systems. Pursuant to the agreement, SDT will complete certain development work within twelve months and thereafter maintain the system for thirty-six months. The total amount to be paid under the agreement is \$1,200,000. As of March 31, 2020, the Company paid SDT \$1,000,000. However, the development has not commenced yet since the Company has not finalized the technology specifications.

On July 2, 2019, the Company entered into a technology development service agreement with HW (HK) Limited, an unaffiliated party. Pursuant to the agreement, the Company appointed HW (HK) Limited to develop an eye protection technical system for a two period ending July 1, 2021. The total payments to made under the agreement is \$1,200,000. As of March 31, 2020, the Company paid HW (HK) Limited \$900,000 and the technology development is in process.

Amortization expense for the three months ended March 31, 2020 and 2019 were \$3,546 and \$1,880, respectively.

Amortization expense for the nine months ended March 31, 2020 and 2019 were \$5,273 and \$3,498, respectively.

**NOTE 5 – PREPAID EXPENSES AND OTHER CURRENT ASSETS**

Prepaid expenses and other current assets consisted of the following:

	<b>March 31, 2020 (Unaudited)</b>	<b>June 30, 2019</b>
Security deposit	\$ 155,900	\$ 46,933
Prepaid expenses and advances	80,910	34,181
Other receivables	197,598	-
Others	57,505	24,818
Total	<u>\$ 491,913</u>	<u>\$ 105,932</u>

On February 20, 2020, Guozhong Times entered an Operation Cooperation Agreement with an unrelated company, Heqin (Beijing) Technology Co, Ltd. (“Heqin”) for marketing and promoting the sale of Face Recognition Payment Processing equipment and related technical support, and other products of the Company including Epidemic Prevention and Control Systems. Heqin has a strong sales team who used to work shoulder by shoulder with fortune 500 companies and specializes in business marketing and sales channel establishment and expansion, especially in education industry and public area. They have had Successful experience of organizing multiple business matchmaking meetings with customers, distributors and retailers.

The cooperation term is from February 2, 2020 through March 1, 2023; however, Heqin is the exclusive distributor of the Company’s face Recognition Payment Processing products for the period up to July 30, 2020. During the period of March and April 2020, Guozhong Times will provide the operating fund to Heqin, together with a credit line provided by Guozhong Times to Heqin for the period from May 2020 through August 2020, for total borrowing amount of RMB 10 million (\$1.41 million) for Heqin’s operating needs. As of March 31, 2020, Guozhong Times had an outstanding receivable of RMB 1.4 million (\$197,598) from Heqin and was recorded as other receivable, with no interest and repayment date no later than the end of current fiscal year. The loan to Heqin is secured against the assets of Heqin, and Heqin’s shareholders are jointly responsible for the timely repayment of the loan.



No profits will be allocated and distributed before the full repayment of the borrowing. After Heqin pays in full the borrowing amount, Guozhong Times and Heqin will start to distribute from the profits of sale of Face Recognition Payment Processing equipment and related technical support at 30% and 70% of the net income, respectively. The profit allocation for the sale of other products of the Company are to be negotiated. Heqin will receive certain stock reward when it reaches the preset sales target under the performance compensation mechanism.

#### NOTE 6 – ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payable consisted of the following:

	<b>March 31, 2020 (Unaudited)</b>	<b>June 30, 2019</b>
Deposit	\$ -	\$ 30,525
Salary and other payables	178,779	234,159
Total	<u>\$ 178,779</u>	<u>\$ 264,684</u>

As of March 31, 2020, accrued expenses and other payables mainly consisted of salary payable of \$111,808, and accrued liabilities and other payables of \$66,971. As of June 30, 2019, salary and other payables mainly consist of salary payable of \$52,551 and other payable of \$180,858.

#### NOTE 7 – ADVANCES FROM CUSTOMERS

On March 5, 2018, the Company entered into separate agreements with two sales agents. Pursuant to the agreements, the Company authorized the agents to market the Company's Safe Campus Management System. The term of the agreements is for five years and will expire on March 6, 2023 and July 1, 2023, respectively. In accordance with ASU 2016-08, Principal versus Agent Considerations (ASC 606), the Company determined that it was the principal in these two contracts and as such, the Company recorded the payments received from the two sales agents as advances. The Company will recognize revenue from these contracts as the sales agents sell the products and services to third parties.

As of March 31, 2020, the Company had advances from customers of \$1,361,134, of which, \$1.28 million was advances from the sales agents. As of June 30, 2019, the Company had advances from customers of \$1,318,897, all was the advances from the sales agents.

As of March 31, 2020, Guozhong Times has received 33 purchase orders from development and construction companies from Anhui and Fujian province, China for customized hardware and software solutions to detect and control the novel coronavirus outbreak in public areas. Datasea's systems sold in these orders are utilized in public places, including campuses, shopping malls, scenic areas, residential areas and factory areas.

The value of a single purchase order ranges from \$1,620 to \$2,620 (RMB 11,500 to RMB 18,600). The total value of the 33 agreements is \$84,000 (RMB 596,520). Pursuant to the purchase orders, customers shall pay the full amount within 15 days after the purchase order is signed. As of March 31, 2020, Guozhong Times has received \$69,500 (RMB493,500).

