

Organic Alliance, Inc.  
Form 10-Q  
June 19, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

OR

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

Commission File Number  
000-51119

ORGANIC ALLIANCE, INC.  
(Exact name of registrant as specified in its charter)

Nevada 20-0853334  
State of I.R.S.  
incorporation Employer Identification  
No.

401 Monterey Street, Suite 202  
Salinas, CA 93901  
(Address of principal executive offices)

(831) 240-0295  
(Issuer's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

Class	Outstanding at June 18, 2012
Common stock, \$0.0001 par value	11,032,593

ORGANIC ALLIANCE, INC.

## FORM 10-Q

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Organic Alliance Inc.  
Condensed Consolidated Balance Sheet

	March 31, 2012 unaudited	December 31, 2011 audited
Assets		
Current assets:		
Cash	\$ 101,819	\$ 5,852
Accounts receivable, net of allowance for doubtful accounts of \$77,968 at March 31, 2012 and December 31, 2011	195,322	128,886
Inventory	19,073	-
Prepaid expenses and other current assets	32,494	23,527
Total current assets	348,708	158,265
Total Assets	\$ 348,708	\$ 158,265
Liabilities and Stockholders' Deficiency		
Current liabilities:		
Accounts payable	\$ 1,196,146	\$ 1,179,753
Due to factor	50,929	82,087
Accrued expenses and other current liabilities	2,136,712	2,001,427
Derivative liabilities	789,058	155,813
Notes payable to related parties and others, net of discounts	1,398,475	1,128,549
Total current liabilities	5,571,320	4,547,629
Commitments and contingencies		
Stockholders' Deficiency:		
Preferred stock, no stated value authorized; 10,000,000 shares authorized; -0- shares issued and outstanding as of March 31, 2012 and December 31, 2011	-	-
Common stock, \$.0001 par value, 100,000,000 shares authorized, 11,032,593 shares issued and outstanding as of March 31, 2012 and December 31, 2011	1,103	1,103
Additional paid-in capital	9,161,849	9,064,265
Accumulated deficit	(14,385,564)	(13,454,732)
Total stockholders' deficiency	(5,222,612 )	(4,389,364 )
Total Liabilities and Stockholders' Deficiency	\$ 348,708	\$ 158,265

The common stock shares authorized, issued and outstanding have been adjusted to reflect a 20 to 1 reverse split, which was effective in February 2011.

The accompanying notes are an integral part of these financial statements



Organic Alliance Inc.  
Condensed Consolidated Statements of Operations (unaudited)

	For the Three Months Ended	
	March 31, 2012	March 31, 2011
Revenue	\$336,007	\$255,755
Cost of sales	302,863	248,405
Gross margin	33,144	7,350
General and administrative expenses	\$456,842	\$1,075,467
Operating loss	(423,698 )	(1,068,117)
Other (income) expense:		
Interest expense	228,870	64,301
Change in fair value of derivative liability	278,265	40,572
Total net other expenses	507,135	104,873
Net loss	\$(930,833 )	\$(1,172,990)
Basic and diluted loss per share	\$(0.05 )	\$(0.19 )
Weighted average number of common shares outstanding - basic and diluted	17,358,027	6,046,778

The common stock shares authorized, issued and outstanding have been adjusted to reflect a 20 to 1 reverse split, which was effective in February 2011.

The accompanying notes are an integral part of these financial statements

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Organic Alliance Inc.  
Condensed Consolidated Statements of Cash Flows (unaudited)

	For the Three Months Ended	
	March 31, 2012	March 31, 2011
Cash flows from operating activities:		
Net loss	\$(930,833 )	\$(1,172,990)
Adjustments to reconcile net loss to net cash used in operating activities:		
Common stock issued for services	-	201,796
Share-based compensation	89,587	388,945
Non-cash interest	22,892	11,762
Change in fair value of derivative liability	278,265	40,572
Amortization on discount of note payable	110,012	24,694
Changes in operating assets and liabilities:		
Accounts receivable	(66,436 )	(187,727 )
Inventory	(19,073 )	(8,978 )
Prepaid expenses and other current assets	(8,967 )	2,263
Accounts payable	16,393	(397,229 )
Accrued expenses and other current liabilities	135,285	365,508
Net cash used in operating activities	(372,875 )	(731,384 )
Cash flows from financing activities		
Proceeds from notes and loans payable	500,000	566,926
Principal payments on note payable	-	(38,262 )
Due to factor - net of repayment	(31,158 )	201,267
Net cash provided by financing activities	468,842	729,931
Net increase (decrease) in cash	95,967	(1,453 )
Cash - beginning of the period	5,852	1,461
Cash - end of the period	\$101,819	\$8
Supplemental disclosures:		
Interest paid	\$95,967	\$20,607
Supplemental disclosure for non-cash financing activities:		
Discount on notes payable	\$362,977	\$137,703
Reclassification of derivative liabilities upon conversion of note	\$-	\$44,852
Issuance of common stock to settle notes payable	\$-	\$274,507
Issuance of common stock to convert notes payable	\$-	\$5,000

The accompanying notes are an integral part of these financial statements





Organic Alliance, Inc. and Subsidiary  
Notes to Condensed Consolidated Financial Statements (unaudited)

## 1. NATURE OF BUSINESS

Organic Alliance, Inc. ("OAI" or the "Company") is a sales and marketing distribution company that supplies conventional, organic, natural, and Fair Trade food products to the global market. OAI works directly with growers while also contracting farming production domestically and abroad to vertically integrate supply chains, reduce costs and provide a high degree of control over quality, food safety and production sustainability.

History - NB Design & Licensing, Inc., ("NB Design") was organized in September 2001. The former parent, New Bridge Products, Inc., was originally incorporated in August 1995 as a manufacturer of minivans and filed a petition in bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. Its Plan of Reorganization was approved by the U.S. Bankruptcy Court for the District of Arizona in September 2002 and NB Design was discharged from bankruptcy in October 2002. NB Design was inactive from October 2002 to April 29, 2008.

Organic Alliance Inc., a Texas corporation, ("Organic Texas") was organized on February 19, 2008 to sell organically grown fruits and vegetables. During the second quarter of 2009, it ceased being a development stage company when it commenced its operations.

On April 29, 2008, NB Design, a Nevada corporation, acquired all 10,916,917 issued and outstanding shares of common stock of Organic Texas for 464,999 shares of the NB Design's common stock. Organic Texas thereupon became a wholly owned subsidiary of NB Design. The business of Organic Texas is the only business of NB Design. The Company operates in California.

The acquisition of Organic Texas by NB Design on April 29, 2008 was accounted for as a reverse capitalization in accordance with the Securities and Exchange Commission's ("SEC") Division of Corporate Financial Reporting manual Topic 12 "Reverse Acquisition and Reverse Capitalization". The reverse capitalization was the acquisition of a private operating company (Organic Texas) into a non-operating public shell corporation with nominal net assets and as such is treated as a capital transaction, rather than a business combination. As a result no goodwill is recorded. In this situation, NB Design is the legal acquirer because it issued its equity interests, and Organic Texas is the legal acquiree because its equity interests were acquired. However, NB Design is the acquiree and Organic Texas is the acquirer for accounting purposes. Organic Texas is treated as the continuing reporting entity that acquired the registrant, NB Design. The pre-acquisition financial statements of Organic Texas are treated as the historical financial statements of the consolidated companies.

On June 2, 2008, the name NB Design was changed to Organic Alliance, Inc. On August 29, 2008, the name of Organic Texas was changed to Organic Texas, Inc. All references throughout the annual report to "Organic Alliance, Inc." or the "Company" refers to the combined operations for Organic Alliance, Inc., a Nevada Corporation, and its wholly owned subsidiary, Organic Texas.

