

Edgar Filing: Fresh Healthy Vending International, Inc. - Form 10-Q

Fresh Healthy Vending International, Inc.
Form 10-Q
May 23, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

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

For the period ended March 31, 2016

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. 000-55164

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.)

2620 Financial Court, Suite 100, San Diego, California 9211
(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.

☒ 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, 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.

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Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer (Do not check if a smaller reporting company) ☐

Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

☐ Yes ☒ No

APPLICABLE ONLY TO 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 May 16, 2016: 27,978,580

FRESH HEALTHY VENDING INTERNATIONAL, INC.
Quarterly Report on Form 10-Q for the
Nine Months Ended March 31, 2016

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

FRESH HEALTHY VENDING INTERNATIONAL, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

	March 31, 2016 (unaudited)	June 30, 2015 (audited)
Assets		
Current assets:		
Cash	\$ 153,995	\$ 325,337
Cash in escrow	271,500	93,000
Accounts receivable, net	2,503,466	2,067,761
Deferred costs	467,372	884,885
Inventories, net	357,316	289,279
Prepaid expenses and other current assets	97,116	89,662
Total current assets	3,850,765	3,749,924
Property and equipment:		
Vending	179,458	312,058
Computer	145,060	145,060
Leasehold	22,846	63,500
Furniture	50,725	40,769
Vehicle	15,597	15,597
Less accumulated depreciation and amortization	(172,006)	(223,455)
	241,680	353,529
Deposits	383,479	41,793
Total assets	\$ 4,475,924	\$ 4,145,246
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,134,496	\$ 1,047,675
Customer advances and deferred revenues	7,097,061	6,428,156
Provision for franchisee rescissions and refunds	1,538,958	575,750
Accrued personnel expenses	234,176	221,194
Notes payable, net of discount of \$362,484 (\$453,793 at June 30, 2015)	745,182	653,873
Derivative liability	318,705	397,840
Notes payable to related party	957,395	95,000
Deferred rent	8,362	1,440
Total current liabilities	12,034,335	9,420,928
Convertible notes payable - long term	250,000	250,000

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Total liabilities	12,284,335	9,670,928
Commitments and contingencies (Notes 6 and 10)		
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; 27,978,580 outstanding (26,784,767 at June 30, 2015)	27,916	26,783
Additional paid-in capital	3,161,428	2,072,422
Accumulated deficit	(10,997,755)	(7,624,887)
Total stockholders' deficit	(7,808,411)	(5,525,682)
Total liabilities and stockholders' deficit	\$4,475,924	\$4,145,246

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	For the three months ended March 31,		For the nine months ended March 31,	
	2016	2015	2016	2015
Revenues:				
Vending machine sales, net	\$865,540	\$1,570,771	\$3,439,745	\$4,193,711
Franchise fees	76,640	149,023	298,596	372,966
Company owned machines	73,142	58,839	275,559	128,943
Agency sales (net)	21,388	24,033	72,752	53,851
Other	166,383	114,445	293,545	190,601
Total revenue, net	1,203,093	1,917,111	4,380,197	4,940,072
Cost of revenues	789,069	895,047	2,436,487	2,274,866
Gross margin	414,024	1,022,064	1,943,710	2,665,206
Operating expenses:				
Selling, general and administrative	1,517,742	1,275,098	4,438,318	3,930,412
Loss from operations	(1,103,718)	(253,034)	(2,494,608)	(1,265,206)
Other income (expense):				
Interest income (expense)	(86,959)	(28,074)	(196,315)	(59,361)
Accretion of discount on notes payable	(151,259)	(15,750)	(391,309)	(15,750)
Loss on conversion of franchisee refund	(263,338)	-	(263,338)	-
Derivative liability income (expense)	1,600	-	(27,298)	-
Loss before provision for income taxes	(1,603,674)	(296,858)	(3,372,868)	(1,340,317)
Provision for income taxes	-	-	-	-
Net loss	\$(1,603,674)	\$(296,858)	\$(3,372,868)	\$(1,340,317)
Net loss per share - basic and diluted	\$(0.06)	\$(0.01)	\$(0.13)	\$(0.05)
Weighted average shares used in computing net loss per share - basic and diluted	27,062,316	26,691,019	26,957,602	26,636,588

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	For the nine months ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net loss	\$(3,372,868)	\$(1,340,317)
Adjustments to reconcile net loss to net cash flows used in operating activities:		
Depreciation and amortization	78,817	61,849
Interest accretion on notes payable	391,309	15,750
Loss on conversion of franchisee refund	263,338	-
Loss on derivative liability	27,298	-
Issuance of common stock to employee	21,562	-
Stock-based compensation	205,056	218,317
Loss on sales of property and equipment	10,122	6,714
Deferred rent	6,922	(13,487)
Bad debt expense	-	17,000
Changes in operating assets and liabilities:		
Accounts receivable	(435,705)	219,019
Deferred costs	417,513	(216,316)
Inventories	37,359	(153,356)
Prepaid expenses and other assets	(7,454)	(29,137)
Deposits	(341,686)	10,000
Accounts payable and accrued liabilities	86,821	118,202
Customer advances and deferred revenues	668,905	179,894
Provision for franchisee rescissions and refunds	1,156,958	89,513
Accrued personnel expenses	12,982	57,450
Cash flows used in operating activities	(772,751)	(758,905)
Cash flows from investing activities:		
Purchases of property and equipment	(82,486)	(113,061)
Cash in escrow	(178,500)	(253,500)
Proceeds from sales of property and equipment	-	438
Cash flows used in investing activities	(260,986)	(366,123)
Cash flows from financing activities:		
Proceeds from issuance of notes payable to related party	950,000	100,000
Proceeds from issuance of notes payable	-	596,500
Payments of notes payable to related parties	(87,605)	-
Cash flows provided by financing activities	862,395	696,500
Change in cash	(171,342)	(428,528)
Cash, beginning of period	325,337	607,288
Cash, end of period	\$153,995	\$178,760

Supplemental disclosure of cash flow information:

Cash paid for:		
Interest expense	\$42,652	\$30,666
Income taxes	\$800	\$-

Supplemental disclosure of non-cash activities:

Transfer of corporate machines from fixed assets to inventory	\$105,395	\$-
Exercise of cashless warrants	\$106,433	\$-
Issuance of common stock in lieu of franchisee liability payments	\$193,750	\$-

See accompanying notes to the unaudited condensed consolidated financial statements.

