Workhorse Group Inc.
Form 10-Q
November 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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 number: 000-53704

WORKHORSE GROUP INC.

(Exact name of registrant as specified in its charter)

Nevada	**26-1394771**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

100 Commerce Drive, Loveland, Ohio 45140

(Address of principal executive offices) (Zip Code)

844-937-9547

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, $0.001 par value per share	**56,270,934**
(Class)	(Outstanding at November 7, 2018)

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Forward-Looking Statements

The discussions in this Quarterly Report contain forward-looking statements reflecting our current expectations that involve risks and uncertainties. When used in this Report, the words "anticipate", expect", "plan", "believe", "seek", "estimate" and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include, but are not limited to, statements about the features, benefits and performance of our products, our ability to introduce new product offerings and increase revenue from existing products, expected expenses including those related to selling and marketing, product development and general and administrative, our beliefs regarding the health and growth of the market for our products, anticipated increase in our customer base, expansion of our products functionalities, expected revenue levels and sources of revenue, expected impact, if any, of legal proceedings, the adequacy of liquidity and capital resources, and expected growth in business. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, market acceptance for our products, our ability to attract and retain customers for existing and new products, our ability to control our expenses, our ability to recruit and retain employees, legislation and government regulation, shifts in technology, global and local business conditions, our ability to effectively maintain and update our product and service portfolio, the strength of competitive offerings, the prices being charged by those competitors and the risks discussed elsewhere herein. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

All references in this Form 10-Q that refer to the "Company", "Workhorse Group", "Workhorse", "we," "us" or "our" are to Workhorse Group Inc. and unless otherwise differentiated, its wholly-owned subsidiaries, Workhorse Technologies Inc., Workhorse Motor Works Inc. and Workhorse Properties Inc.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Workhorse Group, Inc.

Condensed Consolidated Balance Sheets

	(Unaudited) September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$2,994,368	$4,069,477
Accounts receivable, less allowance for doubtful accounts of $52,800 and $0 at September 30, 2018 and December 31, 2017, respectively	1,708	1,013,423
Lease receivable	41,375	45,300
Inventory	4,938,353	4,621,942
Prepaid expenses and deposits	536,411	946,134
	8,512,215	10,696,276
Property, plant and equipment, net of accumulated depreciation of $2,311,024 and $2,095,571 at September 30, 2018 and December 31, 2017, respectively	5,442,000	5,596,013
Lease receivable	211,013	212,004
	$14,165,228	$16,504,293
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Accounts payable	$2,912,747	$4,311,135
Accrued liabilities	2,060,811	1,718,397
Common stock warrant liability	2,013,128	-
Accounts payable, related parties	45,764	54,914
Customer deposits	364,000	54,405
Current portion of long-term debt	-	381,497
	7,396,450	6,520,348
Arosa Loan	7,800,000	-
Unamortized discount and issuance costs	(3,022,084)	-
Net Arosa Loan	4,777,916	-

Senior Secured Notes	-	5,750,000
Less: unamortized discount and debt issuance costs	-	987,500
Net Senior Secured Notes	-	4,762,500
Total current liabilities	12,174,366	11,282,848
Long-term debt	-	1,709,881
Stockholders' equity (deficit):		
Series A preferred stock, par value of $.001 per share 75,000,000 shares authorized, no shares issued and outstanding at September 30, 2018 and December 31, 2017	-	-
Common stock, par value of $.001 per share 100,000,000 shares authorized, 56,270,934 shares issued and outstanding at September 30, 2018 and 41,529,181 shares issued and outstanding at December 31, 2017	56,271	41,529
Additional paid-in capital	125,802,427	107,760,036
Accumulated deficit	(123,867,836)	(104,290,001)
	1,990,862	3,511,564
	$14,165,228	$16,504,293

See accompanying notes to condensed consolidated financial statements.

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Workhorse Group, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net sales	$10,997	$3,066,000	$741,910	$4,888,037
Cost of sales	1,476,822	7,558,082	4,847,097	12,866,095
Gross loss	(1,465,825)	(4,492,082)	(4,105,187)	(7,978,058)
Operating Expenses				
Selling, general and administrative	3,363,103	2,808,696	8,766,452	7,309,868
Research and development	1,449,497	5,084,419	5,681,840	14,139,074
Total operating expenses	4,812,600	7,893,115	14,448,292	21,448,942
Interest expense, net	734,542	26,891	1,786,591	84,394
Change in fair value of common stock warrant liability	(1,527,414)	-	(1,527,414)	-
Net loss	(5,485,553)	(12,412,088)	(18,812,656)	(29,511,394)
Deemed dividend - September 2017 Warrants	-	-	765,179	-
Net loss attributable to common stockholders	$(5,485,553)	$(12,412,088)	$(19,577,835)	$(29,511,394)
Net loss attributable to common stockholders per share - basic and diluted	$(0.12)	$(0.35)	$(0.42)	$(0.82)
Weighted average number of common shares outstanding	46,192,471	35,930,125	46,192,471	35,930,125

See accompanying notes to condensed consolidated financial statements.

Workhorse Group, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the Nine Months Ended September 30	
	2018	2017
Cash flows from operating activities:		
Net loss	$(18,812,656)	$(29,511,394)
Adjustments to reconcile net loss from operations to cash used by operations:		
Depreciation	251,886	415,163
Amortized discount and debt issuance costs on Senior Secured Notes	987,500	-
Amortization of Arosa Loan issuance cost	588,505	-
Change in fair value of common stock warrant liability	(1,527,414)	-
Loss on sale of assets	28,645	-
Stock-based compensation	803,226	1,076,120
Effects of changes in operating assets and liabilities:		
Accounts receivable and lease receivable	1,016,631	403,700
Inventory	(316,411)	(5,003,498)
Prepaid expenses and deposits	409,723	(1,646,187)
Accounts payable and accrued liabilities	(1,055,974)	5,910,998
Accounts payable, related parties	(9,150)	72,242
Customer deposits	309,595	-
Net cash used by operations	(17,325,894)	(28,282,856)
Cash flows from investing activities:		
Capital expenditures	(131,318)	(85,576)
Proceeds from sale of fixed assets	4,800	-
Proceeds from lease receivable	-	134,493
Net cash provided by investing activities	(126,518)	48,917
Cash flows from financing activities:		
Payments on notes payable	(5,750,000)	-
Proceeds from long-term debt	7,800,000	-
Payments on long-term debt	(2,091,378)	(69,348)
Arosa Loan issuance costs	(70,047)	-
Shareholder advances, net of repayments	-	7,000
Issuance of common stock	16,398,662	37,032,831
Exercise of warrants and options	90,066	633,863
Net cash provided by financing activities	16,377,303	37,604,346
Change in cash and cash equivalents	(1,075,109)	9,370,407
Cash at the beginning of the period	4,069,477	469,570

Cash at the end of the period	$2,994,368	$9,839,977

Supplemental disclosure of non-cash activities:

During the nine months ended September 30, 2018, the Company issued warrants to purchase common stock to Arosa in association with the Arosa Loan, which were valued at $3,540,542. The company recorded a provision for the warrant liability in accrued liabilities with the offset recorded as a debt discount against the Arosa Loan.

During the nine months ended September 30, 2018, the Company converted accounts payable of $298,350 to common stock of $114 and additional paid-in-capital of $298,236.

During the nine months ended September 30, 2017, the Company converted Shareholder advances of $229,772 and accrued interests of $26,727 to common stock of $172 and additional paid-in capital of $256,327.

See accompanying notes to condensed consolidated financial statements.

Workhorse Group Inc.

