Fresh Healthy Vending International, Inc.
Form 10-Q
February 17, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

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

For the quarterly period ended December 31, 2014

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 No. 333-177305

FRESH HEALTHY VENDING INTERNATIONAL, INC.
(Exact Name of Registrant as Specified in Its Charter)

Nevada	45-2511250
(State or Other Jurisdiction of Incorporation)	(IRS Employer Identification No.)

9605 Scranton Road, Suite 801, San Diego, CA 92121
(Address of Principal Executive Offices)

858-210-4200
(Registrant's Telephone Number, Including Area Code)

(Former Name or Former Address, 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 and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
[X] 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). [X] Yes [ ] No

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer (Do not check if a smaller reporting company) [ ]	Smaller reporting company [X]

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

APPLICABLE ONLY TO CORPORATE ISSUERS:
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Shares of Common Stock, par value $0.001, outstanding as of February 9, 2015: 26,660,789

FRESH HEALTHY VENDING INTERNATIONAL, INC.
Quarterly Report on Form 10-Q for the
Three and Six Months Ended December 31, 2014

TABLE OF CONTENTS

Table of Contents

Item 1. Financial Statements

FRESH HEALTHY VENDING INTERNATIONAL, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
December 31, 2014 and June 30, 2014

	December 31, 2014 (unaudited)	June 30, 2014 (audited)
Assets		
Current assets:		
Cash	$477,636	$607,288
Accounts receivable, net	1,836,052	2,022,317
Deferred costs	918,705	738,522
Inventories	364,858	182,162
Prepaid expenses and other current assets	30,003	17,570
Total current assets	3,627,254	3,567,859
Property and equipment:		
Cost	442,875	414,777
Less accumulated depreciation and amortization	(173,394)	(135,326)
	269,481	279,451
Deposits	30,067	40,067
Total assets	$3,926,802	$3,887,377
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable and accrued liabilities	$1,194,752	$1,034,112
Notes payable	-	507,666
Customer advances and deferred revenues	5,688,941	5,456,969
Provision for franchisee rescissions and refunds	769,000	530,923
Accrued personnel expenses	198,519	122,714
Deferred rent	10,431	19,422

Total current liabilities	7,861,643	7,671,806
Long-term debt - notes payable	757,666	-
Total liabilities	8,619,309	7,671,806
Contingencies (Note 5)		
Stockholders' deficit:		
Preferred stock; $0.001 par value; 25 million shares authorized; no shares issued and outstanding	-	-
Common stock; $0.001 par value; 100 million shares authorized; 26,659,769 outstanding (26,546,348 at June 30, 2014)	26,659	26,546
Additional paid-in capital	1,832,105	1,696,837
Accumulated deficit	(6,551,271)	(5,507,812)
Total stockholders' deficit	(4,692,507)	(3,784,429)
Total liabilities and stockholders' deficit	$3,926,802	$3,887,377

See accompanying notes to the condensed consolidated financial statements.

3

Table of Contents

FRESH HEALTHY VENDING INTERNATIONAL, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations - Unaudited

	For the three months ended December 31, 2014	For the three months ended December 31, 2013	For the six months ended December 31, 2014	For the six months ended December 31, 2013
Revenues:				
Vending machine sales, net	$988,361	$891,306	$2,622,940	$2,755,557
Franchise fees	84,183	54,000	223,943	131,500
Company owned machines	40,264	41,930	70,104	106,303
Agency sales (net)	12,214	28,895	29,818	45,152
Other	43,072	-	76,156	-
	1,168,094	1,016,131	3,022,961	3,038,512
Cost of Revenues	565,829	518,410	1,378,792	1,453,141
Gross margin	602,265	497,721	1,644,169	1,585,371
Operating expenses:				
Selling, general and administrative	1,404,553	998,660	2,650,719	2,293,195
Loss from operations	(802,288)	(500,939)	(1,006,550)	(707,824)
Other income (expense):				
Interest income (expense)	(16,032)	-	(31,287)	(1,984)
Accretion of discount on notes payable	26,224	-	-	(27,692)
Loss before provision for income taxes	(792,096)	(500,939)	(1,037,837)	(737,500)
Provision for income taxes	-	2,948	5,622	8,367
Net loss	$(792,096)	$(503,887)	$(1,043,459)	$(745,867)
Net loss per share - basic and diluted	$(0.03)	$(0.02)	$(0.04)	$(0.03)
Weighted average shares used in computing net loss per share - basic	26,628,746	25,311,358	26,609,964	25,232,942

See accompanying notes to the condensed consolidated financial statements.

FRESH HEALTHY VENDING INTERNATIONAL, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows - Unaudited
For the six months ended December 31, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Net loss	$(1,043,459)	$(745,867)
Adjustments to reconcile net loss to net cash flows used in operating activities:		
Depreciation and amortization	38,456	26,185
Interest accretion on notes payable	-	27,692
Stock-based compensation	135,381	185,727
Bad debt expense	7,500	-
Loss (gain) on sales of property and equipment	6,714	10,044
Deferred rent	(8,991)	(6,050)
Changes in operating assets and liabilities:		
Accounts receivable	178,765	(87,681)
Deferred costs	(180,183)	385,865
Inventories	(199,550)	(83,448)
Prepaid expenses and other assets	(12,433)	(5,185)
Deposits	10,000	2,227
Accounts payable and accrued liabilities	160,640	113,762
Customer advances and deferred revenues	231,972	(217,595)
Provision for franchisee rescissions and refunds	238,077	(345,720)
Accrued personnel expenses	75,805	(53,956)
Cash flows used in operating activities	(361,306)	(794,000)
Cash flows from investing activities:		
Purchases of property and equipment	(18,784)	(130,352)
Proceeds from sales of property and equipment	438	-
Cash flows used in investing activities	(18,346)	(130,352)
Cash flows from financing activities:		
Repayments of amounts due to related party	-	(32,538)
Proceeds from issuance of notes payable	250,000	191,000
Repayment of notes payable	-	(34,212)

Proceeds from issuance of common stock, net of costs	-	996,034
Cash flows provided by financing activities	250,000	1,120,284
Change in cash	(129,652)	195,932
Cash, beginning of period	607,288	252,845
Cash, end of period	$477,636	$448,777
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest expense	$21,239	$902
Income taxes	$-	$11,790
Supplemental disclosure of non-cash investing and financing activities:		
Conversion of notes payable into common stock	$-	$402,083

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

1. Organization and description of business

Fresh Healthy Vending International, Inc. (referred to herein collectively with its subsidiaries as "we", the "Company", "our Company", or "FHV International") operates through its wholly-owned subsidiaries, Fresh Healthy Vending LLC ("FHV LLC"), The Fresh and Healthy Vending Corporation, and FHV Acquisition Corp., as a franchisor and owner and operator of healthy drink and snack vending machines and micro markets that feature cashless payment devices and remote monitoring software. The Company uses in-house location specialists that are responsible for securing locations for its franchisees; additionally, the Company has negotiated discounts with a national product distribution chain. The Company also operates its own machines and micro markets.

Basis of accounting

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the rules and regulations of the Securities and Exchange Commission ("SEC") for reporting on Form 10-Q. Accordingly, these statements do not include all of the information and disclosures required by GAAP or SEC rules and regulations for complete financial statements. In the opinion of management, these financial statements reflect all adjustments (consisting solely of normal recurring matters) considered necessary for a fair presentation of the results for the interim periods presented. The results of operations for any interim period are not necessarily indicative of results for the full year.

These statements should be read in conjunction with the Company's filings with the SEC, including its most recent annual report on Form 10-K for the fiscal year ended June 30, 2014 filed on September 29, 2014.