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Fresh Healthy Vending International, Inc.
Notes to Unaudited 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, FHV Acquisition Corp. ("FHV Acquisition") and our newly formed subsidiaries, Reis & Irvy's, Inc. ("R&I"), and 19 Degrees, Inc. (which were formed in Nevada on March 7, 2016) as a franchisor and owner and operator of frozen yogurt kiosks, 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 kiosks, 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 unaudited condensed consolidated 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 unaudited condensed consolidated financial statements reflect all adjustments (consisting solely of normal recurring nature) 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 unaudited condensed consolidated 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, 2015 filed on October 13, 2015.

Liquidity and capital resources

For the nine months ended March 31, 2016 we had a net loss totaling \$3,372,868 and negative cash flows from operations totaling \$772,751. Our cash balance at March 31, 2016 was \$153,995. 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.

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

Our current plans include capital expenditures for the purchase of corporate owned and operated kiosks, 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 kiosks and 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, FHV Acquisition, Corp. and its newly formed subsidiaries, Reis & Irvy's, Inc., and 19 Degrees, Inc. 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 and micro markets 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 and micro market 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. During fiscal 2015, the Company changed the process by which franchisees order products. Currently, all franchisees order directly from our national distributor and the Company receives a commission of 5% on those purchases. We recognize the commission when earned. The Company recognizes revenue on product sales of company-owned machines when products are purchased; we receive electronic sales records on our company-owned units. We recognize royalty fees as revenue when earned. Advertising fees are recorded as a liability until marketing expenditures are incurred.

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

The Company records the amount of a franchise sale, machines and franchise fees, as deferred revenue until the conditions above have been met. Once the machines are installed, the Company records the corresponding machine and franchise fee as revenue, on a pro rata basis based on the number of machines installed relative to the total machines purchased.

The Company records the value of company-owned machines as inventory when purchased. Once the machines are installed, the machine value is transferred to fixed assets and depreciated over its useful life.

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 March 31, 2016 and June 30, 2015, the Company's provision for franchisee rescissions and refunds totaled \$1,538,958 and \$575,750, 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 or its distributor.

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 100% of the initial franchise fees) is due at the time of signing, while remaining amounts outlined under the contract are generally due upon our locating 50% of the sites for the vending machines and micro markets. A typical ten unit franchise contract would include the following:

Franchise fee per machine: \$1,250

Cost per machine: \$10,000

Total franchise cost: \$112,500 ($\$1,250 \times 10 + \$10,000 \times 10$)

Initial payment upon signing contract: \$52,500 (100% of franchise fees of \$12,500 + 40% of machine cost of \$100,000)

Upon the signing of the contract, the Company records the initial payment of \$52,500 to cash, with the remaining contract value of \$60,000 to accounts receivable and records the total contract value of \$112,500 to deferred revenue.

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 March 31, 2016, the Company had accounts receivable, deferred costs and customer advances and deferred revenues of \$2,503,466 \$467,372 and \$7,097,061, respectively. As of June 30, 2015, the Company had accounts receivable, deferred costs and customer advances, and deferred revenues totaling \$2,067,761, \$884,885 and \$6,428,156, respectively.

Furthermore, the Company has deferred revenue of \$1,144,163 in excess of one year as of March 31, 2016 which consisted of the following: amounts related to ongoing franchisees - \$942,763; and amounts related franchisees requesting a hold on location procurement - \$201,400. As of June 30, 2015, deferred revenue in excess of one year aggregated \$874,909.

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

Deferred revenue consisted of the following as of March 31, 2016 and June 30, 2015:

	March 31, 2016	June 30, 2015
Vending machines - new	\$5,677,503	\$3,856,387
Vending machines - used	316,547	1,244,770
Micro markets - new	443,390	800,000
Franchise fees	655,541	522,517
Other	4,080	4,482
	\$7,097,061	\$6,428,156

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 March 31, 2016 and June 30, 2015. We may maintain our cash and cash equivalents in amounts that may, at times, exceed federally insured limits. At March 31, 2016, no bank balances exceeded federally insured limits. 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.

Certain states require the Company to maintain customer deposits in escrow accounts until the Company has substantially performed its obligations. At March 31, 2016 and June 30, 2015, the Company had \$271,500 and \$93,000, respectively, maintained in escrow accounts for this purpose.

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 \$100,692 at both March 31, 2016 and June 30, 2015, respectively.

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.

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

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 (84 months). During fiscal 2016, the Company offset the fully depreciated value of leasehold improvements associated with the prior lease aggregating \$63,500 to leasehold improvements and accumulated amortization. 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 March 31, 2016 and 2015 totaled \$23,888 and \$23,393 respectively. For the nine months ended March 31, 2016 and 2015, depreciation and amortization expense totaled \$78,817 and \$61,849, 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 nine months ended March 31, 2016 and 2015, respectively.

License fee

Included in deposits at March 31, 2016 is \$325,000 related to the exclusive license fee on the frozen yogurt kiosks. The license fee will be amortized over the life of the agreement of ten years (see Note 8).

