

PRINCIPAL SOLAR, INC.
CONSOLIDATED FINANCIAL STATEMENTS
For The Years Ended December 31, 2013 and 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Principal Solar, Inc.

We have audited the accompanying consolidated balance sheets of Principal Solar, Inc. and subsidiaries (the “Company”), as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders’ equity (deficit), and cash flows for each of the years in the two year period ended December 31, 2013. The Company’s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company, as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the two year period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the entity will continue as a going concern. The Company has negative cash flows from operating activities, negative working capital, and an accumulated deficit of \$7.1 million as of December 31, 2013. Management’s plans in regard to these matters are described in Note 1. These conditions raise substantial doubt about the Company’s ability to continue as a going concern. These consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

/s/ Whitley Penn LLP

Dallas, Texas
April 16, 2014

PRINCIPAL SOLAR, INC.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2013	2012
ASSETS		
Current Assets		
Cash and equivalents	\$ 122,533	\$ 11,418
Accounts receivable	105,989	20,145
Deposits	10,000	57,000
Prepaid assets	23,867	-
Option to acquire noncontrolling interest in subsidiary	46,010	-
Total current assets	308,399	88,563
Other Assets		
Solar arrays at cost, net	6,984,936	497,565
Intangible assets at cost, net	-	110,000
Restricted cash	140,644	-
Total other assets	7,125,580	607,565
Total assets	<u>\$ 7,433,979</u>	<u>\$ 696,128</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities		
Liabilities arising from reverse merger	\$ 953,967	\$ 906,141
Compensation payable	559,998	305,322
Accounts payable	59,968	127,060
Current portion of acquisition note payable, net of discount	215,574	-
Interest payable	26,753	173
Note payable for insurance premiums	9,040	-
Convertible notes payable, related parties	-	17,000
Accrued expenses and other liabilities	3,378	3,002
Total current liabilities	1,828,678	1,358,698
Other Liabilities		
Acquisition note payable, net of discount	4,652,979	-
Derivative liability on warrants	1,123,149	-
Total other liabilities	5,776,128	-
Total liabilities	<u>7,604,806</u>	<u>1,358,698</u>
Commitments and contingencies		
Stockholders' Deficit		
Preferred stock: \$0.01 par value, 100,000,000 shares authorized; none issued		
Common stock: \$0.01 par value, 300,000,000 shares authorized, 19,017,226 and 14,946,135 shares issued and outstanding at December 31, 2013 and 2012, respectively	190,171	149,462
Additional paid-in capital	5,954,387	3,919,934
Accumulated deficit	(7,102,188)	(4,731,966)
Deficit attributable to common stockholders	(957,630)	(662,570)
Noncontrolling interest in subsidiary	786,803	-
Total stockholders' deficit	(170,827)	(662,570)
Total liabilities and stockholders' deficit	<u>\$ 7,433,979</u>	<u>\$ 696,128</u>

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

PRINCIPAL SOLAR, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended	
	December 31, 2013	December 31, 2012
Revenues		
Power generation	\$ 487,408	\$ 17,045
Other	3,234	18,483
Total revenues	490,642	35,528
Cost of revenues		
Depreciation	177,947	22,424
Direct operating costs	136,406	52,423
Total cost of revenues	314,353	74,847
Gross profit (loss)	176,289	(39,319)
General and administrative expenses	2,162,214	2,701,282
Operating loss	(1,985,925)	(2,740,601)
Other (income) expense		
Interest expense	308,211	50,332
Inducement for conversion of notes payable	102,193	-
Gain on derivative liability warrants	(47,310)	-
Total other expense	363,094	50,332
Loss before provision for income taxes	(2,349,019)	(2,790,933)
Provision for state income taxes	1,227	1,901
Net loss	(2,350,246)	(2,792,834)
Less: Income attributable to noncontrolling interest in subsidiary	19,976	-
Net loss attributable to common stockholders	\$ (2,370,222)	\$ (2,792,834)
Net loss per share - basic and diluted	\$ (0.14)	\$ (0.19)
Weighted average shares outstanding - basic and diluted	17,089,124	14,655,252

