Generation NEXT Franchise Brands, Inc.
Form 10-Q
November 23, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from __________ to __________

Commission File No. 000-55164

GENERATION NEXT FRANCHISE BRANDS, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

2620 Financial Court, Suite 100, San Diego, California 92117

(Address of Principal Executive Offices)

858-210-4200

(Registrant's Telephone Number, Including Area Code)

____

(Former Name or Former Address, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x
(Do not check if a 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). o Yes x No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Shares of Common Stock, par value $0.001, outstanding as of November 15, 2018: 70,873,676.

GENERATION NEXT FRANCHISE BRANDS, INC. AND SUBSIDIARIES

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GENERATION NEXT FRANCHISE BRANDS, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

		September 30, 2018 (unaudited)		June 30, 2018 (audited)
Assets				
Current assets:				
Cash	$	1,595,010	$	10,017,667
Restricted cash		5,243,182		3,710,694
Accounts receivable		-		54,128
Contract assets - due from franchisees		5,834,509		7,250,951
Stock subscriptions receivable		-		300,000
Inventory on-hand, net of allowance for obsolete inventory of $400,000 and $300,000, respectively		10,360,594		3,011,484
Deposit for inventory		6,840,533		5,152,897
Prepaid expenses and other current assets		87,056		70,149
Current assets held for disposition		-		292,664
Total current assets		29,960,884		29,860,634
Property and equipment, less accumulated depreciation of $129,236 and $115,889, respectively		186,443		199,791
Intangible assets, net of accumulated amortization of $784,102 and $686,052, respectively		1,772,074		1,870,124
Deposits		48,896		45,404
Total assets	$	31,968,297	$	31,975,953
Liabilities and Stockholders' Deficit				
Current liabilities:				
Accounts payable and accrued liabilities	$	4,757,903	$	4,531,547
Contract liabilities - customer advances and deferred revenues		39,549,356		37,221,943
Provision for franchisee rescissions and refunds		3,753,050		1,924,121
Accrued personnel expenses		504,597		553,314
Notes payable, net of discount of $49,716 and $49,716, respectively		1,036,724		879,017
Contingent liability		200,000		200,000
Due to related party		536,786		536,786
Deferred rent		47,158		34,541
Current liabilities held for disposition		-		1,291,676

Total current liabilities		50,385,574		47,172,945
Notes payable - long term, net of discount of $37,281 and $49,716, respectively		479,081		736,115
Commitments and contingencies (Notes 5 and 7)				
Stockholders' deficit:				
Preferred stock; $0.001 par value; 25 million shares authorized; no shares issued and outstanding		-		-
Common stock; $0.001 par value; 100 million shares authorized; 70,873,676 and 69,378,052 outstanding, respectively		70,872		69,376
Additional paid-in capital		29,558,351		27,515,602
Accumulated deficit		(48,525,581)		(43,518,085)
Total stockholders' deficit		(18,896,358)		(15,933,107)
Total liabilities and stockholders' deficit	$	31,968,297	$	31,975,953

See accompanying notes to the unaudited condensed consolidated financial statements.

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GENERATION NEXT FRANCHISE BRANDS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations

(Unaudited)

	For the three months ended September 30, 2018	2017
Revenues:		
Vending machine sales, net	$ 1,687,500	$ -
Franchise fees	1,584	-
Company owned machine sales	29,071	61,726
Royalties	17,632	-
Other	22,206	104
Total revenue	1,757,993	61,830
Cost of revenues	1,661,623	53,432
Gross margin	96,370	8,398
Operating expenses:		
Personnel	1,335,407	901,020
Marketing	798,045	746,755
Professional fees	426,106	128,283
Insurance	81,945	52,408
Rent	54,193	43,096
Depreciation and amortization	111,399	106,110
Stock compensation	762,534	124,375
Research and development	999,005	901,407
Provision for legal settlement	83,474	9,000
Other	545,239	208,696
Total operating expenses	5,197,347	3,221,150
Loss from operations	(5,100,977)	(3,212,752)
Other expenses:		
Interest expense	(35,592)	(74,224)
Accretion of discount on notes payable	(12,429)	-
Loss before provision for income taxes	(5,148,998)	(3,286,976)
Provision for income taxes	-	-

Loss from continuing operations	(5,148,998)	(3,286,976)
Gain (loss) from discontinued operations	141,502	(700,353)
Net loss	$ (5,007,496)	$ (3,987,329)
Net loss per share from continuing operations - basic and diluted	$ (0.07)	$ (0.09)
Loss per share from discontinued operations - basic and diluted	0.00	(0.02)
Net loss per share - basic and diluted	$ (0.07)	$ (0.11)
Weighted average shares used in computing net loss per share - basic and diluted	69,611,593	37,018,842

See accompanying notes to the unaudited condensed consolidated financial statements.

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GENERATION NEXT FRANCHISE BRANDS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the three months ended	
	September 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	$ (5,007,496)	$ (3,987,329)
Adjustments to reconcile net loss to net cash flows provided by (used in) operating activities:		
Depreciation and amortization	111,399	106,110
Interest accretion on notes payable	12,429	32,829
Loss on derivative liability	-	220,003
Stock-based compensation	762,534	136,090
Deferred rent	12,617	13,526
Bad debt expense	-	32,516
Stock issued for services	5,010	-
Changes in operating assets and liabilities:		
Accounts receivable	72,579	(1,384,151)
Contract asset - due from franchisee	1,416,442	-
Inventory on-hand	(7,102,814)	(639,890)
Deposits for inventory	(1,687,636)	-
Prepaid expenses and other current assets	(16,907)	181,811
Deposits	(3,490)	-
Accounts payable and accrued liabilities	151,911	911,740
Customer advances and deferred revenues	1,811,896	3,446,955
Provision for franchisee rescissions and refunds	1,132,929	(165,325)
Accrued personnel expenses	(48,717)	37,634
Cash flows used in operating activities	(8,377,314)	(1,057,481)
Cash flows from investing activities:		
Purchases of property and equipment	-	(26,458)
Cash flows used in investing activities	-	(26,458)
Cash flows from financing activities:		
Payments of notes payable to related party	-	(622,500)
Payments of notes payable	(88,756)	-
Proceeds from issuance of common stock, net of issuance costs	1,547,984	2,017,200
Cash flows provided by financing activities	1,459,228	1,394,700

Change in cash and restricted cash		(6,918,086)		310,761
Cash and restricted cash, beginning of period		13,756,278		1,752,522
Cash and restricted cash, end of period	$	6,838,192	$	2,063,283
Supplemental disclosure of cash flow information:				
Cash paid for:				
Interest expense	$	20,135	$	154,939
Income taxes	$	9,850	$	-
Supplemental disclosure of non-cash investing and financing activities:				
Conversion of debt and accrued interest into shares of common stock	$	28,717	$	-
Cashless exercise of options	$	432	$	-

See accompanying notes to the unaudited condensed consolidated financial statements.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Organization and description of business

Generation NEXT Franchise Brands, Inc. (formerly known as Fresh Healthy Vending International, Inc. and referred to herein collectively with its subsidiaries as "we", the "Company", "our Company", or "GNext") operates through its wholly-owned subsidiaries, Fresh Healthy Vending LLC ("FHV LLC"), The Fresh and Healthy Vending Corporation, FHV Acquisition Corp. ("FHV Acquisition"), Reis & Irvy's, Inc. ("R&I"), 19 Degrees, Inc. and Generation Next Vending Robots, Inc. as a franchisor, direct seller and owner and operator of robotic soft serve vending kiosks, healthy drink and snack vending machines and micro markets that feature cashless payment devices and remote monitoring software. The Company uses in-house location specialists that are responsible for securing locations for its franchisees; additionally, the Company has negotiated discounts with a national product distribution chain. The Company also operates its own frozen yogurt equipment. Effective May 2016, the Company shifted focus away from franchise sales of its healthy drink and snack vending machines and micro markets. We will no longer market our vending machines and micro markets to new franchisees. Because it was determined the assets of FHV LLC are currently insufficient to satisfy FHV LLC's obligations to creditors, as of September 28, 2018, FHV LLC has executed an Assignment for the Benefit of Creditors under California law, whereby all of the assets of FHV LLC have been assigned to a third party fiduciary who will expeditiously liquidate such assets and distribute the proceeds thereof to FHV LLC's creditors pursuant to the priorities established and permitted by law.

During fiscal year 2017, we obtained the exclusive rights to sell a new frozen yogurt vending robot, branded Reis & Irvy's. As of the date of this report, we have received approval to sell franchises in a number of states in the U.S. and Canada and have booked a net 1,281 units aggregating approximately $54 million (net of installed robots and franchisee refunds) in customer advances-due from franchisees and contract liabilities- franchisees advances and deferred revenues, prior to certain offset adjustments aggregating 13.8 million. Furthermore, the Company has additional commitments for 2,647 robots aggregating $102 million.

As of September 30, 2018, and through the date of this report, the Company has delivered and installed 123 frozen yogurt vending machines. The Company has redeveloped the next generation frozen yogurt robot and has spent approximately $5.2 million and $1 million in research and development expenses through June 30, 2018 and September 30, 2018, respectively. The Company anticipates it will continue to incur additional research and development expenses throughout fiscal 2019.

On December 29, 2016, the Company entered into an Asset Purchase Agreement (the "Agreement") with Robofusion, Inc. ("RFI"), whereby the Company acquired the intellectual property assets of RFI, a developer of robotic-kiosk vending technology, primarily frozen yogurt and ice cream vending robots, using RFI's trademarked name of Reis & Irvy's (the "Acquisition"). The Company considered the guidance in ASC 805, *Business Combinations,* and determined the transaction was a purchase of an asset. As a result, the estimated fair of the assets acquired were capitalized. The intent of the purchase was to combine robotics and artificial intelligence platforms to facilitate the manufacture of an unattended robot in order to disrupt traditional frozen yogurt and ice cream retail establishments and, on a larger scale, establish ourselves as an industry leader in the emerging and fast-growing space of unattended retail. Since acquisition, we have developed a state-of-the art robotic soft serve vending robot that is a completely unique vending machine and entertainment experience. The robot accepts cash, credit cards, and is the first of its kind to accept bitcoin. A proprietary software platform is utilized that allows us to readily monitor the sales of our franchisees' and our corporate-owned machines, which assists our franchisees and us in facilitating the management and maintenance of the vending robot. In order to protect the Company's rights, several U.S. and international patents have been approved and granted. Our vending standards are UL ("Underwriters Laboratories") (approval in process), NSF ("National Sanitation Foundation") recognized (approved in August 2018), and National Automated Merchandising Association ("NAMA") certified (approved in September 2018), which we believe are among the highest standards in the industry. This ensures food temperature compliance, which includes auto-contingency processes should electrical or hardware malfunction; it also ensures that ambient air stays within specified parameters at all times. Our third-party cashless payment technology provides the highest level of data and network security compliance while ensuring complete transparency. As a result, our robotic soft serve vending robots will contain minimal amounts of cash. All transactions are managed by third parties to facilitate financial compliance with local and national laws and regulations. Funds from all electronic transactions are collected by Reis & Irvy's and remitted to the franchisee within ten days of the subsequent month.