Notes to Consolidated Financial Statements

(Unaudited)

1. SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

The following accounting principles and practices are set forth to facilitate the understanding of data presented in the condensed consolidated financial statements:

Nature of operations and principles of consolidation

Workhorse Group Inc. and its predecessor companies ("Workhorse", the "Company", "we", "us" or "our") is a technology company focused on providing sustainable and cost-effective solutions to the commercial transportation sector. As an American manufacturer, we design and build high performance battery-electric vehicles and aircraft that make movement of people and goods more efficient and less harmful to the environment. As part of the Company's solution, it also develops cloud-based, real-time telematics performance monitoring systems that enable fleet operators to optimize energy and route efficiency. Although the Company operates as a single unit through its subsidiaries, it approaches its development through two divisions, Automotive and Aviation. The Company's core products, under development and/or in manufacture, are the medium duty step van, the light duty pickup, the delivery drone and the manned multicopter ("SureFly" ™).

The Company's wholly owned subsidiaries include Workhorse Technologies Inc., Workhorse Motor Works Inc. and Workhorse Properties Inc.

Basis of presentation

The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and liquidation of liabilities in the normal course of business. However, the Company has limited revenues and a history of negative working capital and stockholders' deficits. These conditions raise substantial doubt about the ability of the Company to continue as a going concern.

In view of these matters, continuation as a going concern is dependent upon the continued operations of the Company, which, in turn, is dependent upon the Company's ability to meet its financial requirements, raise additional capital, and successfully carry out its future operations. The financial statements do not include any adjustments to the amount and classification of assets and liabilities that may be necessary, should the Company not continue as a going concern.

The Company has continued to raise capital. Management believes the proceeds from these offerings, future offerings, and the Company's anticipated revenue, provides an opportunity to continue as a going concern. If additional funding is required, the Company plans to obtain working capital from either debt or equity financing from the sale of common stock, preferred stock, and/or convertible debentures or from the sale of a product line/business. Obtaining such working capital is not assured.

In the opinion of Management, the Unaudited Condensed Consolidated Financial Statements include all adjustments that are necessary for the fair presentation of Workhorse's respective financial conditions, results of operations and cash flows for the interim periods presented. Such adjustments are of a normal, recurring nature. Intercompany balances and transactions are eliminated in consolidation. The results of operations and cash flows for the interim periods presented may not necessarily be indicative of full-year results. It is suggested that these financial statements be read in conjunction with the audited consolidated financial statements and notes thereto of Workhorse contained in its Annual Report on Form 10-K for the year ended December 31, 2017, as amended.

Certain reclassifications were made to the prior year financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operation or stockholders' equity.

2. INVENTORY

As of September 30, 2018, and December 31, 2017, our inventory consisted of the following:

	2018	2017
Raw Materials	$4,108,636	$3,205,618
Work in Process	829,717	1,416,324
Finished Goods	-	-
	$4,938,353	$4,621,942

3. LONG-TERM DEBT

Long-term debt consists of the following:

	September 30, 2018	December 31, 2017
Arosa Loan, due July 6, 2019, interest only quarterly payments, interest rate 8.0% (discount is based on warrant valuation and imputed interest of approximately 58%)	$ 7,800,000	$ -
Arosa Loan unamortized discount and issuance costs	(3,022,084)	
Net Arosa Loan	4,777,916	
Senior Secured Notes, due July 6, 2018 (discount is based on imputed interest rate of 26%)	-	5,750,000
Less: unamortized discount and debt issuance costs on Senior Secured Notes	-	(987,500)
Net Senior Secured Notes	-	4,762,500
Secured mortgage payable, due November 2026, to Bank for 100 Commerce Drive Building, interest rate 6.5%, due in monthly installments of $11,951, inclusive of principal and interest	-	1,741,378
Note payable, former building owner interest payment only due in monthly installments of $1,604 interest at 5.5%. A balloon payment of $350,000 plus unpaid interest due August 2018.	-	350,000
	4,777,916	6,853,878
Less current portion	4,777,916	5,143,997
Long-term debt	$ -	$ 1,709,881

On December 26, 2017, as part of its initial efforts to spin-off Surefly Inc., the Company entered into a Securities Purchase Agreement with several existing institutional investors the ("Spin-Off Investors") pursuant to which the Company issued original issue discount Senior Secured Notes in the aggregate principal amount of $5,750,000 in consideration of gross proceeds of $5,000,000 paid by the Spin-Off Investors. The loan was convertible into Surefly Inc. equity upon achieving the spin-off. On June 28, 2018, the Company entered into an amendment agreement with the Spin-Off Investors. The amendment agreement provided that the Senior Secured Notes were amended to provide a maturity date of July 6, 2018. Upon the closing of the Loan Agreement with Arosa, the Company paid off the Senior Secured Notes.

Amortization expense recorded as interest related to the debt issuance costs and unamortized discounts for the Senior Secured Notes was $987,500 for the nine months ended September 30, 2018.

On June 7, 2018, the Company received a short-term loan in the aggregate principal amount of $550,000 from Stephen S. Burns, H. Benjamin Samuels, Gerald Budde and Ray Chess, each an executive officer and/or director of the Company (collectively, the “Related Parties”). The Company used the net proceeds from the transaction for general business and working capital purposes. To evidence the loans, the Company issued the Related Parties promissory notes (the “Related Parties Notes”) in the aggregate principal amount of $550,000. The Related Parties Notes are unsecured obligations of the Company and are not convertible into equity securities of the Company. Principal and interest under the Related Parties Notes are due and payable December 6, 2018, however, in the event that the Company raises in excess of $10,000,000 in equity financing, then the Company will use part of its proceeds to pay off the Related Parties Notes. Under no circumstance may the Related Parties Notes be paid off on or prior to the 91st day following the maturity date of the Senior Secured Notes issued by the Company on December 27, 2017 in the principal aggregate amount of $5,750,000. Interest accrues on the Related Parties Notes at the rate of 12.0% per annum. The Related Parties Notes contain terms and events of default customary for similar transactions.

On July 6, 2018, the Company received a short-term loan in the aggregate principal amount of $500,000 from accredited investors (collectively, the “Loan Parties”), which included Mr. Samuels, a director of the Company. To evidence the loans, we issued the Loan Parties promissory notes (the “Loan Parties Notes”) in the aggregate principal amount of $500,000. The Loan Parties Notes are unsecured obligations of the Company and are not convertible into equity securities of our company. Principal and interest under the Loan Parties Notes is due and payable January 5, 2019, however, in the event that the Company raises in excess of $10,000,000 in equity or debt financing, the Company will use a portion of the proceeds to pay off the Loan Parties Notes. Interest accrues on the Loan Parties Notes at the rate of 12.0% per annum. The Loan Parties Notes contain terms and events of default customary for similar transactions.

The Related Parties Notes and Loan Parties Notes were paid off following the closing of the August 2018 public offering.

On July 6, 2018, the Company, as borrower, entered into a Loan Agreement with a fund managed by Arosa Capital Management LP (“Arosa”), as lender, providing for a term loan (the “Arosa Loan”) in the principal amount of $6,100,000 (the “Loan Agreement”). The maturity date of the Arosa Loan is July 6, 2019 (the “Maturity Date”). The interest rate for the Arosa Loan is 8% per annum payable in quarterly installments commencing October 6, 2018. The Company may prepay the Arosa Loan at any time upon three days written notice.

The Company used the proceeds from the Arosa Loan to satisfy the Senior Secured Loans initially issued December 27, 2017 in the amount of $5,750,000 and a loan in the amount of $350,000 payable to the former owner of the Company’s facility based in Loveland, Ohio.

The Loan Agreement requires the Company to pay Arosa’s expenses including attorney fees. The Loan Agreement also requires the Company to make certain representations and warranties and other agreements that are customary in loan agreements of this type and also includes covenants to raise $10,000,000 in equity prior to September 30, 2018 and to consummate a sale of Surefly, Inc., the Company’s indirect wholly-owned subsidiary resulting in cash proceeds of no less than $20,000,000. The Loan Agreement also contains customary events of default, including non-payment of principal or interest, violations of covenants, bankruptcy and material judgments. The Company’s subsidiaries and Arosa also entered into a Guarantee and Collateral Agreement and Intellectual Property Security Agreement providing that the Company’s obligations to Arosa are secured by substantially all of the Company’s assets. In addition, the Company is required to appoint to the Board of Directors a person designated in writing by Arosa for a period of no less than 12 months.