Reclassifications

Certain prior period amounts have been reclassified to conform with current year presentation.

Deferred rent

The operating lease for our corporate office 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. Effective August 1, 2015, the Company entered into a new seven year lease agreement for its corporate operations and warehouse facilities. Please see Note 7. Leases.

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 \$265,506 and \$224,587 for the three months ended March 31, 2016 and 2015, respectively. For the nine months ended March 31, 2016 and 2015, marketing and advertising expense totaled \$715,602 and \$610,406 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.

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

Valuation of options and warrants to purchase common stock

We separately value warrants to purchase common stock when issued in connection with notes payable using the Black Scholes quantitative valuation method. The value of such warrants 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. The value of the discount is applied to the note 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"), under authoritative guidance ASC 718 on stock compensation, using the Black Scholes quantitative valuation method. The resulting compensation expense is recognized in the financial statements on a straight-line basis over the vesting period from the date of grant.

Share grants are measured using a fair value method with the resulting compensation cost recognized in the financial statements. Compensation expense is recognized on a straight-line basis over the service period for the stock awards.

Fair value of financial instruments

The Company follows guidance for accounting for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. Additionally, the Company adopted guidance for fair value measurement related to nonfinancial items that are recognized and disclosed at fair value in the financial statements on a nonrecurring basis. The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

The Company monitors the market conditions and evaluates the fair value hierarchy levels at least quarterly. For any transfers in and out of the levels of the fair value hierarchy, the Company elects to disclose the fair value measurement at the beginning of the reporting period during which the transfer occurred.

The Company's financial instruments consisted of cash, cash in escrow, accounts receivable, accounts payable and accrued liabilities, provision for franchisee rescissions and refunds, accrued personnel expenses, due to related party and notes payable. The estimated fair value of these financial instruments approximate the carrying amount due to the short maturity of these instruments. The recognition of the derivative values of convertible debt are based on the weighted-average Black-Scholes option pricing model.

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

Derivatives and Hedging

In April 2008, the FASB issued a pronouncement that provides guidance on determining what types of instruments or embedded features in an instrument held by a reporting entity can be considered indexed to its own stock for the purpose of evaluating the first criteria of the scope exception in the pronouncement on accounting for derivatives. This pronouncement was effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of these requirements can affect the accounting for many convertible instruments with provisions that protect holders from a decline in the stock price. Each reporting period, the Company evaluates whether convertible debt to acquire stock of the Company contains provisions that protect holders from declines in the stock price or otherwise could result in modification of the conversion price under the respective convertible debt agreements. The Company determined that the conversion feature in the convertible notes issued contained such provisions and recorded such instruments as derivative liabilities. See Note 2, Notes Payable.

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, warrants, and shares issuable upon conversion of debt excluded from earnings per share totaled 7,084,761 and 1,174,761 at March 31, 2016 and 2015, 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 March 31, 2016 of which these Financial Statements form a part.

Fresh Healthy Vending International, Inc.
Notes to Unaudited 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, 2017, 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 2019.

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 Holdings Corp, a California corporation ("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 March 31, 2016 and June 30, 2015, \$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 were set to 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, and on March 15, 2016, the Notes were further extended to September 30, 2016.

Fresh Healthy Vending International, Inc.
Notes to Unaudited 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.

At March 31, 2016, there was \$250,000 outstanding under the Financing Agreement, of which \$150,000 originally matures on September 23, 2016 and \$100,000 originally matures on December 15, 2016. There was no beneficial conversion associated with the above Financing Agreement as the stock price was lower than the conversion price.

The lender of the Financing Agreement has informed the Company that he does not intend to lend additional amounts under the Financing Agreement.

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. Mr. Yates further agreed to loan the Company up to \$550,000. Amounts borrowed under the Loan bear interest at 10% per annum and are due on December 31, 2016. The Loan also provides for conversion to common stock, at the option of the holder, at a price equal to the Company's next round of funding. In connection with the beneficial conversion option, the Company has recorded \$300,000 as a discount on the Loan and charged \$31,234 to operations during the quarter ended March 31, 2016. As of March 31, 2016 and June 30, 2015, \$545,000 and \$95,000, respectively were outstanding under the Loan.

On March 13, 2015, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with Gemini Master Fund, Ltd. (the "Purchaser"), under which the Company issued a Note (the "Note") aggregating \$375,000, for a purchase price of \$346,500. The Note bears interest at the rate of 12% per annum. The Note matured 90 days from the closing date payable in cash. Under the terms of Purchase Agreement, the Company also issued a warrant (the "Warrant") granting the Purchaser the right to purchase up to 150,000 shares of the Company's common stock at an exercise price of \$0.60 per share, subject to adjustments and anti-dilution provisions. The Warrant expires on the seventh anniversary from the issuance date.

Fresh Healthy Vending International, Inc.
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If the Company, at any time while this Warrant is outstanding, shall issue shares of Common Stock or securities or rights convertible or exchangeable into shares of common stock at a price per share less than the then current exercise price, then the Warrant exercise price shall be reduced to such lower price per share and the number of Warrant shares issuable hereunder shall be increased such that the aggregate exercise price payable hereunder, after taking into account the decrease in the exercise price, shall be equal to the aggregate exercise price prior to such adjustment.

Subject to an anti-dilution adjustment, the Company issued the Purchaser the right to purchase up to an additional 150,000 shares of the Company's common stock. Concurrent with the Purchaser's right to purchase additional shares of the Company's common stock (up to 300,000 shares), the exercise price of the Warrant was reduced to \$.30 per share.

