

BARFRESH FOOD GROUP INC.
Form 10-Q
November 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 September 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

(State or other jurisdiction of
incorporation or organization)

27-1994406

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

8383 Wilshire Blvd., Suite 750, Beverly Hills, California

(Address of principal executive offices)

90211

(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)
Smaller Reporting Company 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

As of November 13, 2018, there were 120,756,812 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>	13
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk.</u>	20
Item 4. <u>Controls and Procedures.</u>	20
<u>PART II - OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings.</u>	21
Item 1A. <u>Risk Factors.</u>	21
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	21
Item 3. <u>Defaults Upon Senior Securities.</u>	21
Item 4. <u>Mine Safety Disclosures.</u>	21
Item 5. <u>Other Information.</u>	21
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

	September 30, 2018 (Unaudited)	December 31, 2017 (Audited)
Assets		
Current assets:		
Cash	\$316,014	\$1,304,916
Accounts Receivable	656,728	301,012
Inventory	1,082,665	1,415,495
Prepaid expenses and other current assets	95,111	24,496
Total current assets	2,150,518	3,045,919
Property, plant and equipment, net of depreciation	2,413,003	1,760,890
Intangible assets, net of amortization	545,558	586,943
Deposits	39,369	39,369
Total Assets	\$5,148,448	\$5,433,121
Liabilities And Stockholders' Equity		
Current liabilities:		
Accounts payable	\$718,633	\$421,176
Accrued expenses	1,224,427	849,529
Deferred rent liability	-	495
Notes Payable	200,000	-
Total current liabilities	2,143,060	1,271,200
Long term liabilities:		
Accrued Interest	162,941	-
Convertible note - related party, net of discount	613,095	-
Convertible note, net of discount	1,361,071	-
Derivative Liabilities	892,794	-
Total liabilities	5,172,961	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	-	-

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

Common stock, \$0.000001 par value; 300,000,000 shares authorized; 120,756,547 and 118,690,527 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	121	119
Additional paid in capital	39,859,625	37,992,799
Accumulated deficit	(39,884,259)	(33,830,997)
Total stockholders' equity	(24,513)	4,161,921
Total Liabilities and Stockholders' Equity	\$5,148,448	\$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 nine months ended September 30, 2018 and 2017

(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Revenue	\$1,620,214	\$679,952	\$3,329,451	\$1,621,119
Cost of revenue	723,719	334,376	1,521,873	822,902
Gross profit	896,495	345,576	1,807,578	798,217
Operating expenses:				
General and administrative	2,139,064	2,337,634	6,462,989	7,174,457
Depreciation and Amortization	164,602	93,975	426,692	226,576
Total operating expenses	2,303,666	2,431,609	6,889,681	7,401,033
Operating loss	(1,407,171)	(2,086,033)	(5,082,103)	(6,602,816)
Other (income)/expenses /loss from derivative liability	5,911	-	253,807	-
Warrant modification	290,300	-	290,300	-
Interest	196,201	-	426,297	-
Total other expense	492,412	-	970,404	-
Net (loss)	\$(1,899,583)	\$(2,086,033)	\$(6,052,507)	\$(6,602,816)
Per share information - basic and fully diluted:				
Weighted average shares outstanding	120,431,103	118,382,934	119,432,657	117,790,039
Net (loss) per share	\$(0.02)	\$(0.02)	\$(0.05)	\$(0.06)

See the accompanying notes to the condensed consolidated financial statements

Barfresh Food Group Inc.

Condensed Consolidated Statements of Cash Flows

For the nine months ended September 30, 2018 and 2017

(Unaudited)