2. Summary of Significant Accounting Policies

Basis of accounting

The included (a) condensed consolidated balance sheet as of June 30, 2018, which has been derived from audited consolidated financial statements and (b) the unaudited condensed consolidated statements as of September 30, 2018 and 2017, have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the rules and regulations of the Securities and Exchange Commission ("SEC") for reporting on Form 10-Q.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Accordingly, these unaudited condensed consolidated statements do not include all of the information and disclosures required by GAAP or SEC rules and regulations for complete consolidated financial statements. In the opinion of management, these unaudited condensed consolidated financial statements reflect all adjustments (consisting solely of normal recurring nature) considered necessary for a fair presentation of the results for the interim periods presented. The results of operations for any interim period are not necessarily indicative of results for the full year.

These unaudited condensed consolidated financial statements should be read in conjunction with the Company's filings with the SEC, including its most recent annual report on Form 10-K for the fiscal year ended June 30, 2018 filed on October 19, 2018.

Liquidity and capital resources

For the quarter ended September 30, 2018 we had a net loss totaling approximately $5,007,000 with negative cash flows from operations totaling approximately $8,377,000. Our cash balance at September 30, 2018 was approximately $1,595,000. Since the date of the closing of the FHV Acquisition, our sales were less than anticipated and the resulting cash flows from franchise sales were not sufficient to cover expenditures associated with our daily operations resulting in a substantial decrease in our cash balances and an increase in our outstanding debt. Also, we used cash on hand to retire liabilities associated with the franchise rescissions, for research and development expenditures related to our robotic soft serve vending kiosks and for the purchase of robot inventory. In order to ensure sufficient liquidity for our continuing operations, we will require additional capital financing in the form of either debt or equity (or a combination thereof) financing. During fiscal year 2018 and through the date of this report, the Company raised approximately $17.6 million through the sale of common stock. Furthermore, the Company anticipates generating a significant amount of our required capital resources from deposits on sales of new franchises, royalties from existing and future franchise installs and revenue from corporate-owned kiosks. If additional funds are required, management believes that it will be able to obtain such financing on terms acceptable to the Company, although there can be no assurance that we will be successful.

Our current plans include research and development expenditures for the production of the next generation robot, payments required for the purchase of the Robofusion intellectual property (previous owner of the frozen yogurt robot intellectual property), capital expenditures for the purchase of franchisee and corporate-owned and operated robotic soft serve vending kiosks, as well as the repurchase of machines from franchisees opting to rescind their franchise agreements. Given our current cash position, we may be forced to curtail our plans by delaying or suspending the production and purchase of robotic soft serve vending kiosks until such time that we may able to prepay for the robots.

Principles of consolidation

The condensed consolidated financial statements include the accounts of the Company, and its wholly-owned subsidiaries, Reis & Irvy's, Inc., FHV LLC (recorded as discontinued operations), 19 Degrees, Inc., Generation Next Vending Robots, The Fresh and Healthy Vending Corporation, and FHV Acquisition, Corp. All significant intercompany accounts and transactions are eliminated.

Use of estimates

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

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Cash and cash equivalents

All investments with an original maturity of three months or less are considered to be cash equivalents. Cash equivalents primarily represent funds invested in money market funds, bank certificates of deposit and U.S. government debt securities whose cost equals fair market value. We had no cash equivalents at September 30. 2018 and June 30, 2018. We may maintain our cash and cash equivalents in amounts that may, at times, exceed federally insured limits. At September 30, 2018, bank balances, per our bank, exceeding federally insured limits totaled approximately $1,212,000. We have not experienced any losses with respect to cash, and we believe our Company is not exposed to any significant credit risk with respect to our cash.

Certain states require the Company to maintain customer deposits in escrow accounts until the Company has substantially performed its obligations. Furthermore, certain franchisees have elected to pay their remaining balance due directly to an escrow account for the beneficiary of the Company’s contract manufacturer and inventory suppliers. At September 30, 2018 and June 30, 2018, the Company had approximately $5,243,000 and $3,710,000, respectively maintained in escrow accounts for these purposes.

Accounts receivable, net

Accounts receivable arise primarily from royalties and are carried at their estimated collectible amounts, net of any estimated allowances for doubtful accounts. We grant unsecured credit to our customers (located throughout North America, the Bahamas and Puerto Rico) deemed credit worthy. Ongoing credit evaluations are performed and potential credit losses estimated by management are charged to operations on a regular basis. At the time any particular account receivable is deemed uncollectible, the balance is charged to the allowance for doubtful accounts. Our allowance for doubtful accounts aggregated approximately $174,000 and $0 at September 30, 2018 and June 30, 2018, respectively.

Inventory

Inventory is carried at the lower of cost or market, with cost determined using the average cost method.

Property and equipment

Property and equipment are carried at cost and depreciated using the straight-line method over their estimated useful lives of the individual assets, generally five to seven years. Leasehold improvements are amortized over the lesser of the term of the related lease or the estimated useful life of the asset. Costs incurred for maintenance and repairs are expensed as incurred and expenditures for major replacements and improvements are capitalized and depreciated over their estimated remaining useful lives.

Intangible assets

Intangible assets consist primarily of patents, trademarks and trade names. Amortization of intangible assets is recorded as amortization expense in the consolidated statements of operations and amortized over the respective useful lives using the straight-line method.

Impairment of long-lived assets

Impairment losses are recognized on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets’ carrying amount. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amounts of the assets exceed the estimated fair value of the assets. There were no impairments of long-lived assets for the periods ended September 30, 2018 and June 30, 2018, respectively.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Deferred rent

The Company entered into an operating lease for our corporate offices in San Diego, California that contains provisions for future rent increases, leasehold improvement allowances and rent abatements. We record monthly rent expense equal to the total of the payments due over the lease term, divided by the number of months of the lease term. The difference between the rent expense recorded and the amount paid is credited or charged to deferred rent, which is reflected as a separate line item in the accompanying consolidated balance sheet.

Derivatives and Hedging

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

The fair value of derivative instruments is recorded and shown separately under current liabilities. Changes in fair value are recorded in the consolidated statements of operations under other income (expenses).

The accounting treatment of derivative financial instruments requires that the Company record the embedded conversion option and warrants at their fair values as of the inception date of the agreement and at fair value as of each subsequent balance sheet date. Any change in fair value is recorded as a non-operating, non-cash income or expense for each reporting period at each balance sheet date. If the classification changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification.

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instruments are initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the consolidated statements of operations. For stock-based derivative financial instruments, the Company uses the Black-Sholes option pricing model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within twelve months of the balance sheet date.

Revenue, contract liabilities – franchisees advances and deferred revenue, and contract assets – due from franchisees

The Company relies upon ASC 606, *Revenue from Contracts with Customers*, to recognize revenue, contract liabilities-deposits from franchisees and contract assets-due from franchisees.

Reis & Irvy's, Inc

The primary revenue sources consisted of the following:

- Robotic soft serve vending kiosks
- Franchise fees
- Royalties

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Revenues from robotic soft serve vending kiosks and franchise fees are recognized when the Company has substantially performed or satisfied all material services or conditions relating to the franchise agreement. Substantial performance has occurred when: 1) no remaining obligations are unfulfilled under the franchise agreement; 2) there is no intent to refund any cash received or to forgive any unpaid amounts due from franchisees; 3) all of the initial services in the franchise agreement have been performed; and 4) all other material conditions or obligations have been met. During the quarter ended September 30, 2018 and 2017, 50 and 0 robotic soft serve vending kiosks were installed and operational, respectively, and the Company had no further material conditions or obligations. During the quart ended September 30, 2018 and 2017, the Company recognized revenue of approximately $1,688,000 and $0, respectively for robotic soft serve vending kiosks and approximately $1,500 and $0, respectively in franchise fees.

Upon the execution of a franchise agreement, a deposit from the franchisee is required, and generally consists of 40% - 50% of the sales price of the frozen yogurt and ice cream robots, 50% - 100% of the initial franchise fees, and 40% - 50% of location fees. In accordance with ASC 606, the Company recognizes the contract as a contract liability – customer deposits and deferred revenue when the Company receives consideration or is due consideration. As of September 30, 2018 and June 30, 2018, the Company’s customer advances and deferred revenues were approximately $39,549,000 and $37,222,000, respectively. These amounts are net of certain off-set adjustments of $13,295,000 and $9,921,000, respectively.

The Company recognizes contract assets – due from franchisees when the Company has an unconditional right to consideration. As of September 30, 2018 and June 30, 2018, the Company’s contract assets – due from franchisees was approximately $5,835,000 and $7,251,000, respectively.

Fresh Healthy Vending LLC

Because it was determined the assets of FHV LLC are currently insufficient to satisfy FHV LLC’s obligations to creditors, as of September 28, 2018, FHV LLC has executed an Assignment for the Benefit of Creditors under California law, whereby all of the assets of FHV LLC have been assigned to a third party fiduciary who will expeditiously liquidate such assets and distribute the proceeds thereof to FHV LLC’s creditors pursuant to the priorities established and permitted by law. Consequently, the Company has accounted for FHV LLC as a discontinued operation.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

19 Degrees

The Company recognizes revenue from the sale of products from company-owned robotic soft serve vending kiosks when products are purchased. During the quarters ended September 30, 2018 and 2017, the Company recognized approximately $29,000 and $62,000, respectively.

The Company recognizes the value of company-owned machines as inventory when purchased. Subsequent to installation, the purchased cost is recognized in fixed assets and depreciated over its estimated useful life. As of June 30, 2018, there were four company-owned robotic soft serve vending kiosks included in fixed assets.

Generation Next Vending Robots

The Company recognizes revenue from the direct sale of robotic soft serve vending kiosks when the machines are installed and operational. During the quarters ended September 30, 2018 and 2017, there were no revenues from the direct sale of robots.

It is not the Company's policy to allow for returns, discounts or warranties to our franchisees. Under certain circumstances, including as the result of regulatory action, the Company may become obligated to offer our franchisees amounts in rescission to reacquire their existing franchises, including the robotic soft serve vending kiosks Additionally, if the Company is unable to fulfill its obligations under a franchise agreement the Company may, at its sole discretion, agree to refund or reduce part or all of a franchisees payments or commitments to pay.

As of September 30, 2018 and June 30, 2018, the Company's provision for Reis & Irvy's franchisee rescissions and refunds totaled approximately $3,753,000 and $1,924,000, respectively. The balance is based on executed termination agreements and an estimate of future terminations.

