

BARFRESH FOOD GROUP INC.
Form 10-Q
August 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

or

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

For the transition period from _____ to _____

Commission File Number: **000-55131**

BARFRESH FOOD GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware **27-1994406**
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

8530 Wilshire Blvd., Suite 450, Beverly Hills, California **90211**
(Address of principal executive offices) (Zip Code)

310-598-7113

(Registrant’s telephone number, including area code)

Not Applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer (do not check if Smaller Reporting Company)
Emerging Growth Company

Smaller Reporting Company

[X]

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 [X] No

As of August 8, 2018, there were 120,756,547 outstanding shares of common stock of the registrant.

TABLE OF CONTENTS

	Page Number
<u>PART I - FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements.</u>	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	14
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk.</u>	21
Item 4. <u>Controls and Procedures.</u>	21
<u>PART II - OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings.</u>	22
Item 1A. <u>Risk Factors.</u>	22
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	22
Item 3. <u>Defaults Upon Senior Securities.</u>	22
Item 4. <u>Mine Safety Disclosures.</u>	22
Item 5. <u>Other Information.</u>	22
Item 6. <u>Exhibits.</u>	22
<u>SIGNATURES</u>	23

PART I - FINANCIAL INFORMATION**Item 1. Financial Statements.**

Barfresh Food Group Inc.

Condensed Consolidated Balance Sheets

	June 30, 2018 (Unaudited)	December 31, 2017 (Audited)
Assets		
Current assets:		
Cash	\$853,868	\$1,304,916
Accounts Receivable	486,318	301,012
Inventory	1,418,321	1,415,495
Prepaid expenses and other current assets	42,895	24,496
Total current assets	2,801,402	3,045,919
Property, plant and equipment, net of depreciation	2,170,924	1,760,890
Intangible asset, net of amortization	561,200	586,943
Deposits	39,369	39,369
Total Assets	\$5,572,895	\$5,433,121
Liabilities And Stockholders' Equity		
Current liabilities:		
Accounts payable	\$598,922	\$421,176
Accrued expenses	1,105,110	849,529
Deferred rent liability	-	495
Notes Payable	250,000	-
Total current liabilities	1,954,032	1,271,200
Long term liabilities:		
Accrued Interest	78,672	-
Convertible note - related party, net of discount	590,665	-
Convertible note, net of discount	1,261,952	-
Derivative Liabilities	886,883	-
Total liabilities	4,772,204	1,271,200
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, \$0.000001 par value, 5,000,000 shares authorized, none issued or outstanding	-	-
Common stock, \$0.000001 par value; 300,000,000 shares authorized; 119,572,513 and 118,690,527 shares issued and outstanding at June 30, 2018 and December 31, 2017,	120	119

respectively

Additional paid in capital	38,785,245	37,992,799
Accumulated deficit	(37,984,674)	(33,830,997)
Total stockholders' equity	800,691	4,161,921
Total Liabilities and Stockholders' Equity	\$5,572,895	\$5,433,121

See the accompanying notes to the condensed consolidated financial statements

Barfresh Food Group Inc.

Condensed Consolidated Statements of Operations

For the three and six months ended June 30, 2018 and 2017

(Unaudited)

	For the three months ended		For the six months ended	
	June 30, 2018	2017	June 30, 2018	2017
Revenue	\$1,086,166	\$628,997	\$1,709,237	\$941,167
Cost of revenue	519,688	306,877	798,154	488,526
Gross profit	566,478	322,120	911,083	452,641
Operating expenses:				
General and administrative	2,229,262	2,403,293	4,323,925	4,836,823
Depreciation and Amortization	149,623	76,570	262,090	132,601
Total operating expenses	2,378,885	2,479,863	4,586,015	4,969,424
Operating loss	(1,812,407)	(2,157,743)	(3,674,932)	(4,516,783)
Other (income)/expenses				
(Gain)/loss from derivative liability	(196,841)	-	247,896	-
Interest	199,220	-	230,096	-
Total other expense	2,379	-	477,992	-
Net (loss)	\$(1,814,786)	\$(2,157,743)	\$(4,152,924)	\$(4,516,783)
Per share information - basic and fully diluted:				
Weighted average shares outstanding	119,009,293	117,732,465	118,845,319	117,493,592
Net (loss) per share	\$(0.02)	\$(0.02)	\$(0.03)	\$(0.04)

See the accompanying notes to the condensed consolidated financial statements

Barfresh Food Group Inc.

Condensed Consolidated Statements of Cash Flows

For the six months ended June 30, 2018 and 2017

(Unaudited)

	2018	2017
Net Cash (used for) Operating Activities	(2,732,466)	(3,293,056)
Investing Activities		
Purchase of property and equipment	(678,287)	(219,655)
Proceeds from sale of equipment	37,968	-
Purchase of Intangibles	(6,062)	(5,434)
Net Cash (used for) Investing Activities	(646,381)	(225,089)
Financing Activities		
Exercise of Warrant	-	35,400
Issuance of short term notes	250,000	-
Issuance costs of convertible notes	(27,001)	-
Issuance of convertible notes	2,704,800	-
Repayment of long term debt	-	(1,920)
Net Cash from Financing Activities	2,927,799	33,480
Net Change in Cash and Cash Equivalents	(451,048)	(3,484,665)
Cash and Cash Equivalents, Beginning of Year	1,304,916	9,180,947
Cash and Cash Equivalents, End of Year	\$853,868	\$5,696,282
Non Cash		
Discount on convertible notes (warrants & derivative)	966,989	-

See the accompanying notes to the condensed consolidated financial statements

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

Note 1. Basis of Presentation and Significant Accounting Policies

Throughout this report, the terms “our”, “we”, “us” and the “Company” refer to Barfresh Food Group Inc., including its subsidiaries. The accompanying unaudited condensed consolidated financial statements of Barfresh Food Group Inc. at June 30, 2018 and December 31, 2017 have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial statements, instructions to Form 10-Q, and Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2017. In management’s opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation to make our financial statements not misleading have been included. The results of operations for the periods ended June 30, 2018 and 2017 presented are not necessarily indicative of the results to be expected for the full year. The December 31, 2017 balance sheet has been derived from our audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2017.

Basis of Consolidation

The condensed consolidated financial statements include the financial statements of the Company and our wholly owned subsidiaries Barfresh Inc. and Barfresh Corporation, Inc.

Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses during the years reported. Actual results may differ from these estimates.

Concentration of Credit Risk

The amount of cash on deposit with financial institutions exceeds the \$250,000 federally insured limit at June 30, 2018 and December 31, 2017. However, we believe that the financial institution where the cash on deposit that exceeds \$250,000 is financially sound and the risk of loss is minimal.