	2018	2017
Net Cash (used for) Operating Activities	(3,536,246)	(5,224,812)
Investing Activities		
Purchase of property and equipment	(912,102)	(412,865)
Proceeds from sale of equipment	37,968	-
Purchase of Intangibles	(6,322)	(27,684)
Net Cash (used for) Investing Activities	(880,456)	(440,549)
Financing Activities		
Exercise of Warrant	550,000	35,400
Issuance of short term notes	250,000	-
Repayment of short term notes	(50,000)	-
Issuance costs of convertible notes	(27,000)	-
Issuance of convertible notes	2,704,800	-
Repayment of long term debt	-	(2,879)
Net Cash from Financing Activities	3,427,800	32,521
Net Change in Cash and Cash Equivalents	(988,902)	(5,632,840)
Cash and Cash Equivalents, Beginning of Year	1,304,916	9,180,947
Cash and Cash Equivalents, End of Year	\$316,014	\$3,548,107
Non Cash		
Discount on convertible notes (warrants & derivative)	964,734	-
Property, plant and equipment included in Accounts Payable	156,964	-

See the accompanying notes to the condensed consolidated financial statements

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 September 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 September 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 September 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.

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.

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 September 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 \$150,299 and \$107,324 for the three-month periods ended September 30, 2018 and 2017, respectively, and \$493,969 and \$447,927 for the nine-month periods ended September 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.

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 September 30, 2018 and December 31, 2017 consist of the following:

	2018	2017
Furniture and fixtures	\$1,524	\$1,524
Equipment	2,867,159	1,952,538
Leasehold Improvements	4,886	4,886
Vehicles	29,696	29,696
	2,903,266	1,988,644
Less: accumulated depreciation	(1,009,472)	(665,657)
	1,893,794	1,322,987
Equipment not yet placed in service	519,210	437,903
Property and equipment, net of depreciation	\$2,413,003	\$1,760,890

We recorded depreciation expense related to these assets of \$148,700 and \$78,576 for the three-month periods ended September 30, 2018 and 2017, respectively and \$378,985 and \$180,380 for the nine months ended September 30, 2018 and 2017, respectively.

Note 3. Intangible Assets

As of September 30, 2018, intangible assets consist of patent costs of \$764,891, trademarks of \$95,175 and accumulated amortization of \$314,508.

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 September 30, 2018 and 2017, respectively, and \$47,707 and \$46,196 for the nine months ended September 30, 2018 and 2017, respectively.

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

Years ending December 31,	Total Amortization
2018	15,903
2019	63,610
2020	63,610
2021	63,610
2022	63,610
Later years	180,040
	\$ 450,383

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.

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 bears 12% interest per annum with an original maturity date in September 2018 which was extended to December 31, 2018. During the three months ended September 30, 2018, the Company paid down \$50,000 of the short term note, the balance of the note payable is \$200,000.

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.

September
30, 2018

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

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	261,101
	\$1,974,166

Future maturity of convertible notes are as follow:

Years ending December 31,	Total Convertible Notes
2018	-
2019	-
2020	2,704,800
2021	-
2022	-
	\$2,704,800

Note 7. Derivative Liabilities

As discussed in Note 6, Convertible Notes, 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 September 30, 2018 with a value of \$892,794. The change in fair value of the derivative liability resulted in a loss of \$5,911 for the three months ended September 30, 2018, and a loss of \$253,807 for the nine months ended September 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-Sep-18
Expected life	2	1.96	1.45
Volatility	49 %	53.93 %	62.51 %
Risk Free interest rate	2.41 %	2.32 %	2.81 %
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 September 30, 2018:

December 31, 2017	\$-
Initial value - March 14, 2018	569,587
Initial value - April 11, 2018	69,400
Change in value	253,807
For the period ended September 30, 2018	\$892,794

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

	Level 1	Level 2	Level 3	Total
Derivative Liability	\$ -	-	892,794	\$892,794

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	43,463
2019	43,463
	\$86,926

Note 9. Stockholders' Equity

During the nine months ended September 30, 2018, we issued 183,240 shares of common stock, valued at \$100,000, and we issued 227,111 options to purchase our common stock to certain members of the Board of Directors in lieu of cash payments for Director fees. The exercise price of the options is \$0.50 per share, vesting is immediate, and they are exercisable for 8 years. In addition, we issued 1,305,000 options to purchase our common stock to employees and executives. The exercise price of the options ranged from \$0.52 per share, vest after 3 years, and are exercisable for periods of 8 years.

The fair value of the options was calculated using the Black-Sholes option pricing model, based on the criteria shown below.