Marketing and advertising

Marketing and advertising costs are expensed as incurred. There are no existing arrangements under which the Company provides or receives marketing and advertising services from others for any consideration other than cash. Marketing and advertising expense totaled approximately $798,000 and $747,000 for the quarters ended September 30, 2018 and 2017, respectively.

Freight costs and fees

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

Research and Development Costs

Research and development costs are expensed as incurred. For the quarters ended September 30, 2018 and 2017, the Company recorded approximately $999,000 and $901,000, respectively.

Income taxes

The Company provides for income taxes utilizing the liability method. Under the liability method, current income tax expense or benefit is the amount of income taxes expected to be payable or refundable for the current year. A deferred income tax asset or liability is computed for the expected future impact of differences between the financial reporting and tax bases of assets and liabilities and for the expected future tax benefit to be derived from tax credits. Tax rate changes are reflected in the computation of the income tax provision during the period such changes are enacted.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Deferred tax assets are reduced by a valuation allowance when, in management's opinion, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The Company's valuation allowance is based on available evidence, including its current year operating loss, evaluation of positive and negative evidence with respect to certain specific deferred tax assets including evaluation sources of future taxable income to support the realization of the deferred tax assets. The Company has established a full valuation allowance on the deferred tax assets as of September 30, 2018 and June 30, 2018, and therefore has not recognized any income tax benefit or expense (other than the state minimum income tax) for the periods presented.

ASC 740, Income Taxes ("ASC 740"), clarifies the accounting for uncertainty in income taxes recognized in the financial statements. ASC 740 provides that a tax benefit from uncertain tax positions may be recognized when it is more-likely-than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits of the position. Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. ASC 740 also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense. There is no accrual for interest or penalties for income taxes on the balance sheets as of September 30, 2018 and June 30, 2018, and the Company has not recognized interest and/or penalties in the consolidated statements of operations for the quarters ended September 30, 2018 and 2017.

Valuation of options and warrants to purchase common stock and share grants

Warrants to purchase common stock are separately valued when issued in connection with notes payable using a binomial quantitative valuation method. The value of such warrants is recognized as a discount from the related notes payable and credited to additional paid-in capital at the time of the issuance of the related notes payable. The value of the discount is applied to the note payable and amortized over the expected term of the note payable using the interest method with the related accretion charged to interest expense.

Share-based compensation to employees is recognized in accordance with ASC 718, using a binomial quantitative valuation method. The resulting compensation expense is recognized in the financial statements on a straight-line basis over the vesting period from the date of grant.

Share-based compensation to non-employees is recognized in accordance with ASC 505, at the estimated fair value until the options or warrants have vested. The resulting compensation expense is recognized on a straight-line basis over the vesting period from the date of grant.

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

Concentration of credit risk

The Company is subject to credit risk through its accounts receivable consisting primarily of amounts due from franchisees for royalty income, and other products. The financial condition of these franchisees is largely dependent upon the underlying business trends of our brands and market conditions within the vending industry. This concentration of credit risk is mitigated, in part, by the large number of franchisees spread over a large geographical area and the short-term nature of the receivables. Furthermore, this risk is mitigated in large part by the Company's collection of electronic sales from the robot kiosks.

Concentration of manufacturers

Vending machines and micro markets were supplied by a single manufacturer. Additionally, robotic soft serve vending kiosks are manufactured by one supplier; a change in suppliers could cause a delay in deliveries and possible loss of sales, which could adversely affect the Company's operating results.

The Company uses a single supplier for its frozen confectionary consumables. Although there are a limited number of product suppliers with the product selection and distribution capabilities required by the franchise network, other manufacturers and distributors could provide similar products on comparable terms.

Vending food products were primarily supplied by one national distributor. Although there are a limited number of product suppliers with the product selection and distribution capabilities required by the franchise network, other distributors could provide similar products on comparable terms. The Company, and its franchisees, also use supplemental suppliers for their product selections, in addition to the national distributor.

See Note 11 for purchase commitments from our manufacturers for inventory.

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Fair value of financial instruments

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

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

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

Level 3 inputs are unobservable inputs for the asset or liability. The Company determined that the derivative liability was a level 3, as the inputs used to determine the estimated fair value were unobservable.

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

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

Discontinued Operations

Pursuant to ASC 205-20 Discontinued Operations, in determining whether a group of assets that is disposed (or to be disposed) should be presented as a discontinued operation, we analyze whether the group of assets being disposed represents a component of the Company; that is, whether it had historic operations and cash flows that were clearly distinguished, both operationally and for financial reporting purposes. In addition, we consider whether the disposal represents a strategic shift that has or will have a major effect on our operations and financial results. The results of discontinued operations, as well as any gain or loss on the disposal, if applicable, are aggregated and separately presented in our consolidated statements of operations, net of income taxes. The historical financial position of discontinued operations are aggregated and separately presented in our accompanying condensed consolidated balance sheets.

Reclassifications

Certain amounts in previously issued financial statements have been reclassified to conform to the presentation following the Assignment for the Benefit of Creditors, which includes the reclassification of the combined financial position and results of operations of FHV LLC as discontinued operations (see Note 12) for all periods presented.

Net loss per share

The Company calculates basic earnings per share ("EPS") by dividing our net loss by the weighted average number of common shares outstanding for the period, without considering common stock equivalents. Diluted EPS is computed by dividing net income or net loss and comprehensive net loss applicable to common shareholders by the weighted average number of common shares outstanding for the period and the weighted average number of dilutive common stock equivalents. Common stock equivalents are only included in the calculation of diluted EPS when their effect is dilutive.

Segment Information

The Company relies upon ASC 280, *Segment Reporting,* to determine and disclose reportable operating segments, and is organized such that each subsidiary represents a different operating purpose. As a result, the Company analyzed each subsidiary to determine reportable operating segments. In its management of operations, the chief operating decision maker, the Chief Executive Office, Nicholas Yates and Chief Financial Officer, Arthur Budman, reviews subsidiary balance sheets and statements of operations prepared on a basis consistent with U.S. GAAP.

For the periods presented, the Company determined that Reis and Irvy's, Inc., and FHV, LLC (see Note 12 – Discontinued operations) were reportable operating segments; Generation Next Franchise Brands, Inc., 19 Degrees, Inc., Generation Next Vending Robots, The Fresh and Healthy Vending Corporation, FHV Acquisition, Corp. and FHV Acquisition, Corp. were not material segments and therefore have not been reported as such. Reis & Irvy's, Inc. represents the sale of frozen yogurt and ice cream robots, franchise fees, royalties (12% of gross revenue) location fees, and product rebates. FHV, LLC represents the sale of fresh and healthy vending machines, franchise fees, royalties and product rebates.

Generation NEXT Franchise Brands, Inc. and Subsidiaries

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Related Party Transactions

The Company has been involved in transactions with related parties. A party is considered to be related to the Company if the party directly or indirectly or through one or more intermediaries, controls, is controlled by, or is under common control with the Company. Related parties also include principal owners of the Company, its management, members of the immediate families of principal owners of the Company and its management, and other parties with which the Company may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

Recent accounting standards

In July 2015, FASB issued ASU 2015-11, "Inventory (Topic 330) Related to Simplifying the Measurement of Inventory," which applies to all inventory except that which is measured using last-in, first-out ("LIFO") or the retail inventory method. Inventory measured using first-in, first-out ("FIFO") or average cost is within the scope of the new guidance and should be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable cost of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The new guidance is applied prospectively, and earlier application is permitted as of the beginning of an interim or annual reporting period. The Company adopted ASU 2015-11 effective July 1, 2017, which had no material impact on its consolidated financial statements or financial statement disclosures.

In January 2017, the Financial Accounting Standards Board (the "FASB") issued new guidance for goodwill impairment which requires only a single-step quantitative test to identify and measure impairment and record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value. The option to perform a qualitative assessment first for a reporting unit to determine if a quantitative impairment test is necessary does not change under the new guidance. This guidance is effective for the Company beginning in fiscal year 2020 with early adoption permitted. The Company adopted this guidance in fiscal year 2017. The adoption of this guidance will have no impact on the Company's consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* ("ASU 2016-18"). ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and restricted cash. Therefore, amounts generally described as restricted cash should be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows, and transfers between cash and cash equivalents and restricted cash are no longer presented within the statement of cash flows. ASU 2016-18 is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. The Company elected to early adopt ASU 2016-18 for the reporting period ended December 31, 2017 and the standard was applied retrospectively for all periods presented which had no material impact on prior years. As a result of the adoption of ASU 2016-18, the Company no longer presents the change within restricted cash in the consolidated statement of cash flows.

In March 2016, the Financial Accounting Standards Board (the "FASB") issued new guidance for employee share-based compensation which simplifies several aspects of accounting for share-based payment transactions, including excess tax benefits, forfeiture estimates, statutory tax withholding requirements, and classification in the statements of cash flows. This guidance was effective for the Company in fiscal year 2017. Under the new guidance any future excess tax benefits or deficiencies are recorded to the provision for income taxes in the consolidated statements of operations, instead of additional paid-in capital in the consolidated balance sheets. During the quarters ended September 30, 2018 and 2017, no excess tax benefits were recorded to additional paid-in capital that would have been recorded as a reduction to the provision for income taxes.

In February 2016, the FASB issued ASU No. 2016-02 ("ASU 2016-02"), *Leases (Topic 842)*, which supersedes existing guidance on accounting for leases in *Leases (Topic 840)* and generally requires all leases, including operating leases, to be recognized in the statement of financial position as right-of-use assets and lease liabilities by lessees. The provisions of ASU 2016-02 are to be applied using a modified retrospective approach and are effective for reporting periods beginning after December 15, 2018; early adoption is permitted. In July 2018, the FASB issued ASU 2018-10 "*Codification Improvements of Topic 842, Leases*" and ASU No. 2018-11, "*Leases (Topic 842)*: *Targeted Improvements."* ASU 2018-11 provides companies another transition method in addition to the existing transition method by allowing entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The consideration in the contract is allocated to the lease and non-lease components on a relative standalone price basis (for lessees) or in accordance with the allocation guidance in the new revenue standard (for lessors). ASU 2018-11 also provides lessees with a practical expedient, by class of underlying asset, to not separate non-lease components from the associated lease component. If a lessee makes that accounting policy election, it is required to account for the non-lease components together with the associated lease component as a single lease component and to provide certain disclosures. Lessors are not afforded a similar practical expedient. The Company is evaluating the effect ASU 2016-02, 2018-10 and 2018-11 will have on its consolidated financial statements and disclosures and has not yet determined the effect of the standard on its ongoing financial reporting at this time.

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In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 requires an entity to recognize the revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2014-09 supersedes the revenue requirements in *Revenue Recognition (Topic 605)* and most industry-specific guidance throughout the Industry Topics of the Codification. The New Revenue Standard provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

This five-step process will require significant management judgment in addition to changing the way many companies recognize revenue in their financial statements. Additionally, and among other provisions, the New Revenue Standard requires expanded quantitative and qualitative disclosures, including disclosure about the nature, amount, timing and uncertainty of revenue.