During November 2010, the Company increased the number of authorized shares of common stock from 60 million shares to 2 billion shares.

On February 14, 2011, the Company executed a 20:1 reverse split and decreased the number of authorized shares of common stock from 2 billion shares to 100 million shares.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The Company's unaudited condensed consolidated financial statements have been prepared on an accrual basis of accounting, in conformity with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information applicable for a going concern which assumes that the Company will realize its assets and discharge its liabilities in the ordinary course of the business and in accordance with the instructions for Form 10-Q and article 10 of Regulation S-X of the U.S. Securities and Exchange Commission ("SEC"). Certain information and disclosures included in the financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to such rules and regulations.

In the opinion of management, the condensed consolidated financial statements contain all material adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial condition, results of operations, and cash flows of the Company for the interim periods presented.

The results for the three months ended March 31, 2012 are not necessarily indicative of the results of operations for the full year. These financial statements and related footnotes should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission on June 18, 2012.

Use of Estimates - The preparation of condensed consolidated 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly sensitive to change in the near term include but are not limited to, realization of deferred tax assets, allowance for doubtful accounts and assumptions used in share based payment transactions. Actual results could differ from those estimates.

Principles of Consolidation - The condensed consolidated financial statements include the accounts of Organic Alliance, Inc. and its wholly owned subsidiary, Organic Texas, Inc. (collectively, the "Company"). All significant inter-company transactions and balances have been eliminated in consolidation.

Allowance for Doubtful Accounts - An allowance for uncollectible accounts receivable is recorded based on a combination of aging analysis, past practices and any specific troubled accounts. The Company's produce is sold to the Company's customers for cash or on credit terms which are established in accordance with local and industry practices and typically require payment within 10 to 30 days of delivery. Accounts are written off when uncollectibility is confirmed. Subsequent recoveries, if any, are credited to the allowance account. The allowance for doubtful accounts amounted to \$77,969 at March 31, 2012 and December 31, 2011, respectively.

In addition, the Company also factors its receivables with full recourse and, as a result, accounts for the factoring akin to a secured borrowing, maintaining the gross receivable asset and due to factor liability on its books and records. In connection with the factoring of its receivables, the Company estimates an allowance for factoring fees associated with the collections. These fees range from 3% to 5% depending on the actual timing of the collection. The actual recognition of such fees may differ from the estimates depending upon the timing of collections.

Inventory - Inventory is stated at the lower of cost (first-in, first-out) or market, and includes produce the Company purchases from growers and packaging materials. The Company held \$19,073 and \$0 of inventory as of March 31, 2012 and December 31, 2011, respectively.

Fair Value of Financial Instruments - The carrying amounts of financial instruments, including cash, receivables, accounts payable and accrued expenses approximated fair value as of the balance sheet date presented, because of the relatively short maturity dates on these instruments. The carrying amounts of the notes payable issued approximate fair value as of the balance sheet date presented, because interest rates and other terms on these instruments approximate terms currently available on similar instruments.

Derivative Financial Instruments - The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks. The Company evaluates all of the Company's financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the statements of operations. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the instrument could be required within 12 months of the balance sheet date.

The accounting treatment of derivative financial instruments requires that the Company record the conversion option and related warrants at their fair values as of the inception date of the agreements and at fair value as of each subsequent balance sheet date. As a result of entering into the convertible notes, the Company is required to classify all other non-employee warrants as derivative liabilities and record them at their fair values at each balance sheet date. Any change in fair value was recorded as a change in the fair value of derivative liabilities for each reporting period at each balance sheet date. The Company reassesses the classification at each balance sheet date. If the classification changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification.

The fair value of conversion options at a fixed number of shares are recorded using the intrinsic value method and conversion options at variable rates and any options and warrants with ratchet provisions are deemed to be a "down-round protection" and therefore, do not meet the scope exception for treatment as a derivative under ASC 815. Since, "down-round protection" is not an input into the calculation of the fair value of the equity instruments and cannot be considered "indexed to the Company's own stock" which is a requirement for the scope exception as outlined under ASC 815. The Company determined the fair value of the Binomial Lattice Model and the Intrinsic Value Method to be materially the same. Warrants that have been reclassified to derivative liability that did not contain "down-round protection" were valued using the black-scholes model.

For the Black-Scholes pricing model, which approximates the binomial lattice model, the Company used the following assumptions and weighted average fair value ranges for the three months ended March 31:

	2012	2011
Risk-free interest rate	0.31% - 0.38%	0.30%
Dividend yield	N/A	N/A
Expected volatility	46.5%-46.8%	36.0%-37.2%
Expected life in months and years	20 months	9 months- 2 years

For the binomial lattice options pricing model, the Company used the following assumptions and weighted average fair value ranges for the three months ended March 31:

	2012	2011
Risk-free interest rate	0.15% - 0.62%	N/A
Dividend yield	N/A	N/A
Expected volatility	43.4%-46.1%	N/A
Expected life in months and years	6 months - 3 years	N/A

Revenue Recognition - Revenue is recorded when (1) the customer accepts delivery of the product and title has been transferred and the Company has no significant obligations remaining to be performed; (2) a final understanding as to specific nature and terms of the agreed upon transaction has occurred; (3) price is fixed and (4) collection is reasonably assured.

Share Based Compensation - The Company accounts for share-based compensation in accordance with the fair value recognition provisions of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) No. 718. For employees and directors, the fair value of the award is measured on the grant date and for non-employees, the fair value of the award is generally re-measured on interim financial reporting dates until the service period is complete.

Option valuation models require the input of highly subjective assumptions, including the expected life of the option, and such assumptions can materially affect the fair value estimate. The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model. The Company uses historical data to estimate option exercise and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

For the Black-Scholes pricing model, the Company used the following assumptions and weighted average fair value ranges for the three months ended March 31:

	2012	2011
	0.43%	
Risk-free interest rate	-	
	0.86%	2.37%
Dividend yield	N/A	N/A
	44.7%	
Expected volatility	-	
	55.2%	54.5%
Expected life in years	3-5	5

### Concentrations

- Credit Risk - The Company maintains cash balances at various high quality federally insured financial institutions, with balances at times, in excess of federally insured limits. Management believes that the financial institutions that hold the Company's deposits are financially sound and therefore pose a minimum credit risk. The Company has not experienced any losses in such accounts.
- Major customers - The Company has two and four major customers, which accounted for approximately 65% and 61% of the sales during three months ended March 31, 2012 and 2011, respectively. For the three months ended March 31, 2012, the total sales comprised of customer A 42% and customer B 23% compared to the three months ended March 31, 2011, comprised of customer E 26%, customer F 14%, customer G 12% and customer B 10%. The loss of any of these customers could adversely affect the Company's operations.
- Major receivables - The Company has five major receivables at March 31, 2012 comprised of customer E 27%, customer A 16%, customer C 17%, customer B 14% and customer D 11% compared to five major receivables at March 31, 2011, comprised of customer E 28%, customer F 15%, G 13%, customer B 11% and customer H 11%.
- Major suppliers - The Company has four and three major suppliers, which accounted for approximately 63% and 94% of purchases during three months ended March 31, 2012 and 2011, respectively. The loss of any of these suppliers could adversely affect the Company's operations.

Net Loss Per Share - Basic loss per share was computed using the weighted average number of outstanding common shares. Diluted loss per share includes the effect of dilutive common stock equivalents from the assumed exercise of options, warrants and convertible notes. Common stock equivalents were excluded in the computation of diluted loss per share since their inclusion would be anti-dilutive.