#### NOTE 8 – RELATED PARTY TRANSACTIONS

The Company's President, Zhixin Liu, paid certain operating expenses on behalf of the Company. As of March 31, 2020 and June 30, 2019, the amounts due to the President were \$nil and \$86,733 respectively. These amounts were interest-free, unsecured and due on demand.

On January 1, 2019, the Company's President entered into a car rental agreement with the Company for a term of two years. Pursuant to the agreement, the Company rents a car from the Company's President for a monthly rent of approximately \$700. The agreement was replaced by a new agreement entered on November 30, 2019 for the leasing period from December 1, 2019 through December 31, 2020, with monthly rent of approximately \$1,700, or total payment of \$22,288, which was paid in full in advance as required by the agreement, and was recorded as prepaid expenses at March 31, 2020. The Company recorded car rental expense of \$1,429 and \$2,197 for the three months ended March 31, 2020 and 2019. The Company recorded car rental expense of \$3,572 and \$6,591 for the nine months ended March 31, 2020 and 2019.

In April 2019, the Company's President entered into an apartment rental agreement with the Company. Pursuant to the agreement, the Company rents an apartment located in Harbin city as the Company's branch office from the Company's President with an annual rent of approximately \$2,828. The term was from May 1, 2019 through April 30, 2020. The rent paid under this agreement

was \$729 and \$733 for the three months ended March 31, 2020 and 2019, respectively. The rent paid under this agreement was \$2,186 and \$2,197 for the nine months ended March 31, 2020 and 2019, respectively.

On April 22, 2019, the Company borrowed RMB400,000 (or approximately \$57,000) with no interest from the Company's President to pay operating expenses. The loan was repaid on July 8, 2019.

**NOTE 9 – INCOME TAXES**

The Company is subject to income taxes by entity on income arising in or derived from the tax jurisdiction in which each entity is domiciled. The Company's PRC subsidiaries file their income tax returns online with PRC tax authorities. The Company conducts all of its businesses through its subsidiaries and affiliated entities, principally in the PRC.

The Company's US parent company, was incorporated in the US and is subject to U.S. income tax rate of 21% and files U.S. federal income tax return. As of March 31, 2020, the US entity had net operating loss ("NOL") carry forwards for income tax purpose of \$261,419. The NOL arising in tax years beginning after 2017 may reduce 80% of a taxpayer's taxable income, and be carried forward indefinitely. Management believes the realization of benefits from these losses remains uncertain due to the parent Company's limited operating history and continuing losses. Accordingly, a 100% deferred tax asset valuation allowance was provided.

The Company's offshore subsidiary, Shuhai Skill (HK), a HK holding company is subject to 16.5% corporate income tax in HK. Shuhai Beijing received a tax holiday with a 15% corporate income tax rate since it qualified as a high-tech company. Tianjin Information, Xunrui, and Guozhong Times are subject to the regular 25% PRC income tax rate.

As of March 31, 2020, the Company has approximately \$5.17 million of NOL related to its HK holding company, PRC subsidiaries and VIEs that expire in years 2019 through 2023. The Company estimated the NOL based on the unaudited financial statements of each entity per PRC GAAP, which the management believes it approximates the financial statements per PRC tax law. In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the Company's future generation of taxable income during the periods in which temporary differences representing net future deductible amounts become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. After consideration of all the information available, management believes that significant uncertainty exists with respect to future realization of the deferred tax assets and has therefore established a full valuation allowance as of March 31, 2020 and June 30, 2019.

The following table reconciles the U.S. statutory rates to the Company's effective tax rate for the three and nine months ended March 31, 2020 and 2019:

	<b>Three Months Ended March 31 (Unaudited),</b>		<b>Nine Months Ended March 31 (Unaudited),</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
US federal statutory rates	(21.0)%	(21.0)%	(21.0)%	(21.0)%
Tax rate difference – current provision	(3.1)	6.0%	(3.6)	6.0%
Effect of PRC tax holiday	0.8%	-%	5.2%	-%
Valuation allowance	23.3%	15.0%	19.4%	15.0%
Effective tax rate	-	-	-	-

The Company's net deferred tax asset as of March 31, 2020 and June 30, 2019 is as follows:

	<b>March 31, 2020 (Unaudited)</b>	<b>June 30, 2019</b>
Deferred tax asset – net operating loss	\$ 901,777	\$ 1,199,872
Valuation allowance	(901,777)	(1,199,872)
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

## NOTE 10 – COMMIMENTS

### Lease Agreement

On March 20, 2019, the Company entered into the one-year operating lease agreement for a senior management's dormitory. Pursuant to the lease agreement, the lease expires on March 22, 2020 and has a monthly rent of RMB 5,200 (or approximately \$735). The Company did not renew the lease upon lease expiration.