Expected life (in years)	5.5 to 8
Volatility	59.82% to 69.87 %
Risk Free interest rate	2.78% to 2.82 %
Dividend yield (on common stock)	-

The shares of our common stock were valued at the trading price on the date of grant, \$0.39 and \$0.595 per share

During the same period, we cancelled 759,516 options to purchase our common stock.

The following is a summary of outstanding stock options issued to employees and directors as of September 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	1,532,111	0.50 – 0.50	7.55	
Cancelled	(759,516)	0.50 – 0.81		
Exercised	-			
Outstanding, September 30, 2018	7,488,014	0.45 – 0.87	5.75	-
Exercisable, September 30, 2018	3,596,396	0.40 - 0.87	4.56	-

As of September 30, 2018, the Company has \$1,440,039 of total unrecognized share-based compensation expense related to unvested options, which is expected to be amortized over the remaining weighted average period of 5.75 years.

The total amount of equity based compensation expense for the three-month periods ended September 30, 2018 and 2017 was \$209,082 and \$359,949, respectively, and for the nine-month period ended September 30, 2018 and 2017, was \$686,027 and \$1,032,549, respectively.

Note 10. Outstanding Warrants

The following is a summary of all outstanding warrants as of September 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	21,276,808	\$ 0.50 - \$1.00	2.54	\$-
Warrants issued in connection with private placement of notes	2,626,667	\$ 0.45 - \$1.00	1.25	\$64,583
Warrants issued in connection with convertible note	2,261,915	\$ 0.60 - \$0.88	2.45	\$-

During the three month period ended September 30, 2018 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. The warrant modification was revalued at July 31, 2018 with a value of \$452,308. The difference in fair value immediately before and after the modification of the warrant resulted in a loss of \$290,300.

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

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 24 over this time period. In addition, we plan to address this concern by raising additional capital. While these plans to raise additional capital 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 expected 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.

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”, “should”, “could” 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 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 is currently in contract to sell its bulk Easy Pour products into over 300 schools. In addition, the Company 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 is currently in contract to sell its bulk Easy Pour products into over fifty military bases in 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.

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 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 gross proceeds of \$4.1 million. The closing of the first 60% of this amount occurred between March 12 and 22, 2018, after notice was issued by the Company that it had 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 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 930,332 additional warrants.

Currently we have 24 employees and 2 consultants. There are currently 14 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 September 30, 2018 as Compared to the Three Months Ended September 30, 2017

Revenue and cost of revenue

Revenue increased \$940,262 (138%) from \$679,952 in 2017 to \$1,620,214 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 2018. Our products continue 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 \$723,219 as compared to \$334,376 in 2017. Our gross profit was \$896,495 (55.3%) and \$345,576 (50.8%) for 2018 and 2017, respectively. This improvement was driven by 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 comparable to the current quarter.

Operating expenses

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

Our general and administrative expenses decreased \$198,570 (8.5%) from \$2,337,634 in 2017 to \$2,139,064 in 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 three months ended September 30, 2018 and 2017:

	three months ended September 30, 2018	three months ended September 30, 2017	Difference
Personnel costs	\$724,101	\$998,886	\$(274,785)
Stock based compensation/options	134,082	259,949	(125,867)
Legal and professional fees	87,170	103,729	(16,559)
Travel	107,223	84,694	22,529
Rent	46,614	42,674	3,940
Marketing and selling	382,587	188,038	194,549
Consulting fees	17,450	58,870	(41,420)
Director fees	75,000	100,000	(25,000)
Research and development	150,299	107,324	42,975
Shipping and Storage	259,164	235,683	23,481
Other expenses	155,374	157,787	(2,413)
	\$2,139,064	\$2,337,634	\$(198,570)

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 \$274,785 (28%) from \$998,886 to \$724,101. 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 we currently have 24 full time employees.