In connection with the issuance of the Note and Warrant, the Company has recorded \$95,625 as a discount on the Note and derivative liability; additionally, \$28,500 representing the discount on the proceeds of the Note has been recorded as a discount on the Note payable. We calculated the value of the discount using the Black-Scholes option pricing model employing the following assumptions: volatility of common stock – 88%; risk-free interest rate – 0.77%; forfeiture rate – 0%; value per share of common stock - \$0.52; strike price - \$0.30; term – 7 years.

The Note was repaid on June 10, 2015. On August 19, 2015, the Purchaser converted 300,000 warrants into 101,849 share of common stock utilizing the cashless exercise feature. In connection with the warrant exercise, the Company recorded a derivative loss of \$10,808 during fiscal 2016 and charged \$106,433 to additional paid-in capital.

On June 10, 2015, the Company issued a \$600,000 convertible promissory note (the "Promissory Note") with interest payable at 10% per annum. In connection with the issuance of the Promissory Note, the Company also issued 2,000,000 common stock purchase warrants, with a term of four years, at an exercise price of \$.75 per share.

The Promissory Note matures twelve months from issuance, may be extended for an additional three months, and may be converted at any time in whole or in part, at the lesser of:

- (i) 25% discount to the next round of financing prior to conversion in excess of \$1 million; or
- (ii) \$.30 per share; or,
- (iii) Commencing six months after issuance date, at the investor's sole discretion, at a 20% discount to the lowest trading price ten business days prior to conversion.

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In connection with the issuance of the Promissory Note and warrant, the Company has recorded the fair value of the warrant of \$78,707 as additional paid-in capital. Furthermore, the Company has recorded a discount on the Promissory Note of \$480,100 and a derivative liability of \$401,393 due to the lack of explicit limit on the number of shares that may be required to be issued upon future conversion. The discount is amortized as accretion of discount on notes payable over the term of the loan using the effective interest rate method. During the three and nine months ended March 31, 2016, the Company charged \$120,025 and \$360,075, respectively to accretion of discount on notes payable relating to the discount on the Promissory Note. The derivative liability is revalued each period. During the three and nine months ended March 31, 2016, the Company has recorded a derivative gain of \$1,600 and a derivative loss of \$27,298, respectively. At March 31, 2016 the Company had a derivative liability related to the Promissory Note of \$318,705.

We calculated the value of the discount using the Black-Scholes option pricing model employing the following assumptions: volatility of common stock – 76%; risk-free interest rate – 0.28%; forfeiture rate – 0%; value per share of common stock - \$0.45; strike price - \$0.75; term – 4 years.

The Promissory Note maturity may also be extended for an additional three months. Furthermore, there will be a full ratchet, anti-dilution with respect to the shares of common stock only (no adjustments will be made to the warrants), for any equity or Convertible Debt financing completed or a definitive Term Sheet exercised within twelve months of closing or fifteen months if the Company exercises its one-time extension. The ratchet does not come into effect for any non-convertible debt offering arranged by the Company, its advisors or bankers.

The conversion terms of the Promissory Note were amended pursuant to a first amendment to Promissory Note, dated October 14, 2015. The adjustable pricing mechanism commencing 6 months after the Promissory Note issuance date at a 20% discount to the lowest trading price 10 business days prior to conversion was removed. The negative covenants set forth in the subscription agreement were also amended pursuant to a first amendment to subscription agreement, dated October 14, 2015. The modification of an embedded conversion feature is separately accounted for as a derivative before the modification, after the modification or both. Since the bifurcated conversion option is accounted for at fair value both before and after the modification, any changes in the fair value of the conversion option would be reflected in earnings.

On October 27, 2015, the Company obtained secured loans in the aggregate amount of \$500,000 from Socially Responsible Brands, Inc. The Company's Chairman, Nicholas Yates, is a 20% owner of Socially Responsible Brands, Inc.

The Company issued two Secured Promissory Notes and a related Security Agreement, each dated October 27, 2015 (the "Notes" and "Security Agreement"). Certain current lien holders of the Company also executed and delivered a Subordination Agreement in connection with the issuance of the Notes and Security Agreement (the "Subordination Agreement", and together with the Notes and Security Agreement, the "Transaction Documents").

The Notes are each in the principal amount of \$250,000, and have terms of eighteen months and one year, respectively. The first Note is secured by the Company's fifty (50) corporate-owned micro-markets and the Note principal and interest is repaid according to a schedule based on sale of such micro-markets. The second Note is secured by the Company's franchise royalties and principal and interest is repaid on a schedule based on receipt of combo machine sales, with guaranteed payments of at least \$75,000 per quarter during the term of the Note. During the nine months ended March 31, 2016, the Company paid \$92,250 and \$33,677 of principal and interest, respectively, under the Notes.

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

As of March 31, 2016 and June 30, 2015, notes payable consisted of the following:

	March 31, 2016	June 30, 2015
Secured Promissory Notes, bearing interest at 12% per annum, payable monthly. The Senior Secured Notes mature on September 30, 2016.	\$501,000	\$501,000
\$600,000 convertible promissory note, bearing interest at 10% per annum. All principal and interest is due on June 10, 2016, net of discount on note of \$93,718.	506,282	146,207
Convertible secured debt, bearing interest at 10% per annum, payable quarterly. The convertible secured debt matures two years from each funding.	250,000	250,000
Other	6,666	6,666
	1,263,948	903,873
Less current maturities	(1,013,948)	(653,873)
	\$250,000	\$250,000
Maturities of notes payable, net of discounts, are as follows:		
March 31, 2016	\$1,013,948.	\$653,873
March 31, 2017	250,000	250,000
	\$1,263,948.00	\$903,873.00

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.

