

DNA BRANDS, INC.

OTC PINK BASIC DISCLOSURE

UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013

DNA BRANDS, INC.

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DNA BRANDS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2014	December 31, 2013
	(unaudited)	
ASSETS		
Current assets		
Cash	\$ 11,651	\$ 61,336
Accounts receivable, net	26,605	8,750
Inventory, net	229,409	304,264
Prepaid expenses and other current assets	51,357	137,441
Total current assets	319,022	511,791
Property and equipment, net	7,721	11,800
Total assets	\$ 326,743	\$ 523,591
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Accounts payable	\$ 416,073	\$ 405,854
Accrued liabilities	1,426,529	1,217,285
Current portion of convertible subordinated debentures, net of discounts	508,113	445,289
Loans payable, net of discounts	530,000	438,375
Conversion options, derivative liabilities	549,930	336,884
Loans payable to officers	2,878	3,777
Total current liabilities	3,433,523	2,847,464
Long-term portion of convertible, subordinated debentures, net of discounts	202,736	173,875
Loans payable to related party	42,150	67,150
Total liabilities	3,678,409	3,088,489
Commitments and contingencies		
Stockholders' deficit		
Preferred stock, \$0.001 par value, 10,000,000 authorized, 2,100,000 issued and outstanding	2,100	2,100
Common stock, \$0.001 par value, 400,000,000 authorized, 362,239,354 and 177,594,187 shares issued and outstanding	362,239	177,594
Additional paid-in capital	26,727,061	26,232,375
Accumulated deficit	(30,443,066)	(28,976,967)
Total stockholders' deficit	(3,351,666)	(2,564,899)
Total liabilities and stockholders' deficit	\$ 326,743	\$ 523,591

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

DNA BRANDS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2014 AND 2013

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
Sales	\$ 60,621	\$ 4,869	\$ 108,694	\$ 42,816
Cost of goods sold	43,748	8,900	80,805	48,027
Gross margin	16,873	(4,031)	27,889	(5,211)
Operating expenses				
Compensation and benefits	217,878	159,947	483,517	401,681
Depreciation expense	2,051	2,195	4,079	4,392
General and administrative expenses	78,404	97,760	170,352	219,848
Professional and outside services	265,053	151,286	494,958	344,385
Selling and marketing expenses	34,458	5,242	69,568	33,003
Total operating expenses	597,844	416,430	1,222,474	1,003,309
Loss from operations	(580,971)	(420,461)	(1,194,585)	(1,008,520)
Other income (expense)				
Gain(loss) on embedded conversion option				
liabilities	180,104	91,778	297,812	198,703
Interest expense	(271,502)	(293,724)	(569,326)	(260,474)
Total other income (expense)	(91,398)	(201,946)	(274,514)	(260,474)
Loss before income taxes	(672,369)	(622,407)	(1,466,099)	(1,268,994)
Income taxes	-	-	-	-
Net loss	\$ (672,369)	\$ (622,407)	\$ (1,466,099)	\$ (1,268,994)
Loss per share:				
Basic and diluted	\$ (0.00)	\$ (0.01)	\$ (0.01)	\$ (0.02)
Weighted average number of common shares outstanding:				
Basic and diluted	305,406,479	67,827,816	244,041,639	66,338,395

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

DNA BRANDS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE SIX MONTH PERIODS ENDED JUNE 31, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Net loss	\$(1,466,099)	\$(1,268,994)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	4,079	4,392
Gain on conversion options, derivative liabilities	(294,210)	(198,703)
Non-cash interest expense related to discount on convertible subordinated debentures	349,911	359,402
Non-cash interest expense related to loans payable	164,664	—
Allowance for doubtful accounts-includes allowance on employee receivables	2,836	(3,456)
Provision for excess and obsolete inventory	—	8,099
Common stock and common stock warrants issued in exchange for services	90,000	140,333
Common stock issued as employee compensation	—	40,000
Share based compensation expense related to employee stock option grants	8,987	8,990
Changes in operating assets and liabilities:		
Accounts receivable	(20,692)	20,678
Inventory	74,854	30,601
Prepaid expenses and other current assets	86,084	(216,147)
Other assets	—	(9,800)
Bank overdraft	—	(11,042)
Accounts payable	10,218	(8,577)
Accrued expenses	212,017	6,889
Net cash used in operating activities	(777,333)	(1,097,344)
Cash flows from financing activities:		
Net proceeds from (repayments on) loans payable to officers	(20)	587,719
Net repayments on loans payable	(1,837)	—
Net proceeds from (repayments on) loans payable related party	(25,000)	3,000
Net proceeds from the issuance of convertible debentures	561,000	265,000
Net proceeds from the issuance of common stock	193,500	188,000
Net cash provided by financing activities	727,643	1,108,719
Net change in cash and cash equivalents	(49,690)	11,375
Cash and cash equivalents at beginning of period	61,336	—
Cash and cash equivalents at end of period	\$ 11,646	\$ 11,375
Supplemental disclosures:		
Interest paid	\$ 3,710	\$ 14,107
Supplemental disclosures of non-cash investing and financing activities:		
Common stock issued in connection with conversion of convertible debentures and accrued interest	\$ 154,457	\$ —
Discounts on convertible debentures	\$ 407,973	\$ —
Conversion of convertible debentures into common stock	\$ —	\$ 108,000
Conversion of loans payable to officers into Series C preferred stock	\$ —	\$ 200,000

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

DNA Brands, Inc.