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

PRINCIPAL SOLAR, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

	Common Stock		Additional	Accumulated	Stock	Principal	Non-	
	Shares	Amount	Paid-in	Deficit	Subscriptions	Solar, Inc.	Controlling	Total
			Capital		Receivable	Total	Interest	
December 31, 2011	14,321,797	\$ 143,219	\$ 2,106,321	\$ (1,939,132)	\$ (100,248)	\$ 210,160	-	\$ 210,160
Common stock issued at \$1.41 per share in February	32,622	326	45,674	-	-	46,000	-	46,000
Common stock issued at \$1.69 per share in June	591,716	5,917	994,083	-	-	1,000,000	-	1,000,000
Collection on subscriptions receivable from prior period	-	-	-	-	100,248	100,248	-	100,248
Stock-based advisor compensation expense	-	-	773,856	-	-	773,856	-	773,856
Net Loss	-	-	-	(2,792,834)	-	(2,792,834)	-	(2,792,834)
December 31, 2012	14,946,135	149,462	3,919,934	(4,731,966)	-	(662,570)	-	(662,570)
Common stock issued for cash in May	500,000	5,000	495,000	-	-	500,000	-	500,000
Common stock issued upon conversion of convertible debt, accrued interest, and conversion price adjustment	145,990	1,459	246,723	-	-	248,182	-	248,182
Common stock issued for rights to acquire noncontrolling interest in subsidiary	46,010	460	45,550	-	-	46,010	-	46,010
Common stock issued with warrants for cash in June	2,909,091	29,090	400,451	-	-	429,541	-	429,541
Common stock issued for cash in September	400,000	4,000	396,000	-	-	400,000	-	400,000
Stock-based advisor compensation expense	-	-	108,731	-	-	108,731	-	108,731
Stock-based employee compensation expense	-	-	191,249	-	-	191,249	-	191,249
Acquisition note payable - warrants	-	-	81,449	-	-	81,449	-	81,449
Noncontrolling interest in subsidiary	-	-	-	-	-	-	766,827	766,827
Common stock issued for cash in November	70,000	700	69,300	-	-	70,000	-	70,000
Net income (loss)	-	-	-	(2,370,222)	-	(2,370,222)	19,976	(2,350,246)
December 31, 2013	19,017,226	\$ 190,171	\$ 5,954,387	\$ (7,102,188)	\$ -	\$ (957,630)	\$ 786,803	\$ (170,827)

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

PRINCIPAL SOLAR, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended	
	December 31, 2013	December 31, 2012
OPERATING ACTIVITIES		
Net loss	\$ (2,350,246)	\$ (2,792,834)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	287,947	132,424
Stock-based employee compensation expense	191,249	-
Stock-based advisor compensation expense	108,731	773,856
Inducement cost for conversion of notes payable	102,193	-
Gain on derivative liability on warrants	(47,310)	-
Amortization of discount on acquisition note payable	11,030	-
Interest expense paid in stock	7,990	-
Change in operating assets and liabilities:		
Accounts receivable	92,879	(16,929)
Deposits	47,000	(57,000)
Prepaid assets	(12,617)	-
Liabilities arising from reverse merger	47,826	50,159
Compensation payable	254,676	(6,440)
Accounts payable	(67,092)	56,102
Interest payable	26,580	-
Accrued expenses and other liabilities	376	(4,325)
Net cash used in operating activities	<u>(1,298,788)</u>	<u>(1,864,987)</u>
INVESTING ACTIVITIES		
Powerhouse One acquisition, net of cash acquired	(6,077,214)	-
FINANCING ACTIVITIES		
Proceeds from acquisition note payable	5,050,000	-
Payments on acquisition note payable	(111,028)	-
Proceeds from sale of common stock and warrants	2,569,999	1,046,000
Proceeds from convertible note payable	100,000	-
Proceeds from convertible notes payable, related party	21,000	17,000
Payments on note payable for insurance premiums	(2,210)	-
Change in restricted cash	(140,644)	-
Receipts from stock subscriptions receivable	-	100,248
Net cash provided by financing activities	<u>7,487,117</u>	<u>1,163,248</u>
Increase (Decrease) in cash and equivalents	111,115	(701,739)
Cash and equivalents, beginning of year	11,418	713,157
Cash and equivalents, end of year	<u>\$ 122,533</u>	<u>\$ 11,418</u>
Supplemental Disclosures		
Interest paid	<u>\$ 378,732</u>	<u>\$ -</u>
Income taxes paid	<u>\$ 26</u>	<u>\$ -</u>
Non-Cash Transactions:		
Discount on acquisition note payable	\$ 81,449	\$ -
Option to acquire noncontrolling interest in subsidiary	46,010	-
Derivative liability on investor warrants	1,170,459	-
Redemption of convertible notes payable and accrued interest for stock	145,990	-
Note payable for insurance premiums	11,250	-

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

NOTE 1 - OVERVIEW

The Company

Principal Solar, Inc. ("PSI", the "Company", "our", "us", or "we") was incorporated on July 8, 2010, under the laws of the State of Texas and became a New York corporation upon consummation of a reverse merger. On March 7, 2011, the Company was acquired by Kupper Parker Communications, Inc. ("KPCG"), then a public shell company, in a reverse merger transaction whereby KPCG merged with and into PSI, with KPCG remaining as the surviving corporation and PSI becoming a wholly owned subsidiary of KPCG. In connection with the merger, the Company changed its corporate name from "Kupper Parker Communications, Inc." to "Principal Solar, Inc." In accordance with the terms of this transaction, the shareholders of PSI exchanged all of their shares of PSI's \$.01 par value common stock ("Common Stock") for shares of KPCG common stock that, immediately following the transaction, represented approximately 82 percent of the issued and outstanding Common Stock of the Company.

