Where Food Comes From, Inc.
Form 10-Q
November 13, 2018

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 September 30, 2018

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 incorporation or organization)	(I.R.S. Employer Identification No.)

202 6th Street, Suite 400

Castle Rock, CO 80104

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code:

(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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer:	Accelerated filer:
Non-accelerated filer:	Smaller reporting company:
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The number of shares of the registrant's common stock, $0.001 par value per share, outstanding as of November 7, 2018, was [25,087,946].

Where Food Comes From, Inc.

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September 30, 2018

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

Where Food Comes From, Inc.

Consolidated Balance Sheets

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$2,243,782	$2,705,778
Accounts receivable, net of allowance	2,563,148	1,898,749
Short-term investments	496,402	743,206
Prepaid expenses and other current assets	307,476	245,073
Total current assets	5,610,808	5,592,806
Property and equipment, net	1,789,384	1,068,087
Intangible and other assets, net	4,867,464	3,948,530
Goodwill	3,213,444	2,652,250
Deferred tax assets, net	22,246	79,622
Total assets	$15,503,346	$13,341,295
Liabilities and Equity		
Current liabilities:		
Accounts payable	$735,732	$457,307
Accrued expenses and other current liabilities	1,045,742	555,129
Customer deposits and deferred revenue	976,876	851,185
Current portion of notes payable	9,986	9,446
Current portion of capital lease obligations	11,234	7,527
Total current liabilities	2,779,570	1,880,594
Notes payable, net of current portion	34,850	42,452
Capital lease obligations, net of current portion	35,603	25,419
Lease incentive obligation	369,282	147,189
Total liabilities	3,219,305	2,095,654
Commitments and contingencies (Note 9)		
Contingently redeemable non-controlling interest	1,521,504	1,574,765
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; 25,473,115 (2018) and 24,972,684 (2017) shares issued, and 25,087,946 (2018) and 24,652,895 (2017) shares outstanding	25,473	24,972
Additional paid-in-capital	10,995,375	10,353,037
Treasury stock of 385,169 (2018) and 319,789 (2017) shares	(865,380)	(724,530)
Retained earnings	607,069	17,397
Total equity	10,762,537	9,670,876
Total liabilities and stockholders' equity	$15,503,346	$13,341,295

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

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Where Food Comes From, Inc.

Consolidated Statements of Income

(Unaudited)

	Three months ended September 30, 2018	2017
Revenues:		
Verification and certification service revenue	$3,906,996	$3,672,587
Product sales	783,303	687,235
Software license, maintenance and support services revenue	208,541	243,186
Software-related consulting service revenue	226,538	131,427
Total revenues	5,125,378	4,734,435
Costs of revenues:		
Costs of verification and certification services	2,098,462	2,096,907
Costs of products	489,149	410,309
Costs of software license, maintenance and support services	183,942	141,902
Costs of software-related consulting services	117,303	43,981
Total costs of revenues	2,888,856	2,693,099
Gross profit	2,236,522	2,041,336
Selling, general and administrative expenses	1,819,019	1,591,597
Income from operations	417,503	449,739
Other expense (income):		
Dividend income from Progressive Beef	(100,000)	—
Other income, net	(3,516)	(1,691)
Interest expense	1,361	287
Income before income taxes	519,658	451,143
Income tax expense	169,000	199,000
Net income	350,658	252,143
Net loss attributable to non-controlling interest	26,691	38,049
Net income attributable to Where Food Comes From, Inc.	$377,349	$290,192
Per share - net income attributable to Where Food Comes From, Inc.:		
Basic	$0.02	$0.01
Diluted	$0.02	$0.01
Weighted average number of common shares outstanding:		
Basic	24,900,919	24,705,934
Diluted	25,074,477	24,886,147

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

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Where Food Comes From, Inc.

Consolidated Statements of Income

(Unaudited)

	Nine months ended September 30, 2018	2017
Revenues:		
Verification and certification service revenue	$10,210,947	$9,152,520
Product sales	1,633,509	1,226,141
Software license, maintenance and support services revenue	759,301	532,684
Software-related consulting service revenue	580,731	399,120
Total revenues	13,184,488	11,310,465
Costs of revenues:		
Costs of verification and certification services	5,399,626	4,928,139
Costs of products	1,035,094	743,308
Costs of software license, maintenance and support services	489,887	362,139
Costs of software-related consulting services	280,310	182,718
Total costs of revenues	7,204,917	6,216,304
Gross profit	5,979,571	5,094,161
Selling, general and administrative expenses	5,293,961	4,773,446
Income from operations	685,610	320,715
Other expense (income):		
Dividend income from Progressive Beef	(100,000)	—
Other income, net	(11,556)	(10,989)
Interest expense	3,755	603
Income before income taxes	793,411	331,101
Income tax expense	257,000	150,000
Net income	536,411	181,101
Net loss attributable to non-controlling interest	53,261	286,841
Net income attributable to Where Food Comes From, Inc.	$589,672	$467,942
Per share - net income attributable to Where Food Comes From, Inc.:		
Basic	$0.02	$0.02
Diluted	$0.02	$0.02
Weighted average number of common shares outstanding:		
Basic	24,756,262	24,673,080
Diluted	24,938,699	24,834,931

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

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Where Food Comes From, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	Nine months ended September 30,	
	2018	2017
Operating activities:		
Net income	$536,411	$181,101
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	742,780	634,152
Lease incentive obligation	(8,127)	(8,127)
Stock-based compensation expense	125,239	130,637
Common stock issued for services rendered	—	25,000
Deferred tax expense (benefit)	57,376	(207,000)
Bad debt expense	10,000	17,525
Changes in operating assets and liabilities, net of effect from acquisitions:		
Accounts receivable	(674,398)	(584,154)
Short-term investments	(3,196)	(7,635)
Prepaid expenses and other assets	(62,403)	(177,517)
Accounts payable	278,425	385,242
Accrued expenses and other current liabilities	490,613	846,044
Customer deposits and deferred revenue	125,691	324,889
Net cash provided by operating activities	1,618,411	1,560,157
Investing activities:		
Acquisition of Sow Organic	(450,000)	—
Acquisition of JVF Consulting	(500,000)	—
Investment in Progressive Beef	(900,000)	—
Acquisition of A Bee Organic	—	(150,000)
Proceeds from maturity of short-term investments	250,000	—
Purchases of property and equipment	(325,227)	(55,609)
Purchases of other long-term assets	(1,350)	—
Net cash used in investing activities	(1,926,577)	(205,609)
Financing activities:		
Repayments of notes payable	(7,062)	—
Repayments of capital lease obligations	(5,918)	(3,038)
Proceeds from stock option exercise	—	8,168
Stock repurchase under Stock Buyback Plan	(140,850)	(39,796)
Net cash used in financing activities	(153,830)	(34,666)
Net change in cash	(461,996)	1,319,882
Cash at beginning of year	2,705,778	2,489,985
Cash at end of year	$2,243,782	$3,809,867

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

Where Food Comes From, Inc.

Consolidated Statement of Equity

Nine months ended September 30, 2018

(Unaudited)

	Common Stock Shares	Amount	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Total
Balance at January 1, 2018	24,652,895	$24,972	$10,353,037	$(724,530)	$17,397	$9,670,876
Effect of acquisition fair value adjustment	—	—	(321,937)	—	—	(321,937)
Stock-based compensation expense	—	—	125,239	—	—	125,239
Issuance of common shares in acquisition of Sow Organic LLC	217,654	218	432,913	—	—	433,131
Issuance of common shares for investment in Progressive Beef LLC	50,340	50	91,065	—	—	91,115
Issuance of common shares in acquisition of JVF Consulting LLC	158,437	159	315,132	—	—	315,291
Repurchase of common shares under Stock Buyback Plan	(65,380)	—	—	(140,850)	—	(140,850)
Vesting of restricted shares issued to employees	74,000	74	(74)	—	—	—
Net income attributable to Where Food Comes From, Inc.	—	—	—	—	589,672	589,672
Balance at September 30, 2018	25,087,946	$25,473	$10,995,375	$(865,380)	$607,069	$10,762,537

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

Where Food Comes From, Inc.

Notes to the Consolidated Financial Statements

(Unaudited)

Note 1 – The Company and Basis of Presentation

Business Overview

Where Food Comes From, Inc. is a Colorado corporation based in Castle Rock, Colorado ("WFCF", the "Company," "our," "we," or "us"). We are an independent, third-party food verification company conducting both on-site and desk audits to verify that claims being made about livestock, food, other high-value specialty crops and agricultural products are accurate. We care about food and other agricultural products, how it is grown and raised, the quality of what we eat, what farmers and ranchers do, and authentically telling that story to the consumer. Our team visits farms and ranches and looks at their plants, animals, and records, and compares the information we collect to specific standards or claims that farms and ranches want to make about how they are producing food. We strive to ensure that everyone involved in the food business - from growers and farmers to retailers and shoppers – can count on WFCF to provide authentic and transparent information about the food we eat and how, where, and by whom it is produced.

We also provide sustainability programs, compliance management and farming information management solutions to drive sustainable value creation. We employ a software-as-a-service ("SaaS") revenue model that bundles annual software licenses with ongoing software enhancements and upgrades and a wide range of professional services that generate incremental revenue specific to the food and agricultural industry. Finally, the Company's Where Food Comes From Source Verified® retail and restaurant labeling program utilizes the verification of product attributes to connect consumers directly to the source of the food they purchase through product labeling and web-based information sharing and education.

Most of our customers are located throughout the United States.

Basis of Presentation

Our unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and include the results of operations, financial position and cash flows of Where Food Comes From, Inc. and its subsidiaries, International Certification Services, Inc. (“ICS”), Validus Verifications Services, LLC (“Validus”), Sterling Solutions (“Sterling”), SureHarvest Services, Inc. (“SureHarvest”), A Bee Organic and our most recent acquisitions, Sow Organic and JVF Consulting (collectively referred to as “we,” “us,” and “our” throughout this Form 10-Q). The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues, costs and expenses during the reporting period. All significant intercompany transactions and amounts have been eliminated. The results of businesses acquired are included in the consolidated financial statements from the date of the acquisition. Actual results could differ from the estimates.