Fair Value Measurement

Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 820, *Fair Value Measurements and Disclosures* (“ASC 820”), provides a comprehensive framework for measuring fair value and expands disclosures which are required about fair value measurements. Specifically, ASC 820 sets forth a definition of fair value and establishes a hierarchy prioritizing the inputs to valuation techniques, giving the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable value inputs. ASC 820 defines the hierarchy as follows:

Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reported date. The types of assets and liabilities included in Level 1 are highly liquid and actively traded instruments with quoted prices, such as equities listed on the New York Stock Exchange.

Level 2 - Pricing inputs are other than quoted prices in active markets, but are either directly or indirectly observable as of the reported date. The types of assets and liabilities in Level 2 are typically either comparable to actively traded securities or contracts or priced with models using highly observable inputs.

Level 3 - Significant inputs to pricing that are unobservable as of the reporting date. The types of assets and liabilities included in Level 3 are those with inputs requiring significant management judgment or estimation, such as complex and subjective models and forecasts used to determine the fair value of financial transmission rights.

Our financial instruments consist of cash, accounts receivable, accounts payable, accrued expenses, notes payable, convertible notes and derivative liabilities. The carrying value of our financial instruments approximates fair value, except for the derivative liability in which carrying value is fair value.

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

Inventory

Inventory consists of finished goods and is carried at the lower of cost or net realizable value on a first in first out basis.

Intangible Assets

Intangible assets are comprised of patents, net of amortization, and trademarks. The patent costs are being amortized over the life of the patents, which is twenty years from the date of filing the patent applications. In accordance with ASC Topic 350 *Intangibles - Goodwill and Other* (“ASC 350”), the costs of internally developing other intangible assets, such as patents, are expensed as incurred. However, as allowed by ASC 350, legal fees and similar costs relating to patents have been capitalized. In accordance with ASC 350 legal costs related to trademarks have been capitalized. We have determined that trademarks have an indeterminable life and therefore are not being amortized.

Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment loss, if any. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. Leasehold improvements are being amortized over the shorter of the useful life of the asset or the lease term that includes any expected renewal periods deemed to be reasonably assured. The estimated useful lives used for financial statement purposes are:

Furniture and fixtures: 5 years

Equipment: 7 years

Leasehold improvements: 2 years

Vehicle: 5 years

Revenue Recognition

In accordance with ASC 606, Revenue from Contracts with Customers, revenue is recognized when a customer obtains ownership of promised goods. The Company adopted this standard at the beginning of fiscal year 2018, with no significant impact to its financial position or results of operations, using the modified retrospective method. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these goods. The Company applies the following five steps:

1) Identify the contract with a customer

A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party's rights, (ii) the contract has commercial substance and, (iii) the Company determines that collection of substantially all consideration for goods or services that are transferred is probable. For the Company, the contract is the approved sales order, which may also be supplemented by other agreements that formalize various terms and conditions with customers.

2) Identify the performance obligation in the contract

Performance obligations promised in a contract are identified based on the goods or that will be transferred to the customer. For the Company, this consists of the delivery of frozen beverages, which provide immediate benefit to the customer.

3) Determine the transaction price

The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods, and is generally stated on the approved sales order. Variable consideration, which typically includes volume-based rebates or discounts, are estimated utilizing the most likely amount method.

Allocate the transaction price to performance obligations in the contract Since our contracts contain a single performance obligation, delivery of frozen beverages, the transaction price is allocated to that single performance obligation.

5) Recognize Revenue when or as the Company satisfies a performance obligation

The Company recognizes revenue from the sale of frozen beverages when title and risk of loss passes and the customer accepts the goods, which generally occurs at delivery. Customer sales incentives such as volume-based rebates or discounts are treated as a reduction of sales at the time the sale is recognized. Shipping and handling costs are treated as fulfillment costs and presented in distribution, selling and administrative costs.

The company evaluated the requirement to disaggregate revenue, and concluded that substantially all of its revenue comes from a single product, frozen beverages.

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

Earnings per Share

We calculate net loss per share in accordance with ASC Topic 260, *Earnings per Share*. Basic net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding for the period, and diluted earnings per share is computed by including common stock equivalents outstanding for the period in the denominator. At June 30, 2018 and 2017 any equivalents would have been anti-dilutive as we had losses for the periods then ended.

Research and Development

Expenditures for research activities relating to product development and improvement are charged to expense as incurred. We incurred \$153,329 and \$226,002 for the three-month periods ended June 30, 2018 and 2017, respectively, and \$343,670 and \$340,603 for the six-month periods ended June 30, 2018 and 2017, respectively.

Rent Expense

We recognize rent expense on a straight-line basis over the reasonably assured lease term as defined in ASC Topic 840, *Leases* (“ASC 840”).

Derivative Liability

The Company evaluates its convertible instruments, options, warrants or other contracts to determine if those contracts or embedded components of those contracts qualify as derivatives to be separately accounted for under ASC Topic 815, “Derivatives and Hedging.” The result of this accounting treatment is that the fair value of any derivative is

marked-to-market each balance sheet date and recorded as a liability. In the event that the fair value is recorded as a liability, the change in fair value is recorded in the statement of operations as gain/loss from derivative liability. Upon conversion or exercise of a derivative instrument, the instrument is marked to fair value at the conversion date and then that fair value is reclassified to equity. We analyzed the derivative financial instruments in accordance with ASC 815. The objective is to provide guidance for determining whether an equity-linked financial instrument is indexed to an entity's own stock. This determination is needed for a scope exception which would enable a derivative instrument to be accounted for under the accrual method. The classification of a non-derivative instrument that falls within the scope of ASC 815-40-05 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" also hinges on whether the instrument is indexed to an entity's own stock. A non-derivative instrument that is not indexed to an entity's own stock cannot be classified as equity and must be accounted for as a liability. There is a two-step approach in determining whether an instrument or embedded feature is indexed to an entity's own stock. First, the instrument's contingent exercise provisions, if any, must be evaluated, followed by an evaluation of the instrument's settlement provisions. The Company utilized the fair value standard set forth by the Financial Accounting Standards Board, defined as the amount at which the assets (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Recent pronouncements

From time to time, new accounting pronouncements are issued that we adopt as of the specified effective date. We believe that the impact of recently issued standards not yet effective may have an impact on our results of operations and financial position.

In February 2016, the FASB issued ASU No. 2016-02, Leases, to improve financial reporting about leasing transactions. This ASU will require organizations that lease assets ("lessees") to recognize a lease liability and a right-of-use asset on its balance sheet for all leases with terms of more than twelve months. A lease liability is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and a right-of-use asset represents the lessee's right to use, or control use of, a specified asset for the lease term. The amendments in this ASU leaves the accounting for the organization that own the assets leased to the lessee ("lessor") largely unchanged except for targeted improvements to align it with the lessee accounting model and Topic 606, Revenue from Contracts with Customers.