In accordance with ASC 260 "Earnings per Share", the Company has given effect to the issuance of 2,795,538 and 1,323,070 warrants as of March 31, 2012 and 2011, respectively, exercisable at \$0.01. These warrants have been included in computing the basic net loss per share for the three months ended March 31, 2012 and 2011. Additionally, included in the Company's weighted average shares outstanding are 3,529,897 and 56,189 shares earned, but not issued as at March 31, 2012 and 2011, respectively.

Total shares issuable upon the exercise of warrants, options and the conversion of convertible notes for the three months ended March 31, 2012 and 2011 were as follows:

	March 31,	
	2012	2011
Options	4,483,750	33,750
Warrants	4,710,350	320,008
Convertible notes	5,304,352	581,575
Total Common stock equivalents	14,498,452	935,333

### Recently Issued Accounting Standards

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04, "Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." This ASU addresses fair value measurement and disclosure requirements within Accounting Standards Codification ("ASC") Topic 820 for the purpose of providing consistency and common meaning between U.S. GAAP and IFRSs. Generally, this ASU is not intended to change the application of the requirements in Topic 820. Rather, this ASU primarily changes the wording to describe many of the requirements in U.S. GAAP for measuring fair value or for disclosing information about fair value measurements. This ASU is effective for periods beginning after December 15, 2011 and did not have a material impact on the Company's consolidated financial statements or disclosures.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This guidance improves the comparability, consistency and transparency of financial reporting and increases the prominence of items reported in other comprehensive income. The guidance provided by this update becomes effective for interim and annual periods beginning on or after December 15, 2011. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

### 3. GOING CONCERN

The consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America applicable for a going concern which assumes that the Company will realize its assets and discharge its liabilities in the ordinary course of business. As of March 31, 2012, the Company has limited cash, a working capital deficit of approximately \$5,223,000, has accumulated losses of approximately \$14,386,000 since its inception and has withheld \$163,949 of payroll tax liabilities from wages paid which have yet to be remitted to the taxing authorities and are delinquent. The Company is currently delinquent with its payroll tax filings since December 31, 2008. Its ability to continue as a going concern is dependent upon the ability of the Company to obtain the necessary financing to meet its obligations and pay its liabilities arising from normal business operations when they come due and increasing its revenue in order to achieve profitable operations. The Company estimates a \$2,000,000 capital infusion will be required to continue operations through the end of 2012. The outcome of these matters cannot be predicted with any certainty at this time and raises 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.

The Company intends to overcome the circumstances that impact its ability to remain a going concern through a combination of growing high margin revenues, with interim cash flow deficiencies being addressed through additional equity and debt financing. The Company anticipates raising additional funds through public or private financing, strategic relationships or other arrangements in the near future to support its business operations; however the Company does not have commitments from third parties for a sufficient amount of additional capital. The Company cannot be certain that any such financing will be available on acceptable terms, or at all, and its failure to raise capital when needed could limit its ability to continue its operations. The Company's ability to obtain additional funding will determine its ability to continue as a going concern. Furthermore, additional equity financing may be dilutive to the holders of the Company's common stock, and debt financing, if available, may involve restrictive covenants, and strategic relationships, if necessary to raise additional funds, and may require that the Company relinquish valuable rights.





## 4. DUE TO FACTOR

On November 1, 2010 the Company entered into a new one year accounts receivable factoring facility with a financial services company with maximum borrowings of \$1,800,000. The contract expired on October 31, 2011, and the Company is operating on a month to month basis, thereafter. The financial services company advances up to 80% of qualified customer invoices less applicable discount fee, and holds the remaining 20% as a reserve until the customer pays the financial services company. The released reserves are used to fund other vendor purchases or returned to the Company. The Company is charged 3% for the first 30 days outstanding plus 1/10 of 1% for funds outstanding over 30 days. Uncollectable customer invoices are charged back to the Company. The new financial services company commenced funding during February 2011. At March 31, 2012 the advances from the factor inclusive of fees amounted to \$64,789 which was offset against due from factor of approximately \$13,860. Advances from the factor are collateralized by substantially all assets of the Company.

## 5. PREFERRED STOCK

The Company's articles of incorporation authorize the Company's Board of Directors to issue up to 10,000,000 shares of preferred stock, having no par value, in one or more series without stockholder approval. Each such series of preferred stock may have such number of shares, designations, preferences, voting powers, qualifications, and special or relative rights or privileges as determined by the Company's Board of Directors. At December 31, 2011 and 2010, no shares of preferred stock were issued or outstanding.

In August 2010, the Company signed a one year consulting agreement with a consultant to provide investor and public relation services. The consultant's compensation includes convertible preferred stock which, at the final determination date, will be converted into shares of common stock of the Company equivalent to 25% of outstanding common shares, as defined in the agreement. The consultant elected to receive the common stock equivalent directly as compensation. The Company calculated the fair value of the award to be \$868,724 or 4,169,638 shares of common stock. The Company accrued \$506,680 of stock based compensation for these services during the year ended December 31, 2011, which has been included in accrued expenses and other current liabilities. During March 2011, 695,930 shares of common stock valued at \$173,982 were issued to the consultant for the settlement of a portion of the accrued compensation, the remaining 3,473,708 shares of common stock valued at \$694,742 have not been issued as of March 31, 2012 and is currently due and payable.

## 6. NOTES PAYABLE, LOANS AND DERIVATIVE LIABILITES

Notes payable to related parties and others, net of discounts consists of the following:

	March 31, 2012 (Unaudited)	December 31, 2011 (Audited)
N Notes Payable (net of Debt Discount of \$42,076 at March 31, 2012 and \$63,114 at December 31, 2011) (A)	\$ 599,491	\$ 551,978
Notes Payable – Related Parties (net of Debt Discount of \$30,053 at March 31, 2012 and \$50,053 at December 31, 2011) (B)	486,455	348,130
Convertible Notes Payable (net of Debt Discount of \$335,471 at March 31, 2012 and \$41,469 at December 31, 2011) (C)	312,529	228,441
Total	\$ 1,398,475	\$ 1,128,549

Notes Payable

(A) Notes Payable

- i. In May 2010, an individual advanced to the Company \$20,000 bearing interest at 6% per annum. As a financing incentive, the individual received warrants to purchase 20,000 shares of the Company's common stock at \$1.00 per share. The warrants expired in November 2011. The gross proceeds of the note were recorded net of a debt discount of \$9,200. The debt discount consisted of the relative fair value of the warrants of \$9,200 and is accreted to interest expense ratably over the term of the note. The promissory note matured on November 17, 2011. The unpaid balance, including accrued interest, was \$22,142 and \$21,843 at March 31, 2012 and December 31, 2011, respectively. The Company is not compliant with the repayment terms of the note.

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- ii. On November 3, 2010, the Company signed a \$38,262 demand note with an interest rate of 5% per annum. The unpaid balance, including accrued interest, was \$38,565 at December 31, 2011. The note was repaid in January 2011.
- iii. On February 3, 2011, the Company signed a \$500,000 promissory note with a maturity date of August 2, 2012, and has a stated interest rate of 15% per annum. As a financing incentive, the lender received three year warrants vesting on January 31, 2011, to purchase 452,354 shares of common stock at an exercise price of \$0.01 per share and also received five year warrants, vesting on June 30, 2011, to purchase 452,354 shares at an exercise price of \$0.01 per share.