The 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, 2017, included in our Form 10-K filed on April 2, 2018. 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 quarter and year to date period ended September 30, 2018 are not necessarily indicative of the results to be expected for any other interim period of any future year.

Where Food Comes From, Inc.

Notes to the Consolidated Financial Statements

(Unaudited)

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation. Net income and shareholders' equity were not affected by these reclassifications.

Seasonality

Our business is subject to seasonal fluctuations. Significant portions of our verification and certification service revenue are typically realized during late May through early October 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.

Recent Accounting Pronouncements

The Financial Accounting Standards Board (FASB) Accounting Standards Codification is the sole source of authoritative GAAP other than SEC issued rules and regulations that apply only to SEC registrants. The FASB issues an Accounting Standards Update (ASU) to communicate changes to the codification. The Company considers the applicability and impact of all ASU's. ASU's not listed below were assessed and determined to be either not applicable or are not expected to have a material impact on the consolidated financial statements.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers" (ASC 606), which created a comprehensive, five-step model for revenue recognition that requires a company to recognize revenue to depict the transfer of promised goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. Under ASC 606, a company will be required to use more judgment and make more estimates when considering contract terms as well as relevant facts and circumstances when identifying performance obligations, estimating the amount of variable consideration in the transaction price and allocating the transaction price to each separate performance obligation. The Company adopted this standard on January 1, 2018 using the modified retrospective approach. Refer to Note 12, “Revenue,” for a further discussion on the adoption of ASC 606.

In January 2016, the FASB issued ASU No. 2016-01 which requires an entity to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present the changes in instrument-specific credit risk for financial liabilities measured using the fair value option in Other Comprehensive Income; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of available-for-sale debt securities in combination with other deferred tax assets. The Update provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The update also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The Company adopted this standard on January 1, 2018.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, “Leases,” which will require lessees to recognize a right-of-use asset and a lease liability for all leases that are not short-term in nature. For a lessor, the accounting applied is also largely unchanged from previous guidance. The new rules will be effective for the Company in the first quarter of 2019. We continue to execute on our implementation plan and gather lease data to derive the impact of the ASU on its financial statements. The Company expects that the adoption will impact the Company’s financial statements as the standard requires the recognition on the balance sheet of a right of use asset and corresponding lease liability. The adoption is anticipated to have a material impact on assets and liabilities on the balance sheet effective January 1, 2019. However, we do not expect the adoption to have a material impact to our consolidated results of operations or statement of cash flows.

Where Food Comes From, Inc.

Notes to the Consolidated Financial Statements

(Unaudited)

In June 2016 the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which adds a new Topic 326 to the Codification and removes the thresholds that companies apply to measure credit losses on financial instruments measured at amortized cost, such as loans, receivables, and held-to-maturity debt securities. Under current U.S. GAAP, companies generally recognize credit losses when it is probable that the loss has been incurred. The revised guidance will remove all recognition thresholds and will require companies to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. The Company is required to adopt the new standard in 2020.

In April 2017, the FASB has issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment," which removes Step 2 from the goodwill impairment test. As a result, under the ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The Company is required to adopt the new standard in 2020.

In June 2018, the FASB issued ASU 2018-07, Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which simplifies the accounting for share-based payments made to nonemployees so the accounting for such payments is substantially the same as those made to employees. Under this ASU, share based awards to nonemployees will be measured at fair value on the grant date of the awards, entities will need to assess the probability of satisfying performance conditions if any are present, and awards will continue to be classified according to Accounting Standards Codification ("ASC") 718 upon vesting which eliminates the need to reassess classification upon vesting, consistent with awards granted to employees. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and early adoption is permitted. We are in the process of evaluating the impact of adoption of this ASU on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 8420): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement." ASU 2018-13 modifies the requirements associated with the hierarchy associated with Level 1, Level 2 and Level 3 fair value measurements. The provisions of this ASU are effective for reporting periods after December 15, 2019; early adoption is permitted. We are currently evaluating the effect that this ASU will have on our consolidated financial statements.

Note 2 – Business Acquisitions

SureHarvest Acquisition

On December 28, 2016, we entered into an Asset Purchase Agreement (the "SureHarvest Purchase Agreement"), by and among the Company, SureHarvest Services LLC (the "Buyer" or "SureHarvest"); and SureHarvest, Inc., a California corporation (the "Seller" or "SureHarvest, Inc."). We acquired substantially all the assets of the Seller. SureHarvest develops software and provides services related to sustainability measurement and benchmarking, traceability, verification and certification to the food and agriculture industries.

Pursuant to the SureHarvest Purchase Agreement, WFCF purchased the business assets of the Seller for total consideration of approximately $2.66 million, comprised of approximately $1,122,000 in cash and 850,852 shares of common stock of WFCF valued at approximately $1,534,900. Additionally, we issued the Seller a 40% membership interest in SureHarvest, with the Company holding a 60% interest.

Where Food Comes From, Inc.

Notes to the Consolidated Financial Statements

(Unaudited)

Following the thirty-six-month anniversary of the effective date of the SureHarvest Purchase Agreement, the Company shall have the option, but not the obligation, to purchase all the units (the 40% interest) of SureHarvest held by the Seller, and the Seller shall have the option, but not the obligation, to require the Company to purchase all the units of SureHarvest held by the Seller. The purchase price for the units shall be equal to the amount the selling holders of the units would be entitled to receive upon a liquidation of SureHarvest assuming all of the assets of SureHarvest are sold for a purchase price equal to the product of eight and half times trailing twelve-month earnings before income taxes, depreciation and amortization, as defined, subject to an $8 million ceiling.

Because SureHarvest, Inc. at its option, can require the Company to purchase its 40% interest in SureHarvest, the SureHarvest non-controlling interest meets the definition of a contingently redeemable non-controlling interest. Redeemable non-controlling interests are presented at the greater of their carrying amount or redemption value at the end of each reporting period and are shown as a separate caption between liabilities and equity (mezzanine section) in the accompanying consolidated balance sheet.

A Bee Organic Acquisition

On May 30, 2017, we acquired A Bee Organic for $150,000 in cash and 45,684 shares of common stock of WFCF valued at approximately $98,000 based on the closing price of our stock on May 30, 2017, of $2.15 per share. The acquisition primarily consisted of the existing customer relationships and represents further expansion of our verification and certification solutions into hydroponics/aquaponics and apiary spaces. We believe the total consideration paid approximates the fair value of the assets acquired. We have allocated the total consideration to our identifiable intangible assets to be amortized over an estimated useful life of 8 years.

Sow Organic Acquisition

On May 16, 2018, we acquired Sow Organic for $450,000 in cash and 217,654 shares of common stock of WFCF valued at approximately $433,100 based on the closing price of our stock on May 16, 2018, of $1.99 per share. We believe the transaction adds complementary solutions and services. Sow Organic’s software as a service (SaaS) model allows organic certification bodies to automate and accelerate new customer onboarding by converting traditional paper-based processes to digital format, resulting in lower costs, improved workflow management and increased productivity. Sow Organic's unique design allows certification bodies to digitize any certification scheme. Likewise, the software affords producers and handlers a more efficient way to become certified and to digitally manage their records on an ongoing basis, including completing annual certification requirements fully online. We intend to further develop the organic business opportunity and collaborate on a broader rollout of the solution to other certification markets where the tool is equally suited to improve efficiencies and reduce costs in the certification process. This transaction further strengthens our intellectual property portfolio, which we believe represents a distinct competitive advantage for the Company.

The following table summarizes the final fair values assigned to the assets and liabilities acquired in addition to the excess of the purchase price over the net assets acquired at the acquisition date. Measurement period adjustments were completed in 2018 and reflect new information obtained about facts and circumstances that existed as of the Acquisition Date. Accordingly, the carrying amounts were retrospectively adjusted as of May 16, 2018. The impact of the retrospective adjustments was not material to the Company's results of operations or cash flows for the period from the Acquisition Date through September 30, 2018.

Where Food Comes From, Inc.

Notes to the Consolidated Financial Statements

(Unaudited)

Sow Organic, LLC:	May 16, 2018 (as reported)	Adjustments	May 16, 2018 (as adjusted)
Software acquired	$445,000	(289,000)	$156,000
Indentifiable intangible assets:	143,754	(143,754)	—
Tradenames and trademarks	—	48,000	48,000
Non-compete agreements	—	84,000	84,000
Customer relationships	—	162,000	162,000
Goodwill	294,377	138,754	433,131
Total consideration	$883,131		$883,131

Excess attributable to goodwill reflects the excess over the identifiable intangible assets acquired based on the preliminary provisional allocation of the purchase price. Goodwill is primarily attributable to the operational and financial benefits expected to be realized from the acquisition, including cost saving synergies from operating efficiencies, future growth in bundling opportunities across divisions and brands, realized savings from a more sophisticated information technology infrastructure, and strategic advances from expansion of our intellectual property.

This acquisition did not materially affect the Company's consolidated results of operations.

JVF Consulting Acquisition

On August 30, 2018, we acquired JVF Consulting, LLC ("Seller" or "JVF") for $500,000 in cash and 158,437 shares of common stock of WFCF valued at approximately $315,300 based on the closing price of our stock on August 29, 2018, of $1.99 per share. We believe the transaction adds value to certain of our existing software solutions which are based on intellectual property built and owned by the Seller. JVF is currently the largest technology provider to our SureHarvest division. With this acquisition, WFCF will control all of the intellectual property associated with its current Software as a Service (SaaS) offerings. Additionally, WFCF will employ three of the Seller's employees who enhance our ability to address new markets and services with our SaaS Solutions.

We believe the impacts on proforma revenue and earnings are immaterial. Management has not yet completed the fair values of the identifiable intangible assets. The following table summarizes the preliminary purchase price allocated fair values assigned to the assets acquired in addition to the excess of the purchase price over the net assets acquired:

JVF Consulting, LLC:	August 30, 2018
Software acquired	$250,000
Indentifiable intangible assets:	
Tradenames and trademarks	5,290
Non-compete agreements	10,000
Customer relationships	100,000
Goodwill	450,000
Total consideration	$815,290

Excess attributable to goodwill reflects the excess over the identifiable intangible assets acquired based on the preliminary provisional allocation of the purchase price. Goodwill is primarily attributable to the operational and financial benefits expected to be realized from the acquisition, including cost saving synergies from operating efficiencies, future growth in bundling opportunities across divisions and brands, realized savings from a more sophisticated information technology infrastructure, and strategic advances from expansion of our intellectual property.