In October 2012, the Company was re-domiciled in Delaware. The Company is authorized to issue 300,000,000 shares of Common Stock and 100,000,000 shares of preferred stock with a par value of \$.01 per share ("Preferred Stock").

PSI is traded on the OTCPink® market under the symbol "PSWW".

PSI is a renewable energy company with the goal of becoming a leading utility-scale solar power generating company. Power generated by the Company can be sold to the "power grid" through traditional utility companies under long-term fixed or escalating price Power Purchase Agreements ("PPA"). In this instance, the buyer agrees to take all power produced by the Company for the period of the PPA, generally 10-20 years. Alternatively, the power can be sold to one or more industrial users ("merchants") either under a PPA or at market rates. More than 96% of power generation revenues in 2013 were generated under a long-term fixed price PPA having a remaining term of 8 years. The remainder was generated under a single-merchant PPA at a 10% discount to the prevailing market prices in the area. Though the level of power generation is highly predictable over time, shorter-term variations do occur.

As with any long-term contract, the ability of the counterparty to perform its obligations under a PPA is of significant importance. The Company evaluates the strength, stability, and longevity of the counterparty relative to the obligation under the PPA before entering into such an agreement, and periodically reevaluates its initial assessment.

PSI intends to establish itself as a leading solar power company using a 4-pronged approach:

1. **Acquire** existing small and medium sized solar power generating companies in a roll-up strategy using a combination of cash and shares of its Common Stock. The goal of acquiring multiple generating companies is to build the world's first distributed solar generating utility.
2. **Establish** thought leadership by networking well-respected thinkers who will author technical white papers and host interactive webinars at www.principalsolarinstitute.org.
3. **Implement**, opportunistically, new commercial solar projects utilizing our new partnerships and relationships.
4. **Build** an entity capable of winning bids for gigawatt-scale projects around the world based on solid economics. This is the longer-term phase 2 of the Company plan.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. ("GAAP") and the rules of the Securities and Exchange Commission. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the periods presented have been reflected herein.

Going Concern

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As of December 31, 2013, the Company has an accumulated deficit of approximately \$7.1 million, and the Company has had negative cash flows from operations since inception. Its ability to continue as a going concern is dependent upon the ability of the Company to obtain the necessary financing, likely through the continued sale of its equity and equity-linked securities, to meet its obligations and pay its liabilities arising from normal business operations when they come due. The outcome of these matters cannot be predicted with any certainty at this time and raise substantial doubt that the Company will be able to continue as a going concern. These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that may be necessary should the Company be unable to continue as a going concern.

Concentration

In 2013, 96% of our consolidated power generation revenue arose from our Powerhouse One solar installation under a fixed-price PPA having a fixed premium of \$0.12 per kilowatt-hour ("kWh") over the GSA-1 scheduled rate (currently approximately \$0.10 per kWh) resulting in a forecasted rate of \$0.22 per kWh through 2021, and a market rate based upon the GSA-1 scheduled rate for the remaining 10 years of the initial 20 year term. The buyer and counterparty of the PPA is Fayetteville Public Utility of Lincoln County Tennessee. A similar percentage of the accounts receivable also stems from this single relationship.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Recent Accounting Pronouncements

There have been no new accounting pronouncements issued that have had, or are expected to have, a material impact on our results of operations or financial condition.

Principles of Consolidation

The Company consolidates the financial position, results of operations, and cash flows of all majority-owned subsidiaries. The consolidated financial statements include the accounts of the Company (including the dba Principal Solar Institute) and its subsidiaries SunGen Mill 77, LLC; SunGen Step Guys, LLC; and Powerhouse One, LLC. Significant intercompany accounts and transactions have been eliminated in consolidation. Certain previously reported amounts have been reclassified to conform to the current presentation.

Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. We believe the carrying values of cash and equivalents, accounts receivable, and other current assets, accounts payable, accrued expenses, and other current liabilities approximate their fair values. We believe the carrying value of our notes payable approximate their estimated fair value for debts with similar terms, interest rates, and remaining maturities currently available to companies with similar credit ratings.

We do not engage in hedging activities, but we do have a derivative instrument treated as a liability whose value is measured on a recurring basis (see "Derivative Liability on Warrants" included herein).

Fair Value Instruments

In June 2013, in connection with a sale of its Common Stock, the Company issued complex non-traded warrants with the potential for downward adjustments of the exercise price. The Company estimated the value of these warrants upon issuance using a binomial lattice-based option valuation model. Increases or decreases in the Company's share price, the volatility of the share price, changes in interest rates in general, and the passage of time will all impact the value of these warrants. The Company re-values these warrants at the end of each reporting period and any changes are reflected as gains or losses in current period results.

Use of Estimates

The preparation of our financial statements in accordance with GAAP requires us to, on an ongoing basis, make significant estimates and judgments that affect the reported values of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions we believe are reasonable under the circumstances, the results of which form the basis for our conclusions. Actual results may differ from these estimates under different assumptions or conditions. Such differences could have a material impact on our future financial position, results of operations, and cash flows.

