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Where Food Comes From, Inc.  
Form 10-Q  
May 05, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly period ended March 31, 2016

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File No. 333-133624**

**WHERE FOOD COMES FROM, INC.**

(exact name of registrant as specified in its charter)

Colorado 43-1802805  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

221 Wilcox, Suite A

Castle Rock, CO 80104

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code:

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(303) 895-3002

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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, or a non-accelerated filer, or a small reporting company. See definitions of “large accelerated filer” and “accelerated filer” and “smaller reporting entity” in Rule 12b-2 of the Exchange Act.

Large accelerated filer: Accelerated filer:  
Non-accelerated filer: 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

The number of shares of the registrant’s common stock, \$0.001 par value per share, outstanding as of April 29, 2016, was 23,860,961.

**Where Food Comes From, Inc.**

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**March 31, 2016**

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**Where Food Comes From, Inc.**  
**Condensed Consolidated Balance Sheets**

	<b>March 31, 2016</b>	<b>December 31, 2015</b>
	<b>(unaudited)</b>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$4,348,464	\$3,781,397
Accounts receivable, net	1,029,610	1,110,052
Prepaid expenses and other current assets	178,129	154,912
Total current assets	5,556,203	5,046,361
Property and equipment, net	134,091	157,950
Intangible and other assets, net	1,721,432	1,760,199
Goodwill	1,279,762	1,279,762
Deferred tax assets	181,502	231,452
Total assets	\$8,872,990	\$8,475,724
<b>Liabilities and Equity</b>		
Current liabilities:		
Accounts payable	\$359,038	\$417,836
Accrued expenses and other current liabilities	178,745	92,574
Customer deposits	112,208	77,784
Deferred revenue	609,650	194,087
Short-term debt and current portion of notes payable	7,955	7,846
Current portion of capital lease obligations	4,695	4,634
Total current liabilities	1,272,291	794,761
Capital lease obligations, net of current portion	579	1,776
Notes payable and other long-term debt, net of current portion	6,326	8,365
Total liabilities	1,279,196	804,902
Commitments and contingencies		
Contingently redeemable non-controlling interest	—	936,370
Equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; none issued or outstanding	—	—
Common stock, \$0.001 par value; 95,000,000 shares authorized; 23,934,769 (2016) and 23,822,295 (2015) shares issued, and 23,841,961(2016) and 23,736,487 (2015) shares outstanding	23,935	23,822
Additional paid-in-capital	8,232,313	7,446,634
Treasury stock of 92,808 (2016) and 85,808 (2015) shares	(191,611 )	(177,916 )
Accumulated deficit	(470,843 )	(558,088 )
Total equity	7,593,794	6,734,452
Total liabilities and stockholders' equity	\$8,872,990	\$8,475,724

The accompanying notes are an integral part of these financial statements.

**Where Food Comes From, Inc.**  
**Condensed Consolidated Statements of Income**  
**(Unaudited)**

	Quarter ended	
	March 31, 2016	March 31, 2015
Revenues:		
Service revenues	\$2,147,402	\$1,774,152
Product sales	271,075	279,804
Other revenue	27,275	27,345
Total revenues	2,445,752	2,081,301
Costs of revenues:		
Labor and other costs of services	1,109,138	956,039
Costs of products	129,499	161,979
Total costs of revenues	1,238,637	1,118,018
Gross profit	1,207,115	963,283
Selling, general and administrative expenses	1,103,162	950,999
Income from operations	103,953	12,284
Other expense (income):		
Interest expense	295	456
Other income, net	(1,932 )	3,004
Income before income taxes	105,590	8,824
Income tax expense	49,950	35,150
Net income (loss)	55,640	(26,326 )
Net loss attributable to non-controlling interests	31,605	81,173
Net income attributable to Where Food Comes From, Inc.	\$87,245	\$54,847
Net income per share:		
Basic	\$*	\$*
Diluted	\$*	\$*
Weighted average number of common shares outstanding:		
Basic	23,753,000	23,755,990
Diluted	23,904,880	23,966,436

\* less than \$0.01 per share

The accompanying notes are an integral part of these financial statements.