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 \$134,082, a decrease of \$125,785, or 48%, from the year ago quarter

expense of \$259,949. The decrease is primarily due to reductions in our workforce 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 \$16,559 (16%) from \$103,729 in 2017 to \$87,170 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 increased \$22,529 (27%) from \$84,694 in 2017 to \$107,223 in 2018. The increase is primarily due to the net effect of the decrease in travel costs associated with terminated employees, offset by the increase in per employee travel costs as remaining employees have been asked to cover larger territories. We anticipate that travel expenses for the balance of this year will be comparable to the current 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 \$194,549 (103%) from \$188,038 in 2017 to \$382,587 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 \$17,450 in 2018, as compared with \$58,870 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 decreased \$25,000 from \$100,000 in 2017 to \$75,000 in 2018. Annual director fees are anticipated at \$50,000 per non-employee director.

Research and development expenses increased \$42,975, (40%) from \$107,324 in 2017 to \$150,299 in 2018. These expenses relate to the services performed by our Director of Manufacturing and Product Development, and consultants supporting that employee. These activities are primarily directed towards to development of new products.

Shipping and storage expense increased \$23,481 (10%) from \$235,683 in 2017 to \$259,164 in 2018. Shipping and storage expense as a percentage of revenue decreased from 35% in 2017 to 16% in 2018. This improvement is primarily due to the growth of the scale of our business, and the corresponding cost savings associated with freight movement. We anticipate that shipping and storage expense as a percentage of sales will continue to reduce during the balance of the year, as the Company continues 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 \$1,407,171 and \$2,086,033 for the three month periods ended September 30, 2018 and 2017, respectively. The improvement of \$678,862, or 32.5%, was primarily due to higher gross profit margin on higher sales, and lower G&A expenses.

Interest expense in the third quarter of 2018 is \$196,201. 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 \$200,000 that was issued on March 5, 2018, which bears interest at 12%. Interest expense includes amortization of \$121,508 of the value of warrants issued with the convertible debt.

The change in fair value of the derivative liability resulted in a loss of \$5,911 for the three months ended September 30, 2018, and the warrant modification expense was \$290,300.

We had net losses of \$1,899,583 and \$2,086,033 in the three month periods ended September 30, 2018 and 2017.

Results of Operation for Nine Months Ended September 30, 2018 as Compared to the Nine Months Ended September 30, 2017

Revenue and cost of revenue

Revenue increased \$1,708,372 (105%) from \$ 1,621,119 in 2017 to \$ 3,329,451 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 2018. Our products continue 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 \$ 1,521,873 as compared to \$ 822,902 in 2017. Our gross profit was \$ 1,807,578 (54.3%) and \$ 798,217 (49.2%) 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 during 2018 and 2017 were primarily directed towards increasing sales and expanding our distribution network.

Our general and administrative expenses decreased \$711,468 (10%) from \$7,174,457 in 2017 to \$6,462,989 in 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 nine months ended September 30, 2018 and 2017:

	nine months ended September 30, 2018	nine months ended September 30, 2017	Difference
Personnel costs	\$2,461,772	\$3,276,377	\$(814,605)
Stock based compensation/options	498,527	876,253	(377,726)
Legal and professional fees	326,894	359,961	(33,067)
Travel	318,383	313,094	5,289
Rent	147,197	130,472	16,725
Marketing and selling	848,601	453,280	395,321
Consulting fees	53,109	155,371	(102,262)
Director fees	187,500	156,296	31,204
Research and development	493,969	447,927	46,042
Shipping and Storage	718,509	468,952	249,557
Other expenses	408,528	536,474	(127,946)
	\$6,462,989	\$7,174,457	\$(711,468)

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 \$ 814,605 (24.9%) from \$3,276,377 to \$ 2,461,772. During 2016 and 2017, we affected restructurings of our sales force, whereby we eliminated full time sales positions, and replaced the associated sales territory coverage with brokerage arrangements. This change has allowed our remaining sales force to more effectively focus on pursuing larger accounts, while our expanded brokerage network will support and expand our “up and down the street” business.

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 first nine months of 2018 was \$ 498,527 a decrease of \$ 377,726, or 43%, as compared with the first nine months of 2017, which was \$876,523. The decrease in stock based compensation expense was primarily due to reductions in our workforce 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 \$ 33,067 (9.2%) from \$ 359,961 in 2017 to \$326,894 in 2018. We anticipate that legal fees related to our business and financing activities will increase as our business continues to grow.