Cash and Equivalents

We consider cash, deposits, and short-term investments with original maturities of three months or less as cash and equivalents. Our deposits are maintained primarily in two financial institutions and, at times, may exceed amounts covered by U.S. Federal Deposit Insurance Corporation insurance.

Restricted Cash

As part of the June 2013 financing with Bridge Bank, National Association (see "Acquisition Note Payable" herein), the Company agreed to maintain in a restricted cash account all proceeds, less debt service and approved expenses, generated by our Powerhouse One subsidiary. Such account provides a minimum of \$108,000 replacement reserve ("module reserve") on solar panels found to be defective and potentially not covered under the manufacturers warranty. Funds in excess of the modular reserve may be accessed by the Company following one year of operations and four consecutive quarters of performance exceeding covenants.

Accounts Receivable

Accounts receivable are stated at amounts management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of individual accounts. No allowance has been recorded at December 31, 2013 or 2012.

Solar Arrays

Solar arrays are stated at historical cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the remaining estimated useful lives of the assets. The estimated useful lives of solar arrays are 25 years from the date first placed in service. Accumulated depreciation was \$207,851 and \$29,904 at December 31, 2013 and 2012, respectively.

Intangible Assets

Intangible assets, which consist of technological and intellectual property, are stated at the value of the consideration provided by the Company, and are amortized over three years with no residual value.

Long-Lived Assets

The recoverability of the carrying value of long-lived assets is assessed when an indicator of impairment has been identified. The Company judgmentally reviews its long-lived assets each quarter to assess whether impairment indicators are present.

For purposes of recognition and measurement of an impairment loss, a long-lived asset or group of assets is combined with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

For long-lived assets, when impairment indicators are present, the Company compares undiscounted future cash flows, including the eventual disposition of the asset group at market value, to the asset group's carrying value to determine if the asset group is recoverable. If undiscounted cash flows are less than carrying value, the excess of carrying value over fair value is expensed in the period in which it is estimated to have occurred. No impairment was recorded in 2013 or 2012.

Revenue Recognition

Power generation revenue is recognized as generated based upon electrical meters affixed to the solar array and measuring kilowatt-hours ("kWh") produced. Our current power generation operations do not generate renewable energy credits, performance-based incentives, or similar credits to the benefit of the Company.

Income Taxes

Income taxes are recorded under the asset and liability method under which deferred tax assets and liabilities are determined based on the differences between the financial statement and tax bases of assets and liabilities using the enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

We account for uncertain income tax positions in accordance with FASB ASC 740, *Income Taxes*. Interest costs and penalties related to income taxes are classified as interest expense and general and administrative costs, respectively, in our consolidated financial statements. Income tax returns are subject to a three-year statute of limitations during which they are subject to audit and adjustment. We file income tax returns in the United States federal jurisdiction. The tax years that remain subject to examination by major tax jurisdictions as of December 31, 2013, include 2010 through 2012.

Equity Transaction Fair Values

The estimated fair value of our Common Stock issued in share-based payments is measured by the more relevant of (1) the prices received in private placement sales of our stock or, (2) its publically-quoted market price. We estimate the fair value of simple warrants and stock options when issued or, in the case of issuances to non-employees, when vested using the Black-Scholes option-pricing ("Black-Scholes") model that requires the input of subjective assumptions. When valuing more complex warrants, options, or other derivative equity instruments, we use a binomial lattice-based option pricing model or Monte Carlo option pricing model, whichever management deems more appropriate in the circumstances. Recognition in stockholders' equity and expense of the fair value of stock options awarded to employees is on the straight-line basis over the requisite service period. Subsequent changes in fair value are not recognized.

Net Income (Loss) per Share

Basic net income or loss per share is computed by dividing the net income or loss for the period by the weighted average number of shares of Common Stock outstanding for the period. Diluted income per share reflects the potential dilution of derivative securities by including other potential issuances of Common Stock including shares to be issued upon exercise of options and warrants and upon conversion of convertible debt. Potentially dilutive shares are not included in the event of a loss as the effect of doing so would be anti-

dilutive. As of December 31, 2013, options to purchase 1,503,333 shares and warrants to purchase 2,332,868 shares of our Common Stock have been excluded from the calculation of diluted loss per share, as their effect would have been anti-dilutive. As of December 31, 2012, options to purchase 1,083,333 shares and warrant to purchase 17,500 shares of our Common Stock have been excluded from the calculation of diluted loss per share as their effect would have been anti-dilutive.