**Where Food Comes From, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

	Three months ended	
	March 31,	
	2016	2015
Net cash provided by operating activities	\$734,413	\$398,593
Investing activities:		
Acquisition of Validus Verification Services, 40% remaining equity interest	(162,707 )	—
Purchases of property and equipment	(1,999 )	(4,016 )
Net cash used in investing activities	(164,706 )	(4,016 )
Financing activities:		
Repayments of notes payable	(1,931 )	(1,826 )
Repayments of capital lease obligations	(1,136 )	(1,078 )
Stock repurchase under Buyback Program	(13,695 )	—
Proceeds from stock option exercise	14,122	35,958
Net cash (used in) provided by financing activities	(2,640 )	33,054
Net change in cash and cash equivalents	567,067	427,631
Cash and cash equivalents at beginning of period	3,781,397	2,583,058
Cash and cash equivalents at end of period	\$4,348,464	\$3,010,689

The accompanying notes are an integral part of these financial statements.

**Where Food Comes From, Inc.**  
**Condensed Consolidated Statement of Equity**  
**Three Months ended March 31, 2016**

(Unaudited)

	Common Stock		Additional Paid-in Capital	Treasury Stock	Accumulated Deficit	Total
	Shares	Amount				
Balance at December 31, 2015	23,822,295	\$23,822	\$7,446,634	\$(177,916)	\$(558,088 )	\$6,734,452
Stock-based compensation expense	—	—	29,612	—	—	29,612
Issuance of common shares upon exercise of options	19,417	20	14,102	—	—	14,122
Repurchase of common stock under Buyback program	—	—	—	(13,695 )	—	(13,695 )
Issuance of common shares for remaining interest in Validus	93,057	93	199,979	—	—	200,072
Acquisition of noncontrolling interest in Validus	—	—	541,986	—	—	541,986
Net income	—	—	—	—	87,245	87,245
Balance at March 31, 2016	23,934,769	\$23,935	\$8,232,313	\$(191,611)	\$(470,843 )	\$7,593,794

The accompanying notes are an integral part of these financial statements.



**Where Food Comes From, Inc.**  
**Notes to the Condensed Consolidated Financial Statements**

**Note 1 - The Company and Basis of Presentation**

**Business Overview**

Where Food Comes From, Inc. is a Colorado corporation based in Castle Rock, Colorado (the “Company,” “WFCF,” “our,” “we,” or “us”). We provide verification and certification solutions for the agriculture, livestock and food industry. Most of our customers are located throughout the United States.

On September 16, 2013, we acquired a 60% interest in Validus Verification Services LLC (“Validus”) which consisted of the auditing business of Praedium Ventures, LLC (“Praedium”), previously known as Validus Ventures, LLC (“Validus”). This acquisition was accounted for using the acquisition method of accounting and, accordingly, its results are included in the Company’s consolidated financial statements from the date of acquisition. On February 29, 2016, the Company exercised its call option to acquire the remaining 40% (Note 2).

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the results of operations, financial position and cash flows of Where Food Comes From, Inc. and its wholly-owned subsidiaries, International Certification Services, Inc. (“ICS”), Validus and Sterling Solutions, LLC (“Sterling”) (collectively referred to as “we,” “us,” and “our” throughout this Form 10-Q). All intercompany balances have been eliminated in consolidation.

The condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and should be read in conjunction with our audited financial statements and footnotes thereto for the year ended December 31, 2015, included in our Form 10-K filed on February 16, 2016. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. However, we believe that the disclosures are adequate to make the information presented not misleading. The financial statements reflect all adjustments (consisting primarily of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of our financial position and results of operations. The consolidated operating results for the period ended March 31, 2016 are not necessarily indicative of the results to be expected for any other interim period of any future year.

**Seasonality**

Our business is subject to seasonal fluctuations. Significant portions of our revenues are typically realized during the second and third quarters of the fiscal year when the calf marketings and the growing seasons are at their peak. Because of the seasonality of the business and our industry, results for any quarter are not necessarily indicative of the results that may be achieved for any other quarter or for the full fiscal year.

**Where Food Comes From, Inc.**  
**Notes to the Condensed Consolidated Financial Statements**

**Note 2 – Business Acquisition**

Validus Acquisition

On September 16, 2013, we entered into an Asset Purchase and Contribution Agreement (the “Purchase Agreement”), by and among the Company, Validus, and Praedium (the “Seller”). In connection with this transaction, the Seller was issued a 40% interest in Validus, with the Company holding a 60% interest. The Company had the first right of refusal on the remaining 40% of the outstanding stock and a call option to acquire the remaining 40% interest.

Effective February 29, 2016, the Company exercised its call option to purchase the remaining 40% interest of Validus in exchange for cash consideration of approximately \$162,700, and 93,057 shares of common stock valued at approximately \$200,100, pursuant to the Purchase Agreement, dated September 16, 2013. The carrying amount of the contingently redeemable non-controlling interest was adjusted to \$0 to reflect the change in the Company’s ownership interest up to 100%. The difference between the fair value of the consideration paid and the carrying value of the non-controlling interest on the date of the transaction, which totaled approximately \$542,000, was adjusted to equity.