In accordance with the Loan Agreement, the Company issued Arosa a warrant to purchase 5,000,358 shares of common stock of the Company at an exercise price of $2.00 per share exercisable in cash only for a period of five years. While the Arosa Loan remains outstanding, the Company will be required to issue additional warrants to purchase common stock to Arosa equal to 10% of any additional issuance excluding issuances under an approved stock plan. The additional warrants to purchase common Stock will have an exercise price equal to the lesser of $2.00 or a 5% premium to the price utilized in such financing. Pursuant to the warrant, Arosa may not exercise such warrant if such exercise would result in Arosa beneficially owning in excess of 9.99% of the Company’s then issued and outstanding common stock. On August 2, 2018, after conducting additional due diligence on the Company’s available collateral base, Arosa agreed to enter into the First Amendment to the Loan Agreement with the Company pursuant to which an additional $1,700,000 was loaned to the Company for working capital purposes and general corporate purposes. In addition, various covenants were added or amended including, but not limited to, requiring the Company to satisfy its Mortgage on its Loveland, Ohio facility no later than October 1, 2018, which we paid off in August 2018 with a payment of $1.85 million.

The Company determined that the Arosa Loan and related warrants were freestanding instruments issued together and therefore should be accounted for separately. We determined the warrants did not qualify for equity classification and therefore have applied liability treatment to the instruments. The value of the warrants on the date of the Arosa Loan was determined to be $3,540,542, which was determined using the Black-Scholes method and was recorded as a liability with the offset being recorded as a debt discount, which will be amortized into interest expense over the life of the loan. The liability for the warrants, as well as any future warrant issuances, will be marked to marked quarterly in accordance with liability accounting.

On August 14, 2018, in accordance with the Loan Agreement, we issued a warrant to acquire 1,143,200 shares of common stock at an exercise price of $1.208 warrants to Arosa following the closing of our public offering on August 13, 2018 and the related over-allotment on August 14, 2018.

Principal amounts:	At September 30, 2018
Principal	$ 7,800,000
Unamortized debt discount and issuance costs (1)	(3,022,084)
Net debt carrying amount	$ 4,777,916
Carrying amount of warrant the liability component (2)	$ 2,013,128

(1) Includes the unamortized portion of the initial warrant liability of $3,540,542 and issuance costs of $70,047.
(2) Includes marked to market liability of initial warrant liability as well August 2018 warrants issued.

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4. **REVENUE**

Change in Accounting Principle

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)". The guidance in this ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). This guidance requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services.

Beginning in January 2018, the Company adopted the provisions of ASU 2014-09 Topic 606 under the modified retrospective method, which requires a cumulative effect adjustment to the opening balance of retained earnings on the date of adoption. This approach was applied to contracts not completed as of December 31, 2017. No significant change to revenue recognition, as previously recognized, was identified. At date of adoption, there was no adjustment to retained earnings related to the adoption of ASU 2014-09. At date of adoption, there was no significant change to our past revenue recognition practices and therefore no adjustment to the opening balance of retained earnings was required.

Revenue Recognition

Net sales include products and shipping and handling charges, net of estimates for customer allowances. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring products. All revenue is recognized when we satisfy our performance obligations under the contract. We recognize revenue by transferring the promised products to the customer, with the majority of revenue recognized at the point in time the customer obtains control of the products. We recognize revenue for shipping and handling charges at the time the products are delivered to or picked up by the customer. The majority of our contracts have a single performance obligation and are short term in nature.

Accounts Receivable

Credit is extended based upon an evaluation of the customer's financial condition. Accounts receivable are stated at their estimated net realizable value. The allowance for doubtful accounts is based on an analysis of customer accounts and our historical experience with accounts receivable write-offs.

The Company has elected the following practical expedients allowed under ASU 2014-09:

- Performance obligations are satisfied within one year from a given reporting date, consequently we omit disclosure of the transaction price apportioned to remaining performance obligations on open orders

Disaggregation of Revenue

Our revenues related to the following types of business were as follows for the periods ended June 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Automotive	$-	$3,066,000	$523,252	$4,886,500
Aviation	-	-	-	-
Other	10,997	-	218,658	1,537
Total revenues	$10,997	$3,066,000	$741,910	$4,888,037

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5. **INCOME TAXES**

As the Company has not generated taxable income since inception, the cumulative deferred tax assets remain fully reserved, and no provision or liability for federal or state income taxes has been included in the financial statements.

6. EARNINGS PER SHARE

Basic loss per share is computed by dividing net loss available to common shareholders (numerator) by the weighted average number of shares outstanding (denominator) during the period. For all periods presented, all of the Company's common stock equivalents were excluded from the calculation of diluted loss per common share because they were anti-dilutive, due to the Company's net losses.

7. RECENT ACCOUNTING DEVELOPMENTS

Accounting Guidance Adopted in 2017

Effective September 30, 2017, we early-adopted FASB ASU 2017-11, "Earnings per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features. Part I of ASU 2017-11 simplifies the accounting for certain financial instruments with down round features, a provision in an equity-linked financial instrument (or embedded feature) that provides a downward adjustment of the current exercise price based on the price of future equity offerings. Previous accounting guidance created cost and complexity for organizations that issue financial instruments with down round features by requiring, on an ongoing basis, fair value measurement of the entire instrument or conversion option. The new standard requires companies to disregard the down round feature when assessing whether the instrument is indexed to its own stock, for purposes of determining liability of equity classification. Companies that provide earnings per share ("EPS") data will adjust their diluted EPS calculation for the effect of the feature when triggered (i.e., when the exercise price of the related equity-linked financial instrument is adjusted downward because of the down round feature) and will also recognize the effect of the trigger within equity. We applied this guidance on a prospective basis. The primary impact of adoption is that equity-linked financial instruments are less likely to be liability classified than prior to the adoption of this standard. The adoption of the new standard resulted in warrants issued in September 2017 not being classified as liabilities in our Consolidated Financial Statements.

Accounting Guidance Adopted in 2018

Effective January 1, 2018, we adopted FASB ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, and affects the guidance in ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2016-10 clarifies the following two aspects of Topic 606: evaluating whether promised goods and services are separately identifiable and determining whether an entity's promise to grant a license provides a customer with either a right to use the entity's intellectual property, which is satisfied at a point in time, or a right to access the entity's intellectual property, which is satisfied over time. The Company adopted ASU No. 2016-10, using the modified retrospective approach, which did not have a material impact on the Company's condensed consolidated financial statements. Additional information is available in Note 4, "Revenue."

Effective January 1, 2018, we adopted FASB ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), and affects the guidance in ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". When another party is involved in providing goods or services to a customer, ASU No. 2014-09 requires an entity to determine whether the nature of its promise is to provide the specified good or service itself (that is, the entity is a principal) or to arrange for that good or service to be provided by the other party (that is, the entity is an agent). The amendments in ASU No. 2016-08 are intended to improve the operability and understandability of the implementation guidance in ASU No. 2014-09 on principal versus agent considerations by offering additional guidance to be considered in making the determination. The Company adopted ASU No. 2016-08, using the modified retrospective approach, which did not have a material impact on the Company's condensed consolidated financial statements. Additional information is available in Note 4, "*Revenue.*"

Accounting Guidance Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires a lessee to recognize in the statement of financial position a liability to make lease payments ("the lease liability") and a right-of-use asset representing its right to use the underlying asset for the lease term, initially measured at the present value of the lease payments. When measuring assets and liabilities arising from a lease, the lessee should include payments to be made in optional periods only if the lessee is reasonably certain, as defined, to exercise an option to the lease or not to exercise an option to terminate the lease. Optional payments to purchase the underlying asset should be included if the lessee is reasonably certain it will exercise the purchase option. Most variable lease payments should be excluded except for those that depend on an index or a rate or are in substance fixed payments. A lessee shall classify a lease as a finance lease if it meets any of five listed criteria: 1) The lease transfers ownership of the underlying asset to the lessee by the end of the lease term. 2) The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise. 3) The lease term is for the major part of the remaining economic life of the underlying asset. 4) The present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or exceeds substantially all of the fair value of the underlying asset. 5) The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term. For finance leases, a lessee shall recognize in the statement of comprehensive income interest on the lease liability separately from amortization of the right-of-use asset. Amortization of the right-of-use asset shall be on a straight-line basis, unless another basis is more representative of the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. If the lease does not meet any of the five criteria, the lessee shall classify it as an operating lease and shall recognize a single lease cost on a straight-line basis over the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. The amendments in this update are to be applied using a modified retrospective approach, as defined, and are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted. The Company is currently evaluating the financial statement impact of adopting the new guidance.