Notes to Condensed Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

DNA Brands, Inc. (hereinafter referred to as “us,” “our,” “we,” the “Company” or “DNA”) was incorporated in the State of Colorado on May 23, 2007 under the name Famous Products, Inc. Prior to July 6, 2010 we were a holding company operating as a promotion and advertising company. We currently produce, market and sell a proprietary line of five carbonated blends of DNA Energy Drink®, Citrus, Sugar Free Citrus, Original (a unique combination of Red Bull® and Monster® energy drinks), Cryo-Berry (a refreshing mix of cranberry and raspberry) and Molecular Melon (a cool and refreshing taste); as well as three milk based energy coffees fortified with Omega 3. These flavors are Mocha, Vanilla Latte, and Carmel Macchiato.

Our current business commenced in May 2006 in the State of Florida under the name Grass Roots Beverage Company, Inc. (“Grass Roots”). Initial operations of Grass Roots included development of our energy drinks, sampling and other marketing efforts and initial distribution in the State of Florida. In May 2006 we formed DNA Beverage Corporation, a Florida corporation (“DNA Beverage”). Our early years were devoted to brand development, creating awareness through heavy sampling programs and creating credibility among our then core demographic by concentrating marketing efforts on action sports locations and events (surf, motocross, skate, etc.).

Effective July 6, 2010, we executed agreements to acquire all of the assets, liabilities and contract rights of DNA Beverage and 100% of the common stock of DNA Beverage’s wholly owned subsidiary Grass Roots Beverage Company, Inc. (“Grass Roots”) in exchange for the issuance of 31,250,000 shares of our common stock. The share issuance represented approximately 94.6% of our outstanding shares at the time of issuance. As a result of this transaction we also changed our name to “DNA Brands, Inc.” Grass Roots was dissolved and ceased activity on December 31, 2013.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles applicable to interim financial information and the requirements of Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. Interim results are not necessarily indicative of results for a full year. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial position and the results of operations and cash flows for the interim periods have been included.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary Grass Roots Beverage Company, Inc. (“Grass Roots”), which is considered a variable interest entity (“VIE”) since the Company is the primary beneficiary of Grass Roots Beverage Company, Inc. (“Grass Roots”) operations and exerts significant control. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

See Note 1 in the Company’s audited 2013 consolidated financial statements in Form 10-K for a summary of the Company’s significant accounting policies.

2. Recently Issued Accounting Pronouncements

Accounting standards that have been issued or proposed by the Financial Accounting Standards Board ("FASB") or other standard-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

3. Going Concern

The accompanying financial statements have been prepared on a going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business as they become due.

During the six month period ended June 30, 2014, the Company recorded a net loss of \$1,466,099 and had negative cash flows of \$49,690. At June 30, 2014, the Company had a working capital deficit of \$3,114,501 and a stockholders' deficit of \$3,351,666. The Company has relied, in large part, upon debt and equity financing to fund its operations. These matters collectively raise a substantial doubt about the Company's ability to continue as a going concern.

The ability of the Company to continue as a going concern is dependent on management's plans, which includes implementation of its business plan and continuing to raise funds through debt or equity raises. The Company will likely continue to rely upon related-party debt or equity financing in order to ensure the continuing existence of the business. Additionally the Company is working on generating new sales from additional retail outlets, distribution centers or through sponsorship agreements; and allocating sufficient resources to continue with advertising and marketing efforts.

The 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 if the Company is unable to operate as a going concern.

4. Inventory, Net

The following table sets forth the composition of the Company's inventory at June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
	(unaudited)	
Raw materials	\$ 11,127	\$ 16,652
Finished goods-beverages	218,282	287,612
Total inventory, net	<u>\$ 229,409</u>	<u>\$ 304,264</u>

5. Accounts Receivable, Net

The following table sets forth the composition of the Company's accounts receivable at June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
	(unaudited)	
Accounts receivable	\$ 44,269	\$ 26,414
Allowance for doubtful accounts	(17,664)	(17,664)
Accounts receivable, net	<u>\$ 26,605</u>	<u>\$ 8,750</u>

Bad debt expense (recovery) which is included in selling and marketing expenses related to the Company's trade accounts receivable for six month periods ended June 30, 2014 and 2013 was \$2,836 and \$(3,465) respectively.

6. Prepaid Expenses and Other Assets

The following table sets forth the composition of the Company's prepaid expenses and other assets at June 30, 2014 and December 31, 2013:

	June 30, 2014 (unaudited)	December 31, 2013
Short-term security deposit	\$ 6,000	\$ 6,000
Prepaid services	35,794	131,441
Prepaid expenses and other current assets	<u>\$ 41,794</u>	<u>\$ 137,441</u>

7. Property and Equipment, Net

	June 30, 2014 (unaudited)	December 31, 2013
Equipment	\$ 18,690	\$ 18,690
Furniture and fixtures	9,156	9,156
Vehicles	75,907	75,907
Accumulated depreciation	(96,032)	(91,953)
Total property and equipment, net	<u>\$ 7,721</u>	<u>\$ 11,800</u>

Depreciation expense for the six month periods ended June 30, 2014 and 2013 was \$4,079 and \$4,392, respectively.

