

VITAMIN BLUE, INC.
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2013 (UNAUDITED) AND 2012

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VITAMIN BLUE, INC.

Balance Sheets

	December 31, 2013	December 31, 2012
ASSETS	(Unaudited)	
CURRENT ASSETS:		
Cash	\$ 4,870	\$ 3,940
Accounts receivable, net	13,534	10,614
Inventory	9,492	10,527
Prepaid expenses, current	5,400	5,400
Total current assets	33,296	30,481
 PROPERTY AND EQUIPMENT, NET	 3,162	 5,075
 OTHER ASSETS – Prepaid expenses, long-term	 1,600	 23,000
 Total assets	 \$ 38,058	 \$ 58,556
 LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Accounts payable	\$ 96,802	\$ 107,972
Accrued expenses	40,839	34,908
Accrued interest, related party	3,312	2,592
Accrued interest, other	80,775	80,353
Derivative liability	226,825	58,562
Convertible notes payable, net of discount of \$11,778 and \$0, respectively	189,476	145,296
Loans payable	110,000	110,000
Loans payable, related party	8,000	8,000
 Total current liabilities	 756,029	 547,683
 STOCKHOLDERS' DEFICIT:		
Non Convertible Preferred stock, \$0.0001 par value; 100,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, \$0.0001 par value; 900,000,000 shares authorized, 893,405,000 shares issued and outstanding at December 31, 2013 and 575,445,000 at December 31, 2012	89,341	57,545
Additional paid-in capital	1,344,722	215,474
Accumulated deficit	(2,152,034)	(762,146)
 Total stockholders' deficit	 (717,971)	 (489,127)
 Total liabilities and stockholders' deficit	 \$ 38,058	 \$ 58,556

See notes to financial statements

VITAMIN BLUE, INC.
Statements of Operations

	Years Ended December 31,	
	2013	2012
	(Unaudited)	
SALES	\$ 160,501	\$ 129,652
COST OF SALES	91,997	74,153
GROSS PROFIT	68,504	55,499
OPERATING EXPENSES:		
Selling, general and administrative	166,073	174,351
Depreciation	1,912	286
Total operating expenses	167,985	174,637
LOSS FROM OPERATIONS	(99,481)	(119,138)
OTHER INCOME (EXPENSE):		
Penalties	(473)	(473)
Gain (loss) on change in derivative liability	(103,263)	92,383
Gain (loss) on settlement of debt	(922,096)	15,817
Interest expense	(264,575)	(95,615)
Total other income (expense)	(1,290,407)	12,112
LOSS BEFORE INCOME TAXES	(1,389,888)	(107,026)
PROVISION FOR INCOME TAXES	-	-
NET LOSS	\$ (1,389,888)	\$ (107,026)
NET LOSS PER SHARE, BASIC AND DILUTED	\$ (0.00)	\$ (0.00)
WEIGHTED AVERAGE SHARES OUTSTANDING, BASIC AND DILUTED	678,844,780	540,494,563

See notes to financial statements

VITAMIN BLUE, INC.
Statements of Cash Flows

	Years Ended December 31,	
	2013	2012
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,389,888)	\$ (107,026)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	1,913	1,103
Bad debt expense	(268)	(1,679)
Contributed services	24,102	25,329
Common stock issued for services	-	(15,817)
Amortization of debt discount to interest expense	236,272	69,907
Loss on change in derivative liability	103,263	(92,383)
Loss on settlement of debt	922,096	-
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(2,652)	(3,159)
Inventory	1,035	2,514
Prepaid expenses	21,400	6,700
Increase (decrease) in:		
Accounts payable	(11,170)	23,129
Accrued expenses	29,827	25,906
NET CASH USED IN OPERATING ACTIVITIES	(64,070)	(65,476)
CASH FLOWS FROM INVESTING ACTIVITIES	-	-
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from convertible notes payable	65,000	70,000
Payments on related party loans receivable	-	(2,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	65,000	68,000
NET DECREASE IN CASH	930	2,524
CASH, BEGINNING OF THE YEAR	3,940	1,416
CASH, END OF THE YEAR	\$ 4,870	\$ 3,940

See notes to financial statements

VITAMIN BLUE, INC.
Notes to Financial Statements
Year Ended December 31, 2013
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying financial statements of Vitamin Blue, Inc. (the “Company”) have been prepared in accordance with generally accepted accounting principles and, in the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. The financial statements for the year ended December 31, 2013 are unaudited, and the financial statements for the year ended December 31, 2012 have been derived from audited information.