Liquidity and capital resources

For the six months ended December 31, 2014 we had a net loss totaling $1,043,459 and negative cash flows from operations totaling $361,306. Our cash balance at December 31, 2014 was $477,636. Since the date of the closing of the FHV Acquisition, our sales were less than anticipated and the resulting cash flows from franchise sales was not sufficient to cover expenditures associated with our daily operations resulting in a substantial decrease in our cash balances. Also, we used cash on hand to retire liabilities associated with the franchise rescissions. As of the filing date of the Form 10-Q, our Company has consumed the vast majority of its available cash, including the cash proceeds from the sale of our common stock received in July of 2013 and the issuance of several debt instruments. In order to ensure sufficient liquidity for our continuing operations, we will require additional capital financing in the form of either debt or equity (or a combination thereof) financing. Management believes that it will be able to obtain such financing on terms acceptable to the Company, although there can be no assurance that we will be successful.

Our current plans include capital expenditures for the purchase of corporate owned and operated vending machines and micro markets, including the repurchase of machines from franchisees opting to rescind their franchise agreements. Given our current cash position, we may be forced to curtail our plans by delaying or suspending the purchase of machines for our corporate operations.

Principles of consolidation

The consolidated financial statements include the accounts of the Company, and its wholly-owned subsidiaries, FHV LLC, The Fresh and Healthy Vending Corporation, and FHV Acquisition, Corp. All significant intercompany accounts and transactions are eliminated.

Use of estimates

The preparation of our Company's financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our financial statements and the reported amounts of revenues, costs and expenses during the reporting period. Actual results could differ significantly from those estimates. Significant estimates include our provisions for bad debts, franchisee rescissions and refunds, legal estimates and the valuation allowance on deferred income tax assets. It is at least reasonably possible that a change in the estimates will occur in the near term.

Revenue recognition

Our primary revenue generating transactions come from the sale of franchises and vending machines to the franchisees. There are no franchise fees charged beyond the initial first year franchise fee. We receive ongoing fees and royalty payments in the form of annual advertising fees and a percentage of either franchisees' revenues or gross margins on vending machine sales.

We recognize revenues and associated costs in connection with franchises at the time that we have substantially performed or satisfied all material services or conditions relating to the franchise agreement. We consider substantial performance to have occurred when: 1) no remaining obligations are unfulfilled under the franchise agreement; 2) there is no intent to refund any cash received or to forgive any unpaid amounts due from franchisees; 3) all of the initial services spelled out in the franchise agreement have been performed; and 4) we have met all other material conditions or obligations. Revenues and expenses from product sales to franchisees are roughly equivalent and are accounted for on a net basis in the accompanying condensed consolidated statements of operations as agency sales, net. We recognize royalty fees as revenue when earned. Advertising fees are recorded as a liability until marketing expenditures are incurred.

Table of Contents

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

It is not our policy to allow for returns, discounts or warranties to our franchisees. Under certain circumstances, including as the result of regulatory actions, our Company may become obligated to offer our franchisees amounts in rescission to reacquire their existing franchises, including machines. Additionally, if our Company is unable to fulfill its obligations under a franchise agreement we may, at our sole discretion, agree to refund or reduce part or all of a franchisee's payments or commitments to pay. As of December 31, 2014 and June 30, 2014, the Company's provision for franchisee rescissions and refunds totaled $769,000 and $530,923, respectively. There are warranties extended by the machine manufacturer and franchisees are responsible for making any required machine repairs. To the extent the machines remain under warranty, our franchisees transact directly with the manufacturer.

Franchise contracts

We invoice franchisees in full at the time that we enter into contractual arrangements with them. Payment terms vary but usually a significant portion of the contract's cash consideration (typically 40% of amounts due for vending machines plus initial franchise fees) is due at the time of signing, while remaining amounts outlined under the contract are due when locations are secured for the vending machines.

Amounts invoiced to franchisees for which we have not met the criteria for revenue recognition as discussed above, are deferred until such conditions are met. Therefore, these amounts are accounted for as accounts receivable, deferred costs, and customer advances and deferred revenues, respectively in the accompanying condensed consolidated financial statements. As of December 31, 2014, the Company had accounts receivable, deferred costs and customer advances and deferred revenues of $1,836,052 $918,705 and $5,688,941, respectively. As of June 30, 2014, the Company had accounts receivable, deferred costs and customer advances and deferred revenues totaling $2,022,317, $738,522 and $5,456,969, respectively.

Cash and cash equivalents

We consider all investments with an original maturity of three months or less to be cash equivalents. When present, cash equivalents primarily represent funds invested in money market funds, bank certificates of deposit and U.S. government debt securities whose cost equals fair market value. We had no cash equivalents at December 31, 2014 and June 30, 2014. We may maintain our cash and cash equivalents in amounts that may, at times, exceed federally insured limits. At December 31, 2014, bank balances exceeding federally insured limits totaled $267,511. We have not experienced any losses with respect to cash, and we believe our Company is not exposed to any significant credit risk with respect to our cash.

Accounts receivable, net

Accounts receivable arise primarily from invoices for customer deposits, and product orders and are carried at their estimated collectible amounts, net of any estimated allowances for doubtful accounts. We grant unsecured credit to our customers (located throughout North America, the Bahamas and Puerto Rico) deemed credit worthy. Ongoing credit evaluations are performed and potential credit losses estimated by management are charged to operations on a regular basis. At the time any particular account receivable is deemed uncollectible, the balance is charged to the allowance for doubtful accounts. Our allowance for doubtful accounts aggregated $74,081 and $66,581 at December 31, 2014 and June 30, 2014, respectively.

7

Table of Contents

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

Inventories

Inventories consist of vending machines and micro markets held for sale, purchased food and beverages in Company-owned vending machines and micro markets and vending machine parts held for resale, and is valued at the lower of cost or market, with cost determined using the average cost method.

Property and equipment

Property and equipment consists primarily of Company-owned vending machines and micro markets, computer and office equipment and software used in our operations. Property and equipment is carried at cost and depreciated using the straight-line method over the estimated useful lives of the individual assets (generally five to seven years). Leasehold improvements are amortized over the lesser of the term of the related lease or the estimated useful life of the asset (63 months). Costs incurred for maintenance and repairs are expensed as incurred and expenditures for major replacements and improvements are capitalized and depreciated over their estimated remaining useful lives. Depreciation and amortization expense for the three months ended December 31, 2014 and 2013 totaled $19,460 and $15,256, respectively. For the six months ended December 31, 2014 and 2013 depreciation and amortization expense totaled $38,456 and $26,185, respectively.

Impairment of long-lived assets

We record impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amounts of the assets exceed the estimated fair value of the assets. There were no impairments of long-lived assets for the six months ended December 31, 2014 and 2013, respectively.

Deferred rent

The operating lease for our corporate offices in San Diego, California contains provisions for future rent increases, leasehold improvement allowances and rent abatements. We record monthly rent expense equal to the total of the payments due over the lease term, divided by the number of months of the lease term. The difference between the rent expense recorded and the amount paid is credited or charged to deferred rent, which is reflected as a separate line item in the accompanying condensed consolidated balance sheets. Additionally, our Company recorded as deferred rent the cost of the leasehold improvements paid by the landlord, which is amortized on a straight-line basis over the term of the lease.

Marketing and advertising

We expense marketing and advertising costs as incurred. We have no existing arrangements under which we provide or receive marketing and advertising services from others for any consideration other than cash. Marketing and advertising expense totaled $204,873 and $113,118 for the three months ended December 31, 2014 and 2013, respectively. For the six months ended December 31, 2014 and 2013 marketing and advertising expense totaled $385,471 and $262,907, respectively.

Freight costs and fees

Outbound freight charged to customers is recorded as revenue. The related outbound freight costs are considered period costs and charged to cost of revenues.