4. Stock-based compensation

On August 14, 2013, our Board of Directors approved the adoption of the 2013 Equity Incentive Plan (the "2013 Plan"). The 2013 Plan was approved by a majority of our shareholders (as determined by shareholdings) on September 4, 2013. The 2013 Plan provides for granting of stock-based awards including: incentive stock options, non-statutory stock options, stock bonuses and rights to acquire restricted stock. The total number of shares of common stock that may be issued pursuant to stock awards under the 2013 Plan were initially not exceed in the aggregate 2,600,000 shares of the common stock of our Company. On July 13, 2015, the Company increased the total number of shares that may be issued under the 2013 Plan to 4,000,000. Furthermore, in April 2016, the Company further increased the total number of shares that may be issued under the Plan to 6,000,000.

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

During the nine months ended March 31, 2016, 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 three and nine months ended March 31, 2016 and 2015. During the nine months ended March 31, 2016 and 2015, options issued were valued using the Black Scholes method assuming the following:

	2016
Expected volatility	174.63 %
Dividend yield	0 %
Risk-free interest rate	1.26 %
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 \$71,709 and \$82,936 during the three months ended March 31, 2016 and 2015, respectively. During the nine months ended March 31, 2016, and 2015, we recorded stock-based compensation expense of \$226,618 and \$218,318, respectively.

The following table summarizes the stock option activity through March 31, 2016:

	Options	Weighted Average Exercise Price
Outstanding at June 30, 2014	500,000	\$ 0.165
Granted	735,000	0.508
Exercised	(55,552)	0.165
Forfeited	(45,000)	0.550
Outstanding at June 30, 2015	1,134,448	0.372
Granted	1,535,000	0.130
Exercised	-	-
Forfeited	(405,000)	0.443
Outstanding at March 31, 2016	2,264,448	\$ 0.195

Of the 1,535,000 options granted during the nine months ended March 31, 2016, 785,000 were granted to employees and consultants and 750,000 were granted to officers of the Company. Options are granted at the fair market value on the date of grant.

At March 31, 2016, the outstanding options had an average remaining expected life of 5.79 years. Furthermore, at March 31, 2016, 579,170 options were exercisable at a weighted average exercise price of \$0.27.

Fresh Healthy Vending International, Inc.
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5. Contingencies

In June 2014, we received an inquiry from the California Department of Business Oversight (“DBO” related to the sale of 15 franchises that occurred between March 2014 and May 2014. On November 7, 2014, the DBO issued a Stop Order and Citation (“Stop Order”), which prohibits us from selling franchises in the state of California until November 7, 2016. The DBO found that 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 and exposed prospective franchisees to unreasonable risk. The DBO also denied our registration application filed in California on October 3, 2013, imposed administrative penalties against us of \$37,500, required us to pay attorneys’ fees of \$18,200 and required us to again offer rescission and restitution to the 15 franchisees who purchased franchises between March 2014 and May 2014. Nine of the 15 franchisees accepted our offer of rescission and six either denied rescission or failed to respond, and therefore lost their right of rescission due to the elapsed time as stipulated by the DBO. The total rescission payments, aggregating \$934,500, were completed by July 2015. As required by the Stop Order, we developed and implemented a compliance program and engaged an independent monitor for the duration of the Stop Order to review and report to the DBO our compliance activities, including compliance with the Stop Order.

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.

On June 11, 2014, Seaga Manufacturing, the Company’s supplier of automatic merchandising equipment, filed a lawsuit in Illinois state court alleging one count of breach of contract claiming that the Company failed to make payments and to meet the yearly minimum volume of purchases. On August 14, 2014, the Company filed its answer, affirmative defenses, and counterclaims against Seaga. The counterclaims included claims for breach of contract, breach of express warranty, breach of implied warranties of merchantability and fitness for particular purpose, and indemnification. On May 1, 2015, the court granted Seaga’s motion to dismiss the Company’s implied warranty claims. On January 9, 2015, Seaga filed a third-party complaint against the manufacturer of the automatic merchandising equipment, Saeco Vending S.P.A., and on August 26, 2015, the court dismissed the third-party complaint. The Seaga matter was settled by the parties. Neither side admitted wrongdoing or liability, and neither party paid compensation to the other. The court dismissed the action with prejudice on May 5, 2016.

On May 28, 2014 a franchisee filed a complaint in San Diego Superior Court against the Company and certain current and former employees (collectively “Defendants”). The initial Complaint included employment law claims for unpaid wages, which were dismissed on demurrer. Plaintiffs’ operative First Amended Complaint alleges the following six causes of action: (1) Restitution following Rescission; (2) Fraud; (3) Breach of Contract – Franchise Agreement; (4) Breach of Contract – Franchisee Development Team Agreement; (5) Unfair Competition under California Business and Professions Code section 17200; and (6) False Advertising. Each of these causes of action are alleged against the Company. In addition, Plaintiffs named certain individual defendants in their causes of action for Fraud, Unfair Competition, and False Advertising. In November and December 2015, Defendants took the deposition of Plaintiff and responded to multiple sets of discovery requests propounded by Defendant. The Company intends to vigorously

contest Plaintiff's allegations.

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Defendants filed an Answer to Plaintiffs' First Amended Complaint in April of 2015. Written discovery has commenced and trial of the matter was scheduled to begin in January of 2016; however, the parties have submitted a joint stipulation to continue the trial until August of 2016. The Company intends to vigorously contest these allegations in Court.

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 nine months ended March 31, 2016. We recorded stock-based compensation expense totaling \$0 and \$28,125 for the three months ended March 31, 2016 and 2015, respectively related to this stock grant. During the nine months ended March 31, 2016, and 2015, we recorded stock-based compensation expense of \$21,562 and \$79,562, respectively.