Going Concern

The accompanying financial statements have been prepared on a going concern basis of accounting, which contemplates continuity of operations, realization of assets and liabilities and commitments in the normal course of business. The accompanying financial statements do not reflect any adjustments that might result if the Company is unable to continue as a going concern. The Company does not generate significant revenue, and has negative cash flows from operations, which raise substantial doubt about the Company’s ability to continue as a going concern. The ability of the Company to continue as a going concern and appropriateness of using the going concern basis is dependent upon, among other things, additional cash infusion. The Company has obtained funds from its shareholders through the year ended December 31, 2013. Management believes this funding will continue, and has also obtained funding from new investors. Management believes the existing shareholders and the prospective new investors will provide the additional cash needed to meet the Company’s obligations as they become due, and will allow the development of its core business. However, there can be no assurance that the Company will be successful in these endeavors.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Company is presented to assist in understanding the Company’s financial statements. The financial statements and notes are representations of the Company’s management, which is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

Accounts Receivable

The Company extends credit to its customers, who are located primarily in California. Accounts receivable are customer obligations due under normal trade terms. The Company performs continuing credit evaluations of its customers’ financial condition. Management reviews accounts receivable on a regular basis, based on contracted terms and how recently payments have been received to determine if any such amounts will potentially be uncollected. The Company includes any balances that are determined to be uncollectible in its allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off. The balance of the allowance account at December 31, 2013 and December 31, 2012 was \$1,389 and \$1,752, respectively.

Revenue Recognition

The Company recognizes revenue upon delivery, provided that evidence of an arrangement exists, title, and risk of loss have passed to the customer, fees are fixed or determinable, and collection of the related receivable is reasonably assured. We record revenue net of estimated product returns, which is based upon our return policy, sales agreements, management estimates of potential future products returns related to current period revenue, current economic trends, changes in customer composition and historical experience. Generally, we extend credit to our customers and do not require collateral. We perform ongoing credit evaluation of our customers and historic credit losses have been within our expectations.

Advertising

The Company expenses the cost of advertising and promotional materials when incurred. Total advertising costs were not material for the years ended December 31, 2013 and 2012.

Loss Per Common Share

Basic earnings per share is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares from stock options, warrants and convertible debt had been issued and if the additional common shares were dilutive. The Company's diluted loss per share is the same as the basic loss per share for the years ended December 31, 2013 and 2012, as the inclusion of any potential shares would have had an anti-dilutive effect due to the net loss of the Company.

Concentrations of Business and Credit Risk

The Company operates in a single industry segment. The Company markets its services to companies and individuals in many industries and geographic locations. The Company's operations are subject to intense competition in designing and selling surfing clothing and accessories.

Accounts receivable represent financial instruments with potential credit risk. The Company typically offers its customers credit terms. The Company makes periodic evaluations of the credit worthiness of its enterprise customers and other than obtaining deposits pursuant to its policies, it generally does not require collateral. In the event of nonpayment, the Company has the ability to terminate services.

At times, a limited number of customers may account for a significant percentage of the Company's revenues and accounts receivable.

Income Taxes

The Company uses the liability method of accounting for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. The measurement of deferred tax assets and liabilities is based on provisions of applicable tax law. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance based on the amount of tax benefits that, based on available evidence, is not expected to be realized. At December 31, 2013 and 2012, our net deferred tax assets have been reduced entirely by a valuation allowance since we were unable to conclude that it is more likely than not that they will be realized.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Inventory

Inventory consists primarily of raw materials and finished goods and is stated at the lower of cost (first-in, first-out basis) or market.