8.STOCK OFFERINGS

On February 1, 2017, the Company announced the completion of its underwritten public offering of 6,500,000 shares of its common stock at a public offering price of $3.00 per share. In addition, the underwriters exercised an option to purchase an additional 975,000 shares of common stock at the public offering price, less the underwriting discounts and commissions.

All of the shares in the offering were sold by the Company, with gross proceeds to the Company of approximately $22.4 million and net proceeds of approximately $20.5 million, after deducting underwriting discounts and commissions and estimated offering expenses.

On June 22, 2017, the Company entered into an at the market issuance sales agreement (the “Cowen Agreement”) with Cowen and Company, LLC (“Cowen”) under which the Company may offer and sell, from time to time at its sole discretion, shares of its Common Stock having an aggregate offering price of up to $25.0 million through Cowen as its sales agent. As of September 30, 2018, the Company issued 2,855,404 shares from this facility for proceeds of approximately $7.2 million.

On September 14, 2017, the Company entered into an underwriting agreement (the “Underwriting Agreement”) with Cowen relating to the public offering and sale (the “Offering”) of 3,749,996 shares of the Company’s common stock, and five-year warrants (exercisable beginning on the date of issuance) to purchase up to an aggregate of 2,812,497 shares of the Company’s common stock. Each investor received a warrant to purchase 0.75 shares of the Company’s common stock at an exercise price of $3.80 per share, for each share of common stock purchased.

On April 26, 2018, the Company entered into and closed Subscription Agreements with accredited investors (the “April 2018 Accredited Investors”) pursuant to which the April 2018 Accredited Investors purchased 531,066 shares of the Company’s common stock (“April 2018 Shares”) for a purchase price of $1.4 million or $2.72 per share. Stephen Burns, Benjamin Samuels, Gerald Budde and Julio Rodriguez, executive officers and/or directors of the Company, participated in this offering.

Pursuant to the Underwriting Agreement, Cowen purchased 3,749,996 shares of the Company's common stock and accompanying warrants at a price per share of $3.20. The net proceeds to the Company were approximately $10.9 million after deducting underwriting discounts and commissions and offering expenses. The sale of such shares and accompanying warrants closed on September 18, 2017. The warrants contained full ratchet anti-dilution protection upon the issuance of any common stock, securities convertible into common stock or certain other issuances at a price below $3.20, with certain exceptions.

On June 4, 2018, the Company and holders of all outstanding Warrants to Purchase Common Stock of the Company issued September 18, 2017 (collectively, the "Warrants") entered into separate, privately-negotiated exchange agreements (the "Exchange Agreements"), pursuant to which the Company issued to such holders an aggregate of 1,968,736 shares of the Company's common stock in exchange for the Warrants. The closing of the exchanges contemplated by the Exchange Agreements occurred on June 5, 2018. In addition, the "Down Round" feature of the Warrants was triggered in the second quarter of 2018, causing the strike price to decrease from $3.80 per share to $2.62 per share. As a result, the Company recorded approximately $765,179 as a deemed dividend which represents the value transferred to the Warrant holders due to the Down Round being triggered. The deemed dividend was recorded as a reduction of Retained Earnings and increase in Additional Paid-in-Capital and reduced net income available to common shareholders by the same amount.

On August 9, 2018, the Company entered into an Underwriting Agreement (the "Underwriting Agreement") with National Securities Corporation (the "Underwriter"), relating to the public offering and sale (the "2018 Offering") of 9,000,000 shares of our Common Stock at a price per share of $1.15 for aggregate gross proceeds of $10.4 million. This offering closed on August 13, 2018. Pursuant to the Underwriting Agreement, the Company granted the Underwriter a 45-day option to purchase from the Company up to an additional 1,350,000 shares of Common Stock at the offering price to cover over allotments, if any. On August 14, 2018, the Underwriter exercised its over-allotment option and acquired an additional 1,288,800 shares of Common Stock at a price per share of $1.15 for aggregate gross proceeds of $1.4 million. The over-allotment closing occurred on August 14, 2018. The Company used the net proceeds from this offering for working capital, general corporate purposes and repayment of debt and other obligations.

The 2018 Offering was made pursuant to the Company's effective shelf registration statement on Form S-3 (Registration No. 333-213100), including the prospectus dated December 23, 2016 contained therein, as the same was supplemented, as well as a preliminary prospectus supplement and final prospectus supplement filed with the SEC on August 8, 2018 and August 9, 2018, respectively, in connection with the Company's takedown relating to the Offering.

The Underwriting Agreement contains customary representations, warranties and agreements by the Company, customary conditions to closing, indemnification obligations of the Company and the Underwriters, including for liabilities under the Securities Act of 1933, as amended, other obligations of the parties and termination provisions. The representations, warranties and covenants contained in the Underwriting Agreement were made only for purposes of such agreement and as of specific dates, were solely for the benefit of the parties to such agreement and may be subject to limitations agreed upon by the contracting parties.

Pursuant to the Underwriting Agreement, subject to certain exceptions, the Company, its directors and officers have agreed not to sell or otherwise dispose of any of the Company's securities held by them for a period ending 90 days after the date of the Underwriting Agreement without first obtaining the written consent of National Securities Corporation, as representative of the Underwriters, subject to certain exceptions.

9. SUBSEQUENT EVENTS

The Company evaluates events and transactions occurring subsequent to the date of the condensed consolidated financial statements for matters requiring recognition or disclosure in the condensed consolidated financial statements. The accompanying condensed consolidated financial statements consider events through the date on which the condensed consolidated financial statements were available to be issued.

On October 1, 2018, the Company issued a warrant to acquire 108,768 shares of common stock at an exercise price of $1.596 per share to Arosa.

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

Overview and Quarter Highlights

We are a technology company focused on providing sustainable and cost-effective solutions to the commercial transportation sector. As an American manufacturer, we design and build high performance battery-electric vehicles and aircraft that make movement of people and goods more efficient and less harmful to the environment. As part of our solution, we also develop cloud-based, real-time telematics performance monitoring systems that enable fleet operators to optimize energy and route efficiency. Although we operate as a single unit through our subsidiaries, we approach our development through two divisions, Automotive and Aviation. Our core products, under development and/or in manufacture, are the last mile step and cargo vans, the W-15 pickup truck, the delivery drone and the manned multicopter, SureFly.

Workhorse electric delivery vans are currently in production and are in use by our customers on U.S. roads. Our delivery customers include companies such as UPS, FedEx Express, Alpha Baking and WB Mason. Data from our in-house developed telematics system demonstrates our vehicles on the road are averaging approximately a 500% increase in fuel economy as compared to conventional gasoline-based trucks of the same size and duty cycle.

In addition to improved fuel economy, we anticipate that the performance of our vehicles on-route will reduce long-term vehicle maintenance expense by approximately 50% as compared to fossil-fueled trucks.