On July 30, 2019, the Company entered into an operating lease agreement for its office in Beijing. Pursuant to the lease agreement, the delivery date of the property was August 8, 2019 but the lease term started on October 8, 2019 and expire on October 7, 2022, and has a monthly rent of RMB 207,269 without value added tax ("VAT") (or approximately \$29,250). The lease required a security deposit of three months' rent of RMB 677,769 (or approximately \$96,000). The Company will receive a six-month rent abatement.

On July 30, 2019, the Company entered into a property service agreement for its office in Beijing (described above). Pursuant to the property service agreement, the agreement commenced on August 9, 2019 and will expire on October 8, 2022, and has a quarterly fee of RMB 202,352 (or approximately \$29,000). The deposit was RMB202,352 (or approximately \$29,000).

On August 28, 2019, the Company entered an operating lease agreement for senior officers' dormitory in Beijing. The lease has a term of two-years with expiration date on August 31, 2021, the monthly rent is RMB 14,500 (\$2,045), payable every six months in advance.

The Company adopted ASC 842 on July 1, 2019. The components of lease costs, lease term and discount rate with respect of the office and dormitory leases with an initial term of more than 12 months are as follows:

	<b>Three Months Ended March 31, 2020 (Unaudited)</b>	<b>Nine Months Ended March 31, 2020 (Unaudited)</b>
Operating lease expense	\$ 31,727	\$ 113,211
		<b>March 31, 2020 (Unaudited)</b>
Right-of-use assets		\$ 758,162
Lease liabilities		\$ 348,401
Lease liabilities - noncurrent		\$ 421,558
Weighted average remaining lease term		2.47 years
Weighted average discount rate		5.00%

The following is a schedule, by years, of maturities of the operating lease liabilities as of March 31, 2020:

<b>Twelve months ending March 31,</b>	<b>Minimum Lease Payment</b>
2021	\$ 348,401
2022	302,774
2023	175,525
Total undiscounted cash flows	<u>826,700</u>
Less: imputed interest	<u>(56,741)</u>
Present value of lease liabilities	<u>769,959</u>

#### **NOTE 11 – SUBSEQUENT EVENTS**

The Company follows the guidance in FASB ASC 855-10 for the disclosure of subsequent events. The Company evaluated subsequent events through the date the financial statements were issued and determined the Company has the following material subsequent event:

In 2018, the Company's Board of Directors and majority stockholders approved the 2018 Equity Incentive Plan (the "2018 Plan"), the 2018 Plan authorized the reserve of 4,000,000 shares of the Company's common stock as stock reward to attract and retain personnel, provide additional incentives to employees, directors and consultants and promote the success of the Company's business. No awards have been granted under the 2018 Plan as of the date of this Report. In April 2020, the Board approved and authorized the preparation of Form S-8 to register the 4,000,000 shares of the Company's common stock subject to the 2018 Plan.

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

### Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements other than statements of historical fact are "forward-looking statements" for purposes of federal and state securities laws, including, but not limited to, any projections of earnings, revenue or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements concerning proposed new services or developments; any statements regarding future economic conditions of performance; and statements of belief; and any statements of assumptions underlying any of the foregoing. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

In some cases, you can identify forward looking statements by terms such as "may," "intend," "might," "will," "should," "could," "would," "expect," "believe," "anticipate," "estimate," "predict," "potential," or the negative of these terms. These terms and similar expressions are intended to identify forward-looking statements. The forward-looking statements in this report are based upon management's current expectations and belief, which management believes are reasonable. However, we cannot assess the impact of each factor on our business or the extent to which any factor or combination of factors, or factors we are aware of, may cause actual results to differ materially from those contained in any forward-looking statements. You are cautioned not to place undue reliance on any forward-looking statements. These statements represent our estimates and assumptions only as of the date of this report. Except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

- uncertainties relating to our ability to establish and operate our business and generate revenue;
- uncertainties relating to general economic, political and business conditions in China;
- industry trends and changes in demand for our products and services;
- uncertainties relating to customer plans and commitments and the timing of orders received from customers;
- announcements or changes in our advertising model and related pricing policies or that of our competitors;
- unanticipated delays in the development, market acceptance or installation of our products and services;
- changes in Chinese government regulations; and
- availability, terms and deployment of capital; relationships with third-party equipment suppliers;

## Overview

We are an emerging technology company in China engaged in (i) providing smart security solutions primarily to schools, scenic areas and public communities and (ii) developing education-related technologies. We leverage our proprietary technologies, intellectual property, innovative products and market intelligence to provide comprehensive and optimized security solutions and education-related technologies to our clients. We have been certified as one of the Zhongguancun High Tech Enterprises (issued by the Zhongguancun Science Park Administrative Committee) in recognition of our achievement in high technology products. Our security and technology engineers and experts create, design, build and run an intelligent 3D security system through visual and non-visual Perception algorithms, and hardware products such as face recognition cameras, Infra-red Emissions and smoke detectors.

Our mission is to offer products and services to users ranging from businesses to individuals. Empowered by data, our company strives to provide comprehensive smart security solutions applied in a variety of matters, such as campus safety and public space surveillance. Our customers include but are not limited to, schools, public communities, and scenic areas nationwide in China.