Property and Equipment

Property and equipment are stated at cost, and are depreciated using the straight line and accelerated methods over estimated useful lives ranging from three to ten years.

Fair Value of Financial Instruments

Fair Value of Financial Instruments, requires disclosure of the fair value information, whether or not recognized in the balance sheet, where it is practicable to estimate that value. As of December 31, 2013 and December 31, 2012, the balances reported for cash, accounts receivable, inventory, prepaid expenses, accounts payable, accrued expenses, and loans payable approximate the fair value because of their short maturities.

We have adopted ASC Topic 820 (originally issued as SFAS 157, “Fair Value Measurements”) for financial instruments measured as fair value on a recurring basis. ASC Topic 820 defines fair value, established a framework for measuring fair value in accordance with accounting principles generally accepted in the United States and expands disclosures about fair value measurements.

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 at the measurement date. ASC Topic 820 established a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). These tiers include:

- Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets;
- Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable such as quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active; and
- Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

We measure certain financial instruments at fair value on a recurring basis. Assets and liabilities measured at fair value on a recurring basis are as follows at September 30, 2013 and December 31, 2012:

	Total	Level 1	Level 2	Level 3
December 31, 2013:				
Derivative liability	\$ 226,825	\$ -	\$ -	\$ 226,825
Convertible notes payable, net of discount	189,476	-	-	189,476
Total liabilities measured at fair value	<u>\$ 416,301</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 416,301</u>
December 31, 2012:				
Derivative liability	\$ 58,562	\$ -	\$ -	\$ 58,562
Convertible notes payable, net of discount	145,296	-	-	145,296
Total liabilities measured at fair value	<u>\$ 203,858</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 203,858</u>

Recently Issued Accounting Pronouncements

Management reviewed new accounting pronouncements issued during the year ended December 31, 2013 and through the date of filing this report, and believes no pronouncements are applicable to or would have a material impact on the financial statements of the Company.

3. CAPITAL STOCK

As of December 31, 2013, the Company had 900,000,000 shares of common stock authorized at par value of \$0.0001 and 100,000,000 shares of non convertible preferred stock authorized at par value of \$0.0001 and has no conversion feature into the company's common stock.

During the year ended December 31, 2013, the Company issued a total of 317,960,000 shares of common stock in partial conversion of a convertible note payable for \$31,796, or \$0.0001 per share, recognizing a loss on conversion of \$922,096. As of December 31, 2013, the Company had insufficient shares of authorized stock to issue for all potential conversions of convertible notes payable (Note 6). The Company has plans to increase the number of authorized shares in the near future to cover potential conversions of convertible debt and other possible transactions involving its common stock.

During the year ended December 31, 2012, the Company issued a total of 48,920,000 shares of common stock: 28,920,000 shares valued at \$0.0012 per share for the conversion of convertible promissory notes, recognizing a gain on conversion of \$15,817; and 20,000,000 shares valued at \$0.002 per share for services of \$40,000.

During the years ended December 31, 2013 and 2012, services of \$24,102 and \$25,329 were contributed to capital and recorded to additional paid-in capital.

4. LOANS PAYABLE

As of December 31, 2013 and 2012, the principal balance of the Company's outstanding loans payable was \$110,000. The loans payable bear interest at the rate of 8% per annum, and are due upon demand. The loans do not contain any type of conversion feature. The Company intends to retire these loans at a future date through the issuance of shares of common stock at a rate to be agreed upon by both the lenders and the Company at the time the retirement is to be completed. There was no interest paid on the loans during the years ended December 31, 2013 and 2012.

5. RELATED PARTY TRANSACTIONS

As of December 31, 2013 and 2012, the Company had loans outstanding from Veronica Ornelas, Vice President and Secretary of the Company, totaling \$8,000. The Company has imputed interest on these loans at the rate of 9% per annum. As of December 31, 2013 and 2012, the balance of accrued interest payable to this related party was \$3,312 and \$2,592, respectively. There was no interest paid on the loans during the years ended December 31, 2013 and 2012.