From our development modeling and the existing performance of our electric vehicles on American roads, we estimate that our E-GEN Range-Extended Electric delivery vans will save over $150,000 in fuel and maintenance savings over the 20-year life of the vehicle. Due to the positive return-on-investment, we place a premium price for our vehicles when selling to major fleet buyers. We expect that fleet buyers will be able to achieve a four-year or better return-on-investment (without government incentives), which we believe justifies the higher acquisition cost of our vehicles.

We believe that we are the only medium-duty battery-electric OEM in the U.S. and we will be introducing additional light-duty electric and range-extended electric vehicles in late 2018 and 2019.

Our goal is to continue to increase sales and production, while executing on our cost-down strategy to a point that will enable us to achieve gross margin profitability of the last mile-delivery van platform. As a key strategy, we have begun initial production of the Workhorse N-GEN platform, which has been accelerated from our development efforts on the USPS Next Generation Delivery Vehicle (“NGDV”) program.

The Workhorse N-GEN electric cargo van platform will be available in multiple size configurations, 450 and 1,000 cubic feet. The 450 cubic foot configuration is designed to compete with the Sprinter, Transit and RAM gasoline/diesel trucks in the commercial sector with an emphasis on last-mile delivery and other service-oriented businesses, such as telecom. This ultra-low floor platform incorporates state-of-the-art safety features, economy and performance: we expect these vehicles to achieve a fuel economy equivalent of approximately 60 MPG and offer fleet operators the most favorable total cost-of-ownership of any comparable vehicle available today. We believe we are the first American OEM to market a U.S. built electric cargo van, and early indications of fleet interest are significant. We expect the N-GEN trucks will be supported by our Ryder Systems partnership.

As a direct result of the USPS award and development efforts, Workhorse has begun development on the Workhorse W-15, a medium- and light-duty pickup truck platform aimed at commercial fleets. The W-15 pickup truck powertrain is a smaller version of its sister vehicle, the medium-duty battery electric powertrain, and will have two purpose-built variants, a W-15 work truck (pickup) and an N-GEN cargo van. Either of these two variants will appeal to delivery fleets, utility companies, telecom companies, municipalities and more.

Our HorseFly™ Delivery Drone is a custom designed, purpose-built drone that is fully integrated in our electric trucks. HorseFly is an octocopter designed with a maximum gross weight of 30 lbs., a 10 lb. payload and a maximum air speed of 50 mph. It is designed and built to be rugged and consisting of redundant systems to further meet the FAA’s required rules and regulations.

SureFly is our entry into the emerging vertical take-off and landing (“eVTOL”) market. It is designed to be a two-person, 400-pound payload aircraft with a hybrid internal combustion/electric power generation system. Our approach in the design is to build the safest and simplest way to fly rotary wing aircraft in the world. We believe it is a practical answer to personal flight, as well as, commercial transportation segments, including air taxi series, agriculture and beyond.

The FAA to-date has granted eight separate Experimental Airworthiness Certifications, registered as N834LW, for the aircraft. These certifications come after an extensive design review and inspection of the aircraft with each renewed certificate. In addition, the FAA accepted the Company’s application for Type Certification for the SureFly eVTOL aircraft.

We continue to leverage our knowledge of high-voltage battery packs, electric motor controls, software and range extending generators to design a multicopter that can carry a pilot and passenger.

Results of Operations

Our condensed consolidated statement of operations data for the period presented follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net sales	$10,997	$3,066,000	$741,910	$4,888,037
Cost of sales	1,476,822	7,558,082	4,847,097	12,866,095
Gross loss	(1,465,825)	(4,492,082)	(4,105,187)	(7,978,058)
Operating expenses:				
Selling, general and administrative	3,363,103	2,808,696	8,766,452	7,309,868
Research and development	1,449,497	5,084,419	5,681,840	14,139,074
Total operating expenses	4,812,600	7,893,115	14,448,292	21,448,942
Interest expense, net	734,542	26,891	1,786,591	84,394
Change in fair value of common stock warrant liability	(1,527,414)	-	(1,527,414)	-
Net loss	$(5,485,553)	$(12,412,088)	$(18,812,656)	$(29,511,394)

Sales

Net sales for the three months ended September 30, 2018 and 2017 were approximately zero and $3.1 million, respectively. The net sales decrease was primarily due to a decrease in volume of trucks sold.

Net sales for the nine months ended September 30, 2018 and 2017 were approximately $0.7 million and $4.9 million, respectively. The net sales decrease was primarily due to a decrease in volume of trucks sold.

Cost of Sales

Cost of sales for the three months ended September 30, 2018 and 2017 were $1.5 million and $7.6 million, respectively. The cost of sales decrease was primarily related to a decrease in the volume of trucks sold.

Cost of sales for the nine months ended September 30, 2018 and 2017 were $4.8 million and $12.9 million, respectively. The cost of sales decrease was primarily related to a decrease in the volume of trucks sold.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses during the three months ended September 30, 2018 and 2017 were $3.4 million and $2.8 million, respectively. The SG&A expense increase primarily related to higher investment banking related fees of approximately $0.7 million and legal settlement cost of $0.4 million. This was partially offset by lower consulting fees of approximately $0.3 million.

SG&A expenses during the nine months ended September 30, 2018 and 2017 were $8.8 million and $7.3 million, respectively. The SG&A expense increase primarily related higher investment banking related fees of approximately $0.7 million and legal settlement costs of $0.4 million.

Research and Development Expenses

Research and development ("R&D") expenses during the three months ended September 30, 2018 and 2017 were $1.5 million and $5.1 million, respectively. The decrease in R&D expenses is due to the decrease in prototype and consulting expenses for the USPS NGDV and SureFly.

R&D expenses during the nine months ended September 30, 2018 and 2017 were $5.7 million and $14.1 million, respectively. The decrease in R&D expenses is due to the decrease in prototype and consulting expenses for the USPS NGDV and SureFly.

Liquidity and Capital Resources

Cash Requirements

From inception, we have financed our operations primarily through sales of equity securities. We have consumed substantial amounts of capital to date as we continue to invest in our R&D activities and build vehicles.

As of September 30, 2018, we had approximately $3.0 million in cash, cash equivalents and short-term investments, as compared to approximately $4.1 million as of December 31, 2017, a decrease of approximately $1.1 million. The decrease in cash and cash equivalents was primarily attributable to the operating loss for the period partially offset by the issuance of common stock during the period.

We believe our existing capital resources, including our new Arosa Loan, will not be sufficient to support our current and projected funding requirements through the end of the fourth quarter of 2018. Additional funding will be required.

Our operations will require significant additional funding for the foreseeable future. Unless and until we are able to generate a sufficient amount of revenue and reduce our costs, we expect to finance future cash needs through public and/or private offerings of equity securities and/or debt financings. With the exception of contingent and royalty payments that we may receive under our existing collaborations, we do not currently have any committed future funding. To the extent we raise additional capital by issuing equity securities, our stockholders could at that time experience substantial dilution. Any debt financing that we are able to obtain may involve operating covenants that restrict our business.

Our future funding requirements will depend upon many factors, including, but not limited to:

- our ability to acquire or license other technologies or compounds that we may seek to pursue;
- our ability to manage our growth;
- competing technological and market developments;
- the costs and timing of obtaining, enforcing and defending our patent and other intellectual property rights; and
- expenses associated with any unforeseen litigation.

Insufficient funds have required a reduction in business activity. Additional delay in funding will continue to defer, scale back or eliminate some or all of our research or development programs, limit our sales activities, limit or cease production or negatively impact our operations.