We have developed three smart security products: the safe campus security system, the scenic area security system, and the public community security system. As of the date of this report, the safe campus security system has entered the market and is used by many schools in China. Notwithstanding the impact of the COVID-19 outbreak, the the Company continues its work developing of safe campus security system continues. The scenic area security system is in the testing phase and is expected to enter the market during calendar year 2020. Our public community security system is also in the testing phase; we cannot provide an estimate when this system is expected to enter the market. For the time being, however, the Company has focused on developing a detection system designed to assist in monitoring and detecting effects of future outbreaks (discussed below), as a special version of the public community security system, and has already installed it across a large number of public communities.

We market and sell our smart security products, services and solutions to enterprises, institutions, families and individuals through our distributors and city partners. Although we have generated very little revenues to date, we expect to generate revenues from sales of software systems, installation of the systems, including its software and hardware, upgrades of hardware, and support and maintenance services.

In addition, as a value-added service to our safe campus security system, we develop and offer education-related technologies to build campus networks, education management systems, education cloud platforms, science education platform and other education systems used in schools. We expect to generate revenues from sales of software sales, installation of the systems, including software and hardware, and supporting and maintenance services.

We were incorporated in the State of Nevada on September 26, 2014 under the name Rose Rock Inc. and changed its name to Datasea Inc. on May 27, 2015 by amending its articles of incorporation. On December 21, 2018, we completed a registered, underwritten initial public offering and concurrent listing of our common stock on the NASDAQ Capital Market, which offering generated gross proceeds of \$6.7 million before deducting underwriter's commissions and other offering costs, resulting in net proceeds of approximately \$5.7 million, of which \$1,000,000 was placed in an escrow account and subsequently released to the Company of \$400,000. We sold 1,667,500 shares of common stock (including shares issued pursuant to the underwriter's over-allotment option) at an offering price of \$4 per share. In connection with the offering, our common stock began trading on the NASDAQ Capital Market beginning on December 19, 2018 under the symbol "DTSS." In addition, we issued warrants to the representative of the underwriters to purchase 101,500 shares of common stock at an exercise price of \$6.00 per share. These warrants may be purchased in cash or via cashless exercise, will be exercisable for five years from December 21, 2018 through December 17, 2023.

In December 2019, a novel strain of coronavirus (COVID-19) was reported in China, upon which the World Health Organization has declared the outbreak to constitute a "Public Health Emergency of International Concern." During the period from January to March 2020, the Company's marketing and business developments efforts have been materially adversely affected since, among other reasons, the Company's employees were not able to return to our offices to resume their duties. The Company resumed its operations in April. As a recipient of the PRC government support programs intended to mitigate the adverse economic impact of the pandemic, the Company expects that its business operations would recover and not be materially affected going forward. Its intelligent security platform has enabled the Company's R&D team to continue working in online mode during the pandemic, which the Company believes would facilitate and support the Company's recovery. In addition, the Company believes its efforts to move its functions online were sufficiently prompt and effective to minimize adverse effects on the Company's financial reporting and internal control over financing reporting systems. The Company does not anticipate any impairments of its assets. However, the Company expects that the impact of the COVID-19 outbreak on the United States and world economies may have a material adverse affect on the demand for the Company's services. We currently believe that our financial resources will be adequate to see us through the outbreak. However, in the event that the pandemic continues on for a significantly longer period of time, we may need to raise capital in the future.

### **Recent Business Developments**

On October 16, 2019, Shuhai Information Technology Co., Ltd. ("Shuhai Beijing"), our variable interest entity, incorporated a wholly owned subsidiary, Heilongjiang Xunrui Technology Co. Ltd., which to focus on research and development of new technologies and products.

On December 3, 2019, Shuhai Beijing formed Nanjing Shuhai Equity Investment Fund Management Co. Ltd. ("Shuhai Nanjing"), a joint venture in PRC, in which Shuhai Beijing holds a 99% ownership interest with the remaining 1% ownership held by Nanjing Fanhan Zhineng Technology Institute Co. Ltd, an unrelated party that was supported by both Nanjing Municipal Government and Beijing University of Posts and Telecommunications. Shuhai Nanjing was formed for purposes of easy access of government funding and private financing in new technology development and project incubation.

In January 2020, as described below, to expand our business operation, we acquired ownerships in three entities for no consideration from our management who set up such entities on the Company's behalf.

On January 3, 2020, Shuhai Beijing entered into two equity transfer agreements (the "Transfer Agreements") with Zhixin Liu, President of the Company, and Fu Liu, a Director of the Company (Fu Liu is the father of Zhixin Liu). Pursuant to the Transfer Agreements, Fu Liu and Zhixin Liu, each agreed, for no consideration, to (i) transfer their 51% and 49% ownership interest, respectively, in Guozhong Times (Beijing) Technology Ltd. ("Guozhong Times") to Shuhai Beijing; and (ii) transfer their 51% and 49% ownership interest, respectively, in Guohao Century (Beijing) Technology Ltd. ("Guohao Century") to Shuhai Beijing.