Table of Contents

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

Valuation of options to purchase common stock

We separately value options to purchase common stock at a discount when issued in connection with notes payable using quantitative valuation methods. The value of such options is recorded as a discount from the related notes payable and credited to additional paid-in capital at the time of the issuance of the related notes payable and options. The value of the discount is applied to the notes payable and amortized over the expected term of the note payable using the interest method with the related accretion charged to operations.

We account for our share-based compensation as required by the Financial Accounting Standards Board ("FASB") authoritative guidance on stock compensation, which generally requires, among other things, that all employee share-based compensation be measured using a fair value method and that the resulting compensation cost be recognized in the financial statements. Compensation expense for our share-based compensation awards is recognized on a straight-line basis over the vesting period from the date of grant.

Net loss per share

Our Company calculates basic earnings per share ("EPS") by dividing our net loss by the weighted average number of common shares outstanding for the period, without considering common stock equivalents. Diluted EPS is computed by dividing net income or net loss and comprehensive net loss applicable to common shareholders by the weighted average number of common shares outstanding for the period and the weighted average number of dilutive common stock equivalents, such as options and warrants. Options and warrants are only included in the calculation of diluted EPS when their effect is dilutive. Total anti-dilutive stock options and shares issuable upon conversion of debt excluded from earnings per share totaled 1,024,761 and 1,835,000 at December 31, 2014 and 2013, respectively.

Litigation and franchise agreements

From time to time, we may become involved in litigation and other legal actions, including disagreements with franchisees that may result in the termination or rescission of a franchise agreement and refund of all or a portion of amounts previously paid to us. We estimate the range of liability related to any pending litigation or franchise agreement terminations or rescissions where the amount and range of loss can be estimated. We record our best estimate of a loss when the loss is considered probable. If a liability is probable and there is a range of estimated loss with no best estimate in the range, we record a charge equal to at least the minimum estimated liability for a loss contingency when both of the following conditions are met: (i) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements and (ii) the range of loss can be reasonably estimated. Estimated legal costs expected to be incurred to resolve legal matters are recorded to the condensed consolidated balance sheets and statements of operations.

Our Company is subject to state franchise registration and relationship laws, rules and regulations. Any violation of these laws, rules or regulations could result in our Company being fined or prohibited from offering and selling franchises in the state. See Note 5 ("Contingencies") of Notes to Condensed Consolidated Financial Statements and Part II, Item 1 ("Legal Proceedings") of the Company's Form 10-Q for the quarterly period ended December 31, 2014 of which these Financial Statements form a part.

Table of Contents

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

New accounting standards

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which supersedes nearly all existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our consolidated financial statements and have not yet determined the method by which we will adopt the standard in fiscal 2018.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"), which provides principles and definitions for management that are intended to reduce diversity in the timing and content of disclosures provided in footnotes. Under the standard, management is required to evaluate for each annual and interim reporting period whether it is probable that the entity will not be able to meet its obligations as they become due within one year after the date that financial statements are issued (or are available to be issued, where applicable). We are currently evaluating the impact of our pending adoption of ASU 2014-15 on our consolidated financial statements and have not yet determined the method by which we will adopt the standard in fiscal 2017.

Management does not believe that any recently issued, but not effective, accounting standards, if currently adopted, would have a material effect on the accompanying financial statements.

2. Notes payable

Beginning April 2013 through June 19, 2013, we issued convertible notes payable to three entities or individuals in exchange for cash proceeds totaling $249,999. The notes were unsecured and bore interest at 12% per annum. The notes bore maturity dates ranging from June 30, 2013 to August 31, 2013, the earlier of their being outstanding for 60 days, or upon the transfer of 25% or more of our Company's share ownership or upon our merger with a public company (all as defined in the note agreements). Repayment of the notes was personally guaranteed by the beneficial shareholder of FHV CAL, a director of our Company. On July 19, 2013, $210,000 of the outstanding balance of the notes was tendered in exchange for 552,418 shares of FHV International's common stock, $33,333 was repaid and $9,666 principal remained outstanding. As of December 31, 2014 and June 30, 2014, $6,666 of principal remained outstanding under the above notes.

On February 25, 2014, we issued Senior Secured Promissory Notes (the "Initial Notes") to three investors in exchange for cash totaling $501,000. The Initial Notes mature on February 24, 2015 and bear simple interest at a rate of 12% paid monthly over the term of the loan. The Initial Notes also provide that our Company can raise up to $1.5 million in proceeds from the issuance of additional notes (the "Additional Notes") which would have the same seniority and security rights. The Initial Notes are secured by substantially all assets of the Company. On September 23, 2014, the holders of the Company's Initial Notes extended the maturity date from February 24, 2015 to March 15, 2016.

Table of Contents

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

On September 23, 2014, the Company entered into a Financing and Security Agreement (the "Financing Agreement") whereby the Company may be able to borrow up to $1.5 million through the issuance of convertible secured debt. The principal terms of the Financing Agreement are as follows:

The Company may borrow up to $1.5 million in tranches of up to $150,000 each.
The first tranche of $150,000 was issued at the closing of the transaction and was used to acquire and put into service Company-owned micro markets. An additional amount of $100,000 was issued during the quarter ended December 31, 2014.
All subsequent tranches shall be in the amount of up to $150,000, shall be due and funded by the lender within seven days of notice, and shall be contingent upon the Company placing an additional 20 micro markets into service.
The notes payable issued under the terms of the Financing Agreement are due in full 24 months from the funding of each tranche. The Company may, at its discretion, extend the due date for each tranche for an additional 12 months.
Interest on the borrowings accrues at a rate of 10% per annum, and is payable quarterly. In the event the Company elects to extend the maturity date of a tranche, the interest rate will increase to 12% per annum on that tranche.
The lender may at its discretion convert any outstanding principal under any of the tranches into shares of the Company's common stock. The conversion price is 85% of the average closing prices for the 15 trading days prior to the notice of conversion, but in no event at a conversion price lower than $1.28 per share.
On the due date, or the extended due date, the Company may at its discretion convert up to one-half of the outstanding principal into shares of common stock. The conversion price is 85% of the average closing prices for the 15 trading days prior to the due date or extended due date, whichever may be applicable.
Borrowings are secured by the Company-owned micro markets.

The Company calculates the beneficial conversion feature based on the difference between the stock price at the time of issuance of a tranche and 85% of the average stock price for the 15 trading days prior to the issuance of the tranche. During the six months ended December 31, 2014 no amounts were recorded as a beneficial conversion feature due to the price of the Company's common stock was below the $1.28 conversion price at December 31, 2014.

3. Concentrations

Our vending machines are supplied by a single manufacturer who sells through a limited number of suppliers. Our micro markets are also supplied by a single manufacturer. Although there are a limited number of manufacturers of vending machines and micro markets, we believe that other suppliers could provide similar machines on comparable terms. A change in suppliers, however, could cause a delay in deliveries and a possible loss of sales, which could adversely affect our operating results.

Our food products are primarily supplied by one distributor. Although there are a limited number of product suppliers with the product selection and distribution capabilities required by our franchise network, we believe that other distributors could provide similar products on comparable terms. A change in suppliers, however, could cause a delay in deliveries and a possible loss of revenue from both current and prospective franchisees, which could adversely affect our operating results.

Table of Contents

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

4. Stock-based compensation

During the six months ended December 31, 2014, the Company granted stock options under its 2013 Equity Incentive Plan. Stock-based compensation related to these awards is recognized on a straight-line basis over the applicable vesting period and is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the six months ended December 31, 2014 and 2013. During the six months ended December 31, 2014, options issued were valued using the Black Scholes method assuming the following:

	2014
Expected volatility	88%
Dividend yield	0%
Risk-free interest rate	0.77%
Expected life in years	3.5

The expected volatility was estimated based on the volatility of a set of companies that management believes are comparable to the Company. The risk-free rate was based on the U.S. Treasury note rate over the expected life of the options. The expected life was determined using the simplified method as we have no historical experience. We recorded stock-based compensation expense of $42,222 and $50,544 during the three months ended December 31, 2014 and 2013, respectively. During the six months ended December 31, 2014 and 2013, we recorded stock-based compensation expense of $84,444 and $185,727, respectively.