8. Accrued Liabilities

The following table sets forth the composition of the Company's accrued expenses at June 30, 2014 and December 31, 2013:

	June 30, 2014 (unaudited)	December 31, 2013
Salaries and bonuses	\$ 685,539	\$ 505,884
Interest expense on convertible debentures	246,754	202,648
Professional services	45,035	51,035
Payroll taxes and penalties	449,194	449,332
Other	7	8,386
Total accrued expenses	<u>\$ 1,426,529</u>	<u>\$ 1,217,285</u>

In October 2013, Messrs. Marks and Leiner agreed to forgive \$944,000 in accrued salaries which represented the value of substantially all of their compensation from 2010 through July 1, 2013. As a result of this forgiveness we reduced our debt and increased our equity by \$944,000. As of June 30, 2014 and December 31, 2013 the Company's officers were due \$174,750 and \$91,000 as a result of their deferrals and forgiveness; and its employees were owed \$518,731 and \$414,885, respectively.

As of June 30, 2014 and December 31, 2013, accrued payroll taxes and penalties representing the unpaid portion of employer and employee payroll taxes totaled \$280,906 and \$314,122, respectively. The Company has estimated potential penalties associated with these unpaid amounts to be \$231,288 and \$135,210 as of June 30, 2014 and December 31, 2013, respectively. The Company has engaged the services of a professional experienced in payroll

tax matters to work with the Company and the Internal Revenue Service ("IRS") to achieve a re-payment plan acceptable to the IRS. During six months ended June 30, 2014 and the year ended December 31, 2013 the Company made payments of \$0 and \$248,394, respectively against this liability.

9. Loans Payable, Net of Discounts

The composition of loans payable at June 30, 2014 and December 31, 2013 was as follows:

	June 30, 2014 (unaudited)	December 31, 2013
Loans Payable	\$ 530,000	\$ 530,000
Discounts	—	(91,625)
Loans payable, net of discounts	<u>\$ 530,000</u>	<u>\$ 438,375</u>

In June 2013, the Company entered into a loan agreement with Beverage Production and Inventory, LLC ("Beverage") and received a loan of \$265,000. In accordance with ACS 810-10-55, the Company considered its relationship with, and the terms of its interest in, Beverage and determined that it was a VIE that should be consolidated into its financial statements. The Company's involvement with Beverage is that it serves as an entity to obtain inventory financing for DNA.

As of June 30, 2014 and December 31, 2013 the amounts included in the consolidated liabilities, which are reported in loans payable (before discount) totaled \$530,000, relating to Beverage. The loans payable bear interest at a rate of 6% per annum and were scheduled to be repaid to the lenders in equal installments of 66.67% of the original principal on September 30, 2013, December 31, 2013 and March 31, 2014. The aggregate value of the repayment installments totals \$530,000. September, December and March installment payments were not made.

10. Convertible Debentures, Net of Discounts

A summary of all convertible notes outstanding at June 30, 2014:

Date	Interest Rate	Face Value	Original Due Date	
2/18/2011	12 %	\$ 100,000	2/18/2014	
7/18/2011	12 %	25,000	7/14/2014	(1)
7/28/2011	3.75 %	93,729	7/31/2015	(1)
2/1/2012	12 %	75,000	1/31/2013	
7/2/2012	12 %	60,000	7/1/2013	(2)
4/25/2012	12 %	30,000	4/25/2013	
11/7/2013	8 %	53,000	8/8/2014	(3)
10/31/2013	18 %	204,000	1/1/2016	(4)
1/21/2014	6 %	40,550	1/21/2015	(5)
1/21/2014	12 %	59,250	1/21/2015	(6)
2/11/2014	12 %	50,000	2/11/2015	(7)

2/12/2014	—	50,000	7/31/2015	(6)
3/14/2014	5 %	85,000	3/14/2015	(8)
3/14/2014	—	200,000	12/31/2014	(8)
4/22/2014	10 %	77,500	4/22/2015	(9)
5/2/2014	8 %	38,500	5/2/2015	(10)
6/22/2014	—	32,000	6/22/2015	(8)
6/24/2014	—	75,000	6/24/2015	(8)
Total		<u>\$ 1,348,529</u>		