On January 7, 2020, Shuhai Beijing entered into another equity transfer agreement with Zhixin Liu, Fu Liu and Ze Liu, who is an unrelated third party. Pursuant to this equity transfer agreement, Fu Liu, Zhixin Liu and Ze Liu each agreed to transfer their 51%, 16%, 33% ownership interests, respectively, in Guozhong Haoze (Beijing) Technology Ltd. ("Guozhong Haoze") to Shuhai Beijing for no consideration.

Guozhong Times was formed to focus on collaborating with third parties as a means of expanding our business. Guohao Century was formed to explore potential business targets that we could acquire to improve our business model and product offerings. Guozhong Haoze was formed to further develop and market our smart security system products.

The accompanying unaudited condensed consolidated financial statements were prepared assuming the Company will continue as a going concern, which contemplates continuity of operations, realization of assets, and liquidation of liabilities in the normal course of business. For the nine months ended March 31, 2020 and 2019, we had a net loss of \$1.71 million and \$1.28 million, respectively. We had an accumulated deficit of \$7.26 million as of March 31, 2020. This raise substantial doubt about our ability to continue as a going concern. There can be no assurance that we will become profitable or obtain necessary financing for its business or that it will be able to continue in business.

We are currently seeking to modify its products and software to assist schools and communities in addressing the coronavirus outbreak, providing potential monitoring and control tools for possible future outbreaks. Namely, Datasea has completed Installation of Epidemic Prevention and Control Systems in several K-12 schools and public communities. Its system includes a data-based management platform and the front-end equipment, 7-inch facial recognition and temperature measurement terminals and the security turnstiles. These systems have 3 core functions: non-contact and accurate temperature measurement, mask recognition and face comparison. In addition, these systems can be seamlessly integrated with the Company's safe campus security system to record students' arrival and departure and issue various notices.

The company expanded its market partners to facilitate market development. Among them, Heqin Company works for marketing and promoting the sale of Face Recognition Payment Processing equipment and other products of the Company including Epidemic Prevention and Control Systems. In addition, the Company has newly established two sales teams for promoting school clients and smart city project expansion.

## Results of Operations

### Comparison of the nine months ended March 31, 2020 and 2019

The following table sets forth the results of our operations for the periods indicated as a percentage of net sales. Certain columns may not add due to rounding.

	<u>2020</u>	<u>% of Sales</u>	<u>2019</u>	<u>% of Sales</u>
Sales	\$ -		\$ -	
Cost of goods sold	-	-%	-	-%
Gross profit	-	-%		-%
Selling expenses	142,605	-%	183,240	-%
Research and development	229,511	-%	133,103	-
General and administrative expenses	1,373,837	-%	1,013,136	-%
Operating expenses	1,745,953	-%	1,329,479	-%
Loss from operations	(1,745,953)	-%	(1,329,479)	-%
Non-operating income, net	40,196	-%	44,543	-%
Loss before income taxes	(1,705,757)	-%	(1,284,936)	-%
Income tax expense	-	-%	-	-%
Net loss	<u>\$ (1,705,757)</u>	<u>-%</u>	<u>(1,284,936)</u>	<u>-%</u>

### Revenue

We did not generate any revenue for the nine months ended March 31, 2020 and 2019.

On March 5, 2018, we entered into separate agreements with two sales agents. Pursuant to the agreements, we authorized the agents to market the Company's Safe Campus Management System. The term of the agreements is for five years and will expire on March 6, 2023 and July 1, 2023, respectively. In accordance with ASU 2016-08, Principal versus Agent Considerations (ASC 606), we determined that it was the principal in these two contracts and as such, we recorded the payments received from the two sales agents as advances. We will recognize revenue from these contracts as the sales agents sell the products and services to third parties. As of March 31, 2020, we had \$1.28 million advances from the sales agents.

As of March 31, 2020, Guozhong Times has received 33 purchase orders from development and construction companies from Anhui and Fujian province, China for customized hardware and software solutions to detect and control the novel coronavirus outbreak in public areas. Datasea's systems sold in these orders are utilized in 33 public places, including campuses, shopping malls, scenic areas, residential areas and factory areas. The value of a single purchase order ranges from \$1,620 to \$2,620 (RMB 11,500 to RMB 18,600). The total value of the 33 agreements is \$84,000 (RMB 596,520). Pursuant to the purchase orders, customers shall pay the full amount within 15 days after the purchase order is signed. As of March 30, 2020, Guozhong Times has received \$69,500 (RMB493,500).

### Cost of Goods

We recorded \$0 of cost of goods sold for both the nine months ended March 31, 2020 and 2019.

### Gross Profit

The gross profit for the nine months ended March 31, 2020 and 2019 were \$0.

### Selling, General and Administrative Expenses

Selling expenses were \$142,605 and \$183,240 for the nine months March 31, 2020 and 2019, respectively, a decrease of \$40,635 or 22%. The decrease in selling expenses was primarily attributed to a decrease in salary expenses by \$43,803 of Shuhai Beijing, which was partly offset by increased travel expense by \$1,912 and meal and entertainment by \$1,932 of Shuhai Beijing.