**Note 3 - Basic and Diluted Net Income per Share**

Basic net income per share was computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

The following schedule is a reconciliation of the share data used in the basic and diluted net income per share computations:

Three months ended

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	March 31, 2016	March 31, 2015
Basic:		
Weighted average shares outstanding	23,753,000	23,755,990
Diluted:		
Weighted average shares outstanding	23,753,000	23,755,990
Weighted average effects of dilutive securities	151,880	210,446
Total	23,904,880	23,966,436
Antidilutive securities:	98,751	—

The effect of the inclusion of the antidilutive shares would have resulted in an increase in earnings per share. Accordingly, the weighted average shares outstanding have not been adjusted for antidilutive shares.

**Where Food Comes From, Inc.**  
**Notes to the Condensed Consolidated Financial Statements**

**Note 4 – Intangible Assets and Other Assets**

The following table summarizes our intangible and other assets:

	<b>March 31, 2016 (unaudited)</b>	<b>December 31, 2015 (unaudited)</b>	<b>Estimated useful life</b>
Intangible assets subject to amortization:			
Tradenames/ Trademarks	\$64,307	\$64,307	2.5 - 8.0 years
Accreditations	88,663	88,663	5.0 years
Customer Relationships	1,401,330	1,401,330	8.0 - 15.0 years
Beneficial Lease Arrangement	120,200	120,200	11.0 years
	1,674,500	1,674,500	
Less accumulated amortization	431,613	392,846	
	1,242,887	1,281,654	
Tradenames/ trademarks (not subject to amortization)	465,000	465,000	indefinite
	1,707,887	1,746,654	
Deposits	13,545	13,545	
Intangible and other assets, net	\$1,721,432	\$1,760,199	

**Note 5 - Stock-Based Compensation**

Our stock-based award plans (collectively referred to as the “Plan”) provide for the issuance of stock-based awards to employees, officers, directors and consultants. The Plans permit the granting of stock awards and stock options. The vesting of stock-based awards is generally subject to meeting certain performance-based objectives, the passage of time or a combination of both, and continued employment through the vesting period.

The fair value of stock options is estimated using the Black-Scholes option-pricing model, which incorporates ranges of assumptions for inputs. Our assumptions are as follows:

Dividend yield is based on our historical and anticipated policy of not paying cash dividends.  
 Expected volatility assumptions were derived from our actual volatilities.

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The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the date of grant with maturity dates approximately equal to the expected term at the grant date.

The expected term of options represents the period of time that options granted are expected to be outstanding giving consideration to vesting schedules, based on historical exercise patterns, which we believe are representative of future behavior.

There were 4,500 shares of restricted stock granted for the three months ended March 31, 2016. These shares of restricted stock had a weighted average grant date fair value of \$2.10 and vest in March 2017. For the three months ended March 31, 2015, 9,000 shares of restricted stock were granted. Total stock-based compensation expense for the three months ended March 31, 2016 and 2015 was approximately \$29,600 and \$22,000, respectively.

**Where Food Comes From, Inc.**  
**Notes to the Condensed Consolidated Financial Statements**

**Note 6 – Equity Incentive Plan**

Stock option activity under our Equity Incentive Plan is summarized as follows:

	Number of Options/Warrants	Weighted Avg. Exercise Price per Share	Weighted Avg. Fair Value per Share	Weighted Avg. Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding, December 31, 2015	266,003	\$ 0.84	\$ 0.85	6.43	\$416,278
Granted	—	\$ —	\$ —	—	
Exercised	(19,417 )	\$ 0.73	\$ 1.38	5.12	
Canceled	—	\$ —	\$ —	—	
Outstanding, March 31, 2016	246,586	\$ 0.84	\$ 0.86	5.45	\$334,481
Exercisable, March 31, 2016	239,331	\$ 0.81	\$ 0.83	5.40	\$331,942

The aggregate intrinsic value represents the total pre-tax intrinsic value (the aggregate difference between the closing price of our common stock on March 31, 2016 and the exercise price for the in-the-money options) that would have been received by the option holders if all the in-the-money options had been exercised on March 31, 2016.

	Number of Options	Weighted Avg Grant Date Fair Value
Non-vested options, December 31, 2015	44,173	\$ 1.44
Granted	—	\$ —
Vested	(36,918)	\$ 1.32
Forfeited	—	\$ —
Non-vested options, March 31, 2016	7,255	\$ 0.83

Unrecognized compensation expense at March 31, 2016, was approximately \$17,900.