- (1) The Company has determined the conversion ratio as of June 30, 2014. These debentures were convertible at a conversion price equal to 80% of the average share price of the Company's common stock for the ten (10) previous trading days prior to conversion. As a result, the conversion ratio may fluctuate from period to period. Modified to \$0.02 on October 15, 2013.
- (2) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to the lesser of 75% of the average share price of the Company's common stock for the five (5) previous trading days prior to conversion or a base conversion price equivalent to the lowest issued price per share. As a result, the conversion ratio may fluctuate from period to period.
- (3) These debentures are convertible at a conversion price equal to 58% of the average of the 3 lowest share closing bid prices of the Company's common stock on the 10 previous trading days prior to the day of conversion. As a result, the conversion ratio may fluctuate from period to period.
- (4) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to 50% of the lowest closing bid price of the Company's common stock on the 20 previous trading days prior to the day of conversion. As a result, the conversion ratio may fluctuate from period to period.
- (5) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to 70% of the lowest closing bid prices of the Company's common stock on the four previous trading days prior to and day of conversion, but not less than \$0.0001. As a result, the conversion ratio may fluctuate from period to period.
- (6) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to 50% of the lowest intra-day price of the Company's common stock on the 10 previous trading days prior to the day of conversion. As a result, the conversion ratio may fluctuate from period to period.
- (7) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to 50% of the lowest share closing bid prices of the Company's common stock on the 25 previous trading days prior to the day of conversion. As a result, the conversion ratio may fluctuate from period to period.
- (8) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to 50% of the lowest share closing bid prices of the Company's common stock on the 20 previous trading days prior to the day of conversion. As a result, the conversion ratio may fluctuate from period to period.
- (9) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to 42% of the lowest share closing bid prices of the Company's common stock on the 18 previous trading days prior to the day of conversion. As a result, the conversion ratio may fluctuate from period to period.
- (10) The Company has determined the conversion ratio as of June 30, 2014. These debentures are convertible at a conversion price equal to 40% of the lowest share closing bid prices of the Company's common stock on the 20 previous trading days prior to the day of conversion. As a result, the conversion ratio may fluctuate from period to period.

On January 21, 2014, the Company issued a convertible debenture in the amount of \$50,000. The debenture bears interest at 6% per annum, which is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 70% of the lowest share

closing bid price of the Company's common stock on the four previous trading days prior to and day of conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$23,987, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On January 21, 2014, the Company issued a convertible debenture in the amount of \$75,000. The debenture bears interest at 12% per annum, which is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 50% lowest intra-day trading price of the Company's common stock on the ten previous trading days prior to the day of conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$75,000, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On February 11, 2014, the Company issued a convertible debenture in the amount of \$50,000. The debenture bears interest at 12% per annum, which is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to the lesser of \$0.02 or 60% of the lowest bid price of the Company's common stock on the twenty-five previous trading days prior to conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$50,000, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On February 12, 2014, the Company issued a convertible debenture in the amount of \$50,000. The debenture bears no interest and is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 50% of the average share closing bid price of the Company's common stock on the thirty previous trading days prior to the day of conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$50,000, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On March 14, 2014, the Company issued a convertible debenture in the amount of \$110,000. The debenture bears interest at 5% per annum, which is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 50% of the lowest trading price of the Company's common stock on the twenty previous trading days prior to conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$110,000, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On March 14, 2014, the Company issued a convertible debenture in the amount of \$200,000. The debenture bears no interest and is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 50% of the lowest trading price of the Company's common stock on the twenty previous trading days prior to conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$200,000, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On April 22, 2014, the Company issued a convertible debenture in the amount of \$77,500. The debenture bears interest at 10% per annum, which is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 50% of the lowest trading price of the Company's common stock on the twenty previous trading days prior to conversion. The

Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$77,500, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On May 2, 2014, the Company issued a convertible debenture in the amount of \$38,500. The debenture bears interest at 8% per annum, which is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 42% of the lowest trading price of the Company's common stock on the eighteen previous trading days prior to conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$38,500, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On June 22, 2014, the Company issued a convertible debenture in the amount of \$32,000. The debenture bears no interest and is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 50% of the lowest trading price of the Company's common stock on the twenty previous trading days prior to conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$32,000, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

On June 24, 2014, the Company issued a convertible debenture in the amount of \$75,000. The debenture bears no interest and is payable in the Company's common stock at the time of conversion or maturity. The debenture is convertible at any time prior to maturity at a conversion price equal to 50% of the lowest trading price of the Company's common stock on the twenty previous trading days prior to conversion. The Company determined that the terms of the debenture created a beneficial conversion feature. Using the Monte Carlo option model, the beneficial conversion feature was valued at \$75,000, the ceiling of its intrinsic value, and recorded as a discount to the principal amount of the debenture. The discount is amortized using the effective interest method over the term of the debenture and recorded as interest expense in the Company's financial statements.

The following table set forth the composition of the Company's convertible notes at June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
Convertible notes-face value	\$ 1,631,478	\$ 942,829
Loan discount	(920,629)	(617,729)
Amortization of loan discount	710,849	294,064
Current portion	(508,113)	(445,289)
Net convertible notes	<u>\$ 202,736</u>	<u>\$ 173,875</u>

The calculated value of the conversion feature that resulted in the discount in the table above was estimated using the Monte Carlo option pricing model with the following weighted average assumptions for the periods ended June 30, 2014 and December 31, 2013.

	June 30, 2014	December 31, 2013
Expected dividend yield (1)	—	—
Risk-free interest rate (2)	0.10 – 0.12%	0.10 – 0.32%
Expected volatility (3)	227.6 – 268.10%	202.3 – 253.50%
Expected life (in years) (4)	0.50 – 1.26	0.60 – 4.00

- (1) The Company has no history or expectation of paying cash dividends on its common stock.
- (2) The risk-free interest rate is based on the U.S. Treasury yield for a term consistent with the expected life of the awards in effect at the time of grant.
- (3) The volatility is based upon the average volatility rate of the Company's common stock trading price.
- (4) The expected life represents the due date of the note.