On August 19, 2015, the Purchaser (Note 2) converted 300,000 warrants into 101,849 share of common stock utilizing the cashless exercise feature. In connection with the warrant exercise, the Company recorded a derivative loss of \$10,808 during the six months ended December 31, 2015 and charged \$106,433 to additional paid-in capital.

During the quarter ended March 31, 2016, two franchisees converted refunds aggregating \$193,750 into 968,750 shares of common stock at \$.20 per common share. The Company recorded a loss on the conversion of \$263,338.

7. Leases

The Company leases corporate and warehouse facilities (the "Facility Leases") in San Diego aggregating 7,083, square feet. Our corporate offices are located at 9605 Scranton Road, Suite 801, San Diego, California 92121. This Facility Lease commenced in May 2010 and ended on July 31, 2015. The current monthly rental payment, including utilities and operating expenses for the Facility Leases, is approximately \$15,922. On August 1, 2015, the Company moved its corporate and warehouse facilities to a single location aggregating 8,654 feet at 2620 Financial Court, Suite 100, San Diego California 92117. The new lease is for a term of 84 months. The current monthly rental payment, net of utilities for the facility, is \$14,625. Future minimum lease payments under the Company's Facility Lease is as follows:

2016: \$43,876; 2017: \$180,168; 2018: \$185,419; 2019: \$190,855; 2020: \$196,481; Thereafter: \$428,037 Rent expense totaled \$52,266 and \$34,469 for the three months ended March 31 2016 and 2015, respectively. During the

nine months ended March 31, 2016, and 2015, we recorded rent expense of \$147,779 and \$100,004, respectively.
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Fresh Healthy Vending International, Inc.
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8. Contracts

On February 8, 2016, and then amended on April 27, 2016, the Company signed a distribution and license agreement (the “Agreement”) with Robofusion, Inc. (“RFI”), whereby RFI granted an exclusive license to FHV to market its frozen yogurt vending kiosks/cubes in the United States and its territories (excluding Puerto Rico) and Canada.

The term of the Agreement is initially ten years with extension rights for additional five year periods at no cost. As consideration for the exclusive license, FHV has agreed to pay RFI \$370,000. Furthermore, FHV has agreed to provide an advance on machine purchases of \$500,000. The payments will be made as follows: \$125,000 upon execution of the original agreement; \$200,000 on March 11, 2016; \$125,000 upon delivery of a prototype unit; \$70,000 per month for a six month period commencing May 2016. As of March 31, 2016, \$325,000 had been paid under the Agreement (see Note 1).

The Agreement also contains provisions for minimum purchase commitments that require the Company to purchase a minimum of 25 licensed products per month based on a rolling three-month average up to an aggregate of 1,800 products.

9. Subsequent event

On May 10, 2016, Mr. Yates extended the maturity date on his Loans to December 31, 2016 (see Note 2).

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, 2015.

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"), The Fresh and Healthy Vending Corporation ("FHV Corp"), and our newly formed subsidiaries, Reis & Irvy's, Inc. ("R&I"), and 19 Degrees, Inc. 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, FHV Corp., R&I, and 19 Degrees, Inc. 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 "VEND".

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 3,000 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. During February 2016, we signed an exclusive license agreement to market and distribute frozen yogurt kiosks in the United States (excluding Puerto Rico) and its territories and Canada.

The Industry and the Overall Market

We are both a franchisor and operator of vending machine and micro market operations. 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). Upscale vending is taking over as consumers' palates become more refined and they gravitate toward a health-conscious lifestyle, according to Food Business News. Additionally the vending machine market is expected to expand 1.5 percent by 2015 according to Food Business New. The National Automated Merchandising Association ("NAMA") estimates the vending market is a \$30 billion-a-year industry. NAMA also estimates that 100 million Americans will use one of seven million vending machines each day.

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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.

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.

Micro Market Technology

We have developed a high-tech cashless self-checkout kiosk that boasts state-of-the-art point of sale technology currently utilizing an iOS operating system and iPad hardware. The software includes a convenient mobile-based loyalty application with easy to use features and robust functionality. The system also includes a wireless remote monitoring telemetry software with inventory management. The kiosk is completely cashless and 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 United States Department of Agriculture's ("USDA") 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. The Company'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, as well as frozen entrees. 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.

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 37 full-time employees as of March 31, 2016 and 3 part-time positions.

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 March 31, 2016 compared to three months ended March 31, 2015

Revenues

We had revenues of \$1,203,093 for the three months ended March 31, 2016, compared to revenues of \$1,917,111 for the three months ended March 31, 2015. This represented a decrease of \$714,018 or 37.2%. Our revenues decreased largely due to a decrease in the number of machines that were installed. Overall orders received and installations (at which point our Company recognizes revenues) of machines were 233 and 83, respectively, during the three months ended December 31, 2016, compared to 189 and 172, respectively, for the corresponding three months ended March 31, 2015. Although installations decreased by 89 units, or 51.7%, orders received during the quarter ended March 31, 2016 increased by 44 units, or 23.3%.

Cost of revenues

Cost of revenues was \$789,069 during the three months ended March 31, 2016, compared to \$895,047 during the three months ended March 31, 2015. This represents a decrease of \$105,978 or 11.8%. The decrease is primarily due to the decrease in machines installed for the quarter.

Gross margin

Gross margin for the three months ended March 31, 2016 was \$414,024 compared to \$1,022,064 for the corresponding period ending March 31, 2015, representing a decrease of \$608,040 or 59.5%. Gross margin percentage during the three months ended March 31, 2016 was 34.4% compared to 53.3% for the corresponding period ended March 31, 2015. The decrease in gross margin percentage of 18.9% is primarily a result of decreased margin associated with franchisee machines, lower margins on food sales for company-owned machines, as well as costs associated with the write-off of obsolete inventory.