Restricted stock activity under our Equity Incentive Plan is summarized as follows:

	Restricted Shares	Weighted Avg. Exercise Price per Share
Outstanding, December 31, 2015	74,000	\$ 2.63
Granted	4,500	\$ 2.10
Vested	—	\$ —
Canceled	—	\$ —
Outstanding, March 31, 2016	78,500	\$ 2.60

Unrecognized compensation expense at March 31, 2016, was approximately \$164,600. These costs are expected to be recognized over a weighted average period of 1.62 years.



**Where Food Comes From, Inc.**  
**Notes to the Condensed Consolidated Financial Statements**

**Note 7 – Income Taxes**

Deferred tax assets and liabilities have been determined based upon the differences between the financial statement amounts and the tax bases of assets and liabilities as measured by enacted tax rates expected to be in effect when these differences are expected to reverse. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Our net operating loss (“NOL”) carry forwards are the most significant component of our deferred tax assets; however, the ultimate realization of our deferred tax assets is dependent upon generation of future taxable income. We consider past history, the scheduled reversal of taxable temporary differences, projected future taxable income, and tax planning strategies in making this assessment. Utilization of our NOL carry forwards reduces our federal and state income tax liability incurred.

The Company’s subsidiary, Validus, is a Colorado limited liability company (LLC). As an LLC, management believes Validus is not subject to income taxes, and such taxes are the responsibility of the respective members.

The provision (benefit) for income taxes is recorded at the end of each interim period based on the Company’s best estimate of its effective income tax rate expected to be applicable for the full fiscal year. For the three months ended March 31, 2016 and 2015, we recorded income tax expense of \$49,950 and \$35,150, respectively. The difference between the expected tax expense and the effective tax expense is due to the tax effects of the non-controlling interest.

**Note 8 - Notes Payable**

**Equipment Note Payable**

In December 2012, we entered into a note payable of \$37,407 for the purchase of a vehicle. Interest and principal payments are due in equal monthly installments of \$715 over five years beginning January 2013. This note bears an interest rate of 5.5% per annum and is collateralized by the vehicle.

The current and non-current portion of the equipment note payable is as follows:

	March 31, 2016	December 31, 2015
Equipment note payable	\$14,281	\$16,211
Less current portion of note payable	7,955	7,846
Note payable	\$6,326	\$8,365

### ICS Revolving Line of Credit

ICS has a revolving line of credit (LOC) agreement which matures April 1, 2017. The LOC provides for \$70,050 in working capital. The interest rate is at the New York prime rate plus 2.250% and is adjusted daily. Principal and interest are payable upon demand, but if demand is not made, then annual payments of accrued interest only are due, with the principal balance due on maturity. As of March 31, 2016, the effective interest rate was 5.75%. The LOC is collateralized by all the business assets of ICS. As of March 31, 2016, ICS had no amounts outstanding under this LOC.

**Where Food Comes From, Inc.**  
**Notes to the Condensed Consolidated Financial Statements**

**Note 9 - Commitments and Contingencies**

**Operating Leases**

The Company leases a building for its headquarters in Castle Rock, Colorado. This lease is for a period of three years and expired on June 15, 2015. The lease was renewed effective June 15, 2015 for a nine month term and again in February 2016 for an additional five months. In addition to the monthly rent of approximately \$4,400, the lease requires additional payments for operating costs and other common area maintenance costs. We intend to relocate our headquarters within Castle Rock at the end of the lease term; however, no agreement is in place at this time.

In September 2013, the Company entered into a lease agreement with a related party for its Urbandale, Iowa office space. The lease is for a period of three years, expiring October 31, 2016, and requires rental payments of approximately \$2,600 per month. There is no renewal feature. In addition to primary rent, the lease requires additional payments for operating costs and other common area maintenance costs. Management is currently evaluating its options for this location at this time.

The Company also owns approximately  $\frac{3}{4}$  acre on which a 2,300 square foot building is located in Medina, North Dakota. The Company leases space in this building under a five-year lease with an expiration date of March 1, 2018. One additional option to renew for a five-year term exists and is deemed to automatically renew unless written notice is provided 60 days before the end of the term. The Company is charged a monthly rental rate of approximately \$150 plus all utilities, taxes and other expenses based on actual expenses to maintain the building.

As of March 31, 2016, future minimum lease payments are as follows:

Years ended	Amount
December 31, 2016	
(remaining nine months)	\$51,020

2017	1,818
2018	303
Total	
lease	\$53,141
commitments	

### **Legal proceedings**

From time to time, we may become involved in various legal actions, administrative proceedings and claims in the ordinary course of business. We generally record losses for claims in excess of the limits of purchased insurance in earnings at the time and to the extent they are probable and estimable. We are not aware of any legal actions currently pending against us.