11. Embedded Conversion on Option Liabilities

Due to the conversion terms of certain promissory notes, the embedded conversion options met the criteria to be bifurcated and presented as derivative liabilities. The Company calculated the estimated fair values of the liabilities for embedded conversion option derivative instruments at the original note inception date and as of June 30, 2014 using the Monte Carlo option pricing model using the share prices of the Company's stock on the dates of valuation and using the following ranges for volatility, expected term and the risk free interest rate at each respective valuation date, no dividend has been assumed for any of the periods:

	June 30, 2014	December 31, 2013
Expected dividend yield (1)	—	—
Risk - free interest rate (2)	0.11 – 0.34%	0.10 – 0.38%
Embedded volatility (3)	156.2 – 226.40%	223.0– 316.50%
Expected life (in years) (4)	0.06 – 1.46%	0.15 – 2.17%

- (1) The Company has no history or expectation of paying cash dividends on its common stock.
- (2) The risk-free interest rate is based on the U.S. Treasury yield for a term consistent with the expected life of the awards in effect at the time of grant.
- (3) The volatility for the period ended June 30, 2014 is based upon the historical volatility of the Company's stock price, a period equal to the expected life of the note or twenty one months following the reverse capitalization transaction.
- (4) The expected life represents the due date of the note.

The following reflects the initial fair value on the note inception date and changes in fair value through June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
Note inception date fair value allocated to debt discount	\$ 1,307,661	\$ 878,916
Cumulative change in fair value – (gain)	(765,267)	(554,216)
Embedded note conversion option derivative liability fair value	<u>\$ 542,394</u>	<u>\$ 324,700</u>

12. Fair Value

FASB Accounting Standards Codification ("ASC") 820, *Fair Value Measurements and Disclosures* ("ASC 820") establishes a framework for all fair value measurements and expands disclosures related to fair value measurement and developments. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 requires that assets and liabilities measured at fair value are classified and disclosed in one of the following three categories:

Level 1—Quoted market prices for identical assets or liabilities in active markets or observable inputs;

Level 2—Significant other observable inputs that can be corroborated by observable market data; and

Level 3—Significant unobservable inputs that cannot be corroborated by observable market data.

The carrying amounts of cash, accounts receivable, accrued salaries payable, accounts payable and other liabilities, accrued interest payable, due to related parties and notes payable - related party approximate fair value because of

the short-term nature of these items. The assets or liability's fair value measurement within the fair value hierarchy is based upon the lowest level of any input that is significant to the fair value measurement. The following table provides a summary of the assets that are measured at fair value on a recurring basis.

	Consolidated Balance Sheet	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Quoted Prices for Similar Assets or Liabilities in Active Markets (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Liabilities:				
June 30, 2014	\$ 549,930	\$ -	\$ -	\$ 549,930
December 31, 2013	\$ 336,884	\$ -	\$ -	\$ 336,884

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The following table sets forth a summary of the changes in the fair value of the Company's Level 3 financial liabilities that are measured at fair value on a recurring basis:

	June 30, 2014
Beginning balance	\$ 336,884
Aggregate fair value of conversion features upon issuance	507,263
Gain on change in fair value of conversion features	(294,217)
Ending balance	<u>\$ 549,930</u>

13. Loans Payable to Officers

The following table summarizes the Company's loans payable to officers as of June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
Loans payable to officers	<u>\$ 2,878</u>	<u>\$ 3,777</u>

Since the Company's inception, its principal executive officers have loaned the Company significant amounts of operating capital on an interest free basis and without formal repayment terms.

14. Loans Payable to Related Party

Our directors are also executive officers of a company called Illuminations America LLC ("Illuminations") involved with LED lighting. As of December 31, 2013, Illuminations loaned DNA \$67,150. During the six months ended June 30, 2014, the Company repaid \$25,000 of the amount outstanding by to Illuminations. The following table summarizes the Company's loans payable to a related party as of June 30, 2014 and December 31, 2013.

	June 30, 2014	December 31, 2013
Loans payable to related party	<u>\$ 42,150</u>	<u>\$ 67,150</u>

The loans from Illuminations are on an interest free basis and without formal repayment terms.

15. Equity

Preferred and Common Stock

At March 31, 2014 the Company was authorized to issue 10,000,000 shares of \$0.001 Preferred Stock and 400,000,000 shares of \$0.001 par value Common Stock. The holders of common stock are entitled to receive dividends whenever funds are legally available and when declared by the Board of Directors. Each share of common stock is entitled to one vote.

On May 3, 2013 the Company authorized the issuance of 300,000 shares of Series C Preferred Stock ("Series C") and issued 150,000 shares of Series C to Darren Marks, an officer and director of the Company, in settlement of \$100,000 owed by the Company to Mr. Marks; and issued 150,000 shares of its Series C to Mel Leiner, an officer and director of the Company, in settlement of \$100,000 owed by the Company to Mr. Leiner. Each Series C share entitles the holder to 300 votes on all matters submitted to a vote of the Company's shareholders.