The following table summarizes the stock option activity for the six months ended December 31, 2014:

	Options	Weighted Average Exercise Price
Outstanding at June 30, 2014	500,000	$ 0.165
Granted	385,000	$ 0.550
Exercised	(55,552)	$ 0.165
Forfeited	-	-
Outstanding at December 31, 2014	829,448	$ 0.344

5. Contingencies

In March 2013, we entered into a Settlement Agreement with the State of California Department of Business Oversight (the "DBO") regarding allegations of inaccurate and incomplete disclosures in our 2010 and 2011 franchise disclosure documents. Without admitting or denying the allegations, we agreed to the entry of an order that, among other things, required us to desist and refrain from making material misrepresentations or omissions in franchise registration applications filed with the DBO and extend a one-time offer of rescission (refund of initial fees and repurchase of vending machines at depreciated value) to all of our franchisees in California. Of the 13 franchisees offered rescission, nine declined the offer, two accepted and two filed lawsuits against us seeking rescission, both of which were subsequently settled. In February 2014 the DBO delivered a "Notice of Intention to Issue Stop Order and Stop Order Denying Effectiveness of Franchise Registration Application" alleging that we had sold franchises to three of the 13 franchisees described above during August and September 2012, when we were not registered to do so. Of those three, two accepted and one declined our offer of rescission. In connection with the two rescissions that were accepted, the Company remitted a total of $139,000 to the franchisees.

Fresh Healthy Vending International, Inc.
Notes to Condensed Consolidated Financial Statements

On April 2, 2014 the DBO issued a "First Amended Statement of Issues in Support of Stop Order and Stop Order Denying Effectiveness of Franchise Registration Application". The April stop order prohibited us from selling franchises in California until February 28, 2016, or until further order of the Commissioner.
On November 7, 2014 the DBO issued a Stop Order and Citation (the "Stop Order") and the Company entered into a settlement agreement with the DBO. The Stop Order prohibits us from selling franchises in the state of California until November 7, 2016. The DBO found that the we engaged in offers and sales of franchises in California without registration with respect to the three franchise sales we made in August and September 2012, that the sale of 15 franchises that occurred outside the state of California between March 2014 and May 2014 were made pursuant to a franchise disclosure document that contained omissions of material facts by failing to disclose the DBO's prior stop order and the statement of charges and notice of intent to enter an order to cease and desist issued by the state of Washington, and that our prior management failed to exercise due diligence with regard to our registration and disclosure obligations. The DBO also denied our registration application filed in California on October 3, 2013. In connection with the Stop Order, we paid administrative penalties of $37,500 and legal fees of $18,200 and offered rescission and restitution to the 15 franchisees that purchased franchises between March 2014 and May 2014. Of the 15 franchisees offered rescission, eight franchisees have accepted our rescission offer and seven are pending. As of December 31, 2014, the Company's remaining potential liability aggregated $1,528,000, of which the Company has recorded $545,000 for the rescission of five franchisees who accepted the offer in provision for franchisee rescissions and refunds in the accompanying balance sheet. Additionally, the Company has remitted a total of $280,000 to three franchisees. Furthermore, the Company has recorded an additional $224,000 in provision for franchisee rescissions and refunds related to other existing and potential refunds. The remaining franchisees who were offered rescission and restitution have until March 22, 2015 to accept or reject the offer and, if neither, will be deemed to have rejected the offer. Pursuant to the terms of the Stop Order, we also developed and implemented a compliance program and engaged an independent monitor for the duration of the Stop Order to review and report to that DBO our franchise compliance activities, including compliance with the Stop Order.
Our Company is subject to certain other state franchise registration and relationship laws, rules and regulations. Any violation of these laws, rules or regulations could result in our Company being fined or prohibited from offering and selling franchises in the state. Periodically we are contacted by other state franchise regulatory authorities and in some cases have been required to respond to inquiries or make changes to our franchise disclosure documents or franchise offer and sale practices. Management believes these communications from state regulators and corresponding changes in our franchise disclosure documents and practices are administrative in nature and do not indicate the presence of a loss or probable potential loss. See Part II, Item 1 ("Legal Proceedings") of the Company's Form 10-Q for the period ended December 31, 2014 of which these Financial Statements form a part thereof.

In June 2014, Seaga Manufacturing, Inc. ("Seaga") filed a complaint alleging that the Company had breached its agreement with Seaga by failing to purchase certain minimum quantities of automatic merchandising equipment and related parts. The complaint seeks damages in the amount of $3.3 million. In September 2014, the Company filed an answer, affirmative defenses and counterclaims and intends to vigorously defend this action. Although it is too early for management to make an assessment of this claim, we do not believe that the ultimate resolution will have a material adverse effect on the Company's financial position or results of operations.

The Company is also subject to normal and routine litigation and other legal actions by current or former franchisees, employees, and vendors. We assess contingencies to determine the degree of probability and range of possible loss for potential accrual in its financial statements. An estimated loss contingency is accrued in the financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. The Company regularly reviews contingencies to determine the adequacy of the accruals and related disclosures. The amount of ultimate loss may differ from these estimates.

Although we currently believe that the ultimate outcome of these matters will not have a material adverse effect on the results of operations, liquidity or financial position of the Company, it is possible they could be materially affected in any particular future reporting period by the unfavorable resolution of one or more of these matters or contingencies.

6. Stockholders' deficit

On October 1, 2014, Arthur S. Budman was appointed our Chief Executive Officer and Chief Financial Officer. In connection with Mr. Budman's appointment, he was granted 250,000 shares of common stock which vest ratably over a period of one year. Stock-based compensation related to this award is recognized on a straight-line basis over the applicable vesting period and is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the six months ended December 31, 2014. We recorded stock-based compensation expense totaling $50,937 during the period ended December 31, 2014 related to this stock grant.

7. Subsequent event

On January 13, 2015, the Company's Chairman, Nicholas Yates, agreed to loan the Company up to $200,000 (the "Loan"), each incremental borrowing under the Loan to be evidenced by a promissory note, the first of which was issued on the same date (the "January 2015 Note") in the amount of $100,000. The January 2015 Note bears interest at the rate of 7% per annum, and is due and payable on April 30, 2015.

Table of Contents

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

Special Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends, our future expectations and other matters that do not relate strictly to historical facts and are based on certain assumptions of our management (such assumptions may be identified by "we," "our" or "us"). These statements are often identified by the use of words such as "may," "strive," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and similar expressions or variations. Further, these statements are based on the beliefs and assumptions of our management based on information currently available. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation, the risks described in the section entitled "Risk Factors" under Item 1A in our Annual Report on Form 10-K for the year ended June 30, 2014.

We caution the reader to carefully consider such factors. Moreover, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview and Description of Business

Discussions with respect to our Company's operations included herein refer to our operating subsidiaries, Fresh Healthy Vending LLC ("FHV LLC") and The Fresh and Healthy Vending Corporation ("FHV Corp"). Effective as of July 19, 2013 our Company acquired all assets of FHV Holdings Corp ("FHV Cal") which included FHV LLC in a transaction (the "Acquisition") accounted for as an asset acquisition. With the sale of the Green 4 Media, Inc. business under the Indemnity Agreement effective July 22, 2013, our continuing operations are exclusively those of FHV LLC and FHV Corp. Information with respect to our Company's operations prior to the Acquisition is not included herein but may be obtained from viewing our Annual Report for the year ended June 30, 2014 filed on Form 10-K on September 29, 2014.
We are a public company listed under the symbol "GEEM" until September 19, 2013, at which time we began to trade under our current stock symbol "VEND." On August 8, 2013, we changed our name to Fresh Healthy Vending International, Inc.