As we are currently modifying our products and software to assist schools and communities in addressing the coronavirus outbreak, providing possible remedy and prevention for the future outbreak, and expanding the artificial intelligence application and products, we incurred increased research and development expenses by \$96,408 or 72%, we had \$229,511 and \$133,103 R&D expense during the nine months ended March 31, 2020 and 2019, respectively. The increase was mainly from increased salary expense by \$58,000 as a result of hiring more staffs in research and development department, and other related expenses by \$30,000.

General and administration expenses increased \$360,701, or 36% from \$1,013,136 during the nine months ended March 31, 2019 to \$1,373,837 during the same period in 2020. The increases were attributed to increases in rent expenses by \$101,188, and increased professional fee by \$247,825.

*Non-operating income, net*

Non-operating income were \$40,196 and \$44,543 for the nine months ended March 31, 2020 and 2019. For the nine months ended March 31, 2020, we had interest income \$43,828 and other expense \$3,632. For the nine months ended March 31, 2019, we had interest income \$47,114 and other expense \$2,571.

*Net Loss*

Due to our lack of revenue, we generated net losses of \$1,705,757 and \$1,284,936 for the nine months ended March 31, 2020 and 2019, respectively, the increased net loss mainly due to increased operating expense as describe above.

*Comparison of the three months ended March 31, 2020 and 2019*

The following table sets forth the results of our operations for the periods indicated as a percentage of net sales. Certain columns may not add due to rounding.

	<u>2020</u>	<u>% of Sales</u>	<u>2019</u>	<u>% of Sales</u>
Sales	\$ -		\$ -	
Cost of goods sold	-	-%	-	-%
Gross profit	-	-%	-	-%
Selling expenses	33,284	-%	34,388	-%
Research and development	109,146	-%	29,218	-
General and administrative expenses	428,227	-%	510,983	-%
Operating expenses	570,657	-%	574,589	-%
Loss from operations	(570,657)	-%	(574,589)	-%
Non-operating income	12,918	-%	33,590	-%
Loss before income taxes	(557,739)	-%	(540,999)	-%
Income tax expense	-	-%	-	-%
Net loss	<u>\$ (557,739)</u>	<u>-%</u>	<u>(540,999)</u>	<u>-%</u>

*Revenue*

We did not generate any revenue for the three months ended March 31, 2020 and 2019.

On March 5, 2018, we entered into separate agreements with two sales agents. Pursuant to the agreements, we authorized the agents to market the Company's Safe Campus Management System. The term of the agreements is for five years and will expire on March 6, 2023 and July 1, 2023, respectively. In accordance with ASU 2016-08, Principal versus Agent Considerations (ASC 606), we determined that it was the principal in these two contracts and as such, we recorded the payments received from the two sales agents as advances. We will recognize revenue from these contracts as the sales agents sell the products and services to third parties. As of March 31, 2020, we had \$1.28 million advances from the sales agents.

As of March 31, 2020, Guozhong Times has received 33 purchase orders from development and construction companies from Anhui and Fujian province, China for customized hardware and software solutions to detect and control the novel coronavirus outbreak in public areas. Datasea's systems sold in these orders are utilized in 33 public places, including campuses, shopping malls, scenic areas, residential areas and factory areas. The value of a single purchase order ranges from \$1,620 to \$2,620 (RMB 11,500 to RMB 18,600). The total value of the 33 agreements is \$84,000 (RMB 596,520). Pursuant to the purchase orders, customers shall pay the full amount within 15 days after the purchase order is signed. As of March 30, 2020, Guozhong Times has received \$69,500 (RMB493,500).

*Cost of Goods*

We recorded \$0 of cost of goods sold for both the three months ended March 31, 2020 and 2019.

*Gross Profit*

The gross profit for the three months ended March 31, 2020 and 2019 were \$0.

*Selling, General and Administrative Expenses*

Selling expenses were \$33,284 and \$34,388 for the three months March 31, 2020 and 2019, respectively, a slight decrease of \$1,104 or 3%. The decrease in selling expenses was primarily attributed to a decrease in salary expenses by \$2,450 of Shuhai Beijing, which was partly offset by increased travel expense by \$1,336 of Shuhai Beijing.

As we are developing the new products like Epidemic Prevention and Control Systems for schools and communities, which are featuring non-contact temperature measurement, mask recognition and facial comparison, and other artificial intelligence application and products like face-recognition payment processing products, we incurred increased R&D expense of \$79,928 or 274%; we had research and development expenses of \$109,146 and \$29,218 during the three months ended March 31, 2020 and 2019, respectively. The increase was attributed to the increase in salary expense by \$65,471 as a result of hiring more staffs in research and development department, and other related research expense by \$14,000.

General and administration expenses decreased \$82,756, or 16% from \$510,983 during the three months ended March 31, 2019 to \$428,227 during the same period in 2020. As our R&D expense increased significantly, we tried our best to cost control on other general and administrative expenses to keep our overall operating expenses under the budget.

#### *Non-operating income, net*

Non-operating income were \$12,918 and \$33,590 for the three months ended March 31, 2020 and 2019, respectively. For the three months ended March 31, 2020, we had interest income \$10,134 and other income \$2,784. For the three months ended March 31, 2019, we had interest income \$32,696 and other income \$894.