On October 21, 2013 the Company authorized the issuance of 1,800,000 shares of Series D Preferred Stock ("Series D") and issued 900,000 shares of Series D to Darren Marks in settlement of \$900,000 owed by the Company to Mr. Marks; and issued 900,000 shares of its Series D to Mel Leiner in settlement of \$900,000 owed by the Company to Mr. Leiner. Each share of Series D Convertible Preferred Stock is convertible into 68.2721 shares of our Common Stock. If all of these shares are converted it would result in the issuance of 122,448,780 shares.

On December 27, 2013 Messrs. Marks and Leiner returned their Series D shares and these shares were cancelled. Additionally on December 27, 2013 the Company authorized the issuance of 1,800,000 shares of Series E Preferred Stock ("Series E") and issued 900,000 shares of Series E to Darren Marks in settlement of \$50,000 owed by the Company to Mr. Marks; and issued 900,000 shares of its Series E to Mel Leiner in settlement of \$50,000 owed by the Company to Mr. Leiner. Each share of Series E stock has voting rights equal to 68.02721 common shares. The Series E is not convertible into any of our common shares.

The number of shares of common stock issued and their respective values for the six months period ended June 30, 2014 is as follows:

	Shares Issued	Value of Issuances
Conversion of convertible debentures into common stock	11,401,737	\$ 104,137
Common stock issued in connection with private offerings	24,187,500	193,500
Total	<u>35,589,237</u>	<u>\$ 297,637</u>

At June 30, 2014 and December 31, 2013, preferred stock issued and outstanding was 2,100,000 shares for both periods. At June 30, 2014 and December 31, 2013, common stock issued and outstanding totaled 362,239,354 and 177,594,187 shares, respectively.

Historically, the Company has issued and sold preferred stock, common stock and common stock warrants in order to fund a significant portion its operations. Additionally, the Company has issued shares of its common stock to compensate its employees, pay service providers and retire debt.

Stock Options

In April 2011, the Company adopted an Incentive Stock Option Plan and a Non-Qualified Stock Options Plan. Under these plans, the Company may grant up to 500,000 and 1,000,000 stock options, respectively. As of June 30, 2014 and December 31, 2013, the Company had not granted any options pursuant to either the Incentive Stock Option Plan or the Non-Qualified Stock Option Plan.

	Number of Options	Weighted- Average Exercise Price	Average Remaining Contractual Life (Years)
Outstanding and exercisable on December 31, 2013	326,076	\$ 1.11	2.29
Granted	100,000	0.25	4.75
Exercised	—	—	—
Forfeited and expired	—	—	—
Outstanding and exercisable on June 30, 2014	426,076	\$ 0.93	2.43

Intrinsic value is measured using the fair market value price of the Company's common stock less the applicable exercise price. The aggregate intrinsic value of stock options outstanding and exercisable as of June 30, 2014, was \$-0-.

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value based on the closing price of the Company's common stock of \$0.017 at June 30, 2014, which would have been received by the option holders had all option holders exercised their options as of that date.

As of June 30, 2014 and December 31, 2013, there was \$-0- in unrecognized compensation related to stock options outstanding. All outstanding stock options are vested. Since the inception of the Company, no stock options have been exercised.

Stock Warrants

The following table reflects all outstanding and exercisable warrants for the periods ended June 30, 2014 and December 31, 2013. All stock warrants are immediately vested upon issuance and are exercisable for a period five years from the date of issuance.

	Number of Warrants Outstanding	Weighted Average Exercise Price	Remaining Contractual Life (Years)
Balance, December 31, 2013	2,543,686	\$ 1.32	2.30
Warrants issued	—	—	—
Warrants exercised	—	—	—
Warrants expired	(19,294)	\$ 1.32	—
Balance, June 30, 2014	2,524,392	\$ 1.32	2.08(1)

(1) The remaining contractual life of the warrants outstanding as of June 30, 2013 ranges from .06 to 3.51 years.

Warrant Issued in Exchange for Services

On February 1, 2012, the Company issued warrants to purchase 500,000 shares of the Company's common stock to an investor relations professional engaged by the Company. The warrants can be exercised at a price equal to 70% of the average share price of the Company's common stock for the 5 previous trading days prior to conversion. They expire on January 31, 2017. No warrants were issued for services in 2013.

Due to the exercise terms of common stock warrants, the option met the criteria to be bifurcated and presented as derivative liabilities. The Company calculated the estimated fair values of the liabilities for option derivative instrument at the original grant date and as of June 30, 2014 using the Black-Scholes option pricing model using the share prices of the Company's stock on the dates of valuation and using the following ranges for volatility, expected term and the risk free interest rate at each respective valuation date, no dividend has been assumed for any of the periods:

	June 30, 2014
Expected dividend yield (1)	—%
Risk-free interest rate (2)	0.72%
Expected volatility (3)	241.9%
Expected life (in years) (4)	5.00

- (1) The Company has no history or expectation of paying cash dividends on its common stock.
- (2) The risk-free interest rate is based on the U.S. Treasury yield for a term consistent with the expected life of the awards in effect at the time of grant.
- (3) The volatility for the period ended June 30, 2014 is based upon the historical volatility of the Company's stock price, a period equal to the expected life of the note or twenty four months following the reverse capitalization transaction.
- (4) The expected life represents the due date of the note.