In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date* ("ASU 2015-14"), which defers the effective date of ASU 2014-09 by one year. Early adoption is permitted but not before the original effective date. The Company's adoption of ASU 2014-09 will change the timing of the recognition of initial franchise fees. ASU 2014-09 requires these fees to be recognized over the term of the related franchise license for the respective robot, which had a material impact to revenue recognized for initial franchise fees and renewal franchise fees. ASU 2014-09, allows for non-cancellable franchise contract agreements for the Company recognize revenue under the provisions of ASC 606-10-25, Revenue Recognition – Revenue from Contracts with Customers.

In March 2016, FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendments in this update change the accounting for certain stock-based compensation transactions, including the income tax consequences and cash flow classification for applicable transactions. The amendments in this update are effective for annual periods beginning after December 31, 2016 and interim periods within those annual periods. The Company is currently evaluating the impact that this amendment will have on its consolidated financial statements.

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Effective January 2017, FASB issued ASU No. 2016-15 “Statement of Cash Flows” (Topic 230). This guidance clarifies diversity in practice on where in the Statement of Cash Flows to recognize certain transactions, including the classification of payment of contingent consideration for acquisitions between Financing and Operating activities. We are currently evaluating the impact that this amendment will have on our consolidated financial statements.

On January 5, 2017, the FASB issued ASU No. 2017-01, “Clarifying the Definition of a Business” (Topic ASC 805), guidance to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in this ASU provide a screen to determine when an integrated set of assets and activities (collectively referred to as a “set”) is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. If the screen is not met, the amendments require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and remove the evaluation of whether a market participant could replace the missing elements. This ASU is effective for public business entities in annual periods beginning after December 15, 2017, including interim periods therein. We are currently evaluating the impact that this amendment will have on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation – Stock Compensation” (Topic 718) - Scope of Modification Accounting. This ASU clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. This ASU is effective prospectively for the annual period ending December 31, 2018 and interim periods within that annual period. We are currently evaluating the impact that this amendment will have on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, “*Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*”, which adds disclosure requirements to Topic 820 for the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The Company is evaluating the provisions of this ASU and plans to adopt this ASU effective July 1, 2020.

3. Inventory

Inventory consisted of the following:

	September 30, 2018	June 30, 2018
Inventory on-hand:		
Raw material	$ 10,030,659	$ 1,800,991
Work in process	594,762	1,003,773
Finished goods	135,173	506,720
	10,760,594	3,311,484
Allowance for obsolete inventory	(400,000)	(300,000)
	$ 10,360,594	$ 3,011,484

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Prepaid inventory represents payments for raw material that has not been received by the Company.

See Note 10 for purchase commitments from our manufacturers for inventory.

4. Property and equipment

Property and equipment consisted of the following:

	September 30, 2018 (unaudited)	**June 30, 2018 (audited)**
Furniture and fixtures	$ 44,064	$ 44,065
Office equipment	32,517	32,517
Tenant improvements	61,414	61,414
Frozen yogurt robots	177,684	177,684
	315,679	315,680
Accumulated depreciation	(129,236)	(115,889)
	$ 186,443	$ 199,791

For the quarters ended September 30, 2018 and 2017, depreciation expense was $111,000 and $106,000 respectively.

5. Intangible property

Intangible property consisted of the following:

	September 30, 2018 (unaudited)	June 30, 2018 (audited)
Patents	$ 2,440,000	$ 2,440,000
Computer software	116,176	116,176
	2,556,176	2,556,176
Accumulated amortization	(784,102)	(686,052)
	$ 1,772,074	$ 1,870,124

For the quarters ended September 30, 2018 and 2017, amortization expense was $98,000 and $96,000 respectively.

Patents

On December 29, 2016, the Company entered into an Asset Purchase Agreement (the “Agreement”) with Robofusion, Inc. (“RFI”), whereby the Company acquired the intellectual property assets of RFI, a developer of robotic-kiosk vending technology, primarily frozen yogurt vending kiosks/cubes, using RFI's trademarked name of Reis & Irvy's (the “Acquisition”). Pursuant to the Agreement, the Company provided RFI, and its designees, a cash payment of $440,000, The Company also issued to RFI a three-year, $2 million note and a five-year common stock purchase warrant for 1,520,000 shares with a strike price of $0.50 per share. Furthermore, certain RFI Officers, Directors and Shareholders will be subject to a five-year, non-compete agreement. Also, the Agreement provides for indemnification and set-off of up to $1 million, under certain circumstances. Through the date of this report, the Company entered into four settlements related to the intellectual property totaling approximately $401,000. Furthermore, the Company made approximately $174,000 in payments. All settlement payments are a reduction of the note payable. (See Note 6).

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RFI previously granted the Company an exclusive license to market RFI's frozen yogurt vending kiosks/robots, using RFI's trademarked name of Reis & Irvy's, in the United States and its territories (excluding Puerto Rico) and Canada. The assets acquired pursuant to the Agreement, are substantially all of the assets previously licensed to the Company.

Computer software

Computer software represents capitalized costs of the customer relationship management software utilized by the Company.

6. Notes payable

Senior secured promissory notes

On February 25, 2014, we issued Senior Secured Promissory Notes (the "Initial Notes") to three investors in exchange for cash totaling $501,000. The Initial Notes were set to mature on February 24, 2015 and bear simple interest at a rate of 12% paid monthly over the term of the loan. The Initial Notes also provide that our Company can raise up to $1.5 million in proceeds from the issuance of additional notes (the "Additional Notes") which would have the same seniority and security rights. The Initial Notes are secured by substantially all assets of the Company. On September 23, 2014, the holders of the Company's Initial Notes extended the maturity date from February 24, 2015 to March 15, 2016, and on March 15, 2016, the Notes were further extended to September 30, 2016. The notes have been further extended to December 31, 2018 and $478,000 of the notes, plus accrued interest, were converted to common stock at $.16 per share during fiscal 2018. The remaining outstanding notes, aggregating $23,000, were granted conversion rights at $.16 per share and were converted to common stock during the quarter ended September 30, 2018. The conversion right granted was fixed at the closing trading price of the stock. As a result, the Company determined that the conversion right was not a derivative in accordance with ASC 815, *Derivatives and Hedges,* the host instrument was conventional convertible, and that no beneficial conversion feature was present. The modification of the debt terms was not deemed substantive and therefore, was not accounted for as an extinguishment of debt with the recognition of a gain or loss.

As of September 30, 2018 and June 30, 2018, the outstanding balance was approximately $0 and $23,000, respectively.

As of September 30, 2018 and June 30, 2018, accrued interest was approximately $0 and $6,000, respectively.

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Financing and security agreement

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

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

At September 30, 2018 and June 30, 2018, there was $250,000 outstanding under the Financing Agreement, of which $150,000 originally matured on September 23, 2016 and $100,000 originally matured on December 15, 2016. On January 20, 2017, the Company extended both tranches until December 31, 2018. As part of the extension, the holder was granted conversion rights at $.16 per share. The conversion right granted was fixed at the closing trading price of the stock. As a result, the Company determined that the conversion right was not a derivative in accordance with ASC 815, *Derivatives and Hedges,* the host instrument was conventional convertible, and that no beneficial conversion feature was present. The modification of the debt terms was not deemed substantive and therefore, was not accounted for as an extinguishment of debt with the recognition of a gain or loss.

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

As of September 30, 2018 and June 30, 2018, accrued interest was approximately $88,000 and $81,000, respectively.

For the quarters ended September 30, 2018 and 2017, interest expense was approximately $6,250 and $6,250, respectively.

Convertible promissory note

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

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

(i) 25% discount to the next round of financing prior to conversion in excess of $1 million; or

(ii) $.30 per share; or,

(iii) Commencing six months after issuance date, at the investor’s sole discretion, at a 20% discount to the lowest trading price ten business days prior to conversion.

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In connection with the issuance of the Promissory Note and warrant, the Company has recorded the fair value of the warrant of $78,707 as additional paid-in capital. Furthermore, the Company has recorded a discount on the Promissory Note of $480,100 and a derivative liability of $401,393 due to the lack of explicit limit on the number of shares that may be required to be issued upon future conversion. The discount is amortized as accretion of discount on notes payable over the term of the loan using the effective interest rate method. There was no derivative gain or loss during the three months ended March 31, 2018.

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

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

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

On January 20, 2017, the note was extended through June 30, 2017 and the warrant price was reduced to $.30 per share, provided that the warrants must be exercised for cash. Furthermore, the warrant expiration date was amended to June 20, 2018. The modification of the debt terms was not deemed substantive and therefore, was not accounted for as an extinguishment of debt with the recognition of a gain or loss.

The principal balance of $600,000 plus accrued interest was repaid during the first quarter of Fiscal year 2018.

Robofusion note payable

On December 29, 2016, the Company entered into an Asset Purchase Agreement (the "Agreement") with Robofusion, Inc. ("RFI"), whereby the Company acquired the intellectual property assets of RFI, a developer of robotic-kiosk vending technology, primarily frozen yogurt vending kiosks/robots, using RFI's trademarked name of Reis & Irvy's (the "Acquisition"). Pursuant to the Agreement, the Company provided RFI, and its designees, a cash payment of $440,000. The Company also issued to RFI a three-year, $2 million note.

In connection with the issuance of the note payable, the Company issued a five-year common stock purchase warrant for 1,520,000 shares with a strike price of $0.50 per share (see Note 5). At inception, the estimated fair value of the warrant was approximately $174,000, and was recognized as a debt discount. During the quarters ended September 30, 2018 and 2017, approximately $12,500 and $12,500 was accreted to interest expense in the accompanying statements of operations.

As of September 30, 2018 and June 30, 2018, the outstanding balance was approximately $1,353,000 and $1,441,000, respectively. During the quarter ended September 30, 2018, principal payments were approximately $50,000 and indemnification payments were approximately $39,000. During fiscal 2018, principal payments were approximately $424,000 and indemnification payments were approximately $135,000.

As of September 30, 2018 and June 30, 2018, accrued interest was approximately $24,000 and $15,000, respectively.

For the quarters ended September 30, 2018 and 2017, interest expense was approximately $12,000 and $16,000, respectively.

Bridge notes payable

On February 28, 2017, the Company executed two short-term bridge notes aggregating $345,000. The notes bear interest at 0% per annum and matured on July 28, 2017. In connection with the note issuances, the Company recognized an original issue discount of approximately $45,000 and a debt discount approximately $57,000 related to the issuance of 75,000 shares of the Company's common stock (Note 7), for a total debt discount of approximately $102,000. The debt discount was amortized over the life of the loan. The bridge notes were repaid during the fiscal year ended June 20, 2018.