Where Food Comes From, Inc.

Notes to the Consolidated Financial Statements

(Unaudited)

Out of Period Adjustment

For the periods prior to December 31, 2017, the Company discovered that a discount for the lack of marketability related to certain lock-up provisions within our purchase agreements had not been considered for stock issued in which the restriction exceeds one-year. The company evaluated the impact of not recording the discount in the Consolidated Balance Sheet in the historical period presented and concluded that the effect was immaterial. We corrected the immaterial error in second quarter 2018 by recording an out-of-period adjustment for approximately $321,900 to decrease goodwill and additional paid-in-capital.

In evaluating the adjustment, we referred to the SEC Staff Accounting Bulletin (SAB) No. 99, including SAB Topic 1.M, which provides guidance on the assessment of materiality and states that “the omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.” We also referred to SAB 108 for guidance on considering the effects of prior year misstatements when quantifying misstatements in current year financial statements and the assessment of materiality.

Our analysis of the materiality of the adjustment was performed by reviewing quantitative and qualitative factors. We determined based on this analysis that the adjustment was not material to the current period and any prior periods.

Note 3 – Basic and Diluted Net Income per Share

Basic net income per share was computed by dividing 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 restricted stock awards 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 is a reconciliation of the share data used in the basic and diluted income per share computations:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Basic:				
Weighted average shares outstanding	24,900,919	24,705,934	24,756,262	24,673,080
Diluted:				
Weighted average shares outstanding	24,900,919	24,705,934	24,756,262	24,673,080
Weighted average effects of dilutive securities	173,558	180,213	182,437	161,851
Total	25,074,477	24,886,147	24,938,699	24,834,931
Antidilutive securities:	202,750	94,000	202,750	94,000

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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.

Note 4 – Intangible and Other Assets

The following table summarizes our intangible and other assets:

	September 30, 2018	December 31, 2017	Estimated Useful Life
Intangible assets subject to amortization:			
Tradenames and trademarks	$ 335,597	$ 282,307	2.5 - 15.0 years
Accreditations	85,395	97,706	5.0 years
Customer relationships	3,346,551	3,084,551	8.0 - 15.0 years
Beneficial lease arrangement	—	120,200	11.0 years
Patents	970,100	970,100	4.0 years
Non-compete agreements	94,000	—	5.0 years
	4,831,643	4,554,864	
Less accumulated amortization	1,433,839	1,084,879	
	3,397,804	3,469,985	
Tradenames/trademarks (not subject to amortization)	465,000	465,000	
	3,862,804	3,934,985	
Investment in Progressive Beef, LLC (at cost)	991,115	—	
Other assets	13,545	13,545	
Intangible and other assets:	$ 4,867,464	$ 3,948,530	

Beneficial Lease Arrangement

In connection with our acquisition of ICS in 2012, we recorded a beneficial lease arrangement of $120,200 related to a 2,300-square foot building located on approximately ¾ acre in Medina, North Dakota. On January 12, 2018, the Company purchased the 2,300-square foot building and terminated the lease. The net book value of the beneficial lease arrangement at December 31, 2017 was approximately $56,500 and was fully amortized in January 2018.

Investment in Progressive Beef, LLC

On August 9, 2018, the Company purchased a ten percent membership interest in Progressive Beef, LLC (“Progressive Beef”) for an aggregate purchase price of approximately $991,000. The purchase price was payable in cash of $900,000 and 50,340 shares of common stock of WFCF valued at approximately $91,100 based upon the closing price of our stock on August 9, 2018, of $1.81 per share. Where Food Comes From is the primary certifier for Progressive Beef. On September 24, 2018, the Company received dividend income of $100,000 from Progressive Beef representing a distribution of their earnings. The income is reflected within the Other Income section of the Company’s Consolidated Statement of Income for the quarter and nine months ended September 30, 2018. The investment is accounted for as a financial instrument under ASC 321 and the Company has elected to apply the practical expedient to value the investment at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer.

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Note 5 – Accrued Expenses and Other Current Liabilities

The following table summarizes our accrued expenses and other current liabilities as of:

	September 30, 2018	December 31, 2017
Income and sales taxes payable	$24,281	$255,099
Payroll related accruals	660,114	148,408
Professional fees and other expenses	220,386	80,326
Deferred rent expense	140,961	71,296
	$1,045,742	$555,129

Note 6 – Notes Payable

Notes Payable consist of the following:

	September 30, 2018	December 31, 2017
Vehicle note	$ 44,836	$ 51,898
Less current portion of notes payable and other long-term debt	(9,986)	(9,446)
Notes payable and other long-term debt	$ 34,850	$ 42,452

In September 2017, we entered into a note payable of $54,165 for the purchase of a vehicle. Interest and principal payments are due in equal monthly installments of $1,087 over five years beginning October 2017. This note bears an interest rate of 7.44% per annum and is fully secured by the vehicle.

Unison Revolving Line of Credit

The Company has a revolving line of credit (“LOC”) agreement which matures April 12, 2020. The LOC provides for $75,050 in working capital. The interest rate is at the Wall Street Journal prime rate plus 1.50% 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 September 30, 2018, and December 31, 2017, the effective interest rate was 6.75% and 5.5%, respectively. The LOC is collateralized by all the business assets of ICS. As of September 30, 2018, and December 31, 2017, there were no amounts outstanding under this LOC.

Note 7 – Stock-Based Compensation

In addition to cash compensation, the Company may compensate certain service providers, including employees, directors, consultants, and other advisors, with equity-based compensation in the form of stock options and restricted stock awards. The Company recognizes all equity-based compensation as stock-based compensation expense based on the fair value of the compensation measured at the grant date. For stock options, fair value is calculated at the date of grant using the Black-Scholes-Merton option pricing model. For restricted stock awards, fair value is the closing stock price for the Company’s common stock on the grant date. The expense is recognized over the vesting period of the grant. For the periods presented, all stock-based compensation expense was classified as a component within selling, general and administrative expense in the Company’s consolidated statements of income.

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The amount of stock-based compensation expense is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Stock options	$28,445	$14,687	$64,820	$44,100
Restricted stock awards	16,773	26,480	60,419	86,537
Total	$45,218	$41,167	$125,239	$130,637

On March 8, 2018, the Company awarded stock options to purchase 25,000 shares of the Company's common stock at an exercise price of $2.55 per share to one of our business consultants. On July 9, 2018, the Company awarded stock options to purchase 70,750 shares of Company common stock to all eligible full-time employees, excluding the executive officers. The grant-date exercise price is $1.80 per share. In connection with our acquisition of JVF Consulting, on August 29, 2018, we awarded stock options to a new employee to purchase 10,000 shares of the Company's common stock at an exercise price of $1.99 per share.

The Company estimated the fair value of stock options using the Black-Scholes-Merton option pricing model with the following assumptions:

	2018	2017
Number of options awarded to purchase common shares	105,750	None
Risk-free interest rate	2.6 - 2.8%	N/A
Expected volatility	149.3% - 154.3%	N/A
Assumed dividend yield	N/A	N/A
Expected life of options from the date of grant	9.8 years	N/A

The estimated unrecognized compensation cost from unvested awards which will be recognized ratably over the remaining vesting phase is as follows:

Years ended December 31st:	Unvested stock options	Unvested restricted stock awards	Total unrecognized compensation expense
2018 (remaining three months)	$31,686	$ 5,958	$ 37,644
2019	121,749	15,674	137,423
2020	69,154	4,251	73,405
2021	28,071	706	28,777
	$250,660	$ 26,589	$ 277,249

Equity Incentive Plans

Our 2016 Equity Incentive Plan (the “Equity Incentive Plan”) provides for the issuance of stock-based awards to employees, officers, directors and consultants. The Plan permits the granting of stock awards and stock options. The vesting of stock-based awards is generally subject to the passage of time and continued employment through the vesting period.

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Stock Option Activity

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

	Number of awards	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, 2017	266,585	$ 1.23	$ 1.22	6.06	$ 462,508
Granted	105,750	$ 2.00	$ 1.96	9.71	$ —
Exercised	—	$ —	$ —	—	$ —
Expired/Forfeited	(5,334)	$ 1.87	$ 1.86	6.39	$ —
Outstanding, September 30, 2018	367,001	$ 1.44	$ 1.43	6.57	$ 391,117
Exercisable, September 30, 2018	199,913	$ 1.00	$ 1.01	4.40	$ 299,076
Unvested, September 30, 2018	167,088	$ 1.96	$ 1.93	9.16	$ 92,041

The aggregate intrinsic value represents the total pre-tax intrinsic value (the aggregate difference between the closing price of our common stock on September 30, 2018 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 September 30, 2018.

Restricted Stock Activity

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

	Number of options	Weighted avg. grant date fair value
Non-vested restricted shares, December 31, 2017	99,000	$ 2.56
Granted	5,000	$ 2.55
Vested	(74,000)	$ 2.63
Forfeited	—	$ —
Non-vested restricted shares, September 30, 2018	30,000	$ 2.38

Note 8 – Income Taxes

On December 22, 2017, the U.S. government enacted comprehensive tax legislation (the “Tax Act”), which significantly revises the ongoing U.S. corporate income tax law by lowering the U.S. federal corporate income tax rate from 35% to 21%, implementing a territorial tax system, imposing a one-time tax on foreign unremitted earnings and setting limitations on deductibility of certain costs, among other things.

The Company is subject to the provisions of the FASB ASC 740-10, Income Taxes, which requires that the effect on deferred tax assets and liabilities of a change in tax rates be recognized in the period the tax rate change was enacted. Due to the complexities involved in accounting for the recently enacted Tax Act, the U.S. Securities and Exchange Commission’s Staff Accounting Bulletin (“SAB”) 118 requires that the Company include in its financial statements the reasonable estimate of the impact of the Tax Act on earnings to the extent such estimate has been determined.