The following reflects the initial fair value on the date of grant and changes in fair value through June 30, 2014 for warrant derivative liability:

Grant date fair value allocated to derivative liability	\$ 114,315
Change in fair value – (gain)	(106,779)
Warrant option derivative liability fair value on June 30, 2014	<u>\$ 7,536</u>

Stock Based Compensation

For the periods ended June 30, 2014 and December 31, 2013 the Company recorded \$8,987 and \$8,990, respectively, in stock based compensation.

16. Income Taxes

As of June 30, 2014, the Company has available approximately \$13,300,000 of operating loss carry-forwards before applying the provision of Internal Revenue Code ("IRC") Section 382, which may be used in the future filings of the Company's tax returns to offset future taxable income for United States income tax purposes. Net operating losses will begin to expire in the year 2022. As of June 30, 2014 and December 31, 2013, the Company has determined that due to the uncertainty regarding profitability in the near future, a 100% valuation allowance is needed with regards to the deferred tax assets. Changes in the estimated tax benefit that will be realized from the tax loss carry-forwards and other temporary differences will be recognized in the financial statement in the years in which those changes occur.

For the period ended June 30, 2014 the change in of the valuation allowance was \$243,723.

Under the provisions of the IRC Section 382, an ownership change is deemed to have occurred if the percentage of the stock owned by one or more 5% shareholders has increased, in the aggregate, by more than 50 percentage points over the lowest percentage of stock owned by said shareholders at any time during a three year testing period. Once an ownership change is deemed to have occurred under IRC Section 382, a limitation on the annual utilization of net operating loss carry-forwards is imposed and therefore, a portion of the tax loss carry-forwards would be subject to the limitation under Section 382.

The tax years 2009 through 2013 remain open to examination by federal authorities and state jurisdictions where the Company operates.

17. Subsequent Events

We have evaluated events and transactions that occurred subsequent to June 30, 2014 for potential recognition or disclosure in the accompanying financial statements. Other than the disclosures shown, we did not identify any events or transactions that should be recognized or disclosed in the accompanying financial statements.

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

Forward looking statements are statements not based on historical information and which relate to future operations, strategies, financial results or other developments. Forward looking statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and many of which, with respect to future business decisions, are subject to change. These uncertainties and contingencies can affect actual results and could cause actual results to differ materially from those expressed in any forward looking statements made by, or on our behalf. We disclaim any obligation to update forward looking statements.

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. Our financial statements would be affected to the extent there are material differences between these estimates and actual results. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. The following discussion should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this report.

COMPANY OVERVIEW AND HISTORY

DNA Brands, Inc. (hereinafter referred to as "us," "our," "we," the "Company" or "DNA") was incorporated in the State of Colorado on May 23, 2007 under the name Famous Products, Inc. Prior to July 6, 2010 we were a holding company operating as a promotion and advertising company.

We currently produce, market and sell a proprietary line of five carbonated blends of DNA Energy Drink®, Citrus, Sugar Free Citrus, Original (a unique combination of Red Bull® and Monster® energy drinks), Cryo-Berry (a refreshing mix of cranberry and raspberry) and Molecular Melon (a cool and refreshing taste); as well as three milk based energy coffees fortified with Omega 3. These flavors are Mocha, Vanilla Latte, and Carmel Macchiato.

Our current business commenced in May 2006 in the State of Florida under the name Grass Roots Beverage Company, Inc. ("Grass Roots"). Initial operations of Grass Roots included development of our energy drinks, sampling and other marketing efforts and initial distribution in the State of Florida. In May 2006 we formed DNA Beverage Corporation, a Florida corporation ("DNA Beverage"). Our early years were devoted to brand development, creating awareness through heavy sampling programs and creating credibility among our then core demographic by concentrating marketing efforts on action sports locations and events (surf, motocross, skate, etc.).

Effective July 6, 2010, we executed agreements to acquire all of the assets, liabilities and contract rights of DNA Beverage and 100% of the common stock of DNA Beverage's wholly owned subsidiary Grass Roots Beverage Company, Inc. ("Grass Roots") in exchange for the issuance of 31,250,000 shares of our common stock. The share

issuance represented approximately 94.6% of our outstanding shares at the time of issuance. As a result of this transaction we also changed our name to “DNA Brands, Inc.”

Grass Roots Beverage Company, Inc. (“Grass Roots”) was dissolved and ceased activity on December 31, 2013.

Our principal offices are located at 544 NW 77th Street, Boca Raton, Florida, 33487, telephone (954) 970-3826. Our website is www.dnabrandsusa.com.

Presented below are our results of operations for the three and six month periods ended June 30, 2014 and 2013.

RESULTS OF OPERATIONS

Comparison of Results of Operations for the three and six month periods ended June 30, 2014 and 2013

Revenue

Sales for the three month period ended June 30, 2014 were \$60,621 compared to \$4,869 during the three month period ended June 30, 2013. Sales for the six month period ended June 30, 2014 were \$108,694 compared to \$42,816 during the six month period ended June 30, 2013. This increase in revenue is primarily attributable to our re-branding initiatives compared to a period when we winding down activities of our previous product line.