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

The Company is in the initial stages of evaluating the effect of the standard on our financial statements and continue to evaluate the available transition methods. However, based on our initial evaluation, we do not expect there to be material changes to both our current and long-term lease liabilities and our fixed assets of our limited number of operating leases that will be converted to financing leases under the new guidance. The Company does not plan to adopt the standard until the interim period ended March 31, 2019.

Note 2. Property Plant and Equipment

Major classes of property and equipment at June 30, 2018 and December 31, 2017 consist of the following:

	2018	2017
Furniture and fixtures	\$1,524	\$1,524
Equipment	2,500,256	1,952,538
Leasehold Improvements	4,886	4,886
Vehicles	29,696	29,696
	2,536,362	1,988,644
Less: accumulated depreciation	(860,773)	(665,657)
	1,675,589	1,322,987
Equipment not yet placed in service	495,335	437,903
Property and equipment, net of depreciation	\$2,170,924	\$1,760,890

We recorded depreciation expense related to these assets of \$133,721 and \$61,172 for the three-month periods ended June 30, 2018 and 2017, respectively and \$230,285 and \$101,804 for the six months ended June 30, 2018 and 2017, respectively.

Note 3. Intangible Assets

As of June 30, 2018, intangible assets consist of patent costs of \$764,891, trademarks of \$94,915 and accumulated amortization of \$298,606.

As of December 31, 2017, intangible assets consist of patent costs of \$764,891, trademarks of \$88,853 and accumulated amortization of \$266,801.

The amounts carried on the balance sheet represent cost to acquire, legal fees and similar costs relating to the patents incurred by the Company. Amortization is calculated through the expiration date of the patent, which is December 2025. The amount charged to expenses for amortization of the patent costs was \$15,902 and \$15,398 for the three months ended June 30, 2018 and 2017, respectively, and \$31,805 and \$30,797 for the six months ended June 30, 2018 and 2017, respectively.

Estimated future amortization expense related to patents as of June 30, 2018, is as follows:

Years ending December 31,	Total Amortization
2018	31,805
2019	63,610
2020	63,610
2021	63,610
2022	63,610
Later years	180,040
	\$ 466,285

Note 4. Related Parties

As disclosed below in Note 6, members of management and directors invested in company's convertible notes; and in Note 7, members of management and directors have received shares of stock and options in exchange for services.

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

Note 5. Short-Term Notes Payable

In March 31, 2018, we closed an offering of \$250,000 in a short-term note payable. The short-term note bear 12% interest per annum with an original maturity date in September 2018 which subsequent to June 30, 2018 was extended to December 31, 2018.

Note 6. Convertible Notes

During the three months ended March 31, 2018, we closed an offering of \$2,527,500 in convertible notes, of which, management, directors and significant shareholders have invested \$810,000. The convertible notes bear 10% interest per annum and are due and payable on March 14, 2020. The notes are convertible at any time prior to the due date into our common stock at conversion price of \$0.88 per share or 85% of the average closing price of the common stock over the twenty consecutive trading days immediately preceding the date of note holders' election; but in no events lower than \$0.60 per share. In addition, the interest is convertible at any time prior to the due dates into our common stock at conversion price of 85% of the average closing price of the common stock over the twenty consecutive trading days immediately preceding the date of note holders' election; but in no event lower than \$0.60 per share. There were 1,331,583 warrants issued, in conjunction with the convertible note offering.

The fair value of the warrants, \$0.17 per share (\$220,548 in the aggregate), was calculated using the Black-Scholes option pricing model using the following assumptions.

Expected life	3
Volatility	54.816%
Risk Free interest rate	2.41 %
Dividend yield (on common stock)	-

During the three months ended June 30, 2018, we offered investors in our March 2018 Convertible Note (“Series CN Notes”) the opportunity to accelerate the issuance of certain warrants associated with the CN Notes. Pursuant to the acceleration offer, Series CN Notes investors who invested an additional 10% to 20% of the Series CN Note amount, immediately received an additional 25% warrant coverage on their initial CN Note investment, which would otherwise have been issued after one year. During the current quarter we closed the CN Note acceleration offer in the amount of \$177,300 in convertible notes, of which, management, directors and significant shareholders have invested \$30,000. The CN Note acceleration offer convertible notes bear 10% interest per annum and are due and payable on March 14, 2020. The notes are convertible at any time prior to the due date into our common stock at conversion price of \$0.88 per share or 85% of the average closing price of the common stock over the twenty consecutive trading days immediately preceding the date of note holders’ election; but in no events lower than \$0.60 per share. In addition, the interest is convertible at any time prior to the due dates into our common stock at conversion price of 85% of the average closing price of the common stock over the twenty consecutive trading days immediately preceding the date of note holders’ election; but in no events lower than \$0.60 per share. There were 937,373 warrants issued, in conjunction with the CN Note acceleration offer convertible note offering.

The fair value of the warrants, \$0.25 per share (\$235,519 in the aggregate), was calculated using the Black-Scholes option pricing model using the following assumptions.

Expected life	3
Volatility	55.49 %
Risk Free interest rate	2.45 %
Dividend yield (on common stock)	-

The value of \$105,199 was recorded as a debt discount related to the issuance of the warrants as using the fair value would cause the debt discount to exceed the gross proceeds received.

	June 30, 2018
Convertible notes	\$2,704,800
Less: Debt discount (warrant value)	(325,747)
Less: Debt discount (derivative value)	(638,988)
Less: Debt discount (issuance costs paid)	(27,000)
Add: Debt discount amortization	139,552
	\$1,852,617

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

Note 7. Derivative Liabilities

As discussed in Note 6, Convertible Notes, during the current quarter the Company issued Series CN Note acceleration offer convertible notes payable that provide variable conversion provisions. The conversion terms of the convertible notes are variable based on certain factors, such as the future price of the Company's common stock. The number of shares of common stock to be issued is based on the future price of the Company's common stock, therefore the number of shares of common stock issuable upon conversion of the promissory note is indeterminate.

The fair values of the Company's derivative liabilities are estimated at the issuance date and are revalued at each subsequent reporting date. The Company recognized a current derivative liability of \$569,587 at March 14, 2018 related to the Series CN Convertible notes and \$69,400 at April 11, 2018 related to the Series CN Notes Warrant Acceleration. The derivative liability was revalued at June 30, 2018 with a value of \$886,883. The change in fair value of the derivative liability resulted in a gain of \$196,841 for the three months ended June 30, 2018, and a loss of \$247,896 for the six months ended June 30, 2018, which has been reported as loss on fair value of derivative liability in the statements of operations.

The fair value of the derivative liability was calculated using the Black-Scholes opt model using the following assumptions.