The Company accounted for the issuance of the convertible promissory note in accordance with ASC 815 “Derivatives and Hedging”. Accordingly, the warrants are recorded as derivative liabilities at their fair value and are marked to market through earnings at the end of each reporting period. The gross proceeds from the sale of the note \$500,000 was recorded net of a discount of \$137,703. The debt discount consisted of \$137,703 related to the fair value of the warrants and is accreted to interest expense ratably over the term of the note which amounted to \$21,038 and \$15,300 for the three months ended March 31, 2012 and 2011, respectively, and is included as a component of interest expense in the accompanying condensed consolidated statement of operations. The Company has not made any note payments and received a waiver from the lender on September 1, 2011 that defers payment until September 1, 2012 and increased the interest rate to 21% beginning April 4, 2011, the date of the first event of default. The unpaid balance, including accrued interest, was \$619,425 and \$593,247 at March 31, 2012 and December 31, 2011, respectively.

(B) Notes Payable – Related Parties

- i. In September 2008, Earnest Mathis, a former owner, advanced to the Company \$15,000. The advance is evidenced by a promissory note bearing interest at 10% per annum. The promissory note matured on September 13, 2009. The unpaid balance, including accrued interest, was \$20,316 and \$19,942 at March 31, 2012 and December 31, 2011, respectively. The note has not been repaid as of June 18, 2012. The Company is not compliant with the repayment provisions of this note.
- ii. On February 18, 2011, the Company issued 3,858,574 shares of common stock to Parker Booth, Chief Executive Officer, for the settlement of \$231,514 of principal and \$5,996 of the accrued interest. The fair value of the common stock issued exceeded the fair value of the promissory notes and accrued interest by \$64,824 which the Company recorded a charge to stock based compensation expense during the three months ended March 31, 2011. The unpaid balance for accrued interest was \$6,803 at March 31, 2012 and December 31, 2011. The Company is not compliant with the repayment terms of this note.
- iii. In October and December 2009, Michael Rosenthal, director, advanced the Company \$100,000 and \$30,000, respectively, totaling \$130,000. The advances are evidenced by promissory notes bearing interest at 5% per annum. The notes matured on March 31, 2010 and June 30, 2010, respectively. On February 18, 2011, at the option of the holder, the Company issued 964,643 shares of common stock for the settlement of \$57,879 of the remaining principal and accrued interest of \$7,091. The fair value of the common stock issued exceeded the remaining portion of promissory notes plus accrued interest by \$31,092 and is included as a component of stock based compensation expense in the accompanying condensed consolidated statement of operations.
- iv. In November 2009 and February 2010, Morrison Partners, LLC (Thomas Morrison, former CEO and Chairman of the Board is the President), advanced to the Company \$10,000 and \$15,000, respectively, totaling \$25,000. The advances are evidenced by promissory notes bearing interest at 5% per annum. The November advance provides for the issuance of 2,770 shares of the Company’s common stock as a financing incentive. The Company recorded a debt discount of \$2,935 for the relative fair value of the common stock. The discount was accreted over the life of the note.

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The November 2009 and February 2010 notes were due on June 30, 2010 and September 30, 2010, respectively. The unpaid balance, including accrued interest, was \$27,784 and \$27,472 at March 31, 2012 and December 31, 2011, respectively. The shares have not been issued to Morrison Partners, LLC. The Company is not compliant with the repayment terms of this note.

- v. During March, 2010 through October 2011, an employee of the Company loaned to the Company \$65,958 of which an aggregate amount of \$16,000 and \$49,958 was advanced during 2011 and 2010, respectively. The loans are evidenced by promissory notes payable with interest at 5% and are due on demand. The Company repaid \$9,000 during 2010. In addition, the employee will be issued 47,690 shares of the Company's common stock upon repayment of the promissory notes as additional consideration. The Company will record a fair value for these shares on the measurement date as a charge to interest expense. The unpaid balance including accrued interest was \$60,684 and \$59,974 at March 31, 2012 and December 31, 2011, respectively.
- vi. On October 17, 2011, the Company entered into a \$400,000 convertible multi-draw term loan facility ("loan") with an entity owned by a related party who is a 100% shareholder. The loan bears interest at 21% and has a maturity date of the earlier of an event of default or April 17, 2012. The Company has not made a note payment and is currently negotiating an extension of such loan. At the time of any new debt or equity financing of the Company, the note balance of principal and interest may be converted into the number of fully paid and non-assessable debt instruments, shares/or units to be issued in the financing. In addition, the related party received a warrant to purchase 2.5 shares of the Company's common stock for each \$1.00 of principal extended to the Company up to 1,000,000 shares. The warrants have an exercise price of \$.10 per share and vest with each cash advance from the loan and collectively expire on October 17, 2014. The Company received \$75,000 and \$275,000 in gross proceeds during the three months ended March 31, 2012, and year ended December 31, 2012, respectively. The Company issued three-year warrants to purchase an aggregate of 187,500 and 687,500 shares of the Company's common stock during the three months ended March 31, 2012 and the year ended December 31, 2011, respectively. The unpaid balance, including accrued interest, was \$350,000 and \$283,993 at March 31, 2012 and December 31, 2011, respectively. As of June 18, 2012, the Company has been advanced \$400,000 on the loan.

The conversion price of the notes was not fixed and determinable on the date of issuance and as such in accordance with ASC Topic 815 "Derivatives and Hedging" ("ASC 815"), the embedded conversion option of the notes on the date of issuance were valued using the binomial lattice options pricing model and recorded as derivative liabilities. The fair value of the three-year warrants issued in connection with the note on the date of issuance aggregated \$70,074, and was recorded as debt discount. The debt discount was amortized through the term of the notes and amounted to \$40,062 for the three months ended March 31, 2012.

- vii. On February 28, 2012, Michael Rosenthal, director, advanced the Company \$50,000. The advance is evidenced by promissory notes bearing interest at 21% and has a maturity date of the earlier of an event of default or August 28, 2012. In addition, Mr. Rosenthal received three year warrants vesting February 28, 2012, to purchase 125,000 shares of Company's common stock at an exercise price of \$0.10 per share. The Company recorded a debt discount of \$7,997 to the face value of the note based upon the relative fair values of the note and the common stock. The discount is being accreted over the life of the note which amounted to \$1,406 for three months ended March 31, 2012, and is included as a component of interest expense in the accompanying condensed consolidated statement of operations. The unpaid balance including accrued interest was \$50,921 at March 31, 2012.

(C) Convertible Notes Payable

- i. On July 14, 2010, the Company issued a \$52,380 convertible promissory note with a maturity date of September 13, 2012, and with an interest rate of 20% per annum. The note can be converted into the Company's common stock by the holder based on a variable conversion price. The variable conversion price is defined in the note as 45% multiplied by the average of the five lowest intraday prices for the Company's stock during the previous 20 trading days prior to the date of conversion. The total conversion may not exceed 4.99% of the Company's common stock issued and outstanding. In addition, the Company placed 250,000 shares of the Company's common stock in escrow to secure our conversion obligations under the note. During September 2010, the lender converted \$7,500 of the debt into 75,758 shares of the Company's common stock for \$.099 per share. During December 2010, the lender converted \$7,500 of the debt into 53,419 shares of the Company's common stock for \$.14 per share. During March 2011, the lender converted \$5,000 of the debt to 198,413 shares of the Company's common stock for \$.0252 per share. During September 2011, the lender converted \$20,000 of the debt to 444,444 shares of the Company's common stock for \$.045 per share. The unpaid balance, including accrued interest, was \$22,318 and \$21,567 at March 31, 2012 and December 31, 2011, respectively. As of June 18, 2012, approximately \$23,000 of the note and accrued interest remains unpaid.