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Pursuant to the SAB118, the Company is allowed a measurement period of up to one year after the enactment date of the Tax Act to finalize the recording of the related tax impacts. The final impact on the Company from the Tax Act's transition tax legislation may differ from the aforementioned estimates due to the complexity of calculating and supporting with primary evidence. Such differences could be material, due to, among other things, changes in interpretations of the Tax Act, future legislative action to address questions that arise because of the Tax Act, changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates the Company has utilized to calculate the transition tax's reasonable estimate. The Company has implemented the U.S. Tax Act and does not expect any material changes related to the final impact from implementation.

The Company's subsidiary, SureHarvest, is a California limited liability company ("LLC"). As an LLC, management believes SureHarvest is not subject to income taxes, and such taxes are the responsibility of the respective members. The Company is not providing for income taxes for the 40% interest owned by unrelated members of SureHarvest.

The provision or 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 September 30, 2018 we recorded income tax expense of $169,000 compared to $199,000 for the 2017 period. For the nine months ended September 30, 2018 we recorded income tax expense of $257,000 compared to $150,000 for the 2017 period.

Note 9 – Commitments and Contingencies

Operating Leases & Lease Incentive Obligation

The Company relocated its headquarters within Castle Rock, Colorado, during the third quarter 2016 and entered into a new lease agreement for approximately 8,000 square feet of office space. This space is being leased from The Move, LLC in which our CEO and President, each a related party to the Company, have a 27% ownership interest. The lease agreement has an initial term of five years plus two renewal periods, which the Company is more likely than not to renew. In August 2017, the Company amended its lease agreement with The Move, LLC to provide for an additional

7,700 square feet of office space commencing on December 1, 2017. Total rental payments beginning December 1, 2017 increased from $18,000 to approximately $35,100 per month. The rental payments include common area charges and are subject to annual increases over the term of the lease. The Company recognizes rent expense on a straight-line basis over the non-cancelable lease term and option renewal periods. The resulting deferred rent is included in accrued expenses and other current liabilities on the consolidated balance sheet.

Prior to 2018, the Company recorded leasehold improvements of approximately $425,000, which included approximately $163,000 in lease incentives. During the nine months ended September 30, 2018, the Company has recorded an additional $370,500 in leasehold improvements in connection with the August 2017 amended lease agreement, which included approximately $230,200 in lease incentives to build out the new additional square footage. Leasehold improvements are included in property and equipment on the consolidated balance sheets. Lease incentives have been included in other long-term liabilities and will reduce rent expense on a straight-line basis over 15 years. Lease incentives are excluded from minimum lease payments in the schedule below.

In September 2017, the Company entered into a new lease agreement for our Urbandale, Iowa office space. The lease is for a period of two years and expires on August 31, 2019. Rental payments are approximately $2,900 per month, which includes common area charges, and are subject to annual increases over the term of the lease.

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The Company also owns approximately ¾ acre on which a 2,300-square foot building is located in Medina, North Dakota. Until January 12, 2018, the Company leased space in this building under a five-year lease with an expiration date of March 1, 2018. Under the lease, the Company was charged a monthly rental rate of approximately $150 plus all insurance, taxes and other costs based on actual expenses to maintain the building. On January 12, 2018, the Company purchased the 2,300-square foot building and terminated the lease. The purchase price of approximately $135,600 was funded by cash on hand.

In connection with our acquisition of SureHarvest, we added two locations in California: Soquel and Modesto. Our office space in Soquel expires on November 30, 2018 and requires rental payments of approximately $2,700 per month. In addition to primary rent, this lease requires additional payments for operating costs and other common area maintenance costs. The monthly rental payments for our leased space in Modesto was approximately $600 and the lease agreement was month-to-month. We ceased using the Modesto location in July 2018.

In connection with our acquisition of JVF, we added one additional location in Pleasanton, California. The lease expires November 30, 2018. Rental payments are approximately $2,200 per month. In addition to primary rent, this lease requires additional payments for operating costs and other common area maintenance costs. We are currently researching new rental spaces for the SureHarvest and JVF businesses to jointly occupy.

As of September 30, 2018, future minimum lease payments for all operating leases are as follows:

Years ended December 31st:	Total
2018 (remaining three months)	125,957
2019	476,165
2020	465,187
2021	479,143
2022	493,517
Thereafter	4,891,163
Total lease commitments	6,931,132

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.

Contingently redeemable non-controlling interest

Contingently redeemable non-controlling interest on our consolidated balance sheet represents the non-controlling interest related to the SureHarvest acquisition, in which the non-controlling interest holder, at its election, can require the Company to purchase its 40% investment in SureHarvest.

The table below reflects the activity of the contingently redeemable non-controlling interest at September 30, 2018:

Balance, January 1, 2018	$1,574,765
Net loss attributable to non-controlling interest in SureHarvest for the year to date period ended September 30, 2018	(53,261)
Balance, September 30, 2018	$1,521,504

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

Note 10 – Segments

With each acquisition, we assess the need to disclose discrete information related to our operating segments. Because of the similarities of certain of our acquisitions that provide certification and verification services, we aggregate operations into one verification and certification services reportable segment. The factors considered in determining this aggregated reporting segment include the economic similarity of the businesses, the nature of services provided, production processes, types of customers and distribution methods. The Company’s chief operating decision maker (the Company’s CEO) allocates resources and assesses the performance of its certification and verification services activities as one segment, which includes product sales.

Additionally, the Company determined that it also has a software sales and related consulting services segment. This segment includes software license, maintenance, support and software-related consulting service revenues.

Management makes decisions, measures performance, and manages the business utilizing internal reporting operating segment information. Performance of operating segments are based on net sales, gross profit, selling, general and administrative expenses and most importantly, operating income.

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The Company eliminates intercompany transfers between segments for management reporting purposes. The following table shows information for reportable operating segments:

	Three months ended September 30, 2018			Three months ended September 30, 2017		
	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated
Revenues:						
Verification and certification service revenue	$3,906,996	$—	$3,906,996	$3,672,587	$—	$3,672,587
Product sales	783,303	—	783,303	687,235	—	687,235
Software license, maintenance and support services revenue	—	208,541	208,541	—	243,186	243,186
Software-related consulting service revenue	—	226,538	226,538	—	131,427	131,427
Total revenues	$4,690,299	$435,079	$5,125,378	$4,359,822	$374,613	$4,734,435
Costs of revenues:						
Costs of verification and certification services	2,098,462	—	2,098,462	2,096,907	—	2,096,907
Costs of products	489,149	—	489,149	410,309	—	410,309
Costs of software license, maintenance and support services	—	183,942	183,942	—	141,902	141,902
Costs of software-related consulting services	—	117,303	117,303	—	43,981	43,981
Total costs of revenues	2,587,611	301,245	2,888,856	2,507,216	185,883	2,693,099
Gross profit	2,102,688	133,834	2,236,522	1,852,606	188,730	2,041,336
Selling, general and administrative expenses	1,545,512	273,507	1,819,019	1,308,442	283,155	1,591,597
Segment operating income (loss)	$557,176	$(139,673)	$417,503	$544,164	$(94,425)	$449,739

	Nine months ended September 30, 2018			Nine months ended September 30, 2017		
	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated
Revenues:						
Verification and certification service revenue	$10,210,947	$—	$10,210,947	$9,152,520	$—	$9,152,520
Product sales	1,633,509	—	1,633,509	1,226,141	—	1,226,141
Software license, maintenance and support services revenue	—	759,301	759,301	—	532,684	532,684
Software-related consulting service revenue	—	580,731	580,731	—	399,120	399,120
Total revenues	$11,844,456	$1,340,032	$13,184,488	$10,378,661	$931,804	$11,310,465
Costs of revenues:						
Costs of verification and certification services	5,399,626	—	5,399,626	4,928,139	—	4,928,139
Costs of products	1,035,094	—	1,035,094	743,308	—	743,308
Costs of software license, maintenance and support services	—	489,887	489,887	—	362,139	362,139
Costs of software-related consulting services	—	280,310	280,310	—	182,718	182,718
Total costs of revenues	6,434,720	770,197	7,204,917	5,671,447	544,857	6,216,304
Gross profit	5,409,736	569,835	5,979,571	4,707,214	386,947	5,094,161
Selling, general and administrative expenses	4,456,352	837,609	5,293,961	3,670,771	1,102,675	4,773,446
Segment operating income (loss)	$953,384	$(267,774)	$685,610	$1,036,443	$(715,728)	$320,715

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Note 11 – Supplemental Cash Flow Information

	Nine months ended September 30,	
	2018	2017
Cash paid during the year:		
Interest expense	$3,755	$603
Income taxes	$418,965	$184,440
Non-cash investing and financing activities:		
Common stock issued in connection with acquisition of Sow Organic	$433,131	$—
Common stock issued in connection with investment in Progressive Beef	$91,115	$—
Common stock issued in connection with acquisition of JVF Consulting	$315,291	$—
Equipment acquired under a capital lease	$19,809	$18,033
Lease incentive obligation	$230,220	$—
Common stock issued in connection with acquisition of A Bee Organic	$—	$98,221
Common stock issued for acquisition-related consulting fees	$—	$25,000
Vehicle acquired under note payable	$—	$54,165

Note 12 – Revenue from Contracts with Customers

Impact of ASC 606 Adoption

On January 1, 2018, the Company adopted Accounting Standards Update, Topic 606, "Revenue from Contracts with Customers" (ASC 606) using the modified retrospective method of transition. Under this method of transition, we applied ASU 606 to all new contracts entered into on or after January 1, 2018 and all existing contracts for which all (or substantially all) of the revenue attributable to a contract had not been recognized under legacy revenue guidance as of January 1, 2018.

ASU 606 supersedes nearly all existing revenue recognition guidance under U.S. GAAP and includes a five-step process to recognize revenue 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.