**Where Food Comes From, Inc.**  
**Notes to the Condensed Consolidated Financial Statements**

**Note 10 – Contingently Redeemable Non-controlling Interest**

Contingently redeemable non-controlling interest on our condensed consolidated balance sheet represents the non-controlling interest related to the Validus acquisition, in which the non-controlling interest holder, at its election, can require the Company to purchase its 40% investment in Validus. Below is a table reflecting the activity of the contingently redeemable non-controlling interest at March 31, 2016. As discussed in Note 2, the Company exercised its call option to acquire the remaining non-controlling interest effective February 29, 2016.

Balance, December 31, 2015	\$936,370
Loss for year to date period ended February 29, 2016	(31,605 )
Acquisition of non-controlling interest, March 1, 2016	
Cash paid	(162,707)
Fair market value of stock	(200,072)
Adjusted to APIC	(541,986)
Balance, March 31, 2016	\$—

The contingently redeemable non-controlling interest was adjusted to the greater of the carrying value or redemption value as of each period end.

**Note 11 – Supplemental Cash Flow Information**

	<b>Three months ended March 31, 2016 2015</b>	
Cash paid during the year:		
Interest	\$295	\$456

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

### **General**

This information should be read in conjunction with the condensed consolidated financial statements and the notes included in Item 1 of Part I of this Quarterly Report and the audited consolidated financial statements and notes, and Management’s Discussion and Analysis of Financial Condition and Results of Operations, contained in the Form 10-K for the fiscal year ended December 31, 2015. The following discussion and analysis includes historical and certain forward-looking information that should be read together with the accompanying condensed consolidated financial statements, related footnotes and the discussion below of certain risks and uncertainties that could cause future operating results to differ materially from historical results or from the expected results indicated by forward-looking statements.

### **Business Overview**

Where Food Comes From, Inc. and its subsidiaries (“WFCF”, “the Company”, “our”, “we”, or “us”) is a leading North American trusted resource for third-party verification of food production practices. The Company supports more than 10,000 farmers, ranchers, processors, retailers, distributors, and restaurants with a wide variety of value-added services provided through its family of verifiers, including IMI Global, International Certification Services, Validus Verification Services, and Sterling Solutions. In order to have credibility, product claims such as gluten free, non-GMO, non-hormone treated, humane handling, and others require verification by an independent third-party such as Where Food Comes From. The Company’s principal business is conducting both on-site and desk audits to verify that claims being made about livestock, crops and other food products are accurate. In addition, the Company’s Where Food Comes From® retail and restaurant labeling program connects consumers directly to the source of the food they purchase by requiring all product carrying the label to be sourced from third-party verified suppliers. With the use of Quick Response Code (“QR”) technology, consumers can instantly access information about the producers behind their food.

WFCF was founded in 1996 and incorporated in the state of Colorado as a subchapter C corporation on January 1, 2005. The Company’s shares of common stock trade on the OTCQB marketplace under the stock ticker symbol, “WFCF”.

The Company’s original name – Integrated Management Information, Inc. (d.b.a. IMI Global, Inc.) – was changed to Where Food Comes From, Inc. in 2012 to better reflect the Company’s mission. Early growth was attributable to source and age verification services for beef producers who wanted access to markets overseas following the

discovery of “mad cow” disease in the U.S. Over the years, Where Food Comes From has expanded its portfolio to include verification services for most food groups and more than 30 standards. This growth has been achieved both organically and through the acquisition of other companies.

### **Current Marketplace Opportunities**

Because of growing demand for increased transparency into food production practices, we believe there are three main market drivers to promote forward momentum for our business:

#### 1) Consumer awareness and expectations

A recent survey conducted by Acosta, a leading full-service sales and marketing agency in the consumer packaged goods industry, which was released in 2015, indicates consumers are actually changing their shopping habits in the grocery store. Increasingly more Americans are shopping the perimeter of the grocery store rather than stocking their pantries, and choosing to cook healthy meals at home, even if it comes at a higher cost.

According to the US Grocery Shopper Trends 2014 Report, more than 25% of consumers surveyed are seeking products that are minimally processed, locally grown or produced, with recognizable and a short list of ingredients. Jenny Zegler, Global Food and Drink Analyst at Mintel, said “these trends explore how consumers’ evolving priorities, opportunities from advancements in functional formulation and the almost inescapable reach of technology will affect food and drink in the coming year. Consumers are not only the influencers, as shifting economics, natural phenomena and social media are shaping what, how, where and with whom consumers are choosing to eat and drink...”