The conversion price of the note was not fixed and determinable on the date of issuance and as such in accordance with ASC Topic 815 "Derivatives and Hedging" ("ASC 815"), the embedded conversion options of the note on the date of issuance were valued using the Black-Scholes pricing model, which approximates the binomial lattice options pricing model and recorded as derivative liabilities. The fair value of the conversion option in connection with the note on the date of issuance aggregated \$52,380, and was recorded as debt discount. The debt discount was amortized through the term of the notes and amounted to \$6,548 for the three months ended March 31, 2012 and 2011.

- ii. On July 30, 2010, an individual advanced the Company \$8,000. The advance is evidenced by a promissory note bearing interest at 6% per annum and maturing on March 2, 2011. The holder, at any time, may convert the promissory note into shares of Company's common stock at \$0.05 per share. The Company calculated the fair value of the beneficial conversion feature using the Black-Scholes pricing model on the date of issuance. The fair value of the conversion option in connection with the note on the date of issuance aggregated \$8,000, and was recorded as debt discount. The debt discount was amortized through the term of the note and amounted to \$1,333 for the three months ended March 31, 2011. The unpaid balance, including accrued interest, was \$8,802 and \$8,683 at March 31, 2012 and December 31, 2011, respectively. The Company is not compliant with the repayment terms of this note.
- iii. On April 28, 2011, the Company issued a \$70,588 convertible promissory note with an original issue discount of 15%. The convertible promissory note has a maturity date of the earlier of (i) the Company raising debt or equity financing of \$600,000 or more, or (ii) May 31, 2011. The note may be converted into the Company's common stock by the holder at \$0.05 per share. The Company has not made a note payment and received a waiver from the lender on September 1, 2011 that defers payment until May 31, 2012 and waives the provision for payment upon the Company closing a debt or equity financing of \$600,000 or more. The Company is currently negotiating an extension of such loan. As a financing incentive, the lender received five-year warrants vesting April 28, 2011, to purchase 705,882 shares of Company's common stock at an exercise price of \$0.25 per share. The unpaid balance, including accrued interest, was \$70,588 at March 31, 2012 and December 31, 2011. The Company is not compliant with the repayment terms of this note.

The conversion price of the note and five-year warrants was not fixed and determinable on the date of issuance and as such in accordance with ASC Topic 815 "Derivatives and Hedging" ("ASC 815"), the embedded conversion options of the note and warrants on the date of issuance were valued using the binomial lattice options pricing model and recorded as derivative liabilities. The fair value of the conversion option and five-year warrants issued in connection with the note

on the date of issuance aggregated \$60,000, and were recorded as debt discount. The debt discount was amortized through the term of the notes and amounted to \$60,000 for the year ended December 31, 2011.

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- iv. On June 15, 2011, the Company issued a \$57,500 convertible promissory note with an original issue discount of 15%. The convertible promissory note has a maturity date of the earlier of (i) the Company raising debt or equity financing of \$600,000 or more, or (ii) June 14, 2012. The note may be converted into the Company's common stock by the holder at \$0.05 per share. The Company received a waiver from the lender on September 1, 2011 that waives the provision for payment upon the Company closing a debt or equity financing of \$600,000 or more. As a financing incentive, the lender received five-year warrants vesting June 15, 2011, to purchase 575,000 shares of Company's common stock at an exercise price of \$0.25 per share. The unpaid balance, including accrued interest, was \$57,500 at March 31, 2012 and December 31, 2011. The Company is not compliant with the repayment terms of this note.

The conversion price of the note and five-year warrants was not fixed and determinable on the date of issuance and as such in accordance with ASC Topic 815 "Derivatives and Hedging" ("ASC 815"), the embedded conversion options of the note and warrants on the date of issuance were valued using the binomial lattice options pricing model and recorded as derivative liabilities. The fair value of the conversion option and five-year warrants issued in connection with the note on the date of issuance aggregated \$50,000, and were recorded as debt discount. The debt discount was amortized through the term of the notes and amounted to \$12,500 for the three months ended March 31, 2012.

- v. On July 15, 2011, the Company issued a \$109,822 convertible promissory note with an original issue discount of 15% that consolidated various demand notes from September 2010 through July 2011. The convertible promissory note has a maturity date of the earlier of (i) the Company raising debt or equity financing of \$600,000 or more, or (ii) August 31, 2011. The Company has not made a note payment and is currently negotiating an extension of such loan. The note may be converted into the Company's common stock by the holder at \$0.05 per share. As a financing incentive, the lender received five-year warrants vesting July 15, 2011, to purchase 1,098,220 shares of Company's common stock at an exercise price of \$0.25 per share. The unpaid balance, including accrued interest, was \$111,572 at March 31, 2012 and December 31, 2011. The Company is not compliant with the repayment terms of this note.

The conversion price of the note and five-year warrants was not fixed and determinable on the date of issuance and as such in accordance with ASC Topic 815 "Derivatives and Hedging" ("ASC 815"), the embedded conversion options of the note and warrants on the date of issuance were valued using the binomial lattice options pricing model and recorded as derivative liabilities. The fair value of the conversion option and five-year warrants issued in connection with the note on the date of issuance aggregated \$95,497, and were recorded as debt discount. The debt discount was amortized through the term of the notes and amounted to \$95,497 for the year ended December 31, 2011.



vi. On March 2, 2012, the Company entered into an agreement to sell secured promissory notes for an aggregate principal amount of \$1,000,000, with warrants to purchase 2.5 shares the Company's common stock for each \$1 of the principal amount of the notes purchased. In addition, the Company will issue to the investment banker, warrants for the purchase of the number of shares of the Company's common stock equal to 10% of the common stock issuable in conjunction with the promissory notes sold in this offering. The three year warrants vesting immediately was 1,031,250 shares of the Company's common stock at an exercise price of \$.10 per share. The notes bear interest at 18% and have a maturity date of September 2, 2012. At the time of any new debt or equity financing of the Company, the note balance of principal and interest may be converted into the number of fully paid and non-assessable debt instruments, shares/or units to be issued in the financing. The Company received \$375,000 in gross proceeds during the three months ended March 31, 2012. The unpaid balance, including accrued interest, was \$377,219 at March 31, 2012. As of June 18, a total of \$850,000 has been raised by the offering.

The conversion price of the note and three-year warrants was not fixed and determinable on the date of issuance and as such in accordance with ASC Topic 815 "Derivatives and Hedging" ("ASC 815"), the embedded conversion options of the note and warrants on the date of issuance were valued using the binomial lattice options pricing model and recorded as derivative liabilities. The fair value of the conversion option and three-year warrants issued in connection with the note on the date of issuance aggregated \$341,509, and were recorded as debt discount. The debt discount was amortized through the term of the notes and amounted to \$25,542 for the three months ended March 31, 2012.

## 7. FAIR VALUE MEASURES

ASC 820 "Fair Value Measurements and Disclosures" defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. As defined in ASC 820, fair value is 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. The Standard clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date and emphasizes that fair value is a market-based measurement and not an entity-specific measurement.

ASC 820 establishes the following hierarchy used in fair value measurements and expands the required disclosures of assets and liabilities measured at fair value:

Level 1 – Inputs use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 – Inputs use other inputs that are observable, either directly or indirectly. These inputs include quoted prices for similar assets and liabilities in active markets as well as other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 – Inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair measurements requires judgment and considers factors specific to each asset or liability.