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(Unaudited)

	September 30, 2018	**June 30, 2018**
Senior Secured Promissory Notes, bearing interest at 12% per annum, payable monthly. The Senior Secured Notes mature on December 31, 2018 and have conversion rights at $.16 per share.	$ -	$ 23,000
Convertible secured debt, bearing interest at 10% per annum, payable quarterly. The convertible secured debt matures on December 31, 2018 and has conversion rights at $.16 per share.	250,000	250,000
$2,000,000 Promissory Note, bearing interest at 3.25% per annum. Principal and interest is due quarterly, over a 3 year period, net of discount of $86,997 and $99,426, respectively.	1,265,805	1,342,132
	1,515,805	1,615,132
Less current maturities	(1,036,724)	(879,017)
	$ 479,081	$ 736,115

Maturities of notes payable, net of discounts, are as follows:

September 30, 2019	$ 1,036,724
September 30, 2020	479,081
	$ 1,515,805

7. Stockholders' deficit

For the quarter ended September 30, 2018, the Company issued or recognized:

- Αππροξιματελψ 832,000 σηαρεσ οφ χομμον στοχκ φορ γροσσ προχεεδσ οφ αππροξιματελψ ∃1,248,000

- Προχεεδσ οφ ∃300,000 ωερε ρεχειϖεδ συβσεθυεντ το ϑυνε 30, 2018 φορ 200,000 σηαρεσ οφ χομμον στοχκ τηατ ωασ ισσυεδ πριορ το ϑυνε 30, 2018.
- Αππροξιματελψ 179,000 σηαρεσ οφ χομμον στοχκ φορ τηε χονϖερσιον οφ αππροξιματελψ ∃23,000 οφ χονϖερτιβλε δεβτ ανδ ∃5,700 οφ αχχρυεδ ιντερεστ.
- Αππροξιματελψ ∃763,000 ιν στοχκ–βασεδ χομπενσατιον ρελατεδ το οπτιονσ ισσυεδ ινσιδε ανδ ουτσιδε τηε 2013 Εθυιτψ Ινχεντιϖε Πλαν.
- Αππροξιματελψ 432,000 σηαρεσ οφ χομμον στοχκ φορ τηε χασηλεσσ εξερχισε οφ οπτιονσ υνδερ τηε 2013 Εθυιτψ Ινχεντιϖε Πλαν. (Σεε Νοτε 8).

For the quarter ended September 30, 2017, the Company issued or recognized:

- Ωε ισσυεδ 4,120,517 σηαρεσ οφ χομμον στοχκ δυρινγ τηε θυαρτερ ενδεδ Σεπτεμβερ 30, 2017 φορ προχεεδσ αγγρεγατινγ ∃2,017,200.

8. Stock-based compensation

2013 Equity Incentive Plan

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

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

During the three months ended September 30, 2018, the Company granted stock options under its 2013 Equity Incentive Plan. Stock-based compensation related to these awards is recognized on a straight-line basis over the applicable vesting period (24 months) and is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the three months ended September 30, 2018 and 2017. Continuous employment is required for the options to vest, and there are no other performance requirements. The options issued were valued using a binomial method assuming the following:

Expected volatility	232.16%-234.30%
Dividend yield	0%
Risk-free interest rate	2.33%-2.44%
Expected life in years	3.5

The expected volatility was estimated based on the volatility of the Company's stock. The risk-free rate was based on the U.S. Treasury note rate over the expected life of the options. The expected life was determined using the simplified method as we have no historical experience. We recorded stock-based compensation expense of approximately $46,000 and $136,000 during the three months ended September 30, 2018 and 2017, respectively. Remaining stock-based compensation to be recognized is approximately $295,000.

The following table summarizes the stock option activity under the 2013 Plan through September 30, 2018:

	Options	Weighted Average Exercise Price Per Share	Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at June 30, 2018	3,141,876	$ 0.21	5.23	$ 6,168,665
Granted	-	$ -		
Exercised	(449,500)	$ 0.43		
Forfeited	-	$ -		
Outstanding at September 30, 2018	2,692,376	$ 0.38	1.92	$ 674,930

Vested options	2,310,501
Remaining options expected to vest	381,875

At September 30, 2018, the outstanding options had an average remaining expected life of 2.06 years. Furthermore, at September 30, 2018, 2,310,501 options were exercisable at a weighted average exercise price of $0.23.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Non-Qualified Stock Options

On January 20, 2017, the Company granted non-qualified stock options (outside of the 2013 Plan) aggregating 5,000,000 and 500,000, respectively to its Chairman and CEO. The options vest 50% upon the delivery of 400 frozen yogurt robots or achieving cumulative revenue of $15 million and 50% upon the delivery of 800 frozen yogurt robots or achieving cumulative revenue of $30 million.

The estimated fair value of the options was approximately $698,000. Stock-based compensation related to these awards is recognized on a straight-line basis over the expected vesting period (24 months) and is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations for the three months ended September 30, 2018 and 2017. The options issued were valued using a binomial method assuming the following:

Expected volatility	134.81%
Dividend yield	0%
Risk-free interest rate	1.50%
Expected life in years	3.5

During the three months ended September 30, 2018, the Company recognized stock-based compensation expense of approximately $70,000. Remaining stock-based compensation to be recognized is approximately $233,000. No options have vested and the options expected to vest is 4,400,00.

There were no non-qualified stock options granted during the three months ended September 30, 2018.

During February 2018, the Company granted nonqualified stock options (outside of the 2013 Plan) to the following:

- Τηε Χομπανψ γραντεδ α ποτεντιαλ οφ 1,175,000 οπτιονσ το εμπλοψεεσ. Τηε οπτιονσ ϖεστ βασεδ ον οβφεχτιϖε χριτερια χονσιστινγ οφ σαλεσ ανδ οϖεραλλ χομπανψ γοαλσ.

The estimated fair value of the options was approximately $6,464,000. Stock-based compensation related to these awards is recognized on a straight-line basis over the expected vesting period (24 months) and is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. The options issued were valued using a binomial method assuming the following:

Expected volatility	232.16% - 233.60%
Dividend yield	0%
Risk-free interest rate	2.37% - 2.39%
Expected life in years	3.5

During the three months ended September 30, 2018, the Company recognized stock based compensation expense of approximately $646,000. Remaining stock-based compensation to be recognized is approximately $4,750,000. No options have vested and the remaining options expected to vest is 6,040,000.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

9. Leases

On August 1, 2015, the Company moved its corporate and warehouse facilities to a single location aggregating 8,654 feet at 2620 Financial Court, Suite 100, San Diego California 92117. The new lease is for a term of 84 months. The current monthly rental payment, net of utilities for the facility, is $15,995. Future minimum lease payments under the Company's Facility Lease is as follows:

2018: $47,873; 2019: $196,928; 2020: $202,554; 2021: $208,377; 2022: $214,403: Thereafter: $17,909. Rent expense totaled $54,000 and $43,000 for the three months ended September 30, 2018 and 2017, respectively.

10. Commitments and contingencies

During fiscal year 2018, the Company began a voluntary internal investigation into payments made with respect to the Company's primary stock sales and whether the payments complied with Section 15 of the Securities Exchange Act of 1934. The Company paid a bonus to certain members of its franchise sales staff and to the Company's Chairman for any shares of the Company's stock that potential franchisees purchased. In this regard, the Company paid approximately $332,000 to its franchise sales staff and a matching bonus of approximately $332,000 to its Chairman for the time period July 2017 to April 2018. The Company also paid an outside service provider pursuant to a written contract for franchise reengagement leads. The Company has determined that the outside service provider had some involvement in generating reengagement leads of potential franchisees who also may have had an interest in purchasing stock. These payments are in relation to the $16.4 million (net of offering costs) raised by the Company during the fiscal year ended June 30, 2018. The Company has engaged outside counsel, has ceased and will not make further payments with regard to the Company's stock sales, will take remedial measures (including oversight and education), and, as deemed appropriate, will take steps to recapture the value of those payments previously made. The Audit Committee has taken charge of and is overseeing the continued internal investigation and remediation efforts. The Company cannot reasonably estimate any potential liability or recovery, if any, related to these payments.

There are warranties on our vending machines extended by the machine manufacturer and its distributors, but required repairs to the machines are the responsibility of the franchisees. To the extent the machines remain under warranty, our franchisees transact directly with the manufacturer or its distributor. As a result, no warranty liability or expense was recognized in 2018 or 2017. The Company provides a one-year parts warranty on its robotic soft serve vending kiosks. Our frozen yogurt robots are supplied by a single manufacturer. Although there are a limited number of manufacturers, we believe that other suppliers could provide similar machines on comparable terms. A change in suppliers, however, could cause a delay in deliveries and a possible loss of sales, which could adversely affect our operating results.

Our frozen yogurt consumables will be supplied by several distributors, based on geographical location. However, there may be only one supplier in each geographic location. A change in suppliers, however, could cause a delay in deliveries and a possible loss of revenue from both current and prospective franchisees, which could adversely affect our operating results.

As of September 30, 2018, the Company had unconditional purchase contracts of approximately $6,115,000 for the purchase of inventory for the frozen yogurt and ice cream robots.

On May 19, 2018, the Company entered into an 18-month consulting contract with a franchisee. Consideration is a total of 300,000 shares of common stock. 50,000 shares of common stock vest every three months during the term of the contract. If the consultant resigns or is terminated, the Company has the option to repurchase the unreleased shares at the lesser of the fair market value of the shares at the time the repurchase option is exercised and the purchase price The Company accounted for the shares in accordance with ASC 505-50, *Equity-Equity Based Payments to Non-Employees*.

On June 6, 2018, the Company entered into an agreement with two investors in connection with the Company's private placement memorandum. The investors have the right to purchase:

- From June 6 through June 30, 2018, 300,000 shares of common stock at $1.00 per share. As of June 30, 2018, the investors purchased 300,000 shares of common stock.
- From July 1 through September 30, 2018, 1,000,000 shares of common stock at $1.00 per share. As of September 30, 2018, no shares were purchased.
- From October 1 through December 31, 2018, 1,333,333 shares of common stock at $1.50 per share. As of the date of this report, no shares were purchased.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

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

Additionally, our Company is subject to certain state reviews of our Franchise Disclosure Documents. Such state reviews could lead to our Company being fined or prohibited from entering into franchising agreements with the reviewing state.

Periodically, we are contacted by other state franchise regulatory authorities and in some cases have been required to respond to inquiries, or make changes to our franchise disclosure documents or franchise offer and sale practices. Management believes these communications from state regulators and corresponding changes in our franchise disclosure documents and practices are administrative in nature and do not indicate the presence of a loss or probable potential loss.