Based on a survey in the March 13, 2014 Cone Communication Food Issues Trend Tracker, food safety and nutritional value rose to the top as the most important factors when hitting the grocery aisles. Additionally, at least two-thirds of Americans prioritized the following as other significant factors when deciding what makes it into the shopping cart: locally produced, sustainable packaging, animal welfare, non-GMO, protection and renewal of natural resources.

Three in five Americans are on the lookout for non GMO-labeled foods when shopping. Per the March 13, 2014 Cone Communication Food Issues Trend Tracker, 39% believe that non-GMO foods are healthier, 32% are concerned about the effects on the environment, and 24% question the ethics behind the use of GMO's.

According to the USDA website, the U.S. market for certified organic products was estimated at more than \$39 billion as of October 2015 while USDA-approved organic operations have grown more than 250% since 2002. Increasing consumer demand for healthy, better-for-you products produced with sustainable agricultural practices is driving growth in the organic market.

## 2) Global competitiveness among retailers

Restaurant chains and retailers with dominant market shares and large buying power, like McDonald's and Wal-Mart, are leading the way in prioritizing sustainable food supply initiatives in answer to consumer demands. With information literally at our fingertips, Google searches and smart phone apps are making it easier to expose where sustainable food supply chains are, and where they are not.

Producers, packers, distributors and retailers understand that verification, identification and traceability are key competitive differentiators, and many times is necessary for export into international markets, including Korea, Russia and the European Union.

## 3) Government regulation

In January 2013, the Food Safety Modernization Act (FSMA) issued two major proposed rules regarding preventive controls in human food and produce safety. Compliance dates for some businesses will begin September 2016. We have begun to see significant movement in companies requesting our consulting expertise to developing programs designed to assist them in maintaining compliance with the new rules.

The Animal Disease Traceability Rule primarily covers beef cattle 18 months of age or older. Under the final rule, unless specifically exempted, livestock moved interstate must be officially identified and accompanied by an interstate certificate of veterinary inspection or other documentation, such as owner-shipper statements or brand certificates.

In July 2013, the U.S. Food and Drug Administration ("FDA") issued rules on importer foreign supplier verification and accreditation of third-party auditors. The accredited third parties will verify the safety of imports with FDA oversight. These rules help to ensure that imported foods meet the same safety standards that domestic foods do.

In October 2013, the FDA released its proposed rules for preventative controls for animal food. Compliance dates for some businesses will begin September 2016. The rules for animal food controls call on the industry to enact many of the practices that are required of producers and processors of human food. Most notably is the requirement for conducting a Hazard Analysis, establishing controls for identified hazards and enacting monitoring, verification and record-keeping protocols.





### ***Current Concerns in Our Industry***

U.S. beef exports to the European Union (EU) must be third-party verified as High Quality Beef (a USDA feeding claim) and non-hormone treated cattle (NHTC). With duty-free access to the EU lowering the cost of doing business in Europe, we believe that it offers significantly more potential for third-party NHTC verification services and High Quality Beef verification services. However, due to the current strength of the US dollar, we are seeing downward pressure on NHTC cattle prices causing the momentum of these programs to slow.

In early 2014, Porcine Epidemic Diarrhea Virus (PEDv) negatively impacted the pork/sow industry. The total number of known positive PEDv laboratory swine accessions grew rapidly each week with no vaccines against the virus. In February 2014, in order to prevent the spread of PEDv, the USDA published a request that pig farmers submit accurate on-farm inventory, birth, and death rates in an effort to minimize persons sent to farms to collect data. While the impact of this news significantly delayed the number of onsite pork verifications scheduled in 2014, we believe that we have diversified our product offerings such that the impact was not catastrophic to our 2014 or 2015 annual consolidated results. Management continues to monitor the situation but does not believe it will have a material impact on 2016 operations.

Highly Pathogenic Avian Influenza, more commonly known as Bird Flu, refers to strains of influenza that primarily affect several types of birds, including farmed poultry, i.e. chickens, geese, turkeys and ducks. The virus spreads through infected birds, via their saliva, nasal secretions, feces, and feed. According to ThePoultrySite.com, on April 29, 2015, poultry movements in North Dakota were limited to control the spread of avian influenza in the state following two recent outbreaks in commercial poultry. More recently several other state poultry associations in the South are bracing for potential outbreaks and on January 17, 2016, the USDA announced detection of a new strain of the virus in a turkey flock located in Indiana. Autumn and winter months bring the possibility that migrating wild birds will carry the virus to the lower half of the United States. We believe we have diversified our product offerings such that the impact was not material to our 2015 consolidated results. However, at this time we have no way to reasonably estimate the future impact it could have on our business.