The impact of adoption on our current period results is as follows:

	Nine months ended September 30, 2018		
	Under ASC 606	Under ASC 605	Increase / (Decrease)
Revenues:			
Verification and certification service revenue	$—	$114,900	$(114,900)
Costs and expenses:			
Cost of verification and certification services	$—	$114,900	$(114,900)
Gross profit	$—	$—	$—
Net income (loss)	$—	$—	$—
Retained earnings	$—	$—	$—

Changes to verification and certification service revenue and costs of verification and certification services are due to the conclusion that fees collected on behalf of the Non-GMO Project related to the Company's Non-GMO verification services should be excluded from the transaction price (and, thus, revenue), as these amounts are collected on behalf of a third party. This represents a change from our accounting practice under legacy revenue guidance of presenting these amounts on a gross basis in verification and certification service revenue, with an offsetting amount presented as an expense in costs of verification and certification services.

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Revenue Recognition

Verification and Certification Segment

We offer a range of products and services to maintain identification, traceability, and verification systems. We conduct both on-site and desk audits to verify that claims being made about livestock, food, other high-value specialty crops and agricultural products are accurate. We generate revenue primarily from the sale of our verification solutions, consulting services and hardware sales. We sell our products and services directly to customers at various levels in the livestock and agricultural supply chains.

Verification and certification service revenue primarily consists of fees charged for verification audits and other verification services that the Company performs for customers.

A more detailed summary of our verification and certification services is included in the subsections below.

<u>Animal Verification and Certification Services</u>

Our animal verification and certification services contracts are generally structured in one of the following ways: (i) we commit to perform the required number of animal audits to verify a customer's compliance with a standard or claim, or (ii) we commit to perform animal audit services at a fixed price by site or location type as requested by our customer during an annual period. These contract structures are discussed in more detail in the subsections below.

Contract to Provide Required Number of Animal Audit Services

For certain of our animal verification and certification services, we commit to perform the required number of location or site audits within our customer’s supply chain to verify customer’s compliance with a contractually-specified standard or claim. Each location or site audit is typically very short-term in nature, with a typical duration of one to two weeks. Upon completion of an audit, we provide the customer with an audit verification report for the specific site or location that was audited. Payment is made by customer upon completion of each site or location audit.

We generally enter into revenue contracts with a one-year term. Our customers generally have the right to terminate the contract without prejudice with thirty days’ written notice. We have determined that, as a result of the termination provisions present in these contracts, the accounting contract term is a thirty-day period, with each thirty-day time increment representing a separate accounting contract under ASC 606.

Furthermore, we have concluded that there is a single performance obligation that is a series comprised of each distinct location or site audit performed. Our customers are charged a standard daily rate for the provision of an audit based on scale of site operations and geographical location. Consideration attributable to each audit within the series is variable, as the number of days required to complete each audit is not known until performance of that audit occurs. We have concluded that it is appropriate to allocate variable consideration (that is, the number of days required to complete an audit) to each audit within the series. This is because the consideration that we earn for each audit relates specifically to our efforts to transfer to our customer that discrete audit, and the resulting audit opinion or verification report, for that specified site or location, and this allocation is consistent with the allocation objective as defined in ASC 606. As a result, instances in which the Company evaluates and applies the constraint on variable consideration are immaterial.

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We further concluded that over-time recognition is appropriate because: (i) our performance of audits does not create an asset with an alternative use, as the audit and related verification report relates to facts and circumstances that are specific to each customer site or location (that is, there is a practical limitation on our ability to readily direct the asset to another customer) and (ii) we have an enforceable right to payment, inclusive of a reasonable profit, for performance completed to date. We utilize an input method to measure over-time progress of each audit within the series based on the number of audit days performed.

We do, however, note that there are instances in which we only have an enforceable right to payment upon completion of an audit, and thus, over-time recognition is not permitted. For these contracts, revenue is recognized at the point in time at which an audit is completed. This does not result in a significant difference in the timing of revenue recognition (as compared to those audits that are recognized over time) due to the very short-term duration of an audit.

Our customer may also have the option to purchase incremental review services (for example, an investigative audit or video review services) that are unrelated to the audit services to verify compliance with a specified standard or claim. The incremental review services are also typically very short-term in nature (that is, one to two weeks). We have concluded that these optional purchases do not reflect a material right under ASC 606 because the incremental review services are performed at standard pricing that would be charged to other similarly situated customers. Upon customer request for an incremental review service, we believe that our customer has made a discrete purchasing decision that should be treated as a separate accounting contract under ASC 606.

We charge a fixed fee for the incremental review service, and thus, upon customer request, we are entitled to fixed consideration for that service under ASC 606. We concluded that over-time revenue recognition is appropriate for incremental review services because: (i) our performance of incremental review services does not create an asset with an alternative use because that review service, and the associated customer deliverable, relates to facts and circumstances that are specific to each customer site or location (that is, there is a practical limitation on our ability to readily direct the asset to another customer) and (ii) we have an enforceable right to payment, inclusive of a reasonable profit, for performance completed to date on incremental review services. We utilize a time-based input method to measure progress toward complete satisfaction of an incremental review service, which is based on the number of hours performed on the incremental review service relative to the total number of hours required to complete that review service. As previously mentioned, our incremental review services are typically completed within one to two weeks of a customer request.

Contract to Provide Animal Audit Services at Customer Request

Other animal verification and certification services contracts are structured such that we commit to perform audit services at a fixed price by site or location type as requested by our customer during an annual period. Performance of an audit typically occurs within a one to two-week period. We invoice our customer upon completion of an audit, and payment is due from customer within thirty days or less of receipt of invoice.

Under this contract structure, the customer is, in effect, provided a pricing list for animal audit services, and pricing is effective over a one-year period. We have concluded that enforceable rights and obligations do not arise until a customer actually engages us to perform an audit service documented in the pricing list; therefore, each customer request represents a purchasing decision that is a separate accounting contract under ASC 606.

We note that the termination provisions specified in our pricing lists vary. In certain instances, a customer may only have the right to terminate in the event of non-performance. Alternatively, in other contracts, a customer may have the right to terminate without prejudice at any time or with thirty days' written notice. However, regardless of the termination provision specified, we have concluded that the accounting contract term is equal to the duration of the requested audit service (that is, the termination provisions generally do not affect the accounting contract term for each requested audit service).

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(Unaudited)

Upon a customer's request for an audit service, consideration is fixed, as we charge the customer a fixed fee by audit type over the annual period per the pricing list.

We concluded that over-time revenue recognition is appropriate for a requested audit service because: (i) our performance of the requested audit service does not create an asset with an alternative use as that audit, and the associated audit report, relate to facts and circumstances that are specific to each customer site or location (that is, there is a practical limitation on our ability to readily direct the asset to another customer) and (ii) we have an enforceable right to payment, inclusive of a reasonable profit, for performance completed to date on a requested audit. A time-based input method is utilized to measure progress toward complete satisfaction of an audit based on the number of hours performed on that audit relative to the total number of hours expected to be required to complete the audit. As previously mentioned, our audit services are typically completed within one to two weeks of a customer request.

Other Considerations for Animal Certification and Verification Services

In connection with the provision of on-site audits related to animal certification and verification services, reimbursable expenses are incurred and billed to customers, and such amounts are recognized on a gross basis as both revenue and cost of revenue.

Any amounts collected on behalf of a third party and remitted in full to that third party are excluded from the transaction price and, thus, revenue.

<u>Crop and Other Processed Product Verification and Certification Services</u>

Third party crop and other processed product audits are generally structured such that we commit to perform an independent audit to verify that food producers and/or farmers comply with certain standards. We generally provide verification services related to organic, Non-GMO and gluten-free standards. Depending on the crop or product type, verification audit activities may take two months to one year to complete. During this assessment period, various integrated audit activities and/or input reviews are performed in accordance with the regulations specified by the relevant standard.

The fee structure is such that customers pay an annual assessment fee for a crop or other processed product to verify compliance with the specified standard. This fee is payable upfront on a nonrefundable basis. Our customers can typically terminate a crop or other processed product audit at any time without prejudice. However, given the nonrefundable upfront payment structure for the annual assessment service, we have concluded that the contract term is one year. We record the upfront payment made by customer for the annual assessment service as deferred revenue.

The audit activities and input reviews required in the provision of an annual assessment are not distinct under ASC 606, and consequently, we account for an annual assessment as a single integrated performance obligation.

For certain of our third-party crop and other processed product audits, the annual assessment fee is fixed for the annual period. In other scenarios, the annual assessment fee may be variable due to increased review activities required for incremental inputs to a crop or processed product identified through the assessment process. At the time that an incremental input is identified, which generally occurs in the early stages of an annual assessment, the incremental consideration for the provision of review services related to that incremental input also becomes known.

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We allocate the transaction price derived from the annual assessment fee to the single integrated performance obligation for that annual assessment. Revenue related to the annual assessment is recognized over time in accordance with ASC 606. This is because the annual assessment service does not create an asset with an alternative use, as it relates to facts and circumstances that are specific to a customer's crop or processed product. Further, we have an enforceable right to payment for performance completed to date on the annual assessment due to the nonrefundable upfront payment made by customer. We utilize an input method to measure progress toward satisfaction of the annual assessment based on the percentage of activities/phases or input reviews completed under the annual assessment.

As it relates to the upfront payment for the annual assessment, we have utilized the practical expedient that exempts us from adjusting consideration for the effects of a significant financing component when we expect that the period between customer payment and the provision of the related service is one year or less.

In certain contracts, an independent third-party inspection may be required for a site or location in our customer's supply chain in accordance with the regulations for a specified standard. An inspection is performed by an independent third-party inspector, and the customer is charged an hourly rate for these inspection services.

Under this scenario, a separate accounting contract arises upon initiation and performance of an inspection, and we typically invoice our customer for the inspection upon completion of the inspection service. Given that customer has the ability to terminate at any time without prejudice, we have concluded that the contract term for each inspection ends as control of an inspection service transfers. Inspections are generally short-term in nature with a term ranging from a few days to two weeks.

We have further determined that inspections are distinct from an annual assessment. Consideration attributable to an inspection is variable, as the inspector is only able to provide a high-level estimate of the cost of the inspection based on the inspector's hourly rate until the inspector is at the relevant producer/supplier site to determine the time and level of effort required to complete the inspection. Given the very short-term nature of an inspection, variability related to an inspection generally resolves itself within a reporting period. However, we are typically required by certain regulations to provide an inspection cost estimate to our customer, and, if required, we utilize that estimate as our estimate of variable consideration. The cost estimate is generally derived from the cost to perform the prior-year inspection for that specific customer site or location or, when required, the historical cost to provide an inspection for a comparable site or location. In our experience, the historical cost of inspections has been predictive of the future cost of an inspection.