	14-Mar-18	11-Apr-18	30-Jun-18		
Expected life	2	1.96	1.71		
Volatility	49	% 53.93	% 52.22	%	
Risk Free interest rate	2.41	% 2.32	% 2.52	%	
Dividend yield (on common stock)	-	-	-		

Reconciliation of the derivative liability measured at fair value on a recurring basis with the use of significant unobservable inputs (level 3) from December 31, 2017 to June 30, 2018:

December 31, 2017	\$-
Initial value - March 14, 2018	569,587
Initial value - April 11, 2018	69,400
Change in value	247,896
For the period ended June 30, 2018	\$ 886,883

The following table presents the Company's fair value hierarchy for applicable assets and liabilities measured at fair value as of June 30, 2018.

	Level 1	Level 2	Level 3	Total
Derivative Liability	\$ -	-	886,883	\$886,883

Note 8. Commitments and Contingencies

We lease office space under non-cancelable operating leases, which expires on March 31, 2019. The aggregate minimum requirements are as follows:

For years ending December 31,	
2018	86,926
2019	43,462
	\$130,388

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

Note 9. Stockholders' Equity

During the three months ended June 30, 2018, we issued 782,821 shares of common stock, of which 675,000 shares of common stock was issued in pursuant of executive employee contract, and 109,065 shares was issued related to employee stock options.

The following is a summary of outstanding stock options issued to employees and directors as of June 30, 2018:

	Number of Options	Exercise price per share \$	Average remaining term in years	Aggregate intrinsic value at date of grant \$
Outstanding December 31, 2017	6,715,419	0.45 – 0.87	5.69	-
Issued	109,065	0.50 – 0.50	7.80	
Cancelled	(743,516)	0.50 – 0.81		
Exercised	-			
Outstanding, June 30, 2018	6,080,968	0.45 – 0.87	5.51	-
Exercisable, June 30, 2018	3,478,350	0.40 - 0.87	4.71	-

Note 10. Outstanding Warrants

The following is a summary of all outstanding warrants as of June 30, 2018:

	Number of warrants	price per share	remaining term in years	intrinsic value at date of grant
Warrants issued in connection with private placements of common stock	23,189,808	\$ 0.50 - \$1.00	2.33	\$-
Warrants issued in connection with private placement of notes	2,626,667	\$ 0.45 - \$1.00	1.51	\$64,583
Warrants issued in connection with convertible note	2,261,915	\$ 0.60 - \$0.88	2.71	\$-

Note 11. Income Taxes

We account for income taxes in interim periods in accordance with ASC Topic 740, Income Taxes (“ASC 740”). We have determined an estimated annual effective tax rate. The rate will be revised, if necessary, as of the end of each successive interim period during our fiscal year to our best current estimate. As of June 30, 2018, the estimated effective tax rate for the year will be zero.

There are open statutes of limitations for taxing authorities in federal and state jurisdictions to audit our tax returns from 2009 through the current period. Our policy is to account for income tax related interest and penalties in income tax expense in the statement of operations. There have been no income tax related interest or penalties assessed or recorded.

ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This pronouncement also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

For the six-month periods ended June 30, 2018 and 2017, we did not have any interest and penalties associated with tax positions. As of June 30, 2018, we did not have any significant unrecognized uncertain tax positions.

Barfresh Food Group Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2018

(Unaudited)

Note 12. Liquidity

We have a history of operating losses and negative cash flow. As our operations grow, we expect to experience significant increases in our working capital requirements. These conditions raise substantial doubt over the Company's ability to meet all of its obligations over the twelve months following the filing of this Form 10-Q. Management has evaluated these conditions, and concluded that current plans will alleviate this concern. We have significantly reduced core operating costs beginning in 2016, including reducing the number of our employees from 44 to 28 over this time period. After the end of the second quarter of 2018, we eliminated an additional three full time sales positions. During the first six months of 2018, we have entered into numerous contracts in the educational and military channels, which will result in increased revenue over the coming quarters. In addition, we have addressed this concern by raising additional capital through a loan or loans, and by continuing to reduce core operating expenses as required. In addition, we plan to raise additional capital through additional loans, and to further reduce core operating expenses as required. While some of these plans have not yet been implemented, management has concluded that it is probable that all of these plans can be implemented within one year of the issuance of the financial statements, and that they will mitigate the substantial doubt of our ability to continue as a going concern. However, the Company cannot predict, with certainty, the outcome of its action to generate liquidity, including the availability of additional financing, or whether such actions would generate the expect liquidity as planned.

Note 13. Subsequent Events

Management has evaluated all activity and concluded that no subsequent events have occurred that would require recognition in the financial statements or disclosure in the notes to the financial statements.

After the close of the second quarter, we extended the exercise date on warrants that were scheduled to expire by July 26, 2018. As part of the warrant extension transaction, the company received a cash warrant exercise amount of \$550,000, and the Company issued 1,100,000 shares of common stock to the warrant holder, at an exercise price of .50 cents a share. The Company extended the maturity date on the holder's remaining 1,800,000 by three years, adjusted the exercise price of those warrants to .53 cents, and converted those warrants into cash only warrants. In addition, the Company used \$50,000 of those proceeds to repay \$50,000 of the short term note payable, and the note

holder agreed to extend the maturity date of the note from September 12, 2018 to December 31 2018.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the financial information included elsewhere in this Quarterly Report on Form 10-Q (this “Report”), including our unaudited condensed consolidated financial statements and the related notes. References in this Management’s Discussion and Analysis of Financial Condition and Results of Operations section to “us”, “we”, “our” and similar terms refer to Barfresh Food Group Inc. This discussion includes forward-looking statements, as that term is defined in the federal securities laws, based upon current expectations that involve risks and uncertainties, such as plans, objectives, expectations and intentions. Actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of a number of factors. Words such as “anticipate”, “estimate”, “plan”, “continuing”, “ongoing”, “expect”, “believe”, “intend”, “may”, “will” and similar expressions are used to identify forward-looking statements.

We caution you that these statements are not guarantees of future performance or events and are subject to a number of uncertainties, risks and other influences, many of which are beyond our control, which may influence the accuracy of the statements and the projections upon which the statements are based. Any one or more of these uncertainties, risks and other influences could materially affect our results of operations and whether forward-looking statements made by us ultimately prove to be accurate. Our actual results, performance and achievements could differ materially from those expressed or implied in these forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether from new information, future events or otherwise.

Barfresh is a leader in the creation, manufacturing and distribution of ready to blend frozen beverages. The current portfolio of products includes smoothies, shakes and frappes. Products are packaged in two distinct formats. The Company’s original single serve format features portion controlled and ready to blend beverage ingredient packs or “beverage packs”. The beverage packs contain all of the solid ingredients necessary to make the beverage, including the base (either sorbet, frozen yogurt or ice cream), real fruit pieces, juices and ice – five ounces of water are added before blending.