11. Related party transactions

Related party debt consisted of the following:

	September 30, 2018	**June 30, 2018**
Secured Promissory Notes	$ 296,779	$ 296,779
Convertible Promissory Note	240,007	240,007

	536,786	536,786
Less current maturities	(536,786)	(536,786)
	$ -	$ -

Notes Payable to Socially Responsible Brands

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

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

The Notes are each in the principal amount of $250,000, and have terms of eighteen months and one year, respectively. The first Note was secured by the Company's fifty (50) corporate-owned micro-markets and the Note principal and interest is repaid according to a schedule based on sale of such micro-markets. The second Note is secured by the Company's franchise royalties and principal and interest is repaid on a schedule based on receipt of combo machine sales, with guaranteed payments of at least $75,000 per quarter during the term of the Note. During the quarter ended September 30, 2018, the Company paid $0 of principal and interest, respectively, under the Notes.

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Generation NEXT Franchise Brands, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

On January 20, 2017, Socially Responsible Brands agreed to extend the maturity date on their notes until December 31, 2017. In connection with the loan extension, the holder may convert their Notes into shares of the Company’s stock at $.16 per share. Furthermore, on September 18, 2017, the Notes were amended whereby the interest rate was modified to a rate of 20% per annum effective October 1, 2016. Additionally, the Notes were further extended until December 31, 2018.

Notes Payable to Nick Yates

On January 13, 2015, the Company's Chairman, Nicholas Yates, agreed to loan the Company up to $200,000 (the "Loan"), each incremental borrowing under the Loan to be evidenced by a promissory note. Mr. Yates further agreed to loan the Company up to $550,000. Amounts borrowed under the Loan bear interest at 10% per annum and are due on December 31, 2016. The Loan also provides for conversion to common stock, at the option of the holder, at a price equal to the Company’s next round of funding. In connection with the beneficial conversion option, the Company recorded $300,000 as a discount on the Loan and charged $0 and $0, to operations during the quarters ended September 30, 2018 and 2017, respectively. As of September 30, 2018 and June 30, 2018, $240,000 and $240,000, respectively were outstanding under the Loan.

On January 20, 2017, Mr. Yates agreed to extend his loans until December 31, 2017. In exchange for extending the loans, Mr. Yates was granted an option to convert the loan to common stock at $.16 per share. Furthermore, Loans were extended until December 31, 2018.

On October 9, 2018, the Company repaid the outstanding balance of approximately $240,000 of convertible notes payable to the Company's Chairman, Nicholas Yates, and related accrued interest of approximately $14,000, for a total of approximately $254,000.

On January 20, 2017, the Company executed a loan agreement with Nine Dragons Investments (“Nine Dragons”) for borrowings in an amount not to exceed $300,000. Nine Dragons is an entity affiliated with our Chairman Nick Yates. In connection with the loan agreement, the Company borrowed proceeds aggregating $209,931. The loans bear interest at 10% per annum, are due on December 31, 2017 and are secured by certain assets of the Company, including its intellectual property. Furthermore, the loans are convertible at the option of the holder at $.16 per share. During the year ended June 30, 2017, $209,931 of the Nine Dragons loans were redeemed for cash.

Other Transactions

During fiscal 2018, the Company paid a bonus to the Chairman for shares of the Company's stock that potential franchisees purchased. In this regard, the Company paid approximately $332,000 to its Chairman for the time-period July 2017 to April 2018. The Company will take steps to recapture the value of these payments previously made to its Chairman.

In July 2017, the Company issued 150,000 shares of common stock in connection with settlement of a former franchisee. Terms of the agreement state that Nick Yates will receive 50% of the proceeds in excess of $200,000.

The spouse of the Company's Chairman was employed by the Company during 2017 and through May 31, 2018. The Company charged approximately $0 and $10,000 to operations for her compensation during the three months ended September 30, 2018 and 2017, respectively.

As of September 30, 2018 and June 30, 2018, prepaid expenses and other current assets in the accompanying balance sheet included approximately $21,000 and $28,000, respectively, of short-term advances to an officer of the Company.

The Company determined that there may be a material weakness related to the identification of transactions that could be deemed violations of Section 13(k) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 402 of the Sarbanes-Oxley Act of 2002.

12. Discontinued operations

Because it was determined the assets of FHV LLC are currently insufficient to satisfy FHV LLC's obligations to creditors, as of September 28, 2018, FHV LLC has executed an Assignment for the Benefit of Creditors under California law, whereby all of the assets of FHV LLC have been assigned to a third party fiduciary who will expeditiously liquidate such assets and distribute the proceeds thereof to FHV LLC's creditors pursuant to the priorities established and permitted by law.

Discontinued operations as of September 30, 2018 and June 30, 2018 and for the three months ended September 30, 2018 and 2017 consist of the operations from the FHV LLC subsidiary.

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Gain (Loss) from Discontinued Operations

	For the three months ended September 30, 2018	2017
Revenues:		
Vending machine sales, net	-	$ 59,082
Franchise fees	-	6,145
Agency sales, net	-	16,040
Royalties	8,041	72,981
Other	2,050	2,500
Total revenue, net	10,091	156,748
Cost of revenues	5,237	49,558
Gross margin	4,854	107,190
Operating expenses:		
Personnel	-	252,764
Marketing	-	43,276
Professional fees	26,451	46,496
Insurance	-	12,827
Rent	6,199	12,317
Depreciation and amortization	-	432
Stock compensation	-	11,714
Provision for legal settlement	-	90,660
Other	6	36,339
Total operating expenses	32,656	506,825
Income (loss) from operations	(27,802)	(399,635)
Other expenses:		
Interest expense	-	(80,715)
Derivative liability income (expense)	-	(220,003)
Loss before provision for income taxes	(27,802)	(700,353)
Provision for income taxes	-	-
Loss from operations	(27,802)	(700,353)
Gain from disposition of operations	169,304	-
Net gain (loss)	$ 141,502	$ (700,353)

See accompanying notes to the unaudited condensed consolidated financial statements.

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The following tables lists the assets of discontinued operations and liabilities of discontinued operations as of September 30, 2018 and June 30, 2018 and the discontinued operations for FHV LLC for the three months ended September 30, 2018 and 2017.

Assets and Liabilities of Discontinued Operations

		June 30, 2018
Current assets:		
Cash	$	26,417
Restricted cash		1,500
Accounts receivable, net of allowance for doubtful accounts of $174,011		18,451
Inventory on-hand, net of allowance for obsolete inventory of $100,000		246,296
Current assets held for disposition	$	292,664
Current liabilities:		
Accounts payable and accrued liabilities	$	280,159
Contract liabilities - customer advances and deferred revenues		515,517
Provision for franchisee rescissions and refunds		496,000
Total current liabilities	$	1,291,676

13. Subsequent events

On October 9, 2018, the Company repaid the outstanding balance of approximately $240,000 of convertible notes payable to the Company's Chairman, Nicholas Yates, and related accrued interest of approximately $14,000, for a total of approximately $254,000.

On various dates subsequent to September 30, 2018 and through the date of this report, the Company entered into termination agreements with franchisees for refunds aggregating approximately $69,000. The Company considered the guidance in ASC 855, *Subsequent Events*, and determined that no accrual was required as of September 30, 2018.

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

Special Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends, our future expectations and other matters that do not relate strictly to historical facts and are based on certain assumptions of our management (such assumptions may be identified by "we," "our" or "us"). These statements are often identified by the use of words such as "may," "strive," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue, expressions or variations. Further, these statements are based on the beliefs and assumptions of our management based on information currently available. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation, the risks described in the section entitled "Risk Factors" under Item 1A in our Annual Report on Form 10-K for the year ended June 30, 2018.

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

Overview and Description of Business

Discussions with respect to our Company's operations included herein refer to our operating subsidiaries, Fresh Healthy Vending LLC ("FHV LLC") (see Note 12 to the financial statements), The Fresh and Healthy Vending Corporation ("FHV Corp"), Reis & Irvy's, Inc. ("R&I"), 19 Degrees, Inc. ("19 Degrees") and Generation NEXT Vending Robots, Inc. Effective as of July 19, 2013 our Company acquired all assets of FHV Holdings Corp ("FHV Cal") which included FHV LLC in a transaction (the "Acquisition") accounted for as an asset acquisition. With the sale of the Green 4 Media, Inc. business under the Indemnity Agreement effective July 22, 2013, our continuing operations are exclusively those of FHV Corp., R&I, 19 Degrees and Generation NEXT Vending Robots, Inc. Information with respect to our Company's operations prior to the Acquisition is not included herein but may be obtained from viewing our Annual Report for the year ended June 30, 2014 filed on Form 10-K on September 29, 2014.

We are a public company listed under the symbol "VEND".

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Business

Generation NEXT Franchise Brands, Inc. (formerly known as Fresh Healthy Vending International, Inc. and referred to herein collectively with its subsidiaries as "we", the "Company", "our Company", or "GNext") operates through its wholly-owned subsidiaries, Fresh Healthy Vending LLC ("FHV LLC"), The Fresh and Healthy Vending Corporation, FHV Acquisition Corp. ("FHV Acquisition"), Reis & Irvy's, Inc. ("R&I"), 19 Degrees, Inc. and Generation Next Vending Robots, Inc. as a franchisor, direct seller and owner and operator of robotic soft serve vending kiosks, healthy drink and snack vending machines and micro markets that feature cashless payment devices and remote monitoring software. The Company uses in-house location specialists that are responsible for securing locations for its franchisees; additionally, the Company has negotiated discounts with a national product distribution chain. The Company also operates its own frozen yogurt equipment. Effective May 2016, the Company shifted focus away from franchise sales of its healthy drink and snack vending machines and micro markets. We will no longer market our vending machines and micro markets to new franchisees. Because it was determined the assets of FHV LLC are currently insufficient to satisfy FHV LLC's obligations to creditors, as of September 28, 2018, FHV LLC has executed an Assignment for the Benefit of Creditors under California law, whereby all of the assets of FHV LLC have been assigned to a third party fiduciary who will expeditiously liquidate such assets and distribute the proceeds thereof to FHV LLC's creditors pursuant to the priorities established and permitted by law.

During fiscal year 2017, we obtained the exclusive rights to sell a new robotic soft sever vending kiosk, branded Reis & Irvy's. As of the date of this report, we have received approval to sell franchises in a number of states in the U.S. and Canada and have booked a net 1,281 units aggregating approximately $54 million (net of installed robots and franchisee refunds) in customer advances-due from franchisees and contract liabilities- franchisees advances and deferred revenues, prior to certain offset adjustments aggregating 13.8 million. Furthermore, the Company has additional commitments for 2,647 robots aggregating $102 million.

As of September 30, 2018, and through the date of this report, the Company has delivered and installed 123 robotic soft serve vending kiosks. The Company has redeveloped the next generation frozen yogurt robot and has spent approximately $5.2 million and $1 million in research and development expenses through June 30, 2018 and September 30, 2018, respectively. The Company anticipates it will continue to incur additional research and development expenses throughout fiscal 2019.