Other Considerations for Crop and Other Processed Product Verification Services

Reimbursable expenses incurred in the provision of an annual assessment or required inspection are billed to our customers, and such amounts are recognized on a gross basis as both revenue and cost of revenue.

In addition, any amounts collected on behalf of a third party and remitted in full to that third party are excluded from the transaction price and, thus, revenue.

Product Sales

Product sales are primarily generated from the sale of cattle identification ear tags. Each customer purchase request represents a purchasing decision made by customer. As such, enforceable rights and obligations (and, thus, a separate accounting contract under ASC 606) arise at the time a customer submits its purchase request to us. At the time of request, we are entitled to fixed consideration, as the sales quantity and related price of the product is known. All of our customers are charged the same fixed price per tag.

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Revenue for product sales is recognized upon delivery of the goods to customer, at which point title, custody and risk of loss transfer to the customer. We typically deliver product to the customer within a few days of customer's sales request. At the time of delivery, we invoice our customer for the related product sales and record invoiced amounts to accounts receivable. Payment is typically due by customer upon receipt of invoice.

In relation to our product sales, the sales taxes collected from customers and remitted to government authorities are excluded from revenue.

Additionally, we do not typically provide right of return or warranty on product sales.

Software Sales and Related Consulting Segment

We predominately offer software products via a SaaS model, which is an annual subscription based model. Support services are generally included in the subscription. We also provide web hosting services on an annual basis to all of our customers in conjunction with their software subscription. Customers have the ability to terminate without prejudice upon thirty days' written notice; however, the subscription fee, inclusive of maintenance and support services, and the web hosting fee are paid upfront by the customer on a nonrefundable basis. Consequently, we have concluded that the contract term for the annual software subscription and web hosting services is one year.

We have determined that a software license subscription and the related hosting service should be accounted for as a service transaction, as we provide the functionality of our software through the hosting arrangement. The SaaS arrangement provides customers with unlimited access to our software and, thus, is accounted for as a series of distinct daily service periods that provide substantially the same service (that is, continuous access to the hosted software) each day during the annual contract term. Further, the provision of basic technical support services also represents a stand ready obligation that is a series of distinct daily service periods that provide substantially the same service (that is, access to our technical support infrastructure) during the annual contract term. Because the basic technical support services and SaaS each represent performance obligations that are a series of distinct daily service periods, we have elected to combine these performance obligations.

We are entitled to fixed consideration for the software license subscription, inclusive of support services, and the related hosting service. The software license subscription and hosting fees in our contracts represent the standalone selling price for that related service. This is because the fees charged for the software license subscription and hosting service represent the software license subscription and hosting service fees that are charged to other customers with a similar level of data loaded into the software (regardless of whether that customer contracts for professional services). Accordingly, the software license subscription and hosting fees are allocated to the combined SaaS performance obligation.

We recognize revenue related to the SaaS arrangement over time because a customer simultaneously receives and consumes the benefit from the provision of access to the hosted software over the annual subscription period. Accordingly, we utilize a time-based output measure of progress that results in a straight-line attribution of revenue. That is, revenue related to the combined SaaS obligation should be recognized daily on a straight-line basis over the one-year subscription term, as this reflects the direct measurement of value to a customer of the provision of access to the software via hosting each day.

As it relates to the upfront payment for the software subscription and hosting service, we have utilized the practical expedient that exempts us from adjusting consideration for the effects of a significant financing component when we expect that the period between customer payment and the provision of the related service is one year or less.

In addition, we record the upfront payment made by customer for the annual assessment service as deferred revenue.

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In some of our SaaS contracts, we also provide software-related consulting services to our customers during an annual software subscription period. Consulting services fees are derived from a standard rate card by employee level, and we invoice for consulting services monthly on a time incurred basis. Due to the termination provisions present in our SaaS contracts, our customers have an in-substance renewal decision each month for further consulting services (that is, via their decision not to terminate the contract each month). Accordingly, the contract term for consulting services is on a month-to-month basis within the annual subscription period.

We have concluded that consulting services are distinct from the SaaS arrangement. To the extent that consulting services result in a software enhancement or new functionality, we have determined that those consulting services are still distinct because added features typically provide new, discrete capabilities with independent value to a customer and a customer accesses the SaaS in a single-tenant architecture. Further, additional features and functionality are often made available to a customer substantially after the “go-live” date of the software (via the hosting service). As a result, our software-related consulting services represent distinct performance obligations.

We recognize revenue over time in accordance with ASC 606. This is because our performance does not create an asset with an alternative use, as consulting services, and, if applicable, any related software enhancements, are highly tailored to the farming industry specific to the given customer, and we have an enforceable right to payment, inclusive of profit, for performance completed to date. As a result, for our consulting services, we have elected to utilize the practical expedient that allows us to recognize revenue in the amount to which we have a right to invoice, as we believe that we have a right to consideration from a customer in an amount that corresponds directly with the value to the customer of our performance completed to date for the provision of consulting services.

Other Significant Judgments

Principal versus Agent Considerations

Under certain of our verification and certification service contracts, a third-party inspector may be required to perform an independent inspection of a site or location within our customer’s supply chain in accordance with regulations of a certain standard or claim. In this scenario, we have concluded that we are the principal in the provision of inspection services to our customer, as we control the inspection service, and the related inspection report, before it is transferred to our customer. In accordance with this conclusion, we present revenue related to inspections on a gross basis, with customer payment for an inspection presented as revenue and the inspection cost paid to the third-party inspector presented as an expense.

In addition, we utilize a third party to provide web hosting services in the provision of our SaaS arrangements. In this scenario, we are primarily responsible for fulfilling the promise to provide web hosting services to the customer, and we establish the fee that the customer is charged for the web hosting services. Consequently, we have also concluded that we are the principal in the provision of web hosting services under our SaaS arrangements. As such, we present revenue on a gross basis, with consideration received from our customer for the web hosting service recorded as revenue and the cost paid to the third party to provide those web hosting services recorded as an expense.

Disaggregation of Revenue

We have identified four material revenue categories in our business: (i) verification and certification service revenue, (ii) product sales, (iii) software license, maintenance and support services revenue and (iv) software-related consulting service revenue.

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Revenue attributable to each of our identified revenue categories is disaggregated in the table below.

	Three months ended September 30, 2018			Nine months ended September 30, 2018		
Revenues:	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated
Verification and certification service revenue						
Product sales	$3,906,996	$—	$3,906,996	$10,210,947	$—	$10,210,947
Software license, maintenance and support services revenue	783,303	—	783,303	1,633,509	—	1,633,509
Software-related consulting service revenue	—	208,541	208,541	—	759,301	759,301
Total revenues	—	226,538	226,538	—	580,731	580,731
	$4,690,299	$435,079	$5,125,378	$11,844,456	$1,340,032	$13,184,488

Transaction Price Allocated to Remaining Performance Obligations

We generally enter into revenue contracts with a one-year term. In certain instances, we have concluded that our contract term is less than one year because: (i) the termination provisions present in the contract impact the contract term under ASC 606 or (ii) a contract under ASC 606 arises at the time our customer requests the provision of a good or service that is delivered within or over a few days to a couple of weeks. As a result of our short-term contract structures, we have utilized the practical expedient in ASC 606-10-50-14 that exempts us from disclosure of the transaction price allocated to remaining performance obligations if the performance obligation is part of a contract that has an original expected duration of one year or less.

Contract Balances

Under our animal verification and certification services contracts, we invoice customers once the performance obligation for the provision of a site or location audit has been satisfied, at which point payment is unconditional. In addition, any product sales are invoiced upon delivery to the customer, at which point payment is also unconditional. Accordingly, our animal verification and certification services contracts do not give rise to a contract asset under ASC 606; rather, invoiced amounts reflect accounts receivable.

Under our crop and other processed product verification and certification services, a nonrefundable payment for an annual assessment of compliance with a standard is typically made by our customers upfront upon contract execution. That is, payment is made in advance of the provision of annual assessment services. Accordingly, we recognize deferred revenue upon receipt of the upfront payment from our customers for crop and other processed product audit assessment services. Revenue is subsequently recognized, and the related deferred revenue is reduced, over the one-year period during which assessment services are provided to the customer using the over-time measure of progress selected in accordance with ASC 606. To the extent that an inspection is required during the annual assessment period, we invoice customers once the performance obligation for the inspection has been satisfied, at which point payment is unconditional. As such, inspection services give rise to accounts receivable.

Our software subscriptions, web hosting, and support services are paid by our customers upfront on a nonrefundable basis. That is, payment is made in advance of the provision of these services to our customers. As a result, we recognize deferred revenue upon receipt of the upfront payment from our customers for software subscriptions, web hosting and maintenance and support services. Revenue is subsequently recognized, and the related deferred revenue is reduced, on a straight-line basis during the annual contract term that these stand ready services are provided to customer.

Software-related consulting services are invoiced monthly on a time incurred basis, at which point we have an enforceable right to payment for those services. Because payment is unconditional upon invoicing, our software-related consulting services are reflected as accounts receivable.

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As of September 30, 2018, and January 1, 2018, accounts receivable from contracts with customers, net of allowance for doubtful accounts, were approximately $2,563,100 and $1,898,700, respectively.

As of September 30, 2018, and January 1, 2018, deposits and deferred revenue from contracts with customers were approximately $976,900 and $851,200, respectively. The balance of these contract liabilities at the beginning of the period is expected to be recognized as revenue during 2018.

Costs to fulfill a contract

Prior to August 2018, we incurred a fixed cost, payable to JVF Consulting, LLC, a third-party provider, to perform set-up activities for new (or first-year) customers that contract for our software subscription and hosting services. As previously discussed in Note 2, on August 30, 2018, we acquired the JVF Consulting, which included three key employees. We concluded that those set-up activities performed by JVF did not transfer a good or service as defined in ASC 606 to our customers.