The Company’s bulk “Easy Pour” format also contains all of the solid ingredients necessary to make the beverage, packaged in gallon containers in a concentrated formula that is mixed “one to one” with water. The Company has recently launched a “no sugar added” version of the bulk “Easy Pour” format that is specifically targeted for the USDA national school meal program, including the School Breakfast Program, the National School Lunch Program, and Smart Snacks in Schools Program. The Company’s bulk “Easy Pour” product is currently sold to more than 200 school locations throughout the United States. In addition, the Company recently received approval from the United States Defense Logistics Agency (“DLA”) to sell its smoothie products into all branches of the U.S. Armed Forces, and has begun to sell its bulk Easy Pour product into a number of military bases in the United States. The Company’s products are currently sold to more than 45 military locations throughout the United States.

Domestic and international patents and patents pending are owned by Barfresh, as well as related trademarks for all of the single serve products. Patent rights have been granted in 13 jurisdictions including the United States. In addition, the Company has purchased all of the trademarks related to the patented products.

The Company conducts sales through several channels, including National Accounts, Regional Accounts, and Broadline Distributors. Barfresh's primary broadline distribution arrangement is through an exclusive nationwide agreement with Sysco Corporation ("Sysco"), the U.S.'s largest broadline distributor, which was entered into during July 2014, and renewed for an additional two year term on October 2, 2017.

During 2016 and 2017 the Company announced that it had signed supply agreements with several of the major global on-site foodservice operators. On March 8, 2018, the Company announced that it had signed a new supply agreement with one of the largest of these foodservice operators, for exclusive distribution of four of Barfresh's single serve sku's to approximately one thousand food service locations. Distribution of product to these locations through SYSCO began during April of 2018. This new agreement, which marks the culmination of successful in market tests conducted at several locations, and makes Barfresh's blended beverages available across many of the most attractive locations of the customer's diverse customer base.

The Company also sells to broadline distributors that supply products to the food services market place. Effective July 2, 2014, the Company entered into an exclusive agreement with Sysco Merchandising and Supply Chain Services, Inc. for resale by the Sysco Corporation ("Sysco") to the foodservice industry of the Company's ready-to-blend single serve smoothies, shakes and frappes. Pursuant to that agreement, all Barfresh products are included in Sysco's national core selection of beverage items, making Barfresh its exclusive single-serve, pre-portioned beverage provider. The agreement is mutually exclusive; however, Barfresh may also sell the products to other foodservice distributors, but only to the extent required for such foodservice distributors to service multi-unit chain operators with at least 20 units and where Sysco is not such multi- unit chain operator's nominated distributor for our products. On October 2, 2017, the Sysco agreement was extended for an additional two year period, and expanded to cover bulk easy pour products, on a non-exclusive basis.

On October 26, 2015, Barfresh signed a five year agreement with PepsiCo North America Beverages, a division of PepsiCo, to become its exclusive sales representative within the food service channel to present Barfresh's line of ready-to-blend smoothies and frozen beverages throughout the United States and Canada. Through this agreement, Barfresh' products are included as part of PepsiCo's offerings to its significant customer base. The agreement facilitates access to potential National customer accounts, through introductions provided by PepsiCo's one-thousand plus person foodservice sales team. Barfresh products have become part of PepsiCo's customer presentations at national trade shows and similar venues.

Barfresh utilizes contract manufacturers to manufacture all of the products in the United States. Production lines are currently operational at two locations. The first location is in Salt Lake City, which currently produces both bulk easy pour and single serve products. Annual production capacity with this contract manufacturer is 14 million units per year. The second location is with Yarnell Operations, LLC., a subsidiary of Shulze and Burch, located in Arkansas. The Yarnell's agreement, which was signed during February, 2016, and secures the capacity to ramp up to an incremental production capacity of 100 million units. Yarnell's location enhances the company's ability to efficiently move product throughout the supply chain to destinations in the eastern United States, home to many of the country's large foodservice outlets.

During November, 2016, the Company received an equity investment from Unibel, the majority shareholder of the Bel Group ("Unibel"). The Bel Group is headquartered in Paris, France, with global operations in 33 countries, 30 production sites on 4 continents and nearly 12,000 employees. Its many branded products, including The Laughing Cow®, Mini Babybel® and Boursin®, are sold in over 130 countries around the world. Pursuant to the securities purchase agreement, Unibel purchased 15,625,000 shares of common stock at \$0.64 per share ("Shares") and warrants to purchase 7,812,500 shares of common stock ("Warrants") for aggregate gross proceeds to Barfresh of \$10 million. The Warrants are exercisable for a term of five years at a per share price of \$.88 for cash. Pursuant to the Investor Rights agreement, Barfresh has registered the Shares and the Warrants, and Unibel was granted a seat on the Barfresh Board. This strategic investment provided Barfresh with necessary capital while leveraging Unibel's more than 150 years of industrial expertise, innovative capabilities, world-class marketing and branding expertise to accelerate our growth in new and existing markets and product channels.

On February 14, 2018, we announced the private placement of convertible notes with the potential of gross proceeds up of \$4.1 million. The closing shall be no later than five (5) business days after receipt of notice from the Company that it has achieved certain milestones establishing significant sales to national accounts. One milestone is that the Company shall have entered into a material agreement or series of related agreements with a national account for the sale of its products into approximately 1,000 new locations. The first milestone was achieved on March 8, 2018, and according to the terms of the note the Company has received 60% of the principal amount. The remaining 40% of the principal amount will be received upon achieving a second milestone, which is entering into a material agreement or series of related agreements with a national account for the sale of its products into approximately 2,500 new locations.

The convertible notes are unsecured and have (i) a two-year term, (ii) a 10% annual coupon to be paid in cash or stock at the Company's discretion at a conversion price equal to 85% of the average closing bid prices of the Common Stock over the twenty (20) consecutive trading day period immediately preceding the payment date, but in no event lower than sixty cents (\$0.60) per share of Common Stock. The investor's may elect to convert their principal into common stock at a conversion price equal to the lower of: (i) \$0.88 per share of Common Stock, or (ii) 85% of the average closing bid prices of the Common Stock over the twenty (20) consecutive trading day period immediately preceding the date of investor's election to convert; but in no event lower than \$0.60 per share of Common Stock. Investors also received warrant coverage of 25% of the number of shares that would be issuable upon a full conversion of the principal amount at an average of the twenty consecutive trading day period immediately preceding the applicable closing date. If any principal amount remains outstanding after the one-year anniversary of the closing, investors will be granted an additional warrant with identical terms. The warrants are exercisable for a period of three years for cash at the greater of 120% of the closing price or \$0.70 per share of common stock. After the initial private placement, investors were offered the opportunity to accelerate the issuance of the additional warrant by increasing their convertible note investment by 10% to 20%. After the close of the first quarter, a number of investors took advantage of this acceleration opportunity, resulting in an increase in the amount of the total convertible note by \$ 177,300 and the issuance of 937,373 additional warrants.