We believe that our experience in bio-security considerations and the core competency needed to deal with verification system design gives us a competitive advantage creating a barrier to entry for less sophisticated third-party verification companies.

### **Seasonality**

Our business is subject to seasonal fluctuations. Significant portions of our revenues are typically realized during the second and third quarters of the fiscal year when the calf marketings and the growing seasons are at their peak.

Because of the seasonality of the business and our industry, results for any quarter are not necessarily indicative of the results that may be achieved for any other quarter or for the full fiscal year.

## Liquidity and Capital Resources

At March 31, 2016, we had cash and cash equivalents of \$4,348,464 compared to \$3,781,397 of cash and cash equivalents at December 31, 2015. Our working capital at March 31, 2016 was \$4,283,912 compared to \$4,251,600 at December 31, 2015.

Net cash provided by operating activities for the three months ended March 31, 2016 was approximately \$734,400 compared to net cash provided of approximately \$398,600 during the same period in 2015. Net cash provided by operating activities is driven by our net income (loss) and adjusted by non-cash items. Non-cash adjustments primarily include depreciation, amortization of intangible assets, stock based compensation expense, and deferred taxes. In addition, deferred revenue, which due to the changes in timing of our annual billings during the quarter, increased by approximately \$415,600.

Net cash used in investing activities for the three month period ended March 31, 2016, was approximately \$164,700 compared to approximately \$4,000 used in the 2015 period. Net cash used in the three month period ended March 31, 2016 period was primarily attributable to the acquisition of the non-controlling interest of Validus, as well as nominal purchases of property and equipment of approximately \$2,000. Net cash used in the 2015 period was attributable to the purchase of property and equipment of approximately \$4,000.

Net cash used in financing activities for the three month period ended March 31, 2016, was approximately \$2,600 compared to cash provided of \$33,100 in the 2015 period. Net cash used in the three month period ended March 31, 2016, was due to repayments of debt and lease obligations of approximately \$3,100 and repurchase of common shares under the Buyback Program of approximately \$13,700 offset by proceeds from stock option exercises of approximately \$14,100. Net cash provided in the first quarter ended March 31, 2015 was due to stock option exercises of approximately \$36,000 offset by repayments of debt and lease obligations of approximately \$2,900.

Historically, our growth has been funded through a combination of convertible debt from private investors and private placement offerings. We continually evaluate all funding options including additional offerings of our securities to private, public and institutional investors and other credit facilities as they become available.

The primary driver of our operating cash flow is our third-party verification solutions, specifically the gross margin generated from services provided. Therefore we focus on the elements of those operations including revenue growth and long term projects that ensure a steady stream of operating profits to enable us to meet our cash obligations. On a weekly basis we review the performance of each of our revenue streams focusing on third party verification solutions compared with prior periods and our operating plan. We believe that our various sources of capital, including cash flow from operating activities, overall improvement in our performance, and our ability to obtain additional financing

are adequate to finance current operations as well as the repayment of current debt obligations. We are not aware of any other event or trend that would negatively affect our liquidity. In the event such a trend develops, we believe that there are sufficient financing avenues available to us and from our internal cash generating capabilities to adequately manage our ongoing business.

The culmination of all our efforts toward net income has brought opportunities to us including: increased investor confidence and renewed interest in our company, third-party interest in our expertise, as well as the potential to develop business relationships with long term strategic partners. In keeping with our core business, we will continue to review our business model with a focus on profitability, long term capital solutions and the potential impact of acquisitions or divestitures, if such an opportunity arises.

Our plan for continued growth is primarily based upon acquisitions as well as intensifying our focus on international markets. We believe that there are significant growth opportunities available to us because often the only means to entry as imposed on international market imports/exports is via a quality verification program.

## **Debt Facility**

ICS has a revolving line of credit (LOC) agreement which was renewed on April 1, 2014 and matures April 1, 2017. The LOC provides for \$70,050 in working capital. The interest rate is at the New York prime rate plus 2.250% and is adjusted daily. Principal and interest are payable upon demand, but if demand is not made, then annual payments of accrued interest only are due, with the principal balance due on maturity. The LOC is collateralized by all the business assets of ICS.

## **Off-Balance Sheet Arrangements**

As of March 31, 2016, we had no off-balance sheet arrangements of any type.