For the nine months ended September 30, 2018, we maintained an investment portfolio primarily in money market funds, U.S. treasury bills, government-sponsored enterprise securities, and corporate bonds and commercial paper. Cash in excess of immediate requirements is invested with regard to liquidity and capital preservation. Wherever possible, we seek to minimize the potential effects of concentration and degrees of risk. We will continue to monitor the impact of the changes in the conditions of the credit and financial markets to our investment portfolio and assess if future changes in our investment strategy are necessary

Summary of Cash Flows

	Nine Months Ended September 30,	
	2018	2017
Net cash used in operating activities	$(17,325,894)	$(28,282,856)
Net cash used and provided in investing activities	$(126,518)	$48,917
Net cash provided by financing activities	$16,377,303	$37,604,346

Cash Flows from Operating Activities

Our cash flows from operating activities are affected by our cash investments to support the business in research and development, manufacturing, selling, general and administration. Our operating cash flows are also affected by our working capital needs to support fluctuations in inventory, personnel expenses, accounts payable and other current assets and liabilities.

During the nine months ended September 30, 2018 and 2017, cash used by operating activities was $17.3 million and $28.2 million, respectively. The decrease in net cash used in operations in 2018 as compared to 2017 was mainly due to a lower net loss for the period.

Cash Flows from Financing Activities

During the nine months ended September 30, 2018 and 2017, net cash provided by financing activities was $16.4 million and $37.6 million, respectively. Cash flows from financing activities during the nine months ended September 30, 2018 consisted primarily of shares issued related to the Company's August 2018 Offering with National Securities, the Cowen Agreement and April 2018 closed Subscription Agreements. Cash flows from financing activities for the period ended September 30, 2017 consisted primarily of a net $37.0 million from a public stock offering.

The Company may seek to raise additional capital through public or private debt or equity financings in order to fund its operations.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Critical Accounting Policies

Our accounting policies are fundamental to understanding management's discussion and analysis of financial condition and results of operations. Our Unaudited Condensed Consolidated Financial Statements are prepared in conformity with GAAP and follow general practices within the industry in which we operate. The preparation of the financial statements requires management to make certain judgments and assumptions in determining accounting estimates. Accounting estimates are considered critical if the estimate requires management to make assumptions about matters that were highly uncertain at the time the accounting estimate was made, and different estimates reasonably could have been used in the current period, or changes in the accounting estimate are reasonably likely to occur from period to period, that would have a material impact on the presentation of our financial condition, changes in financial condition or results of operations.

For a discussion of our critical accounting policies and estimates, see "Critical Accounting Policies" included in our Annual Report on Form 10-K for the year ended December 31, 2017, as amended, under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations." We have made no significant changes to our critical accounting policies and estimates, other than the adoption of ASC 606, from those described in our Annual Report on Form 10-K and Form 10-K/A for the year ended December 31, 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For a discussion of our quantitative and qualitative disclosures about market risk, see "Quantitative and Qualitative Disclosures About Market Risks" included in our Annual Report on Form 10-K for the year ended December 31, 2017, as amended, under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations." There have been no material changes to the information provided in our Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Pursuant to Rules 13a-15(b) and 15-d-15(b) under the Securities Exchange Act of 1934, as amended (“Exchange Act”), the Company carried out an evaluation, with the participation of the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer of the effectiveness of the Company’s disclosure controls and procedures as of the end of the period covered by this report. The term “disclosure controls and procedures”, as defined under Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

The Company’s management, with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company’s disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were not effective due to material weaknesses in our internal control over financial reporting that existed as of September 30, 2018, as discussed below.

With respect to our internal control over financial reporting, these material weaknesses have been and continue to be discussed among management and our Audit Committee. Management intends to review, revise and improve our internal control over financial reporting until the material weaknesses in internal control over financial reporting are eliminated.

Management’s specific remediation to address these material weaknesses will and has included among other items:

Complete implementation of the ERP system modules covering purchase orders and inventory

Review and implement adequate account reconciliation processes to improve the end of period closing process

Hire a controller with public company experience

We believe the initiated remediation measures will strengthen our internal control over financial reporting and should eventually remediate the material weaknesses identified. However, because we are still assessing the design and operating effectiveness of these measures and need to put more controls in place, the identified material weaknesses have not been remediated as of September 30, 2018. We will continue to monitor the effectiveness of these remediation measures and will make any changes that we deem appropriate.

We assessed the material weaknesses' impact to the condensed consolidated financial statements to ensure they were prepared in accordance with GAAP and present fairly the condensed consolidated financial position, financial results of operations and cash flows as of and for the periods ended September 30, 2018. Based on these additional procedures and assessment, we concluded that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q present fairly, in all material aspects, our financial position, results of operations and cash flows for the periods presented.

Changes in Internal Control over Financial Reporting

The Company has completed implementation of a new ERP system which includes modules covering purchase orders and inventory as of March 31, 2018.

The Company has hired a controller with public company experience as of June 30, 2018.

Beginning January 1, 2018, we implemented ASC 606, Revenue from Contracts with Customers. Although the new revenue standard is expected to have an immaterial impact on our ongoing net income, we did implement changes to our processes related to revenue recognition and the control activities within them. These included the development of new policies based on the five-step model provided in the new revenue standard, new training, ongoing contract review requirements, and gathering of information provided for disclosures.

Except as described above, there were no changes in our internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved from time to time in legal proceedings incidental to the conduct of our business. Except as set forth below, we do not believe that any liability that may result from these proceedings will have a material adverse effect on our Unaudited Condensed Consolidated Financial Statements.

- In May 2017, Autokinetics, Inc. (“AK”) filed a complaint against the Company in the Circuit Court for the County of Oakland, State of Michigan (File No. 2017-158748-CB). AK claims Breach of Contract and Unjust Enrichment/Quantum Meruit and is seeking damages in the amount of $2,098,550. In June 2017, the Company filed an Answer as well as a Counterclaim against AK and J. Bruce Emmons, President of AK, for Breach of Contract, Unjust Enrichment, Promissory Estoppel, Conversion and Statutory Conversion. The Company, AK and Mr. Emmons entered into a Release and Settlement Agreement dated August 28, 2018 providing for the payment by the Company to AK of $200,000.

- In November 2017, Jeffrey Esfeld filed a complaint against the Company in the Superior Court of the State of Washington, County of King seeking unpaid wages and commissions. The case has been removed to the Federal District Court for the Western District of Washington (File No. 17-2-29157-9 SEA). On September 25, 2018, the Company and Mr. Esfeld entered into an Offer of Judgement pursuant to which the Company paid Mr. Esfeld $87,000 and attorney fees.

- In May 2018, Precision Manufacturing Company, Inc. (“PMC”) filed a complaint against the Company in the Common Pleas Court of Montgomery, Ohio, which complaint was amended July 26, 2018. PMC, a former vendor, is claiming Breach of Contract, Unjust Enrichment, Action on Account and Fraud and is seeking $132,189 in damages please attorney fees and costs. The Company has filed its Answer to the Amended Complaint.

ITEM 1A. RISK FACTORS

For a detailed discussion of risk factors affecting us, see “Part I – Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, as amended.

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

On April 26, 2018, the Company entered into and closed Subscription Agreements with accredited investors (the “April 2018 Accredited Investors”) pursuant to which the April 2018 Accredited Investors purchased 531,066 shares of the Company’s common stock (“April 2018 Shares”) for a purchase price of $1,444,500 or $2.72 per share. Stephen Burns, Benjamin Samuels, Gerald Budde and Julio Rodriguez, executive officers and/or directors of the Company, participated in this offering

On April 24, 2018, the Company entered into an Agreement with Prefix Corporation, an integral vendor, pursuant to which the Company issued 113,874 shares of common stock to settle an invoice in the amount of $298,350.

The offer, sale and issuance of the above securities was made to accredited investors and the Company relied upon the exemptions contained in Section 4(a)(2) of the Securities Act and/or Rule 506 of Regulation D promulgated there under with regard to the sale. No advertising or general solicitation was employed in offering the securities. The offer and sales were made to accredited investors and transfer of the common stock will be restricted by the Company in accordance with the requirements of the Securities Act of 1933, as amended.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

On September 28, 2018, the size of the Board of Directors of the Company was increased from five to six and Michael L. Clark was appointed as a director of the Company.