Travel expenses increased \$ 5,289 (1.7%) from \$ 313,094 in 2017 to \$318,383 in 2018. The change is primarily due to the net effect of a reduction in travel costs associated with terminated employees, offset by an increase in per employee travel costs as remaining employees have been assigned larger territories. We anticipate that travel expenses for the balance of this year will be comparable to the quarterly expense for the first nine months of this year. .

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 have entered into a new lease for office space at 8383 Wilshire Boulevard, Beverly Hills, California. The new lease commenced on November 1, 2016 and expires March 31, 2019.

Marketing and selling expenses increased \$ 395,321 (87.2%) from \$ 453,280 in 2017 to \$ 848,601 in 2018. Higher marketing and selling expenses were primarily due to higher sales commissions associated with higher sales revenue.

Consulting fees decreased \$102,262 (65.8%) from \$ 155,371 in 2017 to \$53,109 in 2018. Our consulting fees vary based on needs. We engage consultants in the areas of sales, operations and accounting. The need for future consulting services will be variable

Director fees increased \$31,204 from \$156,296 in 2017 to \$187,500 in 2018. Annual director fees are anticipated at \$50,000 per non-employee director.

Research and development expenses increased \$46,042 (10.3%) from \$447,927 in 2017 to \$493,969 in 2018. The increase in Research and Development Expense is being driven by an increased need for research and development services, as we continue to expand product offerings, both for our standard SKU's, and for National Accounts, and commissioning costs at our third party production facility in Searcy, Arkansas.

Shipping and storage expense increased \$249,547 (53.2%) from \$468,952 in 2017 to \$718,509 in 2018. Shipping and storage expense as a percentage of revenue was 21.5% for the first nine months of 2018 and 28.9% for the first nine months of 2017. The higher expense in the first nine months of 2018 is primarily due to expansion of our business. We anticipate that shipping and storage expense as a percentage of sales will continue to 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 increases in certain of these expenses, as our business continues to grow.

We had operating losses of \$5,082,103 and \$6,602,816 for the nine month periods ended September 30, 2018 and 2017, respectively.

Interest expense was \$426,297 for the nine month period ended September 30, 2018. We did not have any interest expense for the nine month period ended September 30, 2017. Interest primarily relates to convertible debt that was issued during March of 2018. Interest expense includes amortization of \$263,356 of the value of warrants issued with the convertible debt.

The change in fair value of the derivative liability resulted in a loss of \$253,807 for the nine months ended September 30, 2018, and the warrant modification expense was \$290,300.

We had net losses of \$6,052,507 and \$6,602,816 in the nine month periods ended September 30, 2018 and 2017, respectively

Liquidity and Capital Resources

During the nine months ended September 30, 2018, we used cash for operations of \$3,536,246, purchased equipment for \$912,102, and incurred spending for trademarks in the amount \$6,322. Equipment purchased during the nine months ended September 30, 2018 includes blenders, freezers and bulk product blending machines, which are located at the end customer location. No manufacturing equipment was purchased during this period.

We raised cash from the exercise of warrants in the amount of \$550,000, and used \$50,000 of those proceeds to partially repay a short term note that had originally been issued in the amount of 250,000. We also raised cash from the issuance of convertible notes, net of issuance costs, in the amount of \$2,677,800.

During the nine months ended September 30, 2017, we used \$5,224,812 of cash for operations, \$412,865 for the purchase of equipment, and \$27,684 for trademarks. Equipment purchased during the nine months ended September 30, 2017 includes blenders, freezers and bulk product blending machines, which are located at the end customer location, as well as manufacturing equipment.

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 24 over this time period. In addition, we plan to address this concern by raising additional capital. While these plans to raise additional

capital 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 expected 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 September 30, 2018 is \$86,926.

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 September 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 September 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: November 14, 2018 By: */s/ Riccardo Delle Coste*
Riccardo Delle Coste

Chief Executive Officer

(Principal Executive Officer)

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

(Principal Financial Officer)