#### *Net Loss*

Due to our lack of revenue, we generated net losses of \$557,739 and \$540,999 for the three months ended March 31, 2020 and 2019, respectively. The slight increase in net loss mainly due to decreased non-operating income as describe above.

### **Liquidity and Capital Resources**

We have funded our operations to date primarily through the sale of our common stock and shareholder loans. Our management recognizes that we must generate sales and additional cash resources in order for our Company to continue our operations. Based on increased demand for security services in China, our management believes in the potential for growth in our business. In addition, following our December 2018 IPO, we received net proceeds \$5.7 million, which, we expect, along with expected growth in revenue, we will sufficient cash resources for our operations for the next 12 months from this report date.

We expect to generate revenue through expanding our current Safe Campus business, promoting Epidemic Prevention and Control Systems, scenic area and public community security products, and other artificial intelligence application and products such as face recognition products, and through continuous product innovation and development. If revenues are not generated or do not reach the level anticipated in our plan, in order to maintain working capital sufficient to support our operations and finance the future growth of its business, we expect to fund any cash flow shortfall through financial support from our majority stockholders (who are also our board members or officers) and public or private issuance of securities. However, such additional cash resources may not be available to us on desirable terms, or at all, if and when needed by us.

As of March 31, 2020, we had a working capital of \$1,510,925 (or a current liquidity ratio of 1.78:1). Our current assets on March 31, 2020 were \$3,446,007. As of June 30, 2019, we had a working capital of \$4,568,461 excluding the restricted cash of \$600,000 (or current liquidity ratio of 3.71:1). Our current assets on June 30, 2019 were \$6,251,863 excluding the restricted cash of \$600,000, which will be released to the Company following the termination of the Indemnification Escrow Agreement originally executed in connection with our 2019 IPO.

The following is a summary of cash provided by or used in each of the indicated types of activities during the nine months ended March 31, 2020 and 2019, respectively.

	<u>2020</u>	<u>2019</u>
Net cash used in operating activities	\$ (2,285,214)	\$ (1,289,063)
Net cash used in investing activities	\$ (1,648,333)	\$ (64,531)
Net cash provided by (used in) financing activities	\$ (85,901)	\$ 5,534,355

#### *Cash Flow from Operating Activities*

Net cash used in operating activities was \$2,285,214 during the nine months ended March 31, 2020, comparing with net cash used in operating activities of \$1,289,063 during the nine months ended March 31, 2019, an increase of cash outflow by \$996,151. The increase in cash outflow was mainly due to increased net loss by \$420,821, increased cash outflow on inventory by \$204,465, increased cash outflow on prepaid expenses by \$406,116, and increased cash outflow on taxes payable by \$105,098, despite we had cash inflow from account payable by \$34,500 and cash inflow from advance from customers by \$83,889.

#### *Cash Flow from Investing Activities*

Net cash used in investing activities totaled \$1,648,333 for the nine months ended March 31, 2020, which primarily related to cash paid for the acquisition of office furniture and equipment of \$248,333, and for intangible assets of \$1,400,000. Net cash used in investing activities totaled \$64,531 for the nine months ended March 31, 2019, which primarily related to cash paid for the acquisition of office furniture, equipment and patents.



### *Cash Flow from Financing Activities*

Net cash used in financing activities was \$85,091 during the nine months ended March 31, 2019, which primarily consisted of repayment of a shareholder loan of \$85,091. Net cash provided by financing activities was \$5,534,355 during the nine months ended March 31, 2019, which primarily consisted of repayment of a shareholder loan of \$15,392, net proceeds from issuance of our Common Stock of \$308,858, and net proceeds from our public offering of \$5,840,889, which is offset by \$600,000 which is currently held in escrow.

### **Off-Balance Sheet Arrangements**

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

This item is not applicable as we are currently considered a smaller reporting company.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

As required by Rule 13a-15 of the Securities Exchange Act of 1934, our principal executive officer and principal financial officer evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that as of the end of the period covered by this report, these disclosure controls and procedures were not effective to ensure that the information required to be disclosed by us in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and to ensure that such information is accumulated and communicated to our company's management, including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

The conclusion that our disclosure controls and procedures were not effective was due to the following material weaknesses in internal control over financial reporting: (i) inadequate segregation of duties and effective risk assessment; (ii) lack of personnel adequately trained in U.S. GAAP; and (iii) insufficient written policies and procedures for accounting and financial reporting with respect to the requirements and application of both U.S. GAAP and SEC guidelines. Management anticipates that such disclosure controls and procedures will not be effective until the above material weaknesses are remediated.

In order to remediate the foregoing weaknesses, the Company has undertaken the following steps:

- Adopted internal control policies, including, but not limited to, budget approval process, procurement and assets control, cash flow control, travel allowance, reimbursement, credit control, internal auditing and a cost accounting, review of the accounting professional duties and responsibilities handbook.
- Established an internal audit department led by the director of internal audit and a legal team to ensure proper compliance and risk management, training internal staff such as financial department, marketing department and senior management team.
- Established international department to enhance the compliance and financing management in the international capital markets.
- Engaged a new China-based legal counsel to strengthen the Company's operational compliance across markets in China.