During the past two years we have experienced a shortage of available capital which has prevented us from making inventory purchases in sufficient quantities of our SKU's. Based upon our conversations with our retail customers we believe that they are interested in purchasing larger quantities of our products and putting it on their shelves but until we can raise additional capital we are not able to meet this demand. Also, the lack of capital has limited our marketing, advertising and promotions which are critical revenue drivers in the energy drink industry. No assurances can be provided that we will successfully raise the funding necessary to support our marketing efforts, or that these efforts will generate increased revenues.

Gross margin

We calculate gross margin by subtracting cost of goods sold from sales. Gross margin percentage is calculated by dividing the gross margin by sales.

Gross margin for the three month period ended June 30, 2014 was \$16,873 compared \$(4,031) for the three month period ended June 30, 2013. Gross margin percentage for the three month period ended June 30, 2013 was 27.83% compared to (82.8%) during the three month period ended June 30, 2013.

Gross margin for the six month period ended June 30, 2014 was \$27,889 compared \$(5,211) for the six month period ended June 30, 2013. Gross margin percentage for the three month period ended June 30, 2014 was 25.66% compared to (12.2%) during the three month period ended June 30, 2013.

Due to higher sale volumes we believe that the gross margin percentage for the three and six month periods ended June 30, 2014 is near historic levels of approximately 25%-30%. We anticipate that margins will remain in this range, although there can be no assurances.

Compensation and benefits

Compensation and benefits for the three month period ended June 30, 2014 was \$217,878 compared to \$159,947 during the three month period ended June 30, 2013.

Compensation and benefits for the six month period ended June 30, 2014 was \$483,517 compared to \$401,681 during the six month period ended June 30, 2013.

The increase in compensation and benefits during the three and six month periods ended June 30, 2014 compared to the corresponding periods in the prior year is primarily attributable to an increase in salaries for our employees.

General and administrative

General and administrative expenses for the three month period ended June 30, 2014 were \$78,404 compared to \$97,760 during the three month period ended June 30, 2013.

General and administrative expenses for the six month period ended June 30, 2014 were \$170,352 compared to \$219,848 during the six month period ended June 30, 2013.

General and administrative expenses are primarily comprised of rent, utilities, insurance, travel and entertainment, and other expenses. The decrease in general and administrative expenses for both the three and six month periods ended June 30, 2014 as compared to the same period in the prior year is due to reduced spending for travel and other administrative activities consistent with our reduced revenue levels and number of employees.

Professional and outside services

Professional and outside services for the three month period ended June 30, 2014 were \$265,053 compared to \$151,286 during the three month period ended June 30, 2013.

Professional and outside services for the six month period ended June 30, 2014 were \$494,958 compared to \$344,385 during the six month period ended June 30, 2013.

Professional and outside services are comprised primarily of accounting fees, legal fees, investor and public relations expenses and other miscellaneous services. The increase in professional and outside services for both the three and six month periods ended June 30, 2014 as compared to the same period in the prior year is attributable to public company expenditures that are required and not proportional to revenue levels.

Selling and marketing expenses

Selling and marketing expenses for the three month period ended June 30, 2014 were \$34,458 compared to \$5,242 during the three month period ended June 30, 2013.

Selling and marketing expenses for the six month period ended June 30, 2014 were \$69,658 compared to \$33,003 during the six month period ended June 30, 2013.

The increase in selling and marketing expenses over the prior year periods is directly attributable to our efforts to increase awareness and the sales of our new products.

Interest expense

Interest expense for the three month period ended June 30, 2014 was \$271,502 compared to \$293,724 for the three month period ended June 30, 2013. Interest expense for the six month period ended June 30, 2014 was \$569,326 compared to \$459,177 for the six month period ended June 30, 2013. The fluctuations in interest expense over the prior year period are primarily attributable to the non-cash amortization of loan discounts related to convertible debentures.

These debentures and loans were issued with beneficial conversion features or other inducements to the lender to provide funding to us. As a result, we have recorded discounts against these loans that are being amortized over their terms. During the three and six month periods ended June 30, 2014 we recorded \$254,007 and \$514,581 in non-cash interest expense relative to the loan discounts on these notes.

Net loss

We incurred a net loss of \$672,369 for the three month period ended June 30, 2014 or \$(0.00) per basic and fully diluted share compared to \$622,407 or \$(0.01) per basic and fully diluted share for the three month period ended June 30, 2012.

We incurred a net loss for the six month period ended June 30, 2014 of \$1,466,099 or \$(0.01) per basic and fully diluted share compared to a net loss of \$1,268,994 or \$(0.02) per basic and fully diluted share.

Since our inception, we have generated material operating losses. A significant portion of our losses are non-cash in nature; however, our losses remain substantial even after excluding those items.

The weighted average number of basic and fully diluted shares outstanding for the three and six month periods ended June 30, 2014 were 305,406,479 and 244,041,639 shares, respectively; compared to 67,827,816 and 66,338,395, respectively for the three and six month periods ended June 30, 2013. There were no dilutive equivalents included in our calculation of fully diluted shares during either period since their inclusion would be anti-dilutive due to our net loss per share.