Business

We are a Franchise Development Company and operator of Company-owned vending machines and micro markets that makes healthy eating more convenient through access to high quality healthy foods at high foot traffic destinations. We and our franchisees have over 2,500 vending machines and micro markets primarily offering natural, organic and healthy food and beverage products throughout North America, the Bahamas and Puerto Rico. Our obligations to each franchisee include securing locations for the healthy vending machines they purchase. We offer thousands of healthy food and beverage products through a national distributor and we train each franchisee at our San Diego headquarters. We provide dedicated account management and ongoing customer service to our franchisees.

The Industry and the Overall Market

We are both a franchisor of vending machine and micro market operations and an operator of vending machines and micro markets. In the franchise market, 2012 saw the first positive growth in the number of franchise establishments since 2008 according to the IFA's annual Franchise Business Economic Outlook report (compiled by HIS Global Insight). According to the International Franchise Association, the number of franchise establishments in the United States is expected to increase by 1.7% in 2014, ahead of the 2013 pace of 1.4%. The vending machine industry saw the total dollar volume in machine sales rise to $43.3 billion in 2012 from $43.0 billion in 2011.

According to the report "A Roadmap for Simultaneously Developing the Supply and Demand for Energy Efficient Beverage Vending Machines," there are approximately 2.5 million food and beverage vending machines in the United States. We have estimated that up to 35% of these vending machines are situated in locations that meet our Company's minimum demographic and foot-traffic requirements for placement.

Table of Contents

Vending Technology

We have developed a cash and cashless vending platform to readily monitor the sales of our franchisees' and our machines. We help our franchisees to grow their business with onsite and virtual management tools, including as an example, wireless remote monitoring telemetry software. Our vending standards are UL ("Underwriters Laboratories") recognized, which we believe are among the highest standards in the industry. This ensures food temperature compliance, which includes auto-contingency processes should electrical or hardware malfunction; it also ensures that ambient air stays within specified parameters at all times. We believe our third-party cashless technology provides one of the highest levels of data and network compliance while ensuring complete transparency. As a result, we generally handle little if any cash in the process. All transactions are managed by third parties to facilitate financial compliance with local and national laws and regulations.

Products

We primarily provide a portfolio of fresh, organic and all-natural snacks and drinks. Most products are available via an agreement with a national distributor. We also create custom menus for each franchisee specific to each location type based on their guidelines, requests and demographics. The Company supports the efforts of the USDA's Smart Snacks in School regulation that indicates that all foods sold a la carte, in the school store and vending machines will need to meet certain nutritional standards. Fresh Healthy Vending's website platform, www.freshandhealthy.org, caters to the new USDA guidelines and supports locations looking to implement a healthy vending program. We have developed customized menus that meet and exceed school and State nutrition guidelines nationwide, facilitating the placement of machines in schools. Our suppliers generally deliver products to our franchisees on a weekly basis and charge a fee of approximately $35.

During the year ended June 30, 2014, the Company introduced its newest product offering in a micro market kiosk. The micro market is a self-checkout kiosk that contains a similar portfolio of fresh, organic and all-natural snacks and drinks. The micro market also provides fresh full meal options such as salads, sandwiches, and wraps. The micro market is designed for implementation in corporate environments and certain retail locations.

Competition

The vending industry is large, highly fragmented and consolidating as the market leaders acquire regional vending companies to fulfill their real-estate expansion plans or acquire privately-held service verticals. We believe we have laid the foundation for a national health vending operation with built-in, long-term service agreements and residual product and inventory sales. We believe our business model offers competitive advantages including the following.

We focus on healthier food included in school and other health-conscious vending locations. Federal guidelines have been established that aim to counter youth obesity while improving student nutrition, such rules work to discourage our competitors' fare to be marketed to schools.

We outsource non-core functions to third-party vendors. Outsourced services include: machine manufacturing, transport, location set-up, maintenance, inventory, food management and ordering, payment processing, and cash management. This has historically allowed us to focus more of our financial resources to investing in new services.

Table of Contents

International operations

During the year ended June 30, 2014, the Company decided to pursue international expansion of its operations. In connection with our intended expansion, we engaged a consulting firm to assist us in locating and securing a master franchisee. Although the Company initially signed a Letter of Intent ("LOI") with a master franchisee in Australia, we determined that it was in the Company's best interest to terminate the LOI. Furthermore, we decided to manage the international expansion ourselves and therefore, terminated the agreement with the consulting firm as well. The Company is currently evaluating its on-going strategy for international operations.

Our Principal Suppliers

The Company currently purchases substantially all of its vending machines as needed from a sole supplier, Automated Merchandising Systems Inc. ("AMS"), or its designated distributor. We believe that our relationship with AMS is excellent, and likely to continue. In our view, the loss of our relationship with AMS, should it occur, may result in short term disruptions not likely to be material. The Company has identified at least four other suppliers with comparable vending equipment. The Company also purchases its micro markets from a single manufacturer and believes the loss of its supplier may result in short term disruptions not likely to be material.

Additionally, primarily on behalf of our franchisees, the Company has negotiated discounts with a product distribution chain, United Natural Foods, Inc. ("UNFI"). We believe that our relationship with UNFI is excellent, and likely to continue. In our view, the loss of our relationship with UNFI, should it occur, may result in short-term disruptions not likely to be material. The Company has identified several other suppliers that stock the same or comparable products. Furthermore, our franchisees are able to purchase directly from UNFI, however, without our negotiated discount.

Governmental Regulation

We are required to comply with regulations governing the sale of franchises – the primary component of our business. Thirteen states directly regulate franchising and require pre-sale registration of a Franchise Disclosure Document ("FDD"), or offering prospectus, by the franchisor, normally with the state agency that oversees the sale of securities in that state, and pre-sale delivery of an FDD to a franchise candidate by a franchisor before the signing of a binding agreement or the payment of any money to the franchisor. Franchise sales in the remaining 37 states are generally subject to the Franchise Rule promulgated by the Federal Trade Commission ("FTC"), which requires the pre-sale delivery of an FDD to a franchise candidate before the signing of a binding agreement or the payment of any money to the franchisor. A franchisor that fails to properly register and maintain the registration of its FDD and disclose its franchisee candidates in the 13 registration states, unless exempt from registration under a few narrowly drawn exceptions to the registration requirements, is subject to legal action by its franchisees for damages and, under certain circumstances, for rescission of the franchise agreements, and to administrative, civil and criminal penalties that may be imposed as well. The FTC's Franchise Rule does not require registration of an FDD with the FTC; however, a franchisor that fails to properly disclose its franchisee candidates is subject to claims for breach of contract, fraud, damages, sanctions and the like.

Our Employees

We had approximately 26 full-time employees as of December 31, 2014 and 16 part-time positions. None of our employees are subject to collective bargaining agreements.

Seasonality

We do not expect that our business will experience significant seasonality other than that resulting from vending machine sales within schools.

Three months ended December 31, 2014 compared to three months ended December 31, 2013

Revenues

We had total revenues of $1,168,094 for the three months ended December 31, 2014, compared to total revenues of $1,016,131 for the three months ended December 31, 2013. This represented an increase of $151,963 or 15.0%. Our revenues increased primarily due to an increase in vending machine sales and franchise fees, as well as an increase in royalties. Overall bookings and installations (at which point our Company recognizes revenues) of machines was 98 and 107 respectively, during the quarter ended December 31, 2014, and 181 and 89 respectively, during the quarter ended December 31, 2013.