The following table provides the assets and liabilities carried at fair value measured on a recurring basis as of March 31, 2012 and December 31, 2011, respectively:

	Fair Value Measurements			Total
	Level 1	Level 2	Level 3	
Derivative liabilities:				
March 31, 2012	\$-	\$-	\$789,058	\$789,058
December 31, 2011	\$-	\$-	\$155,813	\$155,813

The 2010 derivative liabilities are measured at fair value using the Black-Scholes options pricing model, which approximates the binomial lattice options pricing model, and are classified within Level 3 of the valuation hierarchy. The 2012 and 2011 derivative liabilities are measured at fair value using the binomial lattice options pricing model, and are classified within Level 3 of the valuation hierarchy. 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:

	Three Month Ended March 31, 2012	Year Ended December 31, 2011
Fair value, beginning of period	\$ 155,813	\$ 84,819
Derivative liabilities recorded during the period	354,980	357,040
Reclassification to equity upon conversion of note	-	(66,836)
Net unrealized (gain) loss on derivative financial instruments	278,265	(219,210)
Fair value, end of period	\$ 789,058	\$ 155,813

## 8. STOCK OPTIONS AND WARRANTS

### Stock Options – Employment Letter Agreement:

On January 6, 2012, in conjunction with Mark Zeller's employment as the Company's North American Director of Sales the Company provided an option to purchase 1,500,000 shares of common stock at \$0.20 per share. The option has a life of five years and 250,000 options vested immediately and 416,667 shares vest on each anniversary after such date. The fair value option was approximately \$44,000.

The Company recognized stock based compensation expense included in general and administrative expenses on the consolidated statement of operations for the three months ended March 31, 2012 and 2011, for \$30,134 and \$8,719, respectively for these awards.

## Options Summary:

A summary of option activity during the three months ended March 31, 2012 and year ended December 31, 2011 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Intrinsic Value
Balance at December 31, 2010	33,750	\$10.20	3.88	\$-
Granted	2,950,000	\$0.20	7.00	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Balance at December 31, 2011	2,983,750	\$0.31	4.00	\$-
Granted	1,500,000	\$0.20	5.00	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Balance at March 31, 2012	4,483,750	\$0.28	4.21	\$-
Exercisable at March 31, 2012	1,758,750	\$0.28	4.21	\$-

## Common Stock Warrants Summary:

Warrant transactions during the three months ended March 31, 2012 and the year ended December 31, 2011 are as follows:

	Number of Warrants	Weighted Average Exercise Price	Average Remaining Life In Years	Intrinsic Value
Balance, December 31, 2010	394,858	\$ 15.2		
Granted	5,787,290	0.12		
Exercised	-	-		
Forfeited	(320,008)	18.81		
Balance, December 31, 2011	5,862,140	\$ 0.12		
Granted	1,643,750	0.13		
Exercised	-	-		
Forfeited	-	-		
Balance, March 31, 2012	7,505,890	\$ 0.12	3.16	\$ 744,132
Exercisable, March 31, 2012	7,505,890	\$ 0.12	3.16	\$ 744,132

The intrinsic value is calculated on the difference between the fair market value of the Company's restricted stock, which was \$0.20 per share as of March 31, 2012, and the exercise price of the warrants.

The following table presents information related to warrants at March 31, 2012:

Warrants Outstanding		Warrants Exercisable	
Exercise Price	Number of Warrants	Weighted	Exercisable
		Average Remaining Life In Years	Number of Warrants
\$0.001	74,850	1.50	74,850
0.01	452,354	1.83	452,354
0.01	795,866	3.88	795,866
0.25	705,882	4.08	705,882
0.25	575,000	4.21	575,000
0.01	452,355	4.25	452,355
0.25	1,098,220	4.29	1,098,220
0.001	1,020,113	2.50	1,020,113
0.10	875,000	2.63	875,000
0.10	125,000	2.92	125,000
0.25	300,000	2.92	300,000
0.10	1,031,250	2.96	1,031,250
	7,505,890	3.16	7,505,890

## 9. RELATED PARTY TRANSACTIONS

### Consulting Agreement

On July 1, 2008, the Company signed a 16 month consulting agreement with a related party. The consulting services include financial advisory, investment relations and certain administrative and other services for \$6,250 monthly fees. At March 31, 2012 and December 31, 2011, the Company owed \$100,000 related to above consulting services, which is included in accrued expenses and other current liabilities in the condensed consolidated balance sheets.

### Employee Warrants

On February 29, 2012, an employee was granted three year warrants to purchase 300,000 shares of the Company's common stock for services to the Company. The warrants vest immediately with an exercise price of \$0.25 per share. The Company recorded a charge for \$6,149 to stock based compensation for the three months ended March 31, 2012.

## 10. COMMITMENTS AND CONTINGENCIES

### Agreements

On September 27, 2010 the Company signed a twelve month agreement for investment banking services which was renewed for another 12 months. The banking services include equity financing, business combinations and other financing transactions. The compensation to the banker includes a flat fee plus other compensation as defined in the agreement. The agreement includes three year warrants "Initial Warrants", which were fully vested on the date of the grant to purchase 74,850 shares of Company's common stock at an exercise price of \$0.001 per share. The fair value of the award was \$19,443 and is amortized over the term of the agreement; accordingly, the Company recorded a stock based compensation charge of \$4,861 for the three months ended March 31, 2011.

In addition, the agreement provides for an additional warrant to be issued by the Company upon the 1 year anniversary provided that the banker did not exercise any of their other compensation elements as defined in the agreement. This warrant carries a cashless exercise provision and is limited to up to 4.99% of the Company's outstanding common stock on a fully diluted basis. In September 2011, the Company issued warrants to purchase 1,020,113 shares of the Company's common stock. The warrants are exercisable at \$0.001 per share, have a life of 3 years and were fully vested on the date of the grant. The fair value of the award was \$213,215 and is amortized over the term of the agreement; accordingly, the Company recorded a stock based compensation charge of \$53,304 for the three months ended March 31, 2012.

On November 2, 2010, the Company entered into an agreement with an attorney for general corporate and transactional matters that provide a 3.50% equity interest in the Company upon meeting certain milestones. These milestones were met in February 2011, and the attorney was granted 5 year warrants vesting on February 14, 2011 to purchase 795,866 shares of Company's common stock at an exercise price of \$0.01 per share. The warrant was fully vested on the date of the grant and accordingly the Company recorded a stock based compensation charge of \$279,453 for the three months ended March 31, 2011 which represents the fair value of the award.

### Legal matters

In the normal course of business, the Company is, and in the future may be, subject to various disputes, claims, lawsuits, and administrative proceedings arising in the ordinary course of business with respect to commercial, product liability, employment, and other matters, which could involve substantial amounts of damages. In the opinion of management, any liability related to any such known proceedings would not have a material adverse effect on the

business or financial condition of the Company. Additionally, from time to time, the Company may pursue litigation against third parties to enforce or protect the Company's rights under the Company's trademarks, trade secrets and the Company's intellectual property rights generally.

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During 2010, the Company was served with three lawsuits for past due liabilities of the Company. The first lawsuit was Peri & Sons, plaintiff, vs. Organic Alliance, Inc. and Parker Booth, defendants, for past due produce liabilities. An agreement was reached and OAI has been making payments to the plaintiff. OAI was dismissed from the action and signed a confession of judgment. Over half of the past due amount has been paid with a balance of approximately \$21,000 remaining. The second lawsuit filed in the US. District Court, Northern California District by a group of plaintiffs: Full Circle Sales, Inc., Growers Express LLC, Steinbeck County Produce Inc., Steve Almquist Sales and Brokerage, Dan Andrews Farms, Fresh Networks, LLC and Quebec Distributing Co., Inc., vs. Organic Alliance, Inc., defendant, for approximately \$97,000 plus attorney fees and interest. These plaintiffs are produce suppliers of the Company. An agreement was reached and three of the plaintiffs were paid in full for \$31,000. The balance of \$66,000 remains unpaid. The third lawsuit was filed in Monterey County Superior Court by RE Transportation, plaintiff, vs. Organic Alliance, Inc., defendant, seeking approximately \$34,000 principal plus interest at 18% per annum and attorney's fees. The plaintiff provided transportation services for the Company. An agreement was reach with the plaintiff receiving \$10,000 a month for three months starting May 2012. The Company has accrued for all amounts claimed.