We capitalize fixed set-up costs as an asset on the following basis: (i) the fixed set-up costs incurred relate specifically to a customer contract for our software subscription and hosting service, (ii) the fixed set-up costs incurred are expected to be recovered via provision of the software subscription and hosting service to that customer and (iii) the set-up costs generate or enhance resources of the Company by permitting us to provide software subscription and hosting services to our customer, which, in turn, generates revenues.

Capitalized costs related to those set-up activities are amortized on a straight-line basis over the one-year license subscription and hosting period.

The ending balance at September 30, 2018 of capitalized assets attributable to the set-up costs incurred to fulfill software subscription and hosting contracts was not material. No set-up costs related to our software subscription and hosting services were incurred for the nine months ended September 30, 2018.

In addition, amortization of capitalized set-up costs for the three months ended September 30, 2018 was not material, and no impairment loss was incurred related to capitalized set-up costs for the nine months ended September 30, 2018.

Commissions and other costs to obtain a contract are expensed as incurred as our contracts are typically completed in one year or less, and where applicable, we generally would incur these costs whether or not we ultimately obtain the contract.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

This information should be read in conjunction with the 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, 2017. The following discussion and analysis includes historical and certain forward–looking information that should be read together with the accompanying 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 trusted resour for third-party verification of food production practices in North America. The Company supports more than 15,000 farmers, ranchers, vineyards, wineries, processors, retailers, distributors, trade associations and restaurants with a wide variety of value-added services provided through its family of verifiers and software services, including IMI Global, International Certification Services, Validus Verification Services, Sterling Solutions, SureHarvest Services, A Bee Organic, Sow Organic and JVF Consulting. 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 WFCF. 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, we develop software and provide services related to sustainability measurement and benchmarking, traceability, verification and certification to the food and agriculture industries. The Company's Where Food Comes From Source Verified® retail and restaurant labeling program utilizes the verification of product attributes to connect consumers directly to the source of the food they purchase through product labeling and web-based information sharing and education. 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 in 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 that wanted access to markets overseas following the discovery of "mad cow" disease in the U.S. Over the years, WFCF has expanded its portfolio to include verification and software services for most food groups. We verify claims to over 40 independent 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:

Market Driver #1 - Consumer awareness and expectations

The 13^{th} Edition of "The Why? Behind The Buy," based on the annual survey conducted by Acosta, a leading full-service sales and marketing agency in the consumer packaged goods ("CPG") industry, was released in December 2016. The survey found that today's shoppers are seeking positive culinary experiences, making deliberate decisions from the store to the stove, including wanting to feel good about the foods they eat, have pride in the brands they buy and share their cooking journeys online. The survey also explores the key factors contributing to this experiential evolution for grocery shoppers, including the growing natural/organics category. Shoppers' spending on health products has seen steady growth in the past several years, driven by the desire of shoppers to feel good about the foods they are eating. "From online grocery ordering and a desire to explore new foods, to natural products and socially responsible brands, consumers are at the wheel when it comes to steering the CPG industry in a new direction. There's no doubt that this evolution will continue in the coming year, so it's up to the industry to adapt by leaning into these trends and building trust and loyalty among all shoppers," said Colin Stewart, senior vice president at Acosta.

According to research dated March 2016 from Sullivan Higdon & Sink FoodThink, only one-third of consumers believe that the agriculture community and food companies are transparent. The research appears in "Evolving Trust in the Food Industry," a white paper with insights into Americans' knowledge and trust of the food industry and how those perceptions have changed from 2012 to 2016. These numbers are an improvement from 2012, when only 22% and 19% agreed that the agricultural community and food companies, respectively, are transparent. Increasing media attention and dialogue about food production, and the food industry's willingness to be more open about its production practices, have likely caused this increase in perceived transparency. In turn, this provides consumers the knowledge to have definite opinions on the degree of industry transparency and an increased desire for more knowledge about how their food is produced.

According to the Organic Trade Association's 2018 Organic Industry Survey, American consumers in 2017 filled more of their grocery carts with organic, buying everything from organic produce and organic ice cream to organic fresh juices and organic dried beans. Organic sales in the U.S. totaled a new record of $49.4 billion in 2017, up 6.4 percent from the previous year. Organic continued to increase its penetration into the total food market, and now accounts for 5.5 percent of the food sold in retail channels in the U.S.

Market Driver #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 response 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. Oftentimes, it is necessary for export into international markets, including Korea, Russia, China and the European Union.

Market Driver #3 - Government regulation

The Animal Disease Traceability Rule promulgated by the USDA 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.

The Saudi Arabia market closed to U.S. beef in 2012. Since that time, the beef industry has been working with the U.S. government to re-open that market, which officially happened in early August 2016. In order to be approved to meet the export requirements, a company must have or must be approved by a USDA process verified plan and meet the Saudi Arabia export verification requirements. U.S. exports to Saudi Arabia in 2010 and 2011 were valued at approximately $30 million. We believe the Saudi Arabia market focuses on the highest quality middle meats, making it a valuable market for the U.S. to re-gain access.

On June 12, 2017, officials announced the technical requirements for beef exports to the People's Republic of China. Export verification ("EV") requirements include source and age verification with the use of a program compliant tag. In addition, China bans the use of synthetic growth promotants, including ractopamine. So, although there is not a formal non-hormone component to the EV requirements for the supply chain, due to China's residue testing, packers will be seeking non-hormone treated cattle and/or verified natural cattle to ensure continued market access. China is the world's second largest buyer of beef, but beef imports from the U.S. to China were banned from 2003 until 2017 due to the Bovine Spongiform Encephalopathy outbreak, also known as "mad cow Disease."

Seasonality

Our business is subject to seasonal fluctuations. Significant portions of our verification and certification service revenue are typically realized during late May through early October 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 September 30, 2018, we had cash, cash equivalents and short-term investments of approximately $2,740,200 compared to approximately $3,449,000 at December 31, 2017. Our working capital at September 30, 2018 was approximately $2,831,200 compared to $3,712,200 at December 31, 2017.

Net cash provided by operating activities for the nine months ended September 30, 2018 was approximately $1,618,400 compared to net cash provided of $1,560,200 during the same period in 2017. 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.

Net cash used in investing activities for the nine months ended September 30, 2018, was $1,926,600 compared to $205,600 used in the 2017 period. Net cash used in the 2018 period was primarily attributable to business acquisitions (Sow Organic and JVF Consulting) and other business investments (Progressive Beef) for $1,850,000 in cash, $135,600 for the purchase of a 2,300-square foot building located in Medina, North Dakota, which was previously leased, approximately $140,300 for leasehold improvements for the expansion of our Corporate Office, and approximately $49,400 for other routine purchases of property and equipment, offset by $250,000 in proceeds from the maturity of a certificate of deposit. Net cash used in the 2017 period was primarily attributable $150,000 in cash for the acquisition of A Bee Organic, as well as approximately $55,600 for routine purchases of property and equipment.

Net cash used in financing activities for the nine months ended September 30, 2018, was $153,800 compared to $34,700 used in the 2017 period. Net cash used in the both the 2018 and 2017 period was primarily due to the repurchase of common shares under the Stock Buyback Plan.

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 has brought significant opportunities to us, including increased investor confidence and renewed interest in our company, 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. Additionally, 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.

Our plan for continued growth is primarily based upon continued expansion of verification bundling opportunities, as well as acquisitions in national and international markets. We believe that there are significant growth opportunities available to us because often the only way to differentiate a product or brand, or overcome import/export restrictions is via a quality verification program.

Debt Facility

The Company has a revolving line of credit ("LOC") agreement which matures April 12, 2020. The LOC provides for $75,050 in working capital. The interest rate is at the Wall Street Journal prime rate plus 1.50% 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 upon maturity. As of September 30, 2018, and December 31, 2017, the effective interest rate was 6.75% and 5.5%, respectively. The LOC is collateralized by all the business assets of International Certification Services, Inc. ("ICS"). As of September 30, 2018, and December 31, 2017, there were no amounts outstanding under this LOC.

Off-Balance Sheet Arrangements

As of September 30, 2018, we had no off-balance sheet arrangements of any type.

RESULTS OF OPERATIONS

Three and nine months ended September 30, 2018 compared to the same periods in fiscal year 2017

The following table shows information for reportable operating segments:

	Three months ended September 30, 2018			Three months ended September 30, 2017		
	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated
Revenues:						
Verification and certification service revenue	$3,906,996	$—	$3,906,996	$3,672,587	$—	$3,672,587
Product sales	783,303	—	783,303	687,235	—	687,235
Software license, maintenance and support services revenue	—	208,541	208,541	—	243,186	243,186
Software-related consulting service revenue	—	226,538	226,538	—	131,427	131,427
Total revenues	$4,690,299	$435,079	$5,125,378	$4,359,822	$374,613	$4,734,435
Costs of revenues:						
Costs of verification and certification services	2,098,462	—	2,098,462	2,096,907	—	2,096,907
Costs of products	489,149	—	489,149	410,309	—	410,309
Costs of software license, maintenance and support services	—	183,942	183,942	—	141,902	141,902
Costs of software-related consulting services	—	117,303	117,303	—	43,981	43,981
Total costs of revenues	2,587,611	301,245	2,888,856	2,507,216	185,883	2,693,099
Gross profit	2,102,688	133,834	2,236,522	1,852,606	188,730	2,041,336
Selling, general and administrative expenses	1,545,512	273,507	1,819,019	1,308,442	283,155	1,591,597
Segment operating income (loss)	$557,176	$(139,673)	$417,503	$544,164	$(94,425)	$449,739

	Nine months ended September 30, 2018			Nine months ended September 30, 2017		
	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated	Verification and Certification Segment	Software Sales and Related Consulting Segment	Consolidated
Revenues:						
Verification and certification service revenue	$10,210,947	$—	$10,210,947	$9,152,520	$—	$9,152,520
Product sales	1,633,509	—	1,633,509	1,226,141	—	1,226,141
Software license, maintenance and support services revenue	—	759,301	759,301	—	532,684	532,684
Software-related consulting service revenue	—	580,731	580,731	—	399,120	399,120
Total revenues	$11,844,456	$1,340,032	$13,184,488	$10,378,661	$931,804	$11,310,465
Costs of revenues:						
Costs of verification and certification services	5,399,626	—	5,399,626	4,928,139	—	4,928,139
Costs of products	1,035,094	—	1,035,094	743,308	—	743,308
Costs of software license, maintenance and support services	—	489,887	489,887	—	362,139	362,139
Costs of software-related consulting services	—	280,310	280,310	—	182,718	182,718
Total costs of revenues	6,434,720	770,197	7,204,917	5,671,447	544,857	6,216,304
Gross profit	5,409,736	569,835	5,979,571	4,707,214	386,947	5,094,161
Selling, general and administrative expenses	4,456,352	837,609	5,293,961	3,670,771	1,102,675	4,773,446
Segment operating income (loss)	$953,384	$(267,774)	$685,610	$1,036,443	$(715,728)	$320,715

Verification and Certification Segment

Verification and certification service revenues consist of fees charged for verification audits and other verification and certification related services that the Company performs for customers. Fees earned from our WFCF labeling program are also included in our verification and certification revenues as it represents a value-added extension of our source verification. Verification and certification service revenue for the three and nine months ended September 30, 2018 increased approximately $234,400, or 6.4%, and $1,058,400, or 11.6%, respectively, compared to the same periods in 2017. Overall, the increase is due to an increase in new verification customers, as well as an increase in product offerings. We continue to see increased demand from cattle producers in response to the re-opening of the export market to China as discussed above in “Current Marketplace Opportunities.”