On July 6, 2018, the Company, as borrower, entered into a Loan Agreement with a fund managed by Arosa Capital Management LP (“Arosa”), as lender, providing for a term loan in the principal amount of $6,100,000 (the “Loan Agreement”). Pursuant to the Loan Agreement, the Company is required to appoint to the Board of Directors a person designated in writing by Arosa for a period of no less than 12 months. Mr. Clark was designated by Arosa. On September 28, 2018, Mr. Clark entered into letter agreements with the Company pursuant to which he was appointed as director of the Company in consideration of an annual fee of $40,000. Additionally, the Company granted Mr. Clark options to purchase 50,000 shares of the Company's common stock at $1.10 per share. The options will expire five years from the vesting period with 10,000 options vesting upon the signing of the agreement and 4,000 every June 30 and December 31 thereafter for a total of 50,000 shares.

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ITEM 6. EXHIBITS

Exhibit No.	Description
3.1	Certificate of Designation for Series A Preferred Stock (1)
3.2	Certificate of Change (2)
3.3	Certificate of Correction (2)
3.4	Articles of Merger (3)
3.5	Certificate of Correction (Articles of Merger) (3)
3.6	Certificate of Amendment to the Certificate of Incorporation (4)
3.7	Certificate of Incorporation (5)
3.8	Articles of Merger between AMP Holding Inc. Workhorse Group Inc. (16)
3.9	Certificate of Change filed December 9, 2015 (20)
4.1	Stock Option to acquire 500,000 shares of common stock issued to James Taylor dated May 25, 2011 (6)
4.2	Common Stock Purchase Warrant to acquire 500,000 shares of common stock issued to James Taylor dated May 25, 2011 (6)
4.3	Stock Option to acquire 500,000 shares of common stock issued to Stephen Burns dated May 25, 2011 (6)
4.4	Common Stock Purchase Warrant to acquire 500,000 shares of common stock issued to Stephen Burns dated May 25, 2011 (6)
4.5	Conversion Letter Agreement by and between Stephen Burns and AMP Holding Inc. (7)
4.6	Form of Warrant by and between AMP Holding Inc. and the January 2013 Accredited Investor (8)
4.7	Common Stock Purchase Warrant issued to Stephen Baksa (9)
4.8	2014 Incentive Stock Plan (11)
4.9	Form of Common Stock Purchase Agreement entered between AMP Holding Inc and the December 2014 Investors (31)
4.10	Form of Common Stock Purchase Warrant issued to the December 2014 Investors (31)
4.11	Intentionally Left Blank
4.12	Form of Subscription Agreement by and between Workhorse Group Inc. and the 2015 Accredited Investors (17)
4.13	Form of Securities Purchase Agreement entered between Workhorse Group Inc. and the November 2015 Investors (18)
4.14	Form of 6% Convertible Promissory Note issued to the November 2015 Investors (18)
4.15	Form of Stock Purchase Warrant issued to the November 2015 Investors (18)

(f) Investment Company means an investment company registered under the Investment Company Act of 1940 and as listed under the names of Insureds on the Declarations.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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ENDORSEMENT OR RIDER NO.

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Bond or Policy have the same inception date.

ATTACHED TO AND FORMING PART OF BOND OR POLICY NO.	DATE ENDORSEMENT OR RIDER EXECUTED	* EFFECTIVE DATE OF ENDORSEMENT OR RIDER 12:01 A.M. STANDARD TIME AS SPECIFIED IN THE BOND OR POLICY
ZBN-14T44710-12-N2	12/04/12	11/25/12

* ISSUED TO
GLADSTONE CAPITAL CORPORATION

ADD EXCLUSIONS (N) & (O)

It is agreed that:

1. Section 2, Exclusions, under General Agreements, is amended to include the following sub-sections:

(n) loss from the use of credit, debit, charge, access, convenience, identification, cash management or other cards, whether such cards were issued or purport to have been issued by the Insured or by anyone else, unless such loss is otherwise covered under Insuring Agreement A.

(o) the underwriter shall not be liable under the attached bond for loss due to liability imposed upon the Insured as a result of the unlawful disclosure of non-public material information by the Insured or any Employee, or as a result of any Employee acting upon such information, whether authorized or unauthorized.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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ENDORSEMENT OR RIDER NO.

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

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ATTACHED TO AND FORMING PART OF BOND OR POLICY NO.	DATE ENDORSEMENT OR RIDER EXECUTED	* EFFECTIVE DATE OF ENDORSEMENT OR RIDER 12:01 A.M. STANDARD TIME AS SPECIFIED IN THE BOND OR POLICY
ZBN-14T44710-12-N2	12/04/12	11/25/12

* ISSUED TO
GLADSTONE CAPITAL CORPORATION

ERISA Rider

It is agreed that:

1. Employee as used in the attached bond shall include any natural person who is a director or trustee of the Insured while such director or trustee is engaged in handling funds or other property of any Employee Welfare or Pension Benefit Plan owned, controlled or operated by the Insured or any natural person who is a trustee, manager, officer of employee of any such Plan.

2. If the Bond, in accordance with the agreements, limitations and conditions thereof, covers loss sustained by two or more Employee Welfare or Pension Benefit Plans or sustained by any such Plan in addition to loss sustained by an Insured other than such Plan, it is the obligation of the Insured or the Plan Administrator(s) of such Plans under Regulations published by the Secretary of Labor Implementing Section 13 of the Welfare and Pension Plans Disclosure Act of 1958 to obtain under one or more bonds issued by one or more Insurers an amount of coverage for each such Plan at least equal to that which would be required if such Plans were bonded separately.

3. In compliance with the foregoing, payment by the Company in accordance with the agreements, limitations and conditions of the bond shall be held by the Insured, or, if more than one, by the Insured first named, for the use and benefit of any Employee Welfare or Pension Benefit Plan sustaining loss so covered and to the extent that such payment is in excess of the amount of coverage required by such Regulations to be carried by said Plan sustaining such loss, such excess shall be held for the use and benefit of any other such Plan also covered in the event that such other Plan discovers that it has sustained loss covered thereunder.

4. If money or other property of two or more Employee Welfare or Pension Benefit Plans covered under the bond is commingled, recovery for loss of such money or other property through fraudulent or dishonest acts of Employees shall be shared by such Plans on a pro rata basis in accordance with the amount for which each such Plan is required to carry bonding coverage in accordance with the applicable provisions of said Regulations.

5. The Deductible Amount of this bond applicable to loss sustained by a Plan through acts committed by an Employee of the Plan shall be waived, but only up to an amount equal to the amount of coverage required to be carried by the Plan because of compliance with the provisions of the Employee Retirement Income Security Act of 1974.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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ENDORSEMENT OR RIDER NO.

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Bond or Policy have the same inception date.

ATTACHED TO AND FORMING PART OF BOND OR POLICY NO.	DATE ENDORSEMENT OR RIDER EXECUTED	* EFFECTIVE DATE OF ENDORSEMENT OR RIDER 12:01 A.M. STANDARD TIME AS SPECIFIED IN THE BOND OR POLICY
ZBN-14T44710-12-N2	12/04/12	11/25/12

* ISSUED TO
GLADSTONE CAPITAL CORPORATION

VIRGINIA STATUTORY RIDER

It is agreed that:

1. Any reference to arbitration in the bond is removed.

2. The Representation paragraph found in the application is deleted and replaced by the following

REPRESENTATION

The Insured represents that the information furnished in the application for this bond is complete, true and correct. Such application constitutes part of this bond.

Any misrepresentation, omission, concealment or any incorrect statement of a material fact, in the application or otherwise, may be grounds for the rescission of this bond.

Premium to be returned in the event of termination of this bond shall be determined as follows:

First, any unearned premium for the unexpired term of the bond period shall be the original premium minus the greater of the earned premium computed on the basis of either:

(i) the percentage developed by dividing paid losses during the bond period by the annual aggregate limit of liability, or

(ii) the percentage developed by dividing the elapsed time of the bond period by the bond period.