## **RESULTS OF OPERATIONS**

### **First quarter Period Ended March 31, 2016 Compared to the Same Period in Fiscal Year 2015**

#### **Revenues**

Total revenues for the first quarter ended March 31, 2016, increased 17.5% compared to the same period in 2015.

Service revenues include sales of our US Verified solutions and related consulting, program development and web-based development services. Service revenues for the quarter ended March 31, 2016, of approximately \$2,147,000 increased approximately \$373,300 or 21.0% compared to the same period in 2015. Overall, the increase is due to both an increase in new verification customers, as well as an increase in product offerings.

Product sales represent sales of cattle identification ear tags. Product sales of approximately \$271,100 for the first quarter ended March 31, 2016 decreased approximately \$8,700 or 3.1% compared to the same period in 2015.

Other revenue primarily represents the fees earned from our WFCF labeling program. Other revenue of approximately \$27,300 for the first quarter ended March 31, 2016 decreased approximately \$100 or less than 1% compared to the same period in 2015.

### **Cost of Revenues and Gross Margin**

Cost of revenues for the first quarter ended March 31, 2016 was approximately \$1,239,000 compared to approximately \$1,118,000 during the same period in 2015. Gross margin for the first quarter ended 2016 improved to 49.4% of revenues compared to 46.3% of revenues for the first quarter ended 2015. Overall the improvement is due to absorption of costs over a higher sales base, as well as a slight change in product mix coupled with bundling opportunities where we can provide multiple verifications and/or certifications with one site visit.

Our margins are impacted by various costs such as cost of products, salaries and benefits, insurance, and taxes. Because certain elements of our cost of revenues are fixed in nature, incremental sales positively impact our margins.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses for the first quarter 2016 were approximately \$1,103,200, an increase of approximately \$152,200, or 16.0% over the first quarter ended 2015. However, selling, general and administrative costs have held relatively stable as a percentage of total revenue at 45%. Overall, the increase in our selling, general and administrative expenses is due in part to higher head count, increased sales and marketing costs, and higher costs related to being a publicly held company. In addition, the Company is making significant investments in IT process redesigns related to the integration and standardization of differing field audit and accounting systems used by IMI Global, ICS and Validus. Historically, our first quarter costs are always higher with a smaller revenue base to spread them over.

### **Income Tax Expense**

The provision (benefit) for income taxes is recorded at the end of each interim period based on the Company's best estimate of its effective income tax rate expected to be applicable for the full fiscal year. For the first quarters ended March 31, 2016 and 2015, we recorded income tax expense of approximately \$50,000 and \$35,200, respectively. The difference between the expected tax expense and the effective tax expense is due to the tax effects of the non-controlling interest.

### **Net Income and Per Share Information**

As a result of the foregoing, net income attributable to WFCF shareholders for the first quarter ended March 31, 2016 was approximately \$87,200, or less than \$0.01 per basic and diluted common share, compared to approximately \$54,800, or less than \$0.01 per basic and diluted common share for the first quarter ended March 31, 2015.



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

### **Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 (Exchange Act) Rule 13a-15(e) as of the end of the period covered by this report, have concluded that our disclosure controls and procedures are effective based on our evaluation of these controls and procedures as required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

### **Internal Control Over Financial Reporting**

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

From time to time, we may become involved in various legal actions, administrative proceedings and claims in the ordinary course of business. We generally record losses for claims in excess of the limits of purchased insurance in earnings at the time and to the extent they are probable and estimable.

### **ITEM 1A. RISK FACTORS**

Our business is subject to a number of risks, including those identified in Item 1A. — "Risk Factors" of our 2015 Annual Report on Form 10-K, that could have a material effect on our business, results of operations, financial condition and/or liquidity and that could cause our operating results to vary significantly from period to period. As of March 31, 2016, there have been no material changes to the risks disclosed in our most recent Annual Report on Form 10-K. We

may also disclose changes to such factors or disclose additional factors from time to time in our future filings with the SEC.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In connection with the acquisition of the remaining non-controlling interest of Validus (see Note 2 to the accompanying condensed consolidated financial statements), we issued 93,057 shares of common stock of Where Food Comes From, Inc. valued at approximately \$200,100 pursuant to the terms of the Purchase Agreement dated September 16, 2013.

## ITEM 6. EXHIBITS

### (a) Exhibits

Number	Description
31.1	<u>Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of CEO pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certification of CFO pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002</u>

**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.

Date: May 5, 2016      Where Food Comes  
From, Inc.

By:     /s/ John K.  
Saunders  
Chief Executive  
Officer

By: /s/ Dannette Henning  
Chief Financial Officer