We plan to take these and additional steps to enhance and improve the design of our internal controls over financial reporting and to further implement the following measures in the fiscal year ending June 30, 2020 to remediate the material weaknesses identified, subject to obtaining additional financing, including, appointing additional qualified personnel to address inadequate segregation of duties and ineffective risk management, and adopting sufficient written policies and procedures for accounting and financial reporting. The remediation efforts set out above are largely dependent upon our generating more revenue or raising additional capital to cover the costs of implementing the changes required.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake.

***Changes in Internal Control over Financial Reporting***

There were no changes in our internal control over financial reporting during the quarter ended March 31, 2020 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

None.

### ITEM 1A. RISK FACTORS

For information regarding factors that could affect our results of operations, financial condition and liquidity, refer to the section entitled “Risk Factors” in Part I, Item 1A in our Annual Report on Form 10-K for the most recently completed fiscal year. Except as updated below, there have been no material changes from the risk factors previously disclosed in such Annual Report.

*The COVID-19 pandemic may have material adverse impact on the Company and its operations.*

In December 2019, a novel strain of coronavirus (COVID-19) was reported in China, upon which the World Health Organization has declared the outbreak to constitute a “Public Health Emergency of International Concern.” During the period from January to March 2020, the Company’s marketing and business developments efforts have been materially adversely affected since, among other reasons, the Company’s employees were not able to return to our offices to resume their duties. As the Company resumed in its operations in April, it is expected that its business operations would not be materially affected, particularly in light of the fact that the Company has been the recipient of the PRC government support programs intended to mitigate the economic impact of the pandemic. Its intelligent security platform has enabled the Company’s R&D team to continue working in online mode during the pandemic, which the Company believes would support the Company’s recovery. In addition, the Company believes its efforts to move its functions online were sufficiently prompt and effective to minimize any adverse effect on the Company’s financial reporting and internal control over financing reporting systems. Presently, the Company does not anticipate any impairments of its assets. It is also possible that the outbreak will cause additional disruptions to the Company’s operations and prospects. The Company may incur significant delays, reductions in revenue and increases in expenses relating to such events outside of its control. Moreover, the Company anticipates that the impact of the COVID-19 outbreak on the United States and world economies might have a material adverse affect on the demand for the Company’s services. We currently believe that our financial resources will be adequate to see us through the outbreak. In the event that we do need to raise capital in the future, the outbreak-related instability in the securities markets could affect our ability to raise additional capital.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

### ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

### ITEM 5. OTHER INFORMATION

As previously disclosed, effective January 10, 2020, Wei, Wei & Co., LLP (“WWC”) voluntarily resigned as independent registered public accounting firm of the Company. WWC’s reports on the Company’s financial statements for the fiscal years ended June 30, 2019 and 2018 did not contain an adverse opinion or a disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope, or accounting principle. For the fiscal years ended June 30, 2019 and 2018 and during the subsequent interim periods through the date of this report, there were no disagreements (as that term is defined in Item 304(a)(1)(iv) of Regulation S-K) between the Company and WWC on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of WWC, would have caused WWC to make reference to the subject matter of the disagreements in connection with WWC’s report on the Company’s financial statements for such fiscal year. For the fiscal years ended June 30, 2019 and 2018 and during the subsequent interim periods through the date of this report, there were no reportable events (as defined in Item 304(a)(1)(v) of Regulation S-K).

On January 14, 2020, the Audit Committee of the Company’s Board of Directors appointed Morison Cogen LLP (“Morison”) as the Company’s new independent registered public accounting firm, effective immediately. For the fiscal years ended June 30, 2019 and 2018 and during the subsequent interim periods through January 10, 2020, neither the Company nor anyone acting on behalf of the Company had consulted Morison regarding either: (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company’s financial

statements, nor did Morison provide a written report or oral advice to the Company that Morison concluded was an important factor considered by the Company in reaching a decision as to the accounting, auditing or financial reporting issues; or (ii) any matter that was either the subject of a disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions) or a reportable event (as described in Item 304(a)(1)(v) of Regulation S-K).

**ITEM 6. EXHIBITS.**

<b>Exhibit</b>	<b>Description</b>
16.1	<a href="#">Letter of Wei, Wei &amp; Co., LLP, dated January 16, 2020 (1)</a>
31.1*	<a href="#">Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302</a>
31.2*	<a href="#">Certification by Chief Financial Officer pursuant to Sarbanes Oxley Section 302</a>
32.1*	<a href="#">Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350</a>
101.INS *	XBRL Instance 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

\* Filed herewith.

(1) Incorporated by reference from the Company's Current Report on Form 8-K filed with the SEC on January 16, 2020.

## SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**DATASEA INC.**

Date: May 14, 2020

By: /s/ Zhixin Liu  
Name: Zhixin Liu  
Title: Chief Executive Officer (*principal executive officer*)

Date: May 14, 2020

By: /s/ Jijin Zhang  
Name: Jijin Zhang  
Title: Chief Financial Officer (*principal accounting officer*)