NOTE 3 - LIABILITIES ARISING FROM REVERSE MERGER

Liabilities arising from the reverse merger represent long term real estate leases which had been abandoned, general unsecured liabilities, commercial liens, and tax liens filed with various states all associated with the Company's pre-reverse merger operations, which were unknowingly assumed in the March 2011 reverse merger transaction. The statute of limitations for most of such liabilities is five years and for most liens is ten years, subject to renewal at the lien holders' option, depending upon the jurisdiction. The liens accrue interest at between 8% and 12%. Liabilities not associated with a lien have been accrued based upon management's estimation of the amount to be paid. Liabilities associated with a lien have been accrued at face value. Management believes all such liabilities have been indemnified by Pegasus Funds, LLC who remains a large common stock holder. However, as the Company is obligor, the Company has recorded the liability. To date, only one lien holder has approached the Company concerning payment. Such lien holder is pursuing the former management of the Company first through litigation. To the extent such lien holder recovers the liability from the former management, the lien against the Company will be reduced.

NOTE 4 - COMPENSATION PAYABLE

Certain members of the management team have deferred payment of their compensation for the benefit of the Company. No formal terms of payment have been established.

NOTE 5 - ACQUISITIONS

Powerhouse One

Effective June 17, 2013, PSI entered into an acquisition agreement with Vis Solis, Inc., a Tennessee limited liability company, and AstroSol, Inc., a Tennessee corporation (together "Co-Sellers"), the members of Powerhouse One, LLC ("Powerhouse"), whereby 89% of the outstanding membership interests of Powerhouse were exchanged for \$6,200,000 in cash. At the time of acquisition, the four solar arrays owned by Powerhouse had a remaining estimated useful life of 23 years (being first placed in service in 2011), and power generated is sold to a utility in Franklin County Tennessee under a PPA having a fixed premium of \$0.12 per kilowatt-hour ("kWh") over the GSA-1 scheduled rate (currently approximately \$0.10 per kWh) resulting in a forecasted rate of \$0.22 per kWh through 2021, and a market rate based upon the GSA-1 scheduled rate for the remaining 10 years of the initial 20 year term.

The acquisition was accounted for as a business combination under ASC 805 and was entered into in order to acquire the solar arrays. As part of the acquisition, 46,010 shares were issued to Co-Sellers in consideration for the right to acquire their remaining 11% noncontrolling interest for \$766,827 within one year from the initial acquisition date. The value of the noncontrolling interest was pro-rated based upon the negotiated value of the equity interest acquired by the Company.

The Company incurred \$277,287 in acquisition related fees as part of the transaction which are included in general and administrative expenses. The purchase price was preliminarily allocated as follows:

Cash	\$ 122,786
Accounts receivable	178,723
Solar arrays	6,665,318

Noncontrolling interest	(766,827)
Net purchase price	<u>\$6,200,000</u>

The operating results of Powerhouse have been included in the consolidated financial statements since the acquisition date including revenue of \$468,682 and a net loss of \$48,967 (after interest of \$230,405). On a pro forma basis, had the acquisition of Powerhouse occurred on January 1, 2012, the consolidated revenues and loss of PSI would have been:

(unaudited)	2013	2012
Revenue	\$ 831,999	\$ 917,538
Net Loss	\$ (2,460,219)	\$(2,862,747)

NOTE 6 - NOTES PAYABLE

Convertible Notes Payable

During November 2012, the Company issued to certain related parties three unsecured convertible notes payable for cash proceeds of \$17,000. The notes were scheduled to mature on November 30, 2013, and bore interest at a rate of 12% annually. At maturity, the notes and accrued interest were to convert to shares of Common Stock at the stock price of \$1.70 per share should the Company not be able to repay the debt in cash.

In January 2013, the Company issued to an unrelated party one unsecured convertible note for cash proceeds of \$100,000. The note was scheduled to mature on April 30, 2013, and bore interest at a rate of 12% annually. At maturity, the notes and accrued interest were to convert to shares of Common Stock at the stock price of \$1.70 per share upon maturity should the Company not be able to repay the debt in cash.

In March 2013, the Company issued to certain related parties four unsecured convertible notes for cash proceeds of \$21,000. The notes were scheduled to mature on June 15, 2013, and bore interest at a rate of 18% annually. At maturity, the notes and accrued interest were to convert to shares of Common Stock at the stock price of \$1.70 per share should the Company not be able to repay the debt in cash.

Early Conversion

In May 2013, the Company induced all convertible note holders to convert their notes having a principal of \$138,000 and accrued interest of \$7,990 into 145,990 shares of Common Stock at a price of \$1.00 per share versus the stated conversion price of \$1.70 per share. The difference in the conversion price resulted in an expense of \$102,193 being included in "Other income (expense)" in 2013.

Acquisition Note Payable

On June 17, 2013, Powerhouse One, LLC secured financing of \$5,050,000 from Bridge Bank, National Association to acquire the membership interest (and the underlying solar arrays) of Co-Sellers. The note matures on June 17, 2017, and bears a fixed interest rate of 7.5% annually. Interest is paid monthly and principal is paid quarterly beginning in September 2013 based on an 11-year amortization schedule. Covenants include the maintenance of a restricted cash account, routine reporting, and a minimum debt service coverage ratio of not less than 1.10:1, measured quarterly following the first anniversary of the debt. The debt also restricts the payment of dividends, and it is secured by all the assets of Powerhouse and further guaranteed by Principal Solar, Inc.