Selling, general and administrative expenses

Selling, general and administrative expenses for the three months ended March 31, 2016 of \$1,517,742 represent an increase of \$242,644 from the \$1,275,098 in the three months ended March 31, 2015. The major components of selling, general and administrative expenses were as follows:

Personnel expenses of \$812,905 for the three months ended March 31, 2016 represent an increase of \$95,649 or 13.3% from the \$717,256 in the three months ended March 31, 2015. The increase was primarily attributable to an increase in management personnel expenses.

Marketing and advertising expenses increased \$40,919 to \$265,506 for the three months ended March 31, 2016 compared to \$224,587 for the three months ended March 31, 2015. The increase of \$40,919, or 18.2%, was primarily attributable to an increase in national radio advertising for the new Reis & Irvy's franchise.

Professional fees increased \$48,814 or 160% to \$79,316 during the three months ended March 31, 2016 from \$30,502 during the three months ended March 31, 2015. The increase was primarily attributable to the conversion of an employee to a consultant, as well as additional legal fees.

Insurance expense increased \$26,080, or 59% to \$70,318 during the three months ended March 31, 2016 from 44,238 during the three months ended March 31, 2015. The increase was attributable to an increase in Directors and Officers insurance, as well as an increase in health and workers compensation insurance.

Provision for legal settlements increased from \$0 in the three months ended March 31, 2015 to \$51,558 in the three months ended March 31, 2016 as a result of franchisee refunds.

Provision for income taxes

During the three months ended March 31, 2016 and 2015, 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 loss

Net loss was \$1,603,674 during the three months ended March 31, 2016 compared to a net loss of \$296,858 for the three months ended March 31, 2015. The increase in net loss resulted from a lower revenues, gross margin percentage, as well as increased selling, general and administrative expenses, interest expense, loss on conversion of franchisee refund and accretion of discount.

Basic net loss per share during the three months ended March 31, 2016 and 2015 was \$0.06 and \$0.01, respectively.

Nine months ended March 31, 2016 compared to nine months ended March 31, 2015

Revenues

We had revenues of \$4,380,197 for the nine months ended March 31, 2016, compared to revenues of \$4,940,072 for the nine months ended March 31, 2015. This represented a decrease of \$559,875 or 11.3%. Our revenues decreased largely due to a decrease in installations offset by an increase in additional corporate-owned micro markets that were operational compared to the prior year as well as additional royalties received on an increased number of machines. Overall orders received and installations (at which point our Company recognizes revenues) of machines were 447 and 377, respectively, during the nine months ended March 31, 2016, compared to 481 and 451, respectively, for the corresponding nine months ended March 31, 2015.

Cost of revenues

Cost of revenues was \$2,436,487 during the nine months ended March 31, 2016, compared to \$2,274,866 during the nine months ended March 31, 2015. This represents an increase of \$161,621 or 7.1%. The increase is primarily due

to the cost associated with an increase Company-owned machines as well as the write-off of obsolete inventory.

Gross margin

Gross margin for the nine months ended March 31, 2016 was \$1,943,710 compared to \$2,665,206 for the corresponding period ending March 31, 2015, representing a decrease of \$721,496 or 27.1%. Gross margin percentage during the nine months ended March 31, 2016 was 44.4% compared to 54.0% for the corresponding period ended March 31, 2015. The decrease in gross margin percentage of 9.6% is primarily a result of decreased margin associated with franchisee machines as well as lower margins on food sales for company-owned machines, write-off of obsolete inventory, offset in part by an increase in royalties and agency sales.

Selling, general and administrative expenses

Selling, general and administrative expenses for the nine months ended March 31, 2016 of \$4,438,318 represents an increase of \$507,906 or 12.9% from the \$3,930,412 in the nine months ended March 31, 2015. The major components of selling, general and administrative expenses were as follows:

Marketing and advertising expenses increased \$105,196 to \$715,602 or 17.2% for the nine months ended March 31, 2016 compared to \$610,406 for the nine months ended March 31, 2015. The increase was primarily attributable to an increase in national radio advertising for FHV as well as the radio advertising launch for Reis & Irvy's.

Insurance fees increased \$91,686 or 101% to \$182,182 during the nine months ended March 31, 2016 from \$90,496 during the nine months ended December 31, 2015. The increase was primarily attributable to an increase in the Company's general liability and D&O insurance, as well as health and workers compensation insurance.

Professional fees increased \$67,753 or 23% to \$362,595 during the nine months ended March 31, 2016 from \$294,842 during the nine months ended March 31, 2015. The increase was primarily attributable to the conversion of an employee to a consultant, as well as additional legal fees.

Provision for legal settlements increased to \$110,426 in the nine months ended March 31, 2016 from zero in the same period in the prior year, as a result refund settlements with franchisees.

Provision for income taxes

During the nine months ended March 31, 2016 and 2015, 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 loss

Net loss was \$3,372,868 during the nine months ended March 31, 2016 compared to a net loss of \$1,340,317 for the nine months ended March 31, 2015. The increase in net loss resulted from a lower revenues and gross margin, including both in amount and percentage, as well as increased selling, general and administrative expenses, interest expense, accretion of discount, loss on conversion of franchisee refund and derivative liability loss.

Basic net loss per share during the nine months ended March 31, 2016 and 2015 was \$0.13 and \$0.05, respectively.

Liquidity and Capital Resources

For the nine months ended March 31, 2016 we had a net loss totaling \$3,372,868 and negative cash flows from operations totaling \$772,751. Our cash balance at March 31, 2016 was \$153,995. 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, micro markets, and frozen yogurt kiosks, 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.