On December 29, 2016, the Company entered into an Asset Purchase Agreement (the "Agreement") with Robofusion, Inc. ("RFI"), whereby the Company acquired the intellectual property assets of RFI, a developer of robotic-kiosk vending technology, primarily frozen yogurt and ice cream vending robots, using RFI's trademarked name of Reis & Irvy's (the "Acquisition"). The Company considered the guidance in ASC 805, *Business Combinations,* and determined the transaction was a purchase of an asset. As a result, the estimated fair of the assets acquired were capitalized. The intent of the purchase was to combine robotics and artificial intelligence platforms to facilitate the manufacture of an unattended robot in order to disrupt traditional frozen yogurt and ice cream retail establishments and, on a larger scale, establish ourselves as an industry leader in the emerging and fast-growing space of unattended retail. Since acquisition, we have developed a state-of-the art robotic soft serve vending kiosk that is a completely unique vending machine and entertainment experience. The robot accepts cash, credit cards, and is the first of its kind to accept bitcoin. A proprietary software platform is utilized that allows us to readily monitor the sales of our franchisees' and our corporate-owned machines, which assists our franchisees and us in facilitating the management and maintenance of the vending robot. In order to protect the Company's rights, several U.S. and international patents have been approved and granted. Our vending standards are UL ("Underwriters Laboratories") (approval in process), NSF ("National Sanitation Foundation") recognized (approved in August 2018), and National Automated Merchandising Association ("NAMA") certified (approved in September 2018), which we believe are among the highest standards in the industry. This ensures food temperature compliance, which includes auto-contingency processes should electrical or hardware malfunction; it also ensures that ambient air stays within specified parameters at all times. Our third-party cashless payment technology provides the highest level of data and network security compliance while ensuring complete transparency. As a result, our robotic soft serve vending robots will contain minimal amounts of cash. All transactions are managed by third parties to facilitate financial compliance with local and national laws and regulations. Funds from all electronic transactions are collected by Reis & Irvy's and remitted to the franchisee within ten days of the subsequent month.

Frozen Yogurt Robots

We manufacture a state-of-the-art frozen yogurt vending machine robot that is a completely unique vending machine and entertainment experience. The robot contains both a cash and cashless vending platform that allows us to readily monitor the sales of our franchisees' and our corporate-owned machines. Our vending standards are UL (approval in progress), NAMA, and NSF certified, which we believe are among the highest standards in the industry. This ensures food temperature compliance, which includes auto-contingency processes should electrical or hardware malfunction; it also ensures that ambient air stays within specified parameters at all times. Our third-party cashless technology provides the highest level of data and network compliance while ensuring complete transparency. As a result, we generally handle little if any cash in the process. All transactions are managed by third parties to facilitate compliance with local and national laws and regulations.

The Industry and the Overall Market

We are both a franchisor and operator of vending machines, micro markets, and frozen yogurt robots. In the franchise market, 2012 saw the first positive growth in the number of franchise establishments since 2008 according to the IFA's annual Franchise Business Economic Outlook report (compiled by HIS Global Insight). Upscale vending is taking over as consumers' palates become more refined and they gravitate toward a health-conscious lifestyle, according to Food Business News. The National Automated Merchandising Association ("NAMA") estimates the vending market is a $30 billion-a-year industry. NAMA also estimates that 100 million Americans will use one of seven million vending machines each day.

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Robotic Soft Serve Vending Kiosks

For our Robotic Soft Serve Vending Kiosks, we primarily provide access to Dannon's YoCream products. These products include options of non-dairy, sorbet, tart, no-sugar added, nonfat, and low-fat frozen desserts. YoCream products are available in a wide variety of more than 70 flavors including standard flavors such as more than 5 vanillas and 4 chocolates and trendy flavors such as tarts, fruity sorbets, and seasonal favorites. Dannon YoCream is available to Franchisees across the country and internationally, the product has a 21-day thawed shelf life for minimal waste.

Competition

The vending industry is large, highly fragmented and consolidating. We believe we have laid the foundation for a robust network of vending robots for our franchisees by implementing a strong business model that offers the following competitive advantages:

- Partnering with Compass Groups USA, a large operator of food service locations throughout the world, to provide accounts for our vending Robots.
- Engaging Flex Ltd. to manufacture the vending robots.
- Procuring components of the vending robot from trusted vendors with a history of high-quality products.
- Sourcing the highest quality products from recognized industry leaders, such as Dannon.
- Issuance of U.S. and international patents.

Our Principal Suppliers

The Company currently sources the components for all of its vending robots from various vendors, and has contracted with Flex Ltd., for the assembly and manufacture of the robotic soft serve vending kiosks. Additionally, there are a number of suppliers who provide various subcomponents of the robotic kiosks. We believe that our relationship with our suppliers is excellent, and likely to continue. In our view, the loss of our relationship with Flex Ltd., should it occur, may result in short term disruptions not likely to be material; however, the allocation of resources required to switch manufacturers would likely have a material impact on operations. The Company has identified other suppliers with comparable capabilities, the Company estimates that these suppliers could replace the current suppliers within three months if needed.

The Company has also entered into an agreement with Dannon YoCream, for Dannon YoCream to be a primary supplier of all frozen desserts available within the Reis & Irvy's Froyo Robots, including a wide assortment of frozen yogurts, sorbets and gelatos as well as kosher products.

Governmental Regulation

We are required to comply with regulations governing the sale of franchises – the primary component of our business. Fifteen states directly regulate franchising and fourteen require pre-sale registration of a Franchise Disclosure Document ("FDD"), or offering prospectus, by the franchisor, normally with the state agency that oversees the sale of securities in that state, and pre-sale delivery of an FDD to a franchise candidate by a franchisor before the signing of a binding agreement or the payment of any money to the franchisor. Franchise sales in the remaining 35 states are generally subject to the Franchise Rule promulgated by the Federal Trade Commission ("FTC"), which requires the pre-sale delivery of an FDD to a franchise candidate before the signing of a binding agreement or the payment of any money to the franchisor. A franchisor that fails to properly register and maintain the registration of its FDD and disclose its franchisee candidates in the 15 registration states, unless exempt from registration under a few narrowly drawn exceptions to the registration requirements, is subject to legal action by its franchisees for damages and, under certain circumstances, for rescission of the franchise agreements, and to administrative, civil and criminal penalties that may be imposed as well. The FTC's Franchise Rule does not require registration of an FDD with the FTC. Reis & Irvy's offers franchises in each state within the United States, with the exception of South Dakota.

Reis & Irvy's and franchisees are required to comply with all Federal, state and location regulations related to food handling.

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Our Employees

We had approximately 40 full-time employees as of September 30, 2018.

Seasonality

We do not expect that our business will experience significant seasonality.

Three months ended September 30, 2018 compared to three months September 30, 2017

Revenues

We had revenues of approximately $1.8 million for the three months ended September 30, 2018, compared to revenues of approximately $62,000 for the three months ended September 30, 2017. This represented an increase of approximately $1.7 million. Our revenues increased primarily due to the fact that we were shipping robots in the quarter ended September 30, 2018 and none were shipped in the prior year.

Cost of revenues

Cost of revenues was approximately $1.7 million during the three months ended September 30, 2018. Our cost of revenues are anticipated to be higher for the initial units shipped and installed as the selling price for these units was lower and the corresponding robot and installation costs were higher.

Gross margin

Gross margin for the three months ended September 30, 2018 was approximately $100,000. We anticipate that our gross profit and gross margin will increase as we gain cost efficiencies in our product costs, as well as shipping and installation expenses.

Selling, general and administrative expenses

Selling, general and administrative expenses for the three months ended September 30, 2018 were approximately $5,197,000 representing an increase of approximately $1,976,000 from approximately $3,221,000 in the three months ended September 30, 2017. The major components of selling, general and administrative expenses were as follows:

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Personnel expenses of approximately $1,335,000 for the three months ended September 30, 2018 represent an increase of $434,000 or 48.2% from approximately $901,000 in the three months ended September 30, 2017. The increase was primarily attributable to an increase in personnel mix and commissions during the period from sales of robots and franchises.

Professional fees expense increased approximately $298,000 to approximately $426,000 during the three months ended September 30, 2018 from approximately $128,000 during the three months ended September 30, 2017. The increase was primarily attributable to an increase in legal, accounting and consulting fees.

Stock compensation expense increased approximately $638,000 to approximately $763,000 during the three months ended September 30, 2018 from approximately $125,000 during the three months ended September 30, 2017. The increase was primarily attributable to additional grants of stock options and additional compensation expense related to these stock grants. It should be noted that this is a non-cash expense.

Provision for legal settlement increased approximately $74,000 from approximately $9,000 during the three months ended September 30, 2017 to approximately $83,000 during the three months ended September 30, 2018. The increase was primarily attributable to an increase in franchise refunds.

Other expenses increased approximately $336,000 from approximately $209,000 during the three months ended September 30, 2017 to approximately $545,000 during the three months ended September 30, 2018. The increase was primarily attributable to an increase in franchisee relations ($114,000) and travel expense ($89,000).

Provision for income taxes

During the three months ended September 30, 2018 and 2017, we incurred a net loss and operated as a C-corp for federal and state income tax purposes. A valuation allowance has been recorded to eliminate the tax benefit arising from our net operating loss due to the substantial uncertainty about whether such benefit will ever be realized.

Net loss

Net loss was approximately $5,007,000 during the three months ended September 30, 2018 compared to a net loss of approximately $3,987,000 for the three months ended September 30, 2017. The increase in net loss resulted from increased selling, general and administrative expenses offset by discontinued operations for FHV during the quarter ended September 30, 2017.

Basic net loss per share during the three months ended September 30, 2018 and 2017 was $0.07 and $0.11 per share, respectively.

Liquidity and Capital Resources

For the quarter ended September 30, 2018 we had a net loss totaling approximately $5,007,000 with negative cash flows from operations totaling approximately $8,377,000. Our cash balance at September 30, 2018 was approximately $1,595,000. Since the date of the closing of the FHV Acquisition, our sales were less than anticipated and the resulting cash flows from franchise sales were not sufficient to cover expenditures associated with our daily operations resulting in a substantial decrease in our cash balances and an increase in our outstanding debt. Also, we used cash on hand to retire liabilities associated with the franchise rescissions, for research and development expenditures related to our robotic soft serve vending kiosks and for the purchase of robot inventory. In order to ensure sufficient liquidity for our continuing operations, we will require additional capital financing in the form of either debt or equity (or a combination thereof) financing. During fiscal year 2018 and through the date of this report, the Company raised approximately $17.6 million through the sale of common stock. Furthermore, the Company anticipates generating a significant amount of our required capital resources from deposits on sales of new franchises, royalties from existing and future franchise installs and revenue from corporate-owned kiosks. If additional funds are required, management believes that it will be able to obtain such financing on terms acceptable to the Company, although there can be no assurance that we will be successful.