#### 11. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	March 31, 2012	December 31, 2011
Due to consultant (Note 9)	\$100,000	\$100,000
Accrued consulting fees (Note 5)	694,742	694,742
Payroll and payroll taxes payable (A)	1,277,360	1,131,572
Other accrued liabilities	64,610	75,113
	\$2,136,712	\$2,001,427

(A) As of March 31 2011 and December 31, 2011, the Company has withheld \$163,949 and \$153,009 of payroll tax liabilities from wages paid which have yet to be remitted to the taxing authorities.

#### 12. SUBSEQUENT EVENTS

The Company evaluates events that have occurred after the balance sheet date but before the financial statements are issued. Based upon the evaluation, the Company did not identify any recognized or non-recognized subsequent events that would have required further adjustment to or disclosure in the consolidated financial statements.

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

The following discussion should be read in conjunction with the consolidated financial statements and related notes to the consolidated financial statements included elsewhere in this report. This discussion contains forward-looking statements that relate to future events or our future financial performance. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These forward-looking statements are based largely on our current expectations and are subject to a number of uncertainties and risks including the Risk Factors identified in our Annual Report on Form 10-K for the year ended December 31, 2011. Actual results could differ materially from these forward-looking statements. Organic Alliance, Inc. is sometimes referred to herein as “we”, “us”, “our” and the “Company”.

### OVERVIEW

#### Overview

Organic Alliance, Inc. ("OAI" or the "Company") is a sales and marketing distribution company that supplies conventional, organic, natural, and Fair Trade food products to the global market. Unlike most food marketers, OAI works directly with growers while also contracting farming production domestically and abroad to vertically integrate supply chains, reduce costs and provide a high degree of control over quality, food safety and production sustainability. Direct involvement in growing operations and an unparalleled international agriculture network allows the Company to develop new Organic and Fair Trade production and offer consistent supply with highly competitive pricing – the primary obstacles facing buyers in those fast growing segments. The Company also sources and distributes conventional produce (non-Organic and/or Fair Trade) using its high revenue potential to fuel development of Organic and Fair Trade production.

Beyond fresh produce, OAI applies its direct access to raw materials to create value-added consumer packaged goods and bulk products such as juices, oils, purees and dried fruit allowing a substantial cost and control edge over other large consumer packaged goods firms that rely on third parties for sourcing. Currently, the Company is focusing its sourcing and development strategy in Mexico, the U.S.'s largest food supplier with sales to the U.S. growing 25% in 2010 to \$6 Billion. The focus there is the growing greenhouse agriculture industry (35% in 2010), which drastically reduces the risks of contract farming – particularly in organics.<sup>1</sup> This strategy will be rolled out in stages to key Latin American food exporting countries where OAI currently has strong grower and professional networks in Argentina, Chile, Peru, Dominican Republic and Costa Rica.

The primary segments for marketing the Company's products are the mainstream supermarket channel, natural grocery chains, mass merchandisers, food service distributors, fresh produce processors, consumer package goods companies, and overseas markets focusing on grocery chains and their importer partners. The Company has strong food industry relationships and currently supply product to most of these market segments.

#### Organic Market

Globally, sales of organic products have grown rapidly since 2000, with food products driving the market. In particular, the United States has seen sales of organic foods grow from \$6.1 billion in 2000 to \$29.2 billion in 2011, up 9.4% from 2010. Registering a third straight year of double-digit gains, sales of organic fruits and vegetables rose 11.7% in 2011 to \$11.8 billion. The principal barriers to organic product growth are short supply and inconsistent quality /pricing, which OAI directly addresses. <sup>2</sup>



Organic certified foods are generally viewed as having a positive impact on one's health and long-term viability, even though studies are mixed. As Helpguide.org describes, some studies suggest that, on average, organically grown fruits and vegetables may contain slightly higher levels of vitamin C, trace minerals, and antioxidant phytonutrients than conventionally grown produce. Other studies, however, have found no nutritional differences between organic and non-organic foods.

Aside from the nutritional aspect, there is a more important part of the growing process related to chemicals. In crops that are grown using chemicals (fungicides, herbicides, insecticides) to ensure growth, the chemicals often never leave the product after it leaves the farms and ends up on the store shelves. Studies have linked certain chemicals used in farming to cancer, obesity, Alzheimer's and certain birth defects.<sup>3</sup>

1 Source: <http://www.ota.com/organic/mt/business.html>.

2

Source: <http://www.thepacker.com/fruit-vegetable-eneewsletter/organics-insider/Survey-organic-produce-grows-by-double-dig>

3 Source: <http://www.organicfoodinfo.net>.

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Another advantage of organic foods is that they are often fresher, because they lack the preservatives that other foods often contain. In addition, organic farming practices reduce pollution in the air, water and soil, and use less energy than traditional non-organic farms.<sup>4</sup> While these do not implicate or eliminate all non-organic foods, all things being equal, most would seek to consume organic foods for the benefits to the individual and to the earth.

#### Fair Trade

In addition to providing fresh, healthy foods, the Company is dedicated to the practice of Fair Trade. Global Fair Trade sales have followed the rise of organic at an 18% annual growth rate reaching a total of \$4.8 billion in 2009. Mainstream retailers such as Wal-Mart and Whole Foods have demonstrated strong interest in the segment with each offering a growing number of Fair Trade products including retail-brand private label options. In 2007, Whole Foods launched its 'Whole Trade' initiative requiring 50% of its imported food to be certified as Fair Trade within 10 years. Fair Trade sales in U.S. mainstream grocery outlets grew 24% in 2010. Like organic, the principal barrier to growth is lack of supply and inconsistent quality and/or pricing, which OAI directly addresses.

Fair Trade certification offers producers the ability to trade directly with improved payment terms while paying workers dignified wages and providing a premium for community development. This allows marginalized agricultural communities the opportunity to improve their lives with technical training, better business infrastructure, improved schooling, health care and nutritious food. Fair Trade investment provides a platform from which communities can rise out of poverty, be economically sustainable and take control of their future while providing the market with better, more sustainable products. Fair Trade certified products offer consumers a powerful way to reduce poverty through their everyday shopping.<sup>5</sup>

The key objectives of the Fair Trade standards are to:

- Ensure that producers receive prices that cover their average costs of sustainable production;
- Provide an additional Fair Trade premium which can be invested in projects that enhance social, economic and environmental development;
  - Ensure safe working conditions and dignified wages for agriculture workers
  - Facilitate long-term trading partnerships and enable greater producer control over the trading process; and
- Set clear minimum and progressive criteria to ensure that the conditions of production and trade of all Fair Trade certified products are socially, economically fair and environmentally responsible.

#### Sales and Marketing

Due to the continued increase in demand for certified organic and Fair Trade products, procurement departments are actively seeking additional sources. The challenge continues to be to attain a reliable, year round supply at sensible pricing for their buying programs, in part due to short supply and the fractionalized nature of the organic farm base. By taking control and developing organic and Fair Trade production at the seed level, OAI addresses these issues directly and attracts buyer favor by creating supply and price conditions that more closely resemble the conventional food alternative. While executing this strategy, OAI will continue using its operational infrastructure to sell high volumes of conventional produce to generate substantial resources for the execution of large-scale development in the organic and Fair Trade agriculture sectors.