As of March 31, 2016, the Company had \$501,000 outstanding under the Initial Notes, \$250,000 outstanding under the Financing Agreement, \$600,000 outstanding under the Promissory Note, \$545,000 outstanding under a loan agreement with its Chairman and approximately \$412,000 under two Secured Promissory Notes.

Off Balance Sheet Arrangements

We had no material off balance sheet arrangements at March 31, 2016. However, in February 2016, the Company signed an exclusive agreement for the marketing and distribution of frozen yogurt kiosks that contain minimum purchase commitments.

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 and micro markets to the franchisees. There are no franchise fees charged beyond the initial first year franchise fees. We receive ongoing royalty fees and annual advertising fees as a percentage of either franchisees' gross revenues or gross margins on vending machine sales.

We recognize revenues and associated costs in connection with franchisees (machines and franchise fees) 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. During fiscal 2015, the Company changed the process by which franchisees order products. Currently, all franchisees order directly from our national distributor and the Company receives a commission of 5% on those purchases. We recognize the commission when earned. The Company recognizes revenue on product sales of company-owned machines when products are purchased; we receive electronic sales records on our company-owned units. We recognize royalty fees as revenue when earned. Advertising fees are recorded as a liability until marketing expenditures are incurred.

The Company records the amount of a franchise sale, machines and franchise fees, as deferred revenue until the conditions above have been met. Once the machines are installed, the Company records the corresponding machine and franchise fee as revenue, on a pro rata basis based on the number of machines installed relative to the total machines purchased.

The Company records the value of company-owned machines as inventory when purchased. Once the machines are installed, the machine value is transferred to fixed assets and depreciated over its useful life.

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 March 31, 2016 and June 30, 2015, the Company's provision for franchisee rescissions and refunds totaled \$1,538,958 and \$575,750, respectively. There are warranties extended by the machine manufacturer and its distributors, 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 or its distributor.

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 machines plus 100% of the franchise fees) is due at the time of signing, while remaining amounts outlined under the contract are generally due upon our locating 50% of the sites for the vending machines and micro markets.

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.

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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 September 30, 2015.

Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") has 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 March 31, 2016. 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 March 31, 2016, 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 March 31, 2015. 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"). The Company is in the process of integrating the updated, 2013 version of the 1992 COSO framework. 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 March 31, 2015. 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.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

In June 2014, we received an inquiry from the California Department of Business Oversight (“DBO” related to the sale of 15 franchises that occurred between March 2014 and May 2014. On November 7, 2014, the DBO issued a Stop Order and Citation (“Stop Order”), which prohibits us from selling franchises in the state of California until November 7, 2016. The DBO found that 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 and exposed prospective franchisees to unreasonable risk. The DBO also denied our registration application filed in California on October 3, 2013, imposed administrative penalties against us of \$37,500, required us to pay attorneys’ fees of \$18,200 and required us to again offer rescission and restitution to the 15 franchisees who purchased franchises between March 2014 and May 2014. Nine of the 15 franchisees accepted our offer of rescission and six either denied rescission or failed to respond, and therefore lost their right of rescission due to the elapsed time as stipulated by the DBO. The total rescission payments, aggregating \$934,500, were completed by July 2015. As required by the Stop Order, we developed and implemented a compliance program and engaged an independent monitor for the duration of the Stop Order to review and report to the DBO our compliance activities, including compliance with the Stop Order.

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.

On June 11, 2014, Seaga Manufacturing, the Company’s supplier of automatic merchandising equipment, filed a lawsuit in Illinois state court alleging one count of breach of contract claiming that the Company failed to make payments and to meet the yearly minimum volume of purchases. On August 14, 2014, the Company filed its answer, affirmative defenses, and counterclaims against Seaga. The counterclaims included claims for breach of contract, breach of express warranty, breach of implied warranties of merchantability and fitness for particular purpose, and indemnification. On May 1, 2015, the court granted Seaga’s motion to dismiss the Company’s implied warranty claims. On January 9, 2015, Seaga filed a third-party complaint against the manufacturer of the automatic merchandising equipment, Saeco Vending S.P.A., and on August 26, 2015, the court dismissed the third-party complaint. The Seaga matter was settled by the parties. Neither side admitted wrongdoing or liability, and neither party paid compensation to the other. The court dismissed the action with prejudice on May 5, 2016.

On May 28, 2014 a franchisee filed a complaint in San Diego Superior Court against the Company and certain current and former employees (collectively “Defendants”). The initial Complaint included employment law claims for unpaid wages, which were dismissed on demurrer. Plaintiffs’ operative First Amended Complaint alleges the following six causes of action: (1) Restitution following Rescission; (2) Fraud; (3) Breach of Contract – Franchise Agreement; (4) Breach of Contract – Franchisee Development Team Agreement; (5) Unfair Competition under California Business and Professions Code section 17200; and (6) False Advertising. Each of these causes of action are alleged against the Company. In addition, Plaintiffs named certain individual defendants in their causes of action for Fraud, Unfair Competition, and False Advertising. In November and December 2015, Defendants took the deposition of Plaintiff and responded to multiple sets of discovery requests propounded by Defendant. The Company intends to vigorously contest Plaintiff’s allegations.

Defendants filed an Answer to Plaintiffs' First Amended Complaint in April of 2015. Written discovery has commenced and trial of the matter was scheduled to begin in January of 2016; however, the parties have submitted a joint stipulation to continue the trial until August of 2016. The Company intends to vigorously contest these allegations in Court.

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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.

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 October 13, 2015, 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.

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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.

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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: May 23, 2016 By: /s/ Arthur S. Budman

Arthur S. Budman, Chief Executive Officer

Principal Executive Officer and Principal Financial Officer