Cost of revenues

Cost of revenues was $565,829 during the three months ended December 31, 2014 compared to $518,410 during the three months ended December 31, 2013. This represented an increase of $47,419. The increase corresponded to the overall increase in machine revenue during the comparable period.

Gross margin

Gross margin for the three months ended December 31, 2014 was $602,265 compared to $497,721 for the corresponding period in 2013, representing an increase of $104,544 or 21.0%. Gross margin percentage during the quarter ended December 31, 2014 was 51.6% compared to 49.0% for the same quarter in 2013. The increase in gross margin percentage in 2014 from 2013 of 2.6% was due primarily to the increase in franchise fees and royalties, offset in part by a decrease in net agency sales.

Selling, general and administrative expenses

Selling, general and administrative expenses for the three months ended December 31, 2014 of $1,404,553 represent an increase of $405,953 or 40.6%, from the $998,660 in the three months ended December 31, 2013. The major components of selling, general and administrative expenses were as follows:

Personnel expenses increased $242,532 to $755,496 for the three months ended December 31, 2014 compared to $512,964 for the three months ended December 31, 2013. The increase was attributable to additional commissions, personnel expenses of executive staff and a general increase in employee headcount.

Marketing and advertising expenses increased $91,755 to $204,873 for the three months ended December 31, 2014 compared to $113,118 for the three months ended December 31, 2013. The increase was primarily attributable to an increase in radio advertising.

Stock-based compensation expense increased to $93,159 for the three months ended December 31, 2014, compared to $50,544 for the same period in the prior year. The increase was due to compensation expense incurred in connection with the stock grant to our CEO.

Provision for income taxes

During the three months ended December 31, 2014 and 2013, we incurred a net loss and operated as a C-corp for federal and state income tax purposes. A valuation allowance has been recorded to eliminate the tax benefit arising from our net operating loss due to the substantial uncertainty about whether such benefit will ever be realized.

17

Table of Contents

Net income (loss)

Net loss was $792,096 during the three months ended December 31, 2014 compared to a net loss of $503,887 for the three months ended December 31, 2013. Basic net loss per share during the three months ended December 31, 2014 and 2013 was $0.03 and $0.02, respectively.

Six months ended December 31, 2014 compared to six months ended December 31, 2013

Revenues

We had total revenues of $3,022,961 for the six months ended December 31, 2014, compared to total revenues of $3,038,512 for the six months ended December 31, 2013. This represented a decrease of $15,551 or .51%. The decrease in revenue was primarily related to a change in product mix, offset by an increase in installations. Overall bookings and installations (at which point our Company recognizes revenues) of machines was 305 and 279 respectively, during the six months ended December 31, 2014, and 270 and 258 respectively, during the six months ended December 31, 2013.

Cost of revenues

Cost of revenues was $1,378,792 during the six months ended December 31, 2014 compared to $1,453,141 during the six months ended December 31, 2013. This represented a decrease of $74,349. The decrease corresponds to a decrease in machine revenue and product mix during the period.

Gross margin

Gross margin for the six months ended December 31, 2014 was $1,644,169 compared to $1,585,371 for the corresponding period in 2013, representing an increase of $58,798 or 3.7% Gross margin percentage during the six months ended December 31, 2014 was 54.3% compared to 52.2% for the same period in 2013. The increase in gross margin percentage in 2014 from 2013 of 2.1% was due primarily to the increase in franchise fees and royalties, offset in part by a decrease in net agency sales.

Selling, general and administrative expenses

Selling, general and administrative expenses for the six months ended December 31, 2014 of $2,650,719 represents an increase of $357,524 or 15.6%, from the $2,293,195 in the six months ended December 31, 2013. The major components of selling, general and administrative expenses were as follows:

Personnel expenses increased $389,604 to $1,409,773 for the six months ended December 31, 2014 compared to $1,020,169 for the six months ended December 31, 2013. The increase was attributable to additional commissions, personnel expenses of executive staff and a general increase in employee headcount.

For the six months edned December 31, 2013 we paid our former CEO $191,000 in connection with his surrender of stock at the time of the Acquisition, which did not reoccur during the six months ended December 31, 2014.

Marketing and advertising expenses increased $122,564 to $385,471 for the six months ended December 31, 2014 compared to $262,907 for the six months ended December 31, 2013. The increase was primarily attributable to an increase in radio advertising.

Stock-based compensation expense decreased to $135,381 for the six months ended December 31, 2014, compared to $185,727 for the same period in the prior year. The decrease was primarily related to compensation expense on stock options that vested upon issuance in 2013.

Provision for income taxes

During the six months ended December 31, 2014 and 2013, we incurred a net loss and operated as a C-corp for federal and state income tax purposes. A valuation allowance has been recorded to eliminate the tax benefit arising from our net operating loss due to the substantial uncertainty about whether such benefit will ever be realized.

Net income (loss)

Net loss was $1,043,459 during the six months ended December 31, 2014 compared to a net loss of $745,867 for the six months ended December 31, 2013. Basic net loss per share during the six months ended December 31, 2014 and 2013 was $0.04 and $0.03, respectively.

Table of Contents

Liquidity and Capital Resources

For the six months ended December 31, 2014 we had a net loss totaling $1,043,459 and negative cash flows from operations totaling $361,306. Our cash balance at December 31, 2014 was $477,636. The Company's cash used in investing activities aggregated $18,346 and was related to the purchase of office equipment. Furthermore our cash provided from financing activities was $250,000 and related to borrowings on our financing agreement. Since the date of the closing of the FHV Acquisition, our sales were less than anticipated and the resulting cash flows from franchisee sales was not sufficient to cover expenditures associated with our daily operations resulting in a substantial decrease in our cash balances. Also, we used cash on hand to retire liabilities associated with the franchisee rescissions. As of the filing date of the Form 10-Q, our Company has consumed the vast majority of its available cash, including the cash proceeds from the sale of our common stock received in July of 2013 and the issuance of several debt instruments. In order to ensure sufficient liquidity for our continuing operations, we will require additional capital financing in the form of either debt or equity (or a combination thereof) financing. Management believes that it will be able to obtain such financing on terms acceptable to the Company, although there can be no assurance that we will be successful.

Our current plans include capital expenditures for the purchase of corporate owned and operated vending machines and micro markets, including the repurchase of machines from franchisees opting to rescind their franchise agreements. Given our current cash position, we may be forced to curtail our plans by delaying or suspending the purchase of machines for our corporate operations.

On January 13, 2015, the Company's Chairman, Nicholas Yates, agreed to loan the Company up to $200,000 (the "Loan"), each incremental borrowing under the Loan to be evidenced by a promissory note, the first of which was issued on the same date (the "January 2015 Note") in the amount of $100,000. The January 2015 Note bears interest at the rate of 7% per annum, and is due and payable on April 30, 2015.

As of December 31, 2014, the Company had $501,000 outstanding under the Initial Notes and $250,000 outstanding under the Financing Agreement. Also on September 23, 2014, the holders of the Company's Initial Notes aggregating $501,000 have extended the maturity date from February 24, 2015 to March 15, 2016.

Table of Contents

Off Balance Sheet Arrangements

We had no material off balance sheet arrangements at December 31, 2014.

Critical Accounting Policies

We have identified the following as our most critical accounting estimates, which are those that are most important to the portrayal of the Company's financial condition and results, and that require management's most subjective and complex judgments. Information regarding our other significant accounting estimates and policies are disclosed in Note 1 to our Condensed Consolidated Financial Statements.

Revenue recognition — Our primary revenue generating transactions come from the sale of franchises and vending machines to the franchisees. There are no franchise fees charged beyond the initial first year franchise fees. We receive ongoing fees and royalty payments in the form of annual advertising fees and a percentage of either franchisees' revenues or gross margins on vending machine sales.