Principal payments over the following years are as follows:

2014	\$235,936
2015	249,816
2016	280,056
2017	4,173,164
Total principal payments	4,938,972
Unrecognized discount	(70,419)
Note payable at December 31, 2013	<u>\$4,868,553</u>

In conjunction with the acquisition note payable, warrants to purchase 151,050 shares of Common Stock were issued to Bridge Bank with an exercise price of \$1.00 and a contractual life of 10 years. The value of the warrants issued in connection with this debt, as determined using the Black-Scholes model, was \$81,449 and is recorded as a discount to the debt. The discount is being amortized as interest expense over the life of the note, including \$11,030 in 2013. The assumptions used to value the warrants were as follows:

Estimated fair value	\$0.54
Expected life (years)	5.26 Years
Risk free interest rate	1.27%
Volatility	211.91%

The Bridge Bank warrants has cashless exercise rights, redemption rights providing the Company the right to redeem the warrant for \$604,200, anti-dilution rights associated with offerings of equity securities, a term expiring on the first to occur of (i) the 10 year anniversary of the grant, (ii) the closing of the Company's initial public offering (which is being affected pursuant to Registration Statement on Form S-1), or (iii) the liquidation of the Company (each a "Termination Event"). In each case, unless exercised earlier, the warrants are automatically exercised on a cashless basis upon a Termination Event. The Company also provided the holder registration rights in connection with the grant of the warrant.

NOTE 7 - LEASES

The Company's solar arrays sit on properties subject to long-term real estate leases (or similar agreements in the case of rooftop installations) with initial terms equal to the PPA and having one or more renewal options. Rental payments under the leases vary in type between fixed price, percentage of revenue, or, in the case of rooftop installations, no separate charge. The Company's current solar array installations are as follows:

Installation	Location	kWh	Date	Term	Rent
Powerhouse One	Fayetteville, TN	3,000	Aug 2011	20 yr. + 2 5-yr renewals	4% of revenue
SunGen Step Guys	Alfred, ME	111	Sep 2009	25 yr. + 2 25-yr renewals	None
SunGen Mill 77	Amesbury, MA	63	June 2010	25 yr. + 2 25-yr renewals	None

The Company paid \$33,325 in rent under the Powerhouse One lease in 2013.

In each case, the Company is obligated to remove such installations at the end of the lease terms. As the expected termination dates are decades off; there is little experience de-installing solar arrays anywhere in the world; and, costs are expected to be minimal; such removal costs have not been separately accounted for.

The Company maintains its headquarters in Dallas, Texas pursuant to a month-to-month lease at a cost of \$500 per month.

NOTE 8 - DERIVATIVE LIABILITY ON WARRANTS

In June 2013, the Company issued warrants to purchase 2,181,818 shares of Common Stock with a 10-year contractual term to a Steuben Investment Company II, L.P. in connection with the issuance of Common Stock to fund the Powerhouse One acquisition. The warrants were immediately exercisable into the Company's Common Stock with an exercise price of \$1.00 per share. However, as the warrants have "down round" protection, they are treated as a derivative liability and were valued using a binomial lattice-based option valuation model using holding period assumptions developed from the Company's business plan and management assumptions, and expected volatility from comparable companies including OTCPink® and small-cap companies. Input assumptions at December 31, 2013 were as follows:

Estimated fair value	\$0.51
Expected life (years)	5.95 Years
Risk free interest rate	2.08%
Volatility	205.66%

The fair value of the warrant derivative liability outstanding as of December 31, 2013, was determined using "Level 2 Observable Inputs" as defined in Accounting Standards Codification topic 820 entitled "*Fair Value Measurement*."

The following table sets forth a summary of changes in fair value of the warrants in 2013:

Beginning balance January 1, 2013	\$ -
Derivative warrants issued	1,170,459
Change in fair value included in net loss	(47,310)
Balance at December 31, 2013	<u><u>\$ 1,123,149</u></u>

NOTE 9 – CAPITAL STOCK

Preferred Stock

The Company has authorized 100,000,000 shares of \$.01 par value Class A preferred stock but has none outstanding at December 31, 2013, 2012, or 2011.

Common Stock

The Company has authorized 300,000,000 shares of \$.01 par value Common Stock, and it trades on the OTCPink® under the symbol "PSWW." Holders of our Common Stock are entitled to one vote per share and receive dividends or other distributions when, and if, declared by our Board of Directors. In addition to shares outstanding, we have reserved 2,864,359 shares for issuance upon exercise of equity incentive awards with options to purchase 1,611,333 shares of Common Stock granted to date.