Frank Ornelas, the Company's Chief Executive Officer, receives an annual salary of \$50,000. During the years ended December 31, 2013 and 2012, the Company paid for various personal expenses on behalf of the CEO totaling \$25,898 and \$24,671, respectively, which have been recognized as payment against his annual salary. The unpaid portions of the CEO's salary of \$24,102 and \$25,329 for the years ended December 31, 2013 and 2012, respectively, have been reflected as contributed capital in accordance with SAB Topic 5T. The CEO has agreed to waive the unpaid portions of his salary and no shares have been or will be issued to the CEO in exchange for this unpaid salary.

6. CONVERTIBLE NOTES PAYABLE

On April 17, 2013, the Company combined convertible notes payable dated from September 2010 through February 2013 with an aggregate principal amount of \$160,296 and accrued interest payable of 22,754 into one convertible note with a principal amount of \$183,050 (the "April Note"). The Company accounted for the note modification and exchange in accordance with ASC 470, and determined that there was not a 10% difference between the present value of the new note compared to the original notes, and no embedded conversion option was added, eliminated or changed. There was no gain or lost to recognize on the exchange of the original notes, since the reacquisition amount of the note was the same as the repayment, and the debt did not qualify as an extinguishment. The derivative liability of \$286,209 associated with the original notes was eliminated and recorded as a gain on change in derivative liability.

The April Note may be prepaid in full or in part at any time without penalty or premium. Partial prepayments shall be applied to installments due in reverse order of their maturity. The April Note may be converted to shares of the Company's common stock at a fixed price of \$0.0001 per share and bears interest at a rate of 8% per annum. However, the lender shall not have the right and the Company shall not have the obligation, to convert all or any portion of the April Note if and to the extent that the issuance to the lender of shares of the Company's common stock upon such conversion would result in the lender being deemed the beneficial owner of the more than 4.99% of the then outstanding shares of the Company's common stock within the meaning of Section 13(d) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder. Subsequent to April 17, 2013 through December 31, 2013, the lender converted \$31,796 of the April Note, leaving a remaining balance at December 31, 2013 of \$151,254.

The Company determined that the embedded conversion option is not bifurcated and accounted for as a derivative, primarily because the embedded conversion option, if freestanding, would not qualify as a derivative, due to the fact, that at conversion settlement, the Company would not be delivering an asset that is readily convertible into cash (e.g. freely tradable securities that could be sold rapidly without

significantly affecting share price). In order to assess whether or not the portion of the note that is convertible into common stock represents a beneficial conversion feature, the Company calculated the effective conversion price compared it to the market price of the Company's common stock on the commitment date, and calculated the value of the beneficial conversion feature. Pursuant to ASC 470-20-30-8, the value of the beneficial conversion feature is limited to the amount of the proceeds allocated to the embedded conversion option, with the result that is equal to \$183,050, the total proceeds of the note. The beneficial conversion feature was recorded as a debit to debt discount and credited to additional-paid-in capital. During the year ended December 31, 2013, the Company amortized the debt discount of \$183,050 to interest expense.

On April 2, 2013, May 9, 2013, July 12, 2013, and September 27, 2013, the Company issued four convertible notes payable each in the principal amount of \$10,000 and received cash proceeds totaling \$40,000. These notes bear interest at 8% per annum and may be prepaid in full or in part at any time without penalty or premium. Partial prepayments shall be applied to installments due in reverse order of their maturity. If the notes are not repaid before 180 days from the date of each note, the lender has the right to convert the full amount due into shares of common stock of the Company at a conversion price per share equal to the lesser of \$0.0002 or sixty (60%) of the average bid and ask price of the Company's common stock for the previous three (3) trading days. The lender may elect payment of the principal of the notes before any repayment of interest. The estimated fair value of the notes has been determined by using the Black-Scholes pricing model with the following assumptions: conversion price of \$0.0002 per share, no dividend yield, expected volatility ranging from 182.95% to 516.82%, risk-free interest rate ranging from .03% to .11%, and an expected life of 180 days. The Company recorded total debt discount of \$40,000 related to the conversion feature of the notes, along with derivative liabilities at inception. During the year ended December 31 2013, debt discount of \$34,833 was amortized to interest expense. The remaining debt discount as of December 31, 2013 was \$5,167.