We recognize revenues and associated costs in connection with franchisees at the time that we have substantially performed or satisfied all material services or conditions relating to the franchise agreement. We consider substantial performance to have occurred when: 1) no remaining obligations are unfulfilled under the franchise agreement; 2) there is no intent to refund any cash received or to forgive any unpaid amounts due from franchisees; 3) all of the initial services spelled out in the franchise agreement have been performed; and 4) we have met all other material conditions or obligations. Revenues and expenses from product sales to franchisees are roughly equivalent and are accounted for on a net basis in the accompanying consolidated statements of operations as agency sales, net. We recognize royalty fees as revenue when earned. Advertising fees are recorded as a liability until marketing expenditures are incurred.

It is not our policy to allow for returns, discounts or warranties to our franchisees. Under certain circumstances, including as the result of regulatory action, our Company may become obligated to offer our franchisees amounts in rescission to reacquire their existing franchises, including machines. Additionally, if our Company is unable to fulfill its obligations under a franchise agreement we may, at our sole discretion, agree to refund or reduce part or all of a franchisees payments or commitments to pay. As of December 31, 2014 and June 30, 2014 the Company's provision for franchisee rescissions and refunds totaled $769,000 and $530,923, respectively. There are warranties extended by the machine manufacturer, but required repairs to the machines are the responsibility of the franchisees. To the extent the machines remain under warranty, our franchisees transact directly with the manufacturer.

Franchise contracts — We invoice franchisees in full at the time that we enter into contractual arrangements with them. Payment terms vary but usually a significant portion of the contract's cash consideration (typically 40% of vending machines plus franchise fees) is due at the time of signing, while remaining amounts outlined under the contract are due upon our locating the sites for the vending machines.

Amounts invoiced to franchisees for which we have not met the criteria for revenue recognition as discussed above, are deferred until such conditions are met. Therefore, these amounts are accounted for as accounts receivable, deferred costs, and customer advances and deferred revenues, respectively in the accompanying condensed consolidated financial statements. As of December 31, 2014, the Company had accounts receivable, deferred costs and customer advances and deferred revenues of $1,836,052, $918,705 and $5,688,941, respectively. As of June 30, 2014, the Company had accounts receivable, deferred costs and customer advances and deferred revenues totaling $2,022,317, $738,522 and $5,456,969, respectively.

Accounts receivable, net — Accounts receivable arise primarily from invoices for customer deposits, and product orders and are carried at their estimated collectible amounts, net of any estimated allowances for doubtful accounts. We grant unsecured credit to our customers deemed credit worthy. Ongoing credit evaluations are performed and potential credit losses estimated by management are charged to operations on a regular basis. At the time any particular account receivable is deemed uncollectible, the balance is charged to the allowance for doubtful accounts. Our allowance for doubtful accounts aggregated $74,081 and $66,581 at December 31, 2014 and June 30, 2014, respectively.

Table of Contents

Share-based Compensation — We offer share-based compensation plans to attract, retain and motivate key officers, non-employee directors and employees to work toward the financial success of the Company. Share-based compensation cost for our stock option grants is estimated at the grant date based on the award's fair-value as calculated by an option pricing model and is recognized as expense ratably over the requisite service period. The option pricing models require various highly judgmental assumptions including volatility, forfeiture rates and expected option life. If any of the assumptions used in the model change significantly, share-based compensation expense may differ materially in the future from that recorded in the current period.

Legal Accruals — The Company is subject to claims and lawsuits in the ordinary course of its business. A determination of the amount accrued, if any, for these contingencies is made after analysis of each matter. We continually evaluate such accruals and may increase or decrease accrued amounts, as we deem appropriate. Because lawsuits are inherently unpredictable, and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgment about future events. As a result, the amount of ultimate loss may differ from those estimates.

Income Taxes — We estimate certain components of our provision for income taxes. These estimates include, among other items, depreciation and amortization expense allowable for tax purposes, allowable tax credits, effective rates for state and local income taxes and the tax deductibility of certain other items. We adjust our effective income tax rate as additional information on outcomes or events becomes available. Our estimates are based on the best available information at the time that we prepare the income tax provision. We generally file our annual income tax returns several months after our fiscal year-end. Income tax returns are subject to audit by federal, state and local governments, generally years after the returns are filed. These returns could be subject to material adjustments or differing interpretations of the tax laws.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our chief executive and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. Disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Management has designed our disclosure controls and procedures to provide reasonable assurance of achieving the desired control objectives.

As required by Exchange Act Rule 13a-15(b), we have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive and principal financial officer, of the effectiveness of the design and operation of our management, and the design and operation of our disclosure controls and procedures as of December 31, 2014.

Table of Contents

Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act) were not deemed effective in order to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the SEC and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure (see below for further discussion).

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a- 15(f) under the Securities Exchange Act of 1934, as amended. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America ("GAAP"). We recognize that because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

To evaluate the effectiveness of our internal control over financial reporting, management used the criteria described in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") - 1992.

In connection with management's assessment of our internal control over financial reporting, we determined that there was a material weakness in our internal control over financial reporting as of December 31, 2014. Since the Company is not listed on a national exchange or on an automated interdealer quotation system, it is not required to have an audit committee or independent directors, and thus does not have a controlling independent board or audit committee. We consider this to be a material weakness as an independent board and audit committee provide important oversight. The Company is in the process of addressing this issue by establishing an audit committee and appointing independent directors, with at least one having financial expertise.

Changes in Internal Control Over Financial Reporting

There were no material changes in our internal control over financial reporting (as defined in Rule 13a- 15(f) under the Exchange Act) that occurred as of December 31, 2014, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2014. Our management's evaluation of our internal control was based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Framework - 1992"). Based on its evaluation under the Internal Control - Evaluation Framework, due to the material weakness described above, management concluded that our internal control over financial reporting was not effective as of December 31, 2014. A material weakness is a control deficiency, or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected on a timely basis by the Board in the normal course of their duties.

Table of Contents

PART II – OTHER INFORMATION
Item 1. Legal Proceedings

California
In March 2013, we entered into a Settlement Agreement with the State of California Department of Business Oversight (the "DBO") regarding allegations of inaccurate and incomplete disclosures in our 2010 and 2011 franchise disclosure documents. Without admitting or denying the allegations, we agreed to the entry of an order that, among other things, required us to desist and refrain from making material misrepresentations or omissions in franchise registration applications filed with the DBO and extend a one-time offer of rescission (refund of initial fees and repurchase of vending machines at depreciated value) to all of our franchisees in California. Of the 13 franchisees offered rescission, nine declined the offer, two accepted and two filed lawsuits against us seeking rescission, both of which were subsequently settled. In February 2014 the DBO delivered a "Notice of Intention to Issue Stop Order and Stop Order Denying Effectiveness of Franchise Registration Application" alleging that we had sold franchises to three of the 13 franchisees described above during August and September 2012, when we were not registered to do so. Of those three, two accepted and one declined our offer of rescission. In connection with the two rescissions that were accepted, the Company remitted a total of $139,000 to the franchisees.
On April 2, 2014 the DBO issued a "First Amended Statement of Issues in Support of Stop Order and Stop Order Denying Effectiveness of Franchise Registration Application". The April stop order prohibited us from selling franchises in California until February 28, 2016, or until further order of the Commissioner.
On November 7, 2014 the DBO issued a Stop Order and Citation (the "Stop Order") and the Company entered into a settlement agreement with the DBO. The Stop Order prohibits us from selling franchises in the state of California until November 7, 2016. The DBO found that the we engaged in offers and sales of franchises in California without registration with respect to the three franchise sales we made in August and September 2012, that the sale of 15 franchises that occurred outside the state of California between March 2014 and May 2014 were made pursuant to a franchise disclosure document that contained omissions of material facts by failing to disclose the DBO's prior stop order and the statement of charges and notice of intent to enter an order to cease and desist issued by the state of Washington, and that our prior management failed to exercise due diligence with regard to our registration and disclosure obligations. The DBO also denied our registration application filed in California on October 3, 2013. In connection with the Stop Order, we paid administrative penalties of $37,500 and legal fees of $18,200 and offered rescission and restitution to the 15 franchisees that purchased franchises between March 2014 and May 2014. Of the 15 franchisees offered rescission, eight franchisees have accepted our rescission offer and seven are pending. As of December 31, 2014, the Company's remaining potential liability aggregated $1,528,000, of which the Company has recorded $545,000 for the rescission of five franchisees who accepted the offer in provision for franchisee rescissions and refunds in the accompanying balance sheet. Additionally, the Company has remitted a total of $280,000 to three franchisees. Furthermore, the Company recorded an additional $224,000 in provision for franchisee recissions and refunds related to other existing and potential refunds. The remaining franchisees who were offered rescission and restitution have until March 22, 2015 to accept or reject the offer and, if neither, will be deemed to have rejected the offer. Pursuant to the terms of the Stop Order, we also developed and implemented a compliance program and engaged an independent monitor for the duration of the Stop Order to review and report to that DBO our franchise compliance activities, including compliance with the Stop Order.
Washington