Throughout 2013, we issued a total of 970,000 shares at a price of \$1.00 per share to investors. In addition, in May 2013, the Company issued 145,990 shares of Common Stock for conversion of convertible debt of \$138,000 plus accrued interest of \$7,990 including induced conversion expense of \$102,193. In June 2013, the Company issued 2,909,091 shares of Common Stock and 2,181,818 warrants for \$1,600,000 as part of financing the acquisition of Powerhouse One, LLC (see "Steuben Investment" herein). In June 2013, the Company issued 46,010 shares of Common Stock at \$1.00 for the right to purchase the remaining noncontrolling interest of Powerhouse One, LLC for \$766,827 by June 2014.

Steuben Investment

Effective June 14, 2013, the Company entered into a Subscription Agreement with Steuben Investment Company II, L.P. ("Steuben"). Pursuant to the subscription agreement, Steuben purchased 2,909,091 shares of the Company's common stock for an aggregate of \$1,600,000.05 or \$0.55 per share. As additional

consideration in connection with the subscription, the Company granted Steuben warrants to purchase 2,181,818 shares of the Company's common stock with an exercise price of \$1.00 per share and a term of 10 years. The Company also provided Steuben registration rights pursuant to a Registration Rights Agreement entered into with Steuben in connection with the shares sold and shares of common stock issuable upon exercise of the warrants (collectively, the "Registrable Securities"). Pursuant to the registration rights agreement, the Company was required to file a registration statement to register the Registrable Securities within 90 days after the date of the subscription and to obtain effectiveness of the registration statement within 180 days after the date of the subscription (which deadlines were not met); provided that the Company is not in default of the registration rights agreement unless it fails to file the registration statement within 120 days of the subscription (which date was October 12, 2013) or fails to obtain effectiveness of the registration statement within 210 days of the subscription (which date was January 10, 2014). The Company was required to pay Steuben \$16,000 per month for the first three months that a registration default occurs (including any period that a previously declared effective registration statement is no longer effective) and \$24,000 per month for each month thereafter.

Effective March 27, 2014, the Company and Steuben entered into a letter agreement, pursuant to which Steuben agreed that the Company is required to initially only register 1,300,935 of the shares held by Steuben and that all penalties due pursuant to the Registration Rights Agreement (\$32,000 as of such effective date) immediately ceased accruing notwithstanding further delays in the registration of the Registrable Securities. The letter agreement also provided that the payment of the \$32,000 in penalties would be automatically forgiven by Steuben upon the earlier to occur of (i) the registration of all of the Registrable Securities for resale with the Commission and (ii) the Company's (x) timely filing of all information required to "make and keep public information available" pursuant to Rule 144; (y) timely filing with the Commission of all reports and other documents required of the Company under the Securities Act and the Exchange Act (at all times during which the Company is subject to such reporting requirements, if ever); and (z) furnishing to Steuben upon request a written statement by the Company that it has complied with the reporting requirements of Rule 144 and providing Steuben such other documents and assistance as Steuben may reasonably request (as described in greater detail in the letter agreement), for a period of two years after the effective date of the Company's Form S-1 Registration Statement. However, in the event the Company breaches any term of the letter agreement, the \$32,000 in previously accrued penalties is immediately due and payable by the Company.

In the event we are unable to register all of Steuben's Registrable Securities, or fail to make timely filing to enable Steuben to sell shares pursuant to Rule 144, we may have to pay substantial penalties to Steuben, which could have a material adverse effect on our available cash, our ability to raise capital and ultimately our results of operations.

Stock Options

In November 2011, the Company issued options for 1,300,000 shares of common stock to an advisor that vested over one year and had an exercise price of \$1.41 per share. The options will expire in November 2016 if not exercised earlier. Only 216,666 of such options vested in 2011 and an additional 866,667 vested during 2012. The remaining 216,667 options were cancelled in 2012. The options were valued using the Black-Scholes model resulting in equity-based compensation expense for 2012 of \$773,856 included in "General and administrative expenses."

In 2013, the Company issued to advisors options to acquire 96,000 shares of its Common Stock. The options have exercise prices ranging from \$1.41 to \$1.70, a contractual life of 10 years, and vest over one year. The options were valued using the Black-Scholes model and the resulting equity-based compensation expense included in general and administrative expenses for 2013 was \$108,731, based upon the following parameters:

Estimated fair value	\$1.06 - \$1.31
Expected life (years)	10 Years
Risk free interest rate	1.72 - 2.17%
Volatility	73.26%

In 2013, the Company issued to its independent Directors options to acquire an aggregate of 432,000 shares of its Common Stock. The options have an exercise price of \$1.00 per share and vest over 24 months. The options were valued using the Black-Scholes model and the resulting equity-based compensation expense for 2013 was \$191,249 based upon the following parameters:

Estimated fair value	\$0.54 - \$0.99
Expected life (years)	5.26 - 5.50 Years
Risk free interest rate	0.80 - 1.69%
Volatility	211.91%

As the Company does not have a significant history of post vesting exercises to estimate an expected life of the option, the simplified method was used wherein the expected life becomes the mid-point of the options weighted average life and their contractual life.