Currently we have 25 employees and 3 consultants. There are currently 15 employees and 1 consultant selling our products.

Critical Accounting Policies

Our financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP").

Revenue Recognition

In accordance with ASC 606, Revenue from Contracts with Customers, revenue is recognized when a customer obtains ownership of promised goods. The Company adopted this standard at the beginning of fiscal year 2018, with no significant impact to its financial position or results of operations, using the modified retrospective method. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these goods. The Company applies the following five steps:

1) Identify the contract with a customer

A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party's rights, (ii) the contract has commercial substance and, (iii) the Company determines that collection of substantially all consideration for goods or services that are transferred is probable. For the Company, the contract is the approved sales order, which may also be supplemented by other agreements that formalize various terms and conditions with customers.

2) Identify the performance obligation in the contract

Performance obligations promised in a contract are identified based on the goods or that will be transferred to the customer. For the Company, this consists of the delivery of frozen beverages, which provide immediate benefit to the customer.

3) Determine the transaction price

The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods, and is generally stated on the approved sales order. Variable consideration, which typically includes volume-based rebates or discounts, are estimated utilizing the most likely amount method.

4) Allocate the transaction price to performance obligations in the contract

Since our contracts contain a single performance obligation, delivery of frozen beverages, the transaction price is allocated to that single performance obligation.

5) Recognize Revenue when or as the Company satisfies a performance obligation

The Company recognizes revenue from the sale of frozen beverages when title and risk of loss passes and the customer accepts the goods, which generally occurs at delivery. Customer sales incentives such as volume-based rebates or discounts are treated as a reduction of sales at the time the sale is recognized. Shipping and handling costs are treated as fulfillment costs and presented in distribution, selling and administrative costs.

The company evaluated the requirement to disaggregate revenue, and concluded that substantially all of its revenue comes from a single product, frozen beverages.

Impairments

We periodically evaluate whether the carrying value of long-lived assets has been impaired when circumstances indicate the carrying value of those assets may not be recoverable. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the carrying value is not recoverable, the impairment loss is measured as the excess of the asset's carrying value over its fair value.

Share-based Compensation

We account for share-based employee compensation plans under the fair value recognition and measurement provisions in accordance with applicable accounting standards, which require all share-based payments to employees, including grants of stock options and restricted stock units (RSUs), to be measured based on the grant date fair value of the awards, with the resulting expense generally recognized on a straight-line basis over the period during which the employee is required to perform service in exchange for the award.

Derivative Liability

The Company evaluates its convertible instruments, options, warrants or other contracts to determine if those contracts or embedded components of those contracts qualify as derivatives to be separately accounted for under ASC Topic 815, "Derivatives and Hedging." The result of this accounting treatment is that the fair value of any derivative is marked-to-market each balance sheet date and recorded as a liability. In the event that the fair value is recorded as a liability, the change in fair value is recorded in the statement of operations as gain/loss from derivative liability. Upon conversion or exercise of a derivative instrument, the instrument is marked to fair value at the conversion date and then that fair value is reclassified to equity. We analyzed the derivative financial instruments in accordance with ASC 815. The objective is to provide guidance for determining whether an equity-linked financial instrument is indexed to an entity's own stock. This determination is needed for a scope exception which would enable a derivative instrument to be accounted for under the accrual method. The classification of a non-derivative instrument that falls within the scope of ASC 815-40-05 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" also hinges on whether the instrument is indexed to an entity's own stock. A non-derivative instrument that is not indexed to an entity's own stock cannot be classified as equity and must be accounted for as a liability. There is a two-step approach in determining whether an instrument or embedded feature is indexed to an entity's own stock. First, the instrument's contingent exercise provisions, if any, must be evaluated, followed by an evaluation of the instrument's settlement provisions. The Company utilized the fair value standard set forth by the Financial Accounting Standards Board, defined as the amount at which the assets (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Results of Operations

Results of Operation for Three Months Ended June 30, 2018 as Compared to the Three Months Ended June 30, 2017

Revenue and cost of revenue

Revenue increased \$457,169 (73%) from \$628,997 in 2017 to \$1,086,166 in 2018. The increase in revenue is primarily the result of the rollout of our new bulk Easy Pour product which began during the first quarter of 2017 and has continued to gain momentum during the balance of 2018, especially in the school and Military channels. Our product continues to be distributed through all 72 of Sysco's U.S. mainland distribution centers, as well as through new customers beyond the Sysco distribution network.

Cost of revenue for 2018 was \$519,688 as compared to \$306,877 in 2017. Our gross profit was \$566,478 (52.2%) and \$322,120 (51.2%) for 2018 and 2017, respectively. The strong gross profit margin is attributable to a number factors, including leverage due to larger scale of production and product mix. We anticipate that our gross profit percentage for the remainder of 2018 will be approximately 50%.

Operating expenses

Our operations were primarily directed towards increasing sales and expanding our distribution network.

Our general and administrative expenses decreased \$174,031 (7%) from \$2,403,293 in the second quarter of 2017 to \$2,229,262 in the second quarter of 2018, with the improvement primarily driven by lower personnel expenses resulting from the ongoing realignment of our sales force. The following is a breakdown of our general and administrative expenses for the three months ended June 30, 2018 and 2017:

three	three
months	months
ended	ended

Edgar Filing: BARFRESH FOOD GROUP INC. - Form 10-Q

	June 30, 2018	June 30, 2017	Difference
Personnel costs	\$839,866	\$998,798	\$(158,930)
Stock based compensation/options	117,670	272,036	(154,366)
Legal and professional fees	132,353	143,218	(10,865)
Travel	127,312	135,539	(8,227)
Rent	46,677	33,557	13,120
Marketing and selling	305,634	146,584	159,050
Consulting fees	17,925	47,556	(29,631)
Director fees	50,000	18,796	31,204
Research and development	153,329	226,002	(72,673)
Shipping and Storage	293,274	169,115	124,159
Other expenses	145,222	212,092	(66,870)
	\$2,229,262	\$2,403,293	\$(174,031)

Personnel cost represents the cost of employees including salaries, bonuses, employee benefits and employment taxes and continues to be our largest cost. Personnel cost decreased \$158,930 (16%) from \$998,798 to \$839,868. During the fourth quarters of 2016 and 2017, we realigned our sales force to a more efficient model, by increasing the number of dedicated sales brokers that represent our products, and reducing the number of sales force employees. When taking into consideration start dates for new employees, and separation dates for those employees who left our workforce, we had 43 full time employees during 2016, and at June 30, 2018 we had 28 full time employees. We expect these restructurings to result in estimated annualized savings of \$2.2 to \$2.7 million. After the close of the second quarter 2018, we eliminated three additional positions in our sales force, resulting in approximately \$300,000 of additional annualized savings.