Our product sales are an ancillary part of our verification and certification services and represent sales of cattle identification ear tags. Product sales for the three and nine months ended September 30, 2018 increased approximately $96,100, or 14.0% and $407,400, or 33.2%, respectively, compared to the same periods in 2017. Overall, our product sales have increased primarily in response to the re-opening of the China export market and the requirement for source and age verification using an identification tag at birth for cattle.

Costs of revenues for our verification and certification segment for the three and nine months ended September 30, 2018 were approximately $2.10 million and $5.40 million, respectively, compared to approximately $2.10 million and $4.93 million, respectively, for the same periods in 2017. Gross margin for the three months ended September 30, 2018 improved to 44.8% compared to 42.5% in 2017. Gross margin for the nine months ended September 30, 2018 improved slightly to 45.7% compared to 45.4% in 2017. Fluctuations in our margins are predominately due to product mix changes. Additionally, our margins are impacted by various costs such as cost of products, salaries and benefits, insurance, and taxes.

Selling, general and administrative expenses for the three and nine months ended September 30, 2018 increased approximately 18.1% and 21.4%, respectively compared to the same periods in 2017. Overall, the increase in our selling, general and administrative expenses is due in part to slightly higher head count, an increase in base salaries, the accelerated amortization of the ICS beneficial lease arrangement previously discussed, increased square footage and corresponding rent expense for the corporate headquarters, and increasing public company compliance costs and professional fees due to implementing new accounting standards.

Software Sales and Related Consulting Segment

Software license, maintenance and support services revenue is a revenue stream specific to our acquisitions of SureHarvest, Sow Organic and JVF Consulting. We employ a SaaS revenue model that bundles annual software licenses with ongoing software enhancements and upgrades and a wide range of professional services that generate incremental revenue specific to the food and agricultural industry. Software license, maintenance and support services revenue decreased approximately $34,600, or 14.3%, for the three months ended September 30, 2018 and increased by approximately $226,600, or 42.5%, for the nine months ended September 30, 2018 compared to the same periods in 2017. The year to date increase is predominately due to a significant increase in the number of billable hours of staff focused on software enhancements and upgrades.

Software-related consulting service revenue primarily represents fees earned from professional appearances, customer education and training related services specific to our acquisition of SureHarvest. Software-related consulting service revenue for the three and nine months ended September 30, 2018 increased approximately $95,100, or 72.4%, and $181,600, or 45.5%, respectively compared to the same periods in 2017. The increase is predominately due to growth in customer education and training services.

Costs of revenues for our software sales and related consulting segment for the three and nine months ended September 30, 2018 were approximately $301,200 and $770,200, respectively, compared to approximately $185,900 and $544,900, respectively, for the same periods in 2017. Gross margin for the three months ended September 30, 2018 decreased to 30.8% compared to 50.4% for the same period in 2017. The decrease was predominately due to additional costs absorbed from the Sow Organic and JVF acquisitions. Gross margin for the nine months ended September 30, 2018 improved slightly to 42.5% compared to 41.5% for the same period in 2017. Our margins were positively impacted by improvements in overall efficiency and the number of our billable hours, as well as other variable costs of salaries and benefits, insurance, and taxes.

Selling, general and administrative expenses for the three and nine months ended September 30, 2018 decreased approximately 3.4% and 24.0%, respectively, compared to the same periods in 2017. The decrease is predominately due to some employee turnover and re-alignment with a shift from non-billable hours to billable hours to reduce fixed costs.

As with all of our acquisitions, we continue to identify synergies and implement best practices. We focus our efforts to create value in various ways such as improving the performance of our acquired businesses, removing excess capacity, creating market access for products, acquiring skills and technologies more quickly or at a lower cost than we can build in-house, exploiting our industry-specific scalability and bundling opportunities, and picking winners early and helping them develop their businesses. Achieving any or all of these strategies take time to implement. We have learned that it can take two to three years after an acquisition to fully understand the complexities, at which time, we have seen solid improvements in revenues and/or costs.

Dividend Income from Progressive Beef

On August 9, 2018, the Company purchased a ten percent membership interest in Progressive Beef, LLC ("Progressive Beef") for an aggregate purchase price of approximately $991,000. On September 24, 2018, the Company received dividend income of $100,000 from Progressive Beef representing a distribution of their earnings.

Income Tax Expense

The provision or 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 and nine months ended September 30, 2018, we recorded income tax expense of $169,000 and $257,000, respectively, compared to $199,000 and $150,000, respectively for the comparable periods in 2017.

Net Income and Per Share Information

As a result of the foregoing, net income attributable to WFCF shareholders for the three months ended September 30, 2018 was approximately $377,300, or $0.02 per basic and diluted common share, compared to $290,200, or $0.01 per basic and diluted common share for the same period in 2017. Net income attributable to WFCF shareholders for the nine months ended September 30, 2018 was approximately $589,700 or $0.02 per basic and diluted common share, compared to $467,900, or $0.02 per basic and diluted common share for the same period in 2017.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, including our principal executive and financial officers, have conducted an evaluation of the effectiveness of the design and operation of our "disclosure controls and procedures," as such term is defined under Rules 13a-15(e) and 15d-15(e) of the Exchange Act, to ensure that information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information we are required to disclose in such reports is accumulated and communicated to management, including our principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure. Based on that evaluation, our principal executive and financial officers concluded, as a result of the material weakness in internal control over financial reporting discussed below, that our disclosure controls and procedures were not effective as of the end of the period covered by this report. However, we believe that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

In July 2018, management concluded that a material weakness existed with respect to management placing undue reliance on their third-party specialist’s valuation of restricted stock issued in connection with our business acquisitions. This impacts equity and the calculation of goodwill. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of a company’s annual or interim financial statements will not be prevented or detected on a timely basis.

Since such time, management has implemented the following measure to remediate the material weakness related to the process of valuation in connection with our business acquisitions. Management implemented a review process that is performed in collaboration with outside legal counsel and third-party valuation specialists, where valuations of our business acquisitions are considered and analyzed to determine if discounts on the issuance of restricted stock has been appropriately considered. The valuations are further reviewed and approved by management to ensure the underlying information used by the valuation specialist is complete and accurate and that the valuation is consistent with generally accepted accounting principles.

Based on our assessment, we consider that the material weakness related to the process of valuation of restricted stock issued in connection with our business acquisitions has not been fully remediated and is still present as of September 30, 2018 as the remedial measures have not operated effectively for a sufficient period of time for management to conclude, through testing, that the applicable controls have operated effectively for a sufficient period of time.

Internal Control Over Financial Reporting

As previously discussed, management revised its policies and procedures with respect to controls over the process of valuation of restricted stock issued in connection with our business acquisitions. Additionally, with the adoption of ASC Topic 606 as further described in Note 12 to the Consolidated Financial Statements in Part I of this Quarterly Report, we have analyzed our internal control over financial reporting framework and implemented new controls around contract inception and contract modifications, as well as periodic reviews of material contracts. Except as described above, there have not been any other 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 2017 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 September 30, 2018, 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 Sow Organic acquisition, we issued 217,654 shares of common stock of Where Food Comes From, Inc. valued at approximately $433,100 based upon the closing price of our stock on May 16, 2018, of $1.99 per share.

In connection with the investment in Progressive Beef, LLC, we issued 50,340 shares of common stock of Where Food Comes From, Inc. valued at approximately 91,100 based upon the closing price of our stock on August 9, 2018, of $1.81 per share.

In connection with the JVF Consulting acquisition, we issued 158,437 shares of common stock of Where Food Comes From, Inc. valued at approximately 315,300 based upon the closing price of our stock on August 29, 2018, of $1.99 per share.

The issuance of the shares of our common stock described above was pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended and related state private offering exemptions. All of the investors were Accredited Investors as defined in the Securities Act who took their shares for investments purposes without a view to distribution and had access to information concerning the Company and its business prospects, as required by the Securities Act. In addition, there was no general solicitation or advertising for these shares. All certificates for these shares issued pursuant to Section 4(2) contain a restrictive legend. Finally, our stock transfer agent has been instructed not to transfer any of such shares, unless such shares are registered for resale or there is an exemption with respect to their transfer.

ITEM 6. EXHIBITS

(a) Exhibits

Number	Description
10.1	Purchase Agreement for Membership Interests between Where Food Comes From, Inc and Progressive Beef, LLC signed on August 9, 2018
10.2	Asset Purchase Agreement between Where Food Comes From, Inc and JVF Consulting, LLC signed on August 30, 2018
31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of CEO pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of CFO pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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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: November 13, 2018	Where Food Comes From, Inc.
	By: /s/ John K. Saunders Chief Executive Officer
By: /s/ Dannette Henning Chief Financial Officer	