A summary of option activity for 2013 and 2012 is as follows:

	Shares	Weighted Avg. Exercise Price	Weighted Avg. Grant Date Value
Outstanding, January 1, 2012	1,300,000	\$1.41	\$.88
Granted	-	-	-
Exercised	-	-	-
Forfeited	216,666	-	-
Expired	-	-	-
Outstanding, December 31, 2012	1,083,333	1.41	0.88
Granted	528,000	1.09	0.77
Exercised	-	-	-
Forfeited	-	-	-
Expired	-	-	-
Outstanding, December 31, 2013	1,611,333	\$1.30	\$0.85

The following is a summary of stock options outstanding at December 31, 2013:

Exercise Price	Options Outstanding	Average Remaining Contractual Lives (Years)	Options Exercisable	Non-Vested Options
\$1.41	1,083,333	7.8	1,083,333	-
\$1.00	288,000	8.0	288,000	-
\$1.41	36,000	8.1	36,000	-
\$1.41	36,000	8.2	36,000	-
\$1.70	24,000	8.7	24,000	-
\$1.00	72,000	9.4	24,000	48,000
\$1.00	72,000	9.7	12,000	60,000
	<u>1,611,333</u>		<u>1,503,333</u>	<u>108,000</u>

At December 31, 2013, a total of \$106,920 of compensation expense related to options not yet vested remains unrecognized. Such amount is expected to be fully recognized in 2014.

The weighted average exercise price of those options currently outstanding is \$1.30 and those currently exercisable is \$1.32. Based upon the Company's stock price at December 31, 2013, of \$1.50 as quoted on OTCPink® market, the options then outstanding had an intrinsic value of \$319,980 and those exercisable had an intrinsic value of \$265,980.

Warrants

At December 31, 2013, the Company has warrants to purchase 2,350,368 shares of Common Stock outstanding having an exercise price of \$1.00 per share. See notes herein entitled "Acquisition Notes Payable" and "Derivative Liability on Warrants" for detailed descriptions of their issuances. The Company had warrants to purchase 17,500 shares of Common Stock outstanding at December 31, 2012.

NOTE 10 - NONCONTROLLING INTEREST

The original owners of Powerhouse One continue to own approximately 11% of the membership interest of the limited liability company. The noncontrolling interests of equity investors in Powerhouse One is reported on the consolidated balance sheet and statement of operations as "Noncontrolling interest in subsidiary" ("noncontrolling interest") and reflects their respective interests in the equity and the income or loss of the limited liability company.

The following table sets forth the activity in the noncontrolling interest equity account during 2013:

Balance December 31, 2012	\$ -
Noncontrolling interest at acquisition	766,827
Earnings allocated to noncontrolling interest	19,976
Balance December 31, 2013	<u>\$786,803</u>

NOTE 11 – RELATED PARTY TRANSACTIONS

Other than the converted notes payable as described in a note herein entitled "Convertible Notes Payable" and the Board member options described herein in a note entitled "Stock Options", no other related party transactions occurred during 2013 and 2012.

NOTE 12 - TAXES

Our \$6,160,697 federal income tax net operating loss carryover expires over the period from 2030 through 2033. Our federal and state income tax returns are no longer subject to examination for years before 2010. We have taken no tax positions that, more likely than not, may not be realized.

Significant components of our income tax provisions were:

	2013	2012
Current provision		
Federal	\$ -	\$ -
State	1,227	1,901
Total current tax provision	1,227	1,901
Deferred provision		
Federal	-	-
State	-	-
Total deferred tax provision	-	-
Total income tax provision	\$ 1,227	\$ 1,901

The provision for income tax differs from the amount estimated by applying the statutory federal income tax rate to the net loss before taxes as follows at December 31:

Taxes at statutory rate (34%)	\$ (798,946)	\$ (948,917)
State taxes	(231,920)	1,901
Change in valuation allowance	1,059,316	948,419
Permanent differences	(15,713)	498
Change in state tax rate	(69,976)	-
Other (prior year adjustments)	58,466	-
Total income tax provision	\$ 1,227	\$ 1,901

Deferred tax assets (liabilities) are comprised of the following at December 31:

Bad debt allowance	\$	-	\$	-
Accrued compensation		214,782		-
Other accrued expenses		55,688		37,594
Gross current deferred tax assets		<u>270,470</u>		<u>37,594</u>
Fixed assets		(499,066)		(83,089)
Intangible assets		50,627		61,136
Stock compensation expense		481,509		324,860
Net operating losses		<u>2,362,884</u>		<u>1,266,608</u>
Gross non-current deferred tax assets, net		<u>2,395,954</u>		<u>1,569,515</u>
Total deferred tax assets		2,666,424		1,607,109
Valuation allowance for deferred tax assets		<u>(2,666,424)</u>		<u>(1,607,109)</u>
Deferred tax assets, net of valuation allowance	\$	-	\$	-

The Company had established a valuation allowance to fully reserve the net deferred tax assets at December 31, 2013 and 2012, due to the uncertainty of the timing and amounts of future taxable income.