Our current plans include research and development expenditures for the production of the next generation robot, payments required for the purchase of the Robofusion intellectual property (previous owner of the frozen yogurt robot intellectual property), capital expenditures for the purchase of franchisee and corporate-owned and operated robotic soft serve vending kiosks, as well as the repurchase of machines from franchisees opting to rescind their franchise agreements. Given our current cash position, we may be forced to curtail our plans by delaying or suspending the production and purchase of robotic soft serve vending kiosks until such time that we may able to prepay for the robots.

As of September 30, 2018, the Company owed $250,000 outstanding under the Financing Agreement, approximately $240,000 outstanding under a loan agreement with its Chairman, approximately $297,000 under two Secured Promissory Notes and approximately $1.4 million under a loan related to the Robofusion acquisition.

Furthermore, in connection with the sale of robots, the Company has made non-cancellable purchase commitments for certain parts aggregating $6.1 million.

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Off Balance Sheet Arrangements

We had no material off balance sheet arrangements at September 30, 2018.

Critical Accounting Policies

We have identified the following as our most critical accounting estimates, which are those that are most important to the portrayal of the Company's financial condition and results, and that require management's most subjective and complex judgments. Information regarding our other significant accounting estimates and policies are disclosed in Note 2 to our condensed consolidated financial statements.

Revenue recognition — Our primary revenue generating transactions will come from the sale of franchises and robotic soft serve vending kiosks to the franchisees. There are no franchise fees charged beyond the initial first year franchise fees. We receive ongoing royalty fees, which represent other revenues in the Company's financial statements, as a percentage of either franchisees' gross revenues or gross margins on vending machine sales. We also receive rebates on purchases of products made by our franchisees.

We recognize revenues and associated costs in connection with franchisees (machines and franchise fees) at the time that we have substantially performed or satisfied all material services or conditions relating to the franchise agreement. We consider substantial performance to have occurred when: 1) no remaining obligations are unfulfilled under the franchise agreement; 2) there is no intent to refund any cash received or to forgive any unpaid amounts due from franchisees; 3) all of the initial services spelled out in the franchise agreement have been performed; and 4) we have met all other material conditions or obligations. The Company recognizes revenue on product sales of Company-owned machines when products are purchased; we receive electronic sales records on our Company-owned units.

The Company records the amount of a franchise sale, machines and franchise fees, as deferred revenue until the conditions above have been met. Once the machines are installed, the Company records the corresponding machine and as revenue, on a pro rata basis based on the number of machines installed relative to the total machines purchased. Franchise fees are recognized over the life of the contract period, usually ten years.

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

It is not our policy to allow for returns, discounts or warranties to our franchisees. Under certain circumstances, including as the result of regulatory action, our Company may become obligated to offer our franchisees amounts in rescission to reacquire their existing franchises, including machines. Additionally, if our Company is unable to fulfill its obligations under a franchise agreement we may, at our sole discretion, agree to refund or reduce part or all of a franchisees payments or commitments to pay. As of September 30, 2018 and June 30, 2018, the Company's provision for franchisee rescissions and refunds totaled approximately $3,753,000 and $1,924,000, respectively. Our robotic soft serve vending kiosks include a one-year parts warranty from the Company. Extended parts warranties beyond the initial year may be purchased for an additional cost by the franchisee.

Reis & Irvy's Franchise contracts — We invoice franchisees in full at the time that we enter into contractual arrangements with them. Payment terms vary but usually a significant portion of the contract's cash consideration (typically 40% - 50% of machines plus 50% - 100% of the franchise fees) is due at the time of signing, while remaining amounts outlined under the contract are generally due upon the securing of locations and/or prior to shipment of the machines.

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Amounts invoiced to franchisees for which we have not met the criteria for revenue recognition as discussed above, are deferred until such conditions are met. Therefore, these amounts are accounted for as contract assets – due from franchisees and customer advances and deferred revenues, respectively in the accompanying consolidated financial statements. As of September 30, 2018, the Company had contract assets – due from franchisees and customer advances and deferred revenues totaling approximately $5,835,000 and $39,549,000, respectively. As of June 30, 2018, the Company had contract assets – due from franchisees and customer advances and deferred revenues totaling approximately $7,251,000 and $37,222,000, respectively.

Accounts receivable, net **—** Accounts receivable arise primarily from invoices for customer deposits, product royalties and annual advertising fees and are carried at their estimated collectible amounts, net of any estimated allowances for doubtful accounts. We grant unsecured credit to our customers deemed credit worthy. Ongoing credit evaluations are performed and potential credit losses estimated by management are charged to operations on a regular basis. At the time, any particular account receivable is deemed uncollectible, the balance is charged to the allowance for doubtful accounts. Our allowance for doubtful accounts aggregated approximately $174,000 and $174,000 at September 30, 2018 and June 30, 2018, respectively.

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

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

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

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

We account for our share-based compensation as required by the Financial Accounting Standards Board ("FASB") under authoritative guidance ASC 718 on stock compensation, using a binomial quantitative valuation method. The resulting compensation expense is recognized in the financial statements on a straight-line basis over the vesting period from the date of grant.

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

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

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

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

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

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

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

Fair value of financial instruments — In April 2008, the FASB issued a pronouncement that provides guidance on determining what types of instruments or embedded features in an instrument held by a reporting entity can be considered indexed to its own stock for the purpose of evaluating the first criteria of the scope exception in the pronouncement on accounting for derivatives. This pronouncement was effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of these requirements can affect the accounting for many convertible instruments with provisions that protect holders from a decline in the stock price. Each reporting period, the Company evaluates whether convertible debt to acquire stock of the Company contains provisions that protect holders from declines in the stock price or otherwise could result in modification of the conversion price under the respective convertible debt agreements. The Company determined that the conversion feature in the convertible notes issued contained such provisions and recorded such instruments as derivative liabilities. See Note 6, Notes payable.

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Reis & Irvy's Franchise contracts — We invoice franchisees in full at the time that we enter into contractual arrangements with them. Payment terms vary but usually a significant portion of the contract's cash consideration (typically 40% - 50% of machines plus 50% - 100% of the franchise fees) is due at the time of signing, while remaining amounts outlined under the contract are generally due upon the securing of locations and/or prior to shipment of the machines.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

As required by Exchange Act Rule 13a-15(b), we have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive and principal financial officer, of the effectiveness of the design and operation of our management, and the design and operation of our disclosure controls and procedures as of September 30, 2018.

Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") has concluded that as of the end of the period covered by this quarterly report on Form 10-Q, our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the

Exchange Act) were not deemed effective in order to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the SEC and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure (see below for further discussion).

Management's Report on Internal Control Over Financial Reporting

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

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To evaluate the effectiveness of our internal control over financial reporting, management used the criteria described in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") – 1992, as amended in 2013.

In connection with management's assessment of our internal control over financial reporting, we determined that as of September 30, 2018, there was a material weakness in our internal control over financial reporting due the lack of a formalized audit committee charter. Since the Company is not listed on a national exchange or on an automated interdealer quotation system, it is not required to have an audit committee or independent directors, and thus did not have a controlling independent board or audit committee. We consider this to be a material weakness as an independent board and audit committee provide important oversight. The Company has partially remediated the material weakness by establishing an audit committee and appointing two independent directors, with at least one having financial expertise to be the Audit Chairman. The Company determined that there may be a material weakness related to the identification of transactions that could be deemed violations of Section 13(k) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 402 of the Sarbanes-Oxley Act of 2002. The specific material weaknesses identified by the Company's management as of end of the period covered by this report include the following:

- we have not performed a risk assessment and mapped our processes to control objectives;
- we have not implemented comprehensive entity-level internal controls;
- we have not implemented adequate system and manual controls; and
- we do not have sufficient segregation of duties. As such, the officers approve their own related business expense reimbursements

Despite the material weaknesses reported above, our management believes that our consolidated 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 and that this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

The Company remediated this material weakness by adding qualified personnel to the accounting department, and developing and implementing internal controls to eliminate such transactions.

Changes in Internal Control Over Financial Reporting

There were no material changes in our internal control over financial reporting (as defined in Rule 13a- 15(f) under the Exchange Act) that occurred as of September 30, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting as of September 30, 2018. Our management's evaluation of our internal control was based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Framework – 1992, as amended in 2013"). Based on its evaluation under the *Internal Control - Evaluation Framework,* due to the material weakness described above, management concluded that our internal control over financial reporting was not effective as of September 30, 2018. A material weakness is a control deficiency, or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected on a timely basis by the Board in the normal course of their duties.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Additionally, our Company is subject to certain state reviews of our Franchise Disclosure Documents. Such state reviews could lead to our Company being fined or prohibited from entering into franchising agreements with the reviewing state.

Periodically, we are contacted by other state franchise regulatory authorities and in some cases have been required to respond to inquiries, or make changes to our franchise disclosure documents or franchise offer and sale practices. Management believes these communications from state regulators and corresponding changes in our franchise disclosure documents and practices are administrative in nature and do not indicate the presence of a loss or probable potential loss.

During fiscal year 2018, the Company began a voluntary internal investigation into payments made with respect to the Company's primary stock sales and whether the payments complied with Section 15 of the Securities Exchange Act of 1934. The Company paid a bonus to certain members of its franchise sales staff and to the Company's Chairman for any shares of the Company's stock that potential franchisees purchased. In this regard, the Company paid approximately $332,000 to its franchise sales staff and a matching bonus of approximately $332,000 to its Chairman for the time period July 2017 to April 2018. The Company also paid an outside service provider pursuant to a written contract for franchise reengagement leads. The Company has determined that the outside service provider had some involvement in generating reengagement leads of potential franchisees who also may have had an interest in purchasing stock. These payments are in relation to the $16.4 million (net of offering costs) raised by the Company during the fiscal year ended June 30, 2018. The Company has engaged outside counsel, has ceased and will not make further payments with regard to the Company's stock sales, will take remedial measures (including oversight and education), and, as deemed appropriate, will take steps to recapture the value of those payments previously made. The Audit Committee has taken charge of and is overseeing the continued internal investigation and remediation efforts.

The Company cannot reasonably estimate any potential liability or recovery, if any, related to these payments.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1, “Risk Factors” in our Current Report on Form 10-K filed on October 19, 2018, which could materially affect our business, financial condition or operating results.

The risks described in our Annual Report on Form 10-K and above are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

During the quarter ended September 30, 2018, the Company issued 832,000 shares aggregating approximately $1,248,000.

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

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

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

A. Exhibits

31.1	Certification of the Principal Executive and Financial Officer Pursuant to Rule 13a-14 or 15d-14 of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Executive and Financial Officer Pursuant to Rule 13a-14 or 15d-14 of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive and Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Executive and Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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GENERATION NEXT FRANCHISE BRANDS, INC.

SIGNATURES

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

GENERATION NEXT FRANCHISE BRANDS, INC.

Dated: November 23, 2018

By: */s/ Nicholas Yates*
Nicholas Yates