Second, the dollar amount of the unearned premium so determined shall be returned accordingly:

(i) if the bond is canceled at the Underwriter s request, or it coverage is being canceled and rewritten, the entire amount shall be returned, or

(ii) if the bond is canceled at the Insured s request 90% of the amount shall be returned.

3. The second sentence of Section 18. CHANGE OR MODIFICATION, is hereby deleted in its entirety and replaced with:
No changes in or modification thereof shall be effective unless made by written endorsement.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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The following spaces preceded by an (*) need not be completed if this endorsement or rider and the Bond or Policy have the same inception date.

ATTACHED TO AND FORMING PART OF BOND OR POLICY NO.	DATE ENDORSEMENT OR RIDER EXECUTED	* EFFECTIVE DATE OF ENDORSEMENT OR RIDER 12:01 A.M. LOCAL TIME AS SPECIFIED IN THE BOND OR POLICY
ZBN-14T44710-12-N2	12/04/12	11/25/12

* ISSUED TO
GLADSTONE CAPITAL CORPORATION

NON-ACCUMULATION ENDORSEMENT

For use with forms: ICB005 Ed. 7/04, FIIC100 Ed. 02/06 and SAA Form 25

MEL3983 Ed. 2/06

It is agreed that:

The liability of the Underwriter under this bond shall not be cumulative with amounts which may be recoverable under any one or more bonds written by TRAVELERS; 14T44678, 14T44630 & 14T44710.

The liability of the Underwriter for any loss payable under this bond and any other bond shall not exceed in the aggregate the largest applicable single limit of liability under any such bond.

Nothing herein contained shall be held to vary, alter, waive, or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Bond or Policy, other than as above stated.

By

Authorized Representative

INSURED

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ACTION BY WRITTEN CONSENT

OF THE

BOARD OF DIRECTORS

OF

GLADSTONE CAPITAL CORPORATION

The undersigned, being all of the members of the Board of Directors of Gladstone Capital Corporation, a Maryland Corporation (the ***Company***), pursuant to Section 2-408(c) of the Maryland General Corporation Law, hereby adopt the following resolutions by written consent dated effective as of the 25th day of November, 2012:

WHEREAS, the Board has reviewed the renewal of the Company s Investment Company Blanket Bond No. 14T44710, the terms of which are attached hereto as ***Exhibit A***, issued by The St. Paul Fire and Marine Insurance Company (the ***Fidelity Bond***);

NOW, THEREFORE, BE IT RESOLVED, that the members of the Board, including Paul W. Adelgren, Anthony Parker, Michela A. English, John H. Outland, John Reilly and Terry Earhart, each of whom is not an interested person under the 1940 Act, hereby acknowledge and agree that the Fidelity Bond is reasonable in form and amount; and it be

RESOLVED FURTHER, that the appropriate officers of the Company be, and they hereby are, authorized to enter into the Fidelity Bond for the Company; and it be

RESOLVED, FURTHER, that any and all previous actions taken by the Company s officers, principals or agents in connection with the Fidelity Bond be, and hereby are, approved and ratified as duly authorized actions of the Company; and it be

RESOLVED FURTHER, that the appropriate officers of the Company be, and each of them hereby is, authorized and directed, for and on behalf of the Company, to file the Fidelity Bond with the Securities and Exchange Commission.

[SIGNATURE PAGE FOLLOWS]

In Witness Whereof, the undersigned have executed this Action by Written Consent of the Board of Directors of Gladstone Capital Corporation as of the day and year first written above.

/s/ David Gladstone
David Gladstone

/s/ Terry Lee Brubaker
Terry Lee Brubaker

/s/ George Stelljes III
George Stelljes III

/s/ Anthony Parker
Anthony Parker

/s/ David Dullum
David Dullum

/s/ Michela English
Michela English

/s/ John Outland
John Outland

/s/ Paul Adelgren
Paul Adelgren

/s/ Terry Earhart
Terry Earhart

/s/ John Reilly
John Reilly

Exhibit A

Terms of Fidelity Bond

SelectOne SM Bond
TRAVELERS

SUITE 2200

200 NORTH LASALLE STREET

CHICAGO, IL 60601

11/21/2012

AON RISK SERVS CENTRAL

Ryan O´hare

200 E RANDOLPH ST 12TH FL

CHICAGO, IL 60601

Binder

Bond Policy Number: 14T44710 **Prior Bond Number:** 412PB1602

We are pleased to offer the following Binder for Investment Company Blanket Bond coverages.

Insured:	Gladstone Capital Corporation McLean, VA 22102	
Company:	St. Paul Fire & Marine Insurance Company	
Term:	11/25/2012 to 11/25/2013	
Commission:	15.0%	
Bond Premium Payable [Pre-Paid]:		$7,822
Bill Type:	Agency Bill	
Payment Type:	Lump Sum / Full Pay	1 installments

Insuring Agreements	Single Loss Limit of Liability	Single Loss Deductible Amount
All insuring agreements are shown. A checked checkbox indicates an agreement that was selected by the insured.		
þ **(A) Fidelity**	$ 3,000,000	$ 100,000
¨ Data Processing Organizations		
¨ Partners		
þ **(B) Audit Expense**	$ 100,000	$ 0
þ **(C) Premises**	*Same As Insuring Agreement A*	*Same As Insuring Agreement A*
þ **(D) Transit**	*Same As Insuring Agreement A*	*Same As Insuring Agreement A*
þ **(E) Forgery or Alteration**	$ 3,000,000	$ 100,000

SelectOne SM Bond

Insuring Agreements	Single Loss Limit of Liability		Single Loss Deductible Amount	
All insuring agreements are shown. A checked checkbox indicates an agreement that was selected by the insured.				
þ **(F) Securities**	$	3,000,000	$	100,000
þ **(G) Counterfeit Currency**	*Same As Insuring Agreement A*		*Same As Insuring Agreement A*	
þ **(H) Stop Payment**	$	100,000	$	5,000
þ **(I) Uncollectible Items of Deposit**	$	100,000	$	5,000
þ **Computer Systems**	$	3,000,000	*Same As Insuring Agreement A*	
þ **Voice Initiated Transactions**	$	3,000,000	$	100,000
þ **Telefacsimile**	$	3,000,000	$	100,000
þ **Unauthorized Signature**	$	3,000,000	$	100,000
¨ **Registered Representatives**				
¨ **Extortion Threats to Persons and Property**				

Endorsements

Form #	*Form Title*
ICB001	Investment Company Blanket Bond Declarations Page
ICB005	Investment Company Blanket Bond Form
ICB010	Named Insured Endorsement
ICB011	Computer Systems
ICB012	Unauthorized Signature
ICB013	Telefacsimile Coverage
ICB014	Voice Initiated Transactions
ICB016	Definition of Investment Company
ICB026	Add Exclusions N&O (Mandatory)
ICB030	ERISA Rider
ICB065	Virginia Statutory Rider
MEL 3983	Non-accumulative

SelectOne SM Bond
Proposal Subjectivities For Investment Company Blanket Bond

þ This binder is valid until 12:01 a.m. on 12/25/2012.
This binder shows the premiums for the general coverages described, but in no way changes or affects any terms, conditions or exclusions of policies as actually issued.

Thank you for considering the Travelers for your client s specialty insurance coverages. Please call if you have any questions regarding the terms and conditions offered here.

Michael Parduhn
Underwriting Manager, Bond

Telephone: 312/458-6688
Facsimile: 312/458-6674
E-mail Address: MPARDUHN@travelers.com

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IMPORTANT NOTICE REGARDING COMPENSATION DISCLOSURE

For information about how Travelers compensates independent agents, brokers, or other insurance producers, please visit this website:

http://www.travelers.com/w3c/legal/Producer_Compensation_Disclosure.html

If you prefer, you can call the following toll-free number: 1-866-904-8348. Or you can write to us at Travelers, Enterprise Development, One Tower Square, Hartford, CT 06183

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