In May 2012, the Securities Division of the Washington Department of Financial Institutions ("DFI") alleged that we and the former Chairman of the Board of FHV Cal ("former FHV Cal chairman"), (a) made inaccurate or incomplete disclosures in our 2010 and 2011 franchise disclosure documents regarding (i) our business experience and the business experience of our directors and managers, (ii) the litigation history of a former shareholder of FHV Cal ("former FHV Cal shareholder"), and our Chairman, (iii) the former FHV Cal chairman's bankruptcy history, and (iv) the relationship among us, our Chairman, and the former FHV Cal shareholder; (b) solicited the sale of franchises in

Washington using inaccurate or incomplete franchise disclosure documents or franchise disclosure documents that had not yet been registered; and (c) sold at least one franchise in the State of Washington using an inaccurate franchise disclosure document. Without admitting or denying the DFI's findings of fact or conclusions of law, we and the former FHV Cal chairman agreed to (a) cease and desist from the offer and sale of franchises in violation of the Washington Franchise Investment Protection Act, (b) pay the Securities Division $5,000 for its costs of investigation of the matter, and (c) waive all rights to a hearing and judicial review of the matter. This consent order has no expiration date.

Table of Contents

Also in May 2012, the DFI alleged that, between 2007 and 2009, FHV Cal, our Chairman and the former FHV Cal shareholder offered and sold business opportunities in Washington without a registered disclosure document and without providing a disclosure document to the purchasers of those business opportunities. Without admitting or denying the DFI's findings of fact or conclusions of law, FHV Cal, our Chairman, and the former FHV Cal shareholder agreed to (a) cease and desist from the offer and sale of business opportunities in violation of the Business Opportunity Fraud Act of the State of Washington, (b) pay the Securities Division $3,000 for its costs of investigation of the matter, and (c) waive all rights to a hearing and judicial review of this matter. This consent order has no expiration date.

In February 2014, the DFI issued a notice to us entitled "Statement of Charges and Notice of Intent to Enter Order to Cease and Desist". The notice alleged that (a) one Washington resident had purchased, and two had received offers to purchase, franchises from us in April, May and November of 2012, when we were not registered in the State of Washington, and (b) the disclosures made in our franchise disclosure documents did not include certain information regarding the prior consent order issued by the DFI and, therefore, violated the consent order. On June 9, 2014, the DFI issued a consent order providing that (a) we and our agents and employees cease and desist from offering or selling franchises in violation of the registration section of the Franchise Investment Protection Act of the state of Washington; (b) we and our agents and employees cease and desist from violating the anti-fraud section of the Franchise Investment Protection Action of the state of Washington; and (c) we reimburse the DFI $7,500 for its costs of investigation payable before the entry of the consent order. We reimbursed DFI and the consent order was entered.

Other Matters

Our Company is subject to certain other state franchise registration and relationship laws, rules and regulations. Any violation of these laws, rules or regulations could result in our Company being fined or prohibited from offering and selling franchises in the state. To date, the Company has not received any indication that any state or domicile intends to seize any previously recognized revenues related to any franchise agreement.

In June 2014, Seaga Manufacturing, Inc. ("Seaga") filed a complaint alleging that the Company had breached its agreement with Seaga by failing to purchase certain minimum quantities of automatic merchandising equipment and related parts. The complaint seeks damages in the amount of $3.3 million. In September 2014, the Company filed an answer, affirmative defenses and counterclaims and intends to vigorously defend this action. Although it is too early for management to make an assessment of this claim, we do not believe that the ultimate resolution will have a material adverse position on the Company's financial position or results of operations.

The Company is also subject to normal and routine litigation and other legal actions by current or former franchisees, employees, and vendors. We assess contingencies to determine the degree of probability and range of possible loss for potential accrual in its financial statements. An estimated loss contingency is accrued in the financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. The Company regularly reviews contingencies to determine the adequacy of the accruals and related disclosures. The amount of ultimate loss may differ from these estimates.

Although we currently believe that the ultimate outcome of these matters will not have a material adverse effect on the results of operations, liquidity or financial position of the Company, it is possible they could be materially affected in any particular future reporting period by the unfavorable resolution of one or more of these matters or contingencies

Table of Contents

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1, "Risk Factors" in our Current Report on Form 10-K filed on September 29, 2014, which could materially affect our business, financial condition or operating results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

In instances where we issued securities in reliance upon Regulation D, we relied upon Rule 506 of Regulation D. The parties who received the securities in such instances made representations that such party (a) is acquiring the securities for his, her or its own account for investment and not for the account of any other person and not with a view to or for distribution, assignment or resale in connection with any distribution within the meaning of the Securities Act, (b) agrees not to sell or otherwise transfer the purchased shares unless they are registered under the Securities Act and any applicable state securities laws, or an exemption or exemptions from such registration are available, (c) has knowledge and experience in financial and business matters such that the purchaser is capable of evaluating the merits and risks of an investment in us, (d) had access to all of our documents, records, and books pertaining to the investment and was provided the opportunity to ask questions and receive answers regarding the terms and conditions of the offering and to obtain any additional information which we possessed or were able to acquire without unreasonable effort and expense, and (e) has no need for the liquidity in its investment in us and could afford the complete loss of such investment. Management made the determination that the investors in instances where we relied on Regulation D are accredited investors (as defined in Regulation D) based upon management's inquiry into their sophistication and net worth. In addition, there was no general solicitation or advertising for securities issued in reliance upon Regulation D.

In instances where we indicate that we relied upon Section 4(a)(2) of the Securities Act in issuing securities, our reliance was based upon the following factors: (a) the issuance of the securities was an isolated private transaction by us which did not involve a public offering; (b) there were only a limited number of offerees, each of whom was deemed in our view to be an "accredited investor" within the meaning of federal securities laws; (c) there were no subsequent or contemporaneous public offerings of the securities by us; and (d) the securities were not broken down into smaller denominations.

Item 3. Defaults Upon Senior Securities

None.

Item 4 Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

A. Exhibits

31.1 Certification of the Principal Executive and Financial Officer Pursuant to Rule 13a-14 or 15d-14 of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification of Principal Executive and Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1 Promissory Note to Nicholas Yates, Chariman Fresh Healthy Vending International, Inc.

Table of Contents

FRESH HEALTHY VENDING INTERNATIONAL, INC.

SIGNATURES

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

FRESH HEALTHY VENDING INTERNATIONAL, INC.

Dated: February 17, 2015 By: /s/ Arthur S. Budman
Arthur S. Budman, Chief Executive Officer
Principal Executive Officer and Principal Financial Officer