Stock based compensation is used as an incentive to attract new employees and to compensate existing employees. Stock based compensation includes stock issued and options granted to employees and non-employees. Stock compensation for the current quarter was \$117,670, a decrease of \$154,366, or 57%, from the year ago quarter expense of \$272,036. The decrease is primarily due to the reductions in our work force and the timing of equity grants. The Company issues additional stock options to its employees from time to time under its Equity Compensation Plan.

Legal and professional fees decreased \$10,865 (8%) from \$143,218 in 2017 to \$132,353 in 2018. The decrease was primarily due to a timing of legal services required. We anticipate legal fees related to our business and financing activities to increase as our business continues to grow.

Travel expenses decreased \$8,227 (6%) from \$135,539 in 2017 to \$127,312 in 2018. The decrease is primarily due to reduction in travel costs associated with terminated employees. We anticipate that quarterly travel expenses for the balance of this year will be about \$15,000 lower than the current quarter due to the additional work force reduction that occurred after the close of the second quarter.

Rent expense is primarily for our location in Beverly Hills, California. Rent expense for the Beverly Hills office is approximately \$14,488 per month. We lease office space at 8383 Wilshire Boulevard, Beverly Hills, California pursuant to a new lease that commenced on November 1, 2016 and expires March 31, 2019.

Marketing and selling expenses increased \$159,050 (109%) from \$146,584 in 2017 to \$305,634 in 2018. Higher marketing and selling expenses were primarily due to higher sales agent commissions associated with higher sales during the quarter.

Consulting fees were \$17,925 in 2018, as compared with \$47,556 in 2017. Our consulting fees vary based on needs. We engaged consultants in the areas of sales and operations during the quarter. The need for future consulting services will be variable.

Director fees increased \$31,204 from \$18,796 in 2017 to \$50,000 in 2018. Annual director fees are anticipated at \$50,000 per non-employee director.

Research and development expenses decreased \$72,673, (32%) from \$226,002 in 2017 to \$153,329 in 2018. These expenses relate to the services performed by our Director of Manufacturing and Product Development, and consultants

supporting that employee. The reduction in research and development expense was primarily driven by lower commissioning expense at manufacturing facilities in the current quarter, as our manufacturing processes have continued to mature.

Shipping and storage expense increased \$124,159 (73%) from \$169,115 in 2017 to \$293,794 in 2018. Shipping and storage expense as a percentage of revenue was comparable at 27% in both 2017 and in 2018. We anticipate that shipping and storage expense as a percentage of sales will reduce during the balance of the year, as the Company is able to take advantage of more efficient distribution arrangements.

Other expenses consist of ordinary operating expenses such as investor relations, office, telephone, insurance, and stock related costs. We anticipate these expenses to be comparable for the balance of the year.

We had operating losses of \$1,812,407 and \$2,157,743 for the three month periods ended June 30, 2018 and 2017, respectively. The improvement of \$345,336, or 16%, was primarily due to higher gross profit margin on higher sales, and lower G&A expenses.

Interest expense for the three months ended June 30, 2018 is \$199,220. Interest relates to convertible debt in the amount of \$2,527,500 that was issued on March 14, 2018, which bears interest at 10%, and to a note payable in the amount of \$250,000 that was issued on March 5, 2018, which bears interest at 12%, and to acceleration notes in the amount of \$177,300, issued on April 11, 2018, which bear interest at 10%. Interest expense includes amortization of \$124,840 of the value of warrants issued with the convertible debt.

We had net losses of \$1,814,786 and \$2,157,743 in the three month periods ended June 30, 2018 and 2017.

Results of Operation for Six Months Ended June 30, 2018 as Compared to the Six Months Ended June 30, 2017

Revenue and cost of revenue

Revenue increased \$768,070 (82%) from \$941,167 in 2017 to \$1,709,237 in 2018. The increase in revenue is primarily the result of the rollout of our new bulk Easy Pour product which began during the first quarter of 2017 which has continued to gain momentum during the first half of 2018, especially in the school and Military channels. Our product continues to be distributed through all 72 of Sysco's U.S. mainland distribution centers, as well as through new customers beyond the Sysco distribution network.

Cost of revenue for 2018 was \$798,154 as compared to \$488,526 in 2017. Our gross profit was \$911,083 (53%) and \$452,641 (48%) for 2018 and 2017, respectively. We anticipate that our gross profit percentage for the remainder of 2018 will be approximately 50%.

Operating expenses

Our operations were primarily directed towards increasing sales and expanding our distribution network.

Our general and administrative expenses decreased \$512,898 (11%) from \$4,836,823 in the first half of 2017 to \$4,323,925 in the first half of 2018, with the improvement primarily driven by lower personnel expenses resulting from the realignment of our sales force. The following is a breakdown of our general and administrative expenses for the six months ended June 30, 2018 and 2017:

	six months ended June 30, 2018	six months ended June 30, 2017	Difference
Personnel costs	\$1,737,671	\$2,277,490	\$(539,819)
Stock based compensation/options	364,445	616,304	(251,859)
Legal and professional fees	239,724	256,232	(16,508)
Travel	211,160	228,400	(17,240)
Rent	100,583	87,798	12,785
Marketing and selling	466,014	265,242	200,772
Consulting fees	35,659	96,501	(60,842)
Director fees	112,500	56,296	56,204
Research and development	343,670	340,603	3,067
Shipping and Storage	459,345	233,269	226,076
Other expenses	253,154	378,688	(125,534)
	\$4,323,925	\$4,836,823	\$(512,898)

Personnel cost represents the cost of employees including salaries, bonuses, employee benefits and employment taxes and continues to be our largest cost. Personnel cost decreased \$539,819 (24%) from \$2,277,490 to \$1,737,671. During the fourth quarters of 2016 and 2017, we realigned our sales force to a more efficient model, by increasing the number of dedicated sales brokers that represent our products, and reducing the number of sales force employees. When taking into consideration start dates for new employees, and separation dates for those employees who left our workforce, we had 43 full time employees during 2016, and at June 30, 2018 we had 28 full time employees. We expect these restructurings to result in estimated annualized savings of \$2.2 to \$2.7 million. After the close of the second quarter 2018, we eliminated three additional positions in our sales force, resulting in approximately \$300,000 of additional annualized savings.

Stock based compensation is used as an incentive to attract new employees and to compensate existing employees. Stock based compensation includes stock issued and options granted to employees and non-employees. Stock compensation for the six months ended June 30, 2018 was \$364,445, a decrease of \$251,859, or 41%, from the year ago period expense of \$616,304. The decrease is primarily due to the reductions in our work force and the timing of equity grants. The Company issues additional stock options to its employees from time to time under its Equity Compensation Plan.

Legal and professional fees decreased \$16,508 (6%) from \$256,232 in 2017 to \$239,724 in 2018. The decrease was primarily due to a timing of legal services required. We anticipate legal fees related to our business and financing activities to increase as our business continues to grow.