On October 31, 2013, the Company issued a convertible note payable in the principal amount of \$10,000 and received cash proceeds totaling \$10,000. This notes bears interest at 8% per annum and may be repaid in full or in part at any time without penalty. If the notes are not repaid before 180 days from the date of each note, the lender has the right to convert the full amount due into shares of common stock of the Company at a conversion price per share equal to the lesser of \$0.0002 or sixty (60%) of the average closing price of the Company's common stock for the previous three (3) trading days. The estimated fair value of the notes has been determined by using the Black-Scholes pricing model with the following assumptions: conversion price of \$0.0002 per share, no dividend yield, expected volatility of 161.69%, risk-free interest rate of .08% and an expected life of 180 days. The Company recorded total debt discount of \$10,000 related to the conversion feature of the notes, along with a derivative liability at inception. During the year ended December 31 2013, debt discount of \$3,389 was amortized to interest expense. The remaining debt discount as of December 31, 2013 was \$6,611.

ASC Topic 815 provides applicable guidance to the convertible notes issued by the Company in instances where the number of shares into which a note can be converted is not fixed. For example, when a note converts at a discount to market based on the stock price on the date of conversion, ASC Topic 815 requires that the embedded conversion option of the convertible notes payable be bifurcated from the host contract and recorded at their fair value. In accounting for derivatives under accounting standards, the Company recorded a liability representing the estimated present value of the conversion feature considering the historic volatility of the Company's stock, and a discount representing the imputed interest associated with the embedded derivative. The derivative liability is adjusted periodically according to stock price fluctuations. At the time of conversion, the remaining derivative liability will be charged to additional paid-in capital.

The Company estimated the value of the derivative liability at \$226,825 and \$58,562 as of December 31, 2013 and 2012, respectively.

7. SUPPLEMENTAL STATEMENT OF CASH FLOWS INFORMATION

During the years ended December 31, 2013 and 2012, we had no amounts paid for income taxes or interest.

We had the following non-cash investing and financing activities during the year ended December 31, 2013:

We decreased accrued interest payable and increased convertible notes payable by \$22,754.

We issued 317,960,000 shares of common stock in partial conversion of convertible notes payable, increasing common stock and decreasing convertible notes payable by \$31,796.

We had the following non-cash investing and financing activities during the year ended December 31, 2012:

We issued 28,920,000 shares of common stock in partial conversion of convertible notes payable, increasing common stock by \$2,892, increasing additional paid-in capital by \$54,948 and decreasing convertible notes payable by \$57,840.

We issued 16,525,000 shares of common stock in settlement of \$33,050 in subscriptions payable.

8. SECURITY OWNERSHIP OF MANAGEMENT

Name and Position(s)	Title of Class	Common Stock Beneficially Owned
Frank D. Ornelas President, Treasurer and Chief Executive Officer	Common Stock	510,050,000
Veronica C. Ornelas Vice President and Secretary	Common Stock	75,000
All directors and executive Officers as a group	Common Stock	510,125,000

A total of 510,075,000 shares of our common stock presently outstanding are deemed to be “restricted securities” as defined by Rule 144 under the Securities Act of 1933 (the “*Securities Act*”). Rule 144 is the common means for a stockholder to resell restricted securities and for affiliates, to sell their securities, either restricted or non-restricted, control shares. Rule 144 was amended by the SEC, effective February 15, 2008.

9. SUBSEQUENT EVENTS

Management has evaluated subsequent events through the date of the financial statements according to the requirements of ASC TOPIC 855 and did not identify any material subsequent event to be reported.