Travel expenses decreased \$17,240 (8%) from \$228,400 in 2017 to \$211,160 in 2018. The decrease is primarily due to reduction in travel costs associated with terminated employees. We anticipate that travel expenses for the balance of this year will be about \$30,000 lower than the first half of this year due to the additional work force reduction.

Rent expense is primarily for our location in Beverly Hills, California. Rent expense for the Beverly Hills office is approximately \$14,488 per month. We lease office space at 8383 Wilshire Boulevard, Beverly Hills, California pursuant to a new lease that commenced on November 1, 2016 and expires March 31, 2019.

Marketing and selling expenses increased \$200,772 (76%) from \$265,242 in 2017 to \$466,014 in 2018. Higher marketing and selling expenses were primarily due to higher sales agent commissions associated with higher sales during the period.

Consulting fees were \$35,659 in 2018, as compared with \$96,501 in 2017. Our consulting fees vary based on needs. We engaged consultants in the areas of sales and operations during the period. The need for future consulting services will be variable.

Director fees increased \$56,204 from \$56,296 in 2017 to \$112,500 in 2018. Annual director fees are \$50,000 per non-employee director.

Research and development expenses increased \$3,067 (1%) from \$340,603 in 2017 to \$343,670 in 2018. These expenses relate to the services performed by our Director of Manufacturing and Product Development, consultants supporting that employee, and certain commissioning expenses at our contract manufacturing locations

Shipping and storage expense increased \$226,076 (97%) from \$233,269 in 2017 to \$459,345 in 2018. Shipping and storage expense as a percentage of revenue was comparable at 25% in 2017 and 27% in 2018. We anticipate that shipping and storage expense as a percentage of sales will reduce during the balance of the year, as the Company is able to take advantage of more efficient distribution arrangements.

Other expenses consist of ordinary operating expenses such as investor relations, office, telephone, insurance, and stock related costs. We anticipate these expenses to be comparable for the balance of the year.

We had operating losses of \$3,674,932 and \$4,516,783 for the six month periods ended June 30 2018 and 2017, respectively. The improvement of \$841,851, or 19%, was primarily due to higher gross margin percent on higher sales, and lower G&A expenses.

Interest expense for the six months ended June 30, 2018 was \$230,096. Interest relates to convertible debt in the amount of \$2,527,500 that was issued on March 14, 2018, which bears interest at 10%, and to a note payable in the amount of \$250,000 that was issued on March 5, 2018, which bears interest at 12%, and to acceleration notes in the amount of \$177,300, issued on April 11, 2018, which bear interest at 10%. Interest expense includes amortization of \$141,807 of the value of warrants issued with the convertible debt.

We had net losses of \$4,152,424 and \$4,516,783 in the six month periods ended June 30, 2018 and 2017.

Liquidity and Capital Resources

During the six months ended June 30, 2018, we used cash for operations of \$2,732,466, purchased equipment for \$678,287, and incurred spending for trademarks in the amount \$6,062. We raised cash from issuance of convertible notes, net of issuance cost, in the amount of \$2,677,799 plus we issued a short term note in the amount of \$250,000.

During the six months ended June 30, 2017, we used \$3,293,056 of cash for operations, \$219,655 for the purchase of equipment, and \$5,434 for trademarks.

After the close of the second quarter, we extended the exercise date on warrants that were scheduled to expire by July 26, 2018. As part of the warrant extension transaction, the company received a cash warrant exercise amount of \$550,000, and the Company issued 1,100,000 shares of common stock to the warrant holder, at an exercise price of .50 cents a share. The Company extended the maturity date on the holder's remaining 1,800,000 by three years, adjusted the exercise price of those warrants to .53 cents, and converted those warrants into cash only warrants. In addition, the Company used \$50,000 of those proceeds to repay \$50,000 of the short term note payable, and the note holder agreed to extend the maturity date of the note from September 12, 2018 to December 31 2018.

We have a history of operating losses and negative cash flow. As our operations grow, we expect to experience significant increases in our working capital requirements. These conditions raise substantial doubt over the Company's ability to meet all of its obligations over the twelve months following the filing of this Form 10-Q. Management has evaluated these conditions, and concluded that current plans will alleviate this concern. We have significantly reduced core operating costs beginning in 2016, including reducing the number of our employees from 44 to 28 over this time period. In addition, we plan to address this concern by raising additional capital through an additional loan or loans, and by continuing to reduce core operating expenses as required. While these plans have not yet been implemented, management has concluded that it is probable that they will be implemented within one year of the issuance of the financial statements, and that they will mitigate the substantial doubt of our ability to continue as a going concern. However, the Company cannot predict, with certainty, the outcome of its action to generate liquidity, including the availability of additional financing, or whether such actions would generate the expect liquidity as planned.

We lease office space under a non-cancelable operating lease, which expires March 31, 2019.

The aggregate minimum requirements under non-cancelable leases as of June 30, 2018 is \$130,388.

Off-Balance Sheet Arrangements

We have 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 or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to stockholders.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required because we are a smaller reporting company.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Accounting Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Securities and Exchange Act of 1934 Rules 13a-15(f). Based on this evaluation, our Chief Executive Officer and our Chief Accounting Officer concluded that the Company's disclosure controls and procedures were not effective as of June 30, 2018.

Management has identified the following material weaknesses in our internal control over financial reporting:

Inadequate Segregation of Duties: We have an inadequate number of personnel to properly implement internal controls over financial reporting.

Since the assessment of the effectiveness of our internal control over financial reporting did identify material weaknesses, management considers its internal control over financial reporting to be ineffective.

Management believes that the material weakness set forth above did not have an effect on our financial results.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the three months ended June 30, 2018 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.

Neither the Company nor its subsidiaries are party to or have property that is the subject of any material pending legal proceedings. We may be subject to ordinary legal proceedings incidental to our business from time to time that are not required to be disclosed under this Item 1.

Item 1A. Risk Factors.

Not required because we are a smaller reporting company.

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

The Company did not issue or sell any other unregistered equity securities during the period covered by this report that were not previously reported on a Current Report on Form 8-K.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit No.	Description
31.1	<u>Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u>
31.2	<u>Certification of Principal Accounting Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u>
32.1	<u>Certification of Principal Executive Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u>
32.2	<u>Certification of Principal Accounting Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)</u>

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

*XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

In accordance with SEC Release 33-8238, Exhibits 32.1 and 32.2 are furnished and not filed.

SIGNATURES

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

BARFRESH FOOD GROUP INC.

Date: August 14, 2018 By: */s/ Riccardo Delle Coste*
Riccardo Delle Coste

Chief Executive Officer

(Principal Executive Officer)

Date: August 14, 2018 By: */s/ Joseph S. Tesoriero*
Joseph S. Tesoriero
Chief Financial Officer

(Principal Financial Officer)