OAI brand marketing leverages its direct relationships with growing communities to take advantage of the "know where your food comes from" consumer trend. This is supported by creating entertaining media that highlights the producer story; tracking sustainability metrics such as agrochemicals eliminated, wage increases and carbon emissions; and making these available to consumers online and at the point of purchase via the increasingly popular quick response ("QR") scan technology available on smart phones. The Company's conversations with grocery executives indicate that the industry is hungry for point-of-purchase methods of communicating product information

and promotional media. Additionally, Wal-Mart has developed and is implementing in phases its 'Sustainability Index' that will grade the level of sustainability of each of its supplier's products with a label. OAI believes it is far ahead of these trends and well poised to address the emerging production and communication needs of the 21st century food industry.

The primary segments for marketing the Company's products are the mainstream supermarket channel, natural grocery chains, mass merchandisers, food service distributors, fresh produce processors, consumer packaged goods companies, and overseas markets focusing on grocery chains and their importer partners. The Company has strong food industry relationships and currently supply product to most of these market segments with overseas markets in Asia being served.

4 Source: [http://www.helpguide.org/life/organic\\_foods\\_pesticides\\_gmo.htm](http://www.helpguide.org/life/organic_foods_pesticides_gmo.htm).

5 Source: [http://www.fairtrade.net/what\\_is\\_fairtrade.html](http://www.fairtrade.net/what_is_fairtrade.html).

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## History

NB Design & Licensing, Inc., (“NB Design”) was organized in September 2001. The former parent, New Bridge Products, Inc., was originally incorporated in August 1995 as a manufacturer of minivans and filed a petition in bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. Its Plan of Reorganization was approved by the U.S. Bankruptcy Court for the District of Arizona in September 2002 and NB Design was discharged from bankruptcy in October 2002. NB Design was inactive from October 2002 to April 29, 2008.

Organic Alliance Inc., a Texas corporation, (“Organic Texas”) was organized on February 19, 2008 to sell organically grown fruits and vegetables. During the second quarter of 2009, it ceased being a development stage company when it commenced its operations.

On April 29, 2008, NB Design, a Nevada corporation, acquired all 10,916,917 issued and outstanding shares of common stock of Organic Texas for 464,999 shares of the NB Design’s shares of common stock. Organic Texas thereupon became a wholly owned subsidiary of NB Design. The business of Organic Texas is the only business of NB Design. The Company operates in California.

The acquisition of Organic Texas by NB Design on April 29, 2008 was accounted for as a reverse capitalization in accordance with the Security and Exchange Commission’s (“SEC”) Division of Corporate Financial Reporting manual Topic 12 “Reverse Acquisition and Reverse Capitalization”. The reverse capitalization was the acquisition of a private operating company (Organic Texas) into a non-operating public shell corporation with nominal net assets and as such is treated as a capital transaction, rather than a business combination. As a result no goodwill is recorded. In this situation, NB Design is the legal acquirer because it issued its equity interests, and Organic Texas is the legal acquiree because its equity interests were acquired. However, NB Design is the acquiree and Organic Texas as the acquirer for accounting purposes. Organic Texas is treated as the continuing reporting entity that acquired the registrant, NB Design. The pre-acquisition financial statements of Organic Texas are treated as the historical financial statements of the consolidated companies. Pursuant to the Securities Exchange, NB Design issued 464,999 shares of the Company’s Common Stock for all of the issued and outstanding Common Stock of Organic Texas and assumed all assets and liabilities.

On June 2, 2008, the name NB Design was changed to Organic Alliance, Inc. On August 29, 2008, the name of Organic Texas was changed to Organic Texas, Inc.

## Critical Accounting Estimates and Policies

**Use of Estimates** - The preparation of consolidated 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly sensitive to change in the near term include but are not limited to, realization of deferred tax assets, allowance for doubtful accounts, derivative liabilities and assumptions used in share based payment transactions. Actual results could differ from those estimates.

**Principles of Consolidation** - The consolidated financial statements include the accounts of Organic Alliance, Inc. and its wholly owned subsidiary, Organic Texas, Inc. (collectively, the "Company"). All significant inter-company transactions and balances have been eliminated in consolidation.

**Allowance for Doubtful Accounts** - An allowance for uncollectible accounts receivable is recorded based on a combination of aging analysis, past practices and any specific troubled accounts. The Company's produce is sold to the Company's customers for cash or on credit terms which are established in accordance with local and industry practices and typically require payment within 10 to 30 days of delivery. Accounts are written off when uncollectibility is confirmed. Subsequent recoveries, if any, are credited to the allowance account. The allowance for doubtful accounts amounted to \$77,969 at March 31, 2012 and December 31, 2011, respectively.

In addition, the Company also factors its receivables with full recourse and, as a result, accounts for the factoring akin to a secured borrowing, maintaining the gross receivable asset and due to factor liability on its books and records. In connection with the factoring of its receivables, the Company estimates an allowance for factoring fees associated with the collections. These fees range from 3% to 5% depending on the actual timing of the collection. The actual recognition of such fees may differ from the estimates depending upon the timing of collections.

**Inventory** - Inventory is stated at the lower of cost (first-in, first-out) or market, and includes produce the Company purchases from growers and packaging materials. The Company held \$19,073 and \$0 of inventory as of March 31, 2012 and December 31, 2011, respectively.

**Income Taxes** - The Company uses the asset and liability method of accounting for income taxes in accordance with ASC Topic 740, "Income Taxes". Under this method, income tax expense is recognized for the amount of (i) taxes payable or refundable for the current year and (ii) deferred tax consequences of temporary differences resulting from matters that have been recognized in an entity's financial statements or tax returns. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is provided to reduce the deferred tax assets reported if based on the weight of the available positive and negative evidence, it is more likely than not some portion or all of the deferred tax assets will not be realized.

**Fair Value of Financial Instruments** - The carrying amounts of financial instruments, including cash, receivables, and accounts payable and accrued expenses approximated fair value as of the balance sheet date presented, because of the relatively short maturity dates on these instruments. The carrying amounts of the notes payable issued approximate fair value as of the balance sheet date presented, because interest rates and other terms on these instruments approximate terms currently available on similar instruments.

**Derivative Financial Instruments** - The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks. The Company evaluates all of the Company's financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial

instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the statements of operations. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the instrument could be required within 12 months of the balance sheet date.

Revenue Recognition - Revenue is recorded when (1) the customer accepts delivery of the product and title has been transferred and the Company has no significant obligations remaining to be performed; (2) a final understanding as to specific nature and terms of the agreed upon transaction has occurred; (3) price is fixed and (4) collection is reasonably assured. Sales are presented net of discounts and allowances.

Share Based Compensation - The Company accounts for share-based compensation in accordance with the fair value recognition provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") No. 718. Share-based compensation expense for all share-based payment awards is based on the estimated grant-date fair value. The Company recognizes these compensation costs over the requisite service period of the award, which is generally the option vesting term. Option valuation models require the input of highly subjective assumptions, including the expected life of the option, and such assumptions can materially affect the fair value estimate. The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model. The Company accounts for the expected life of options in accordance with the "simplified" method provisions of SEC Staff Accounting Bulletin ("SAB") No. 110, which enables the use of the simplified method for "plain vanilla" share options as defined in SAB No. 107.

## Results of Operations

Results of operations for the three months ended March 31, 2012 compared to the three months ended March 31, 2011

For the three months ended March 31, 2012, the Company had net sales of \$336,007 compared to \$255,755, for the three months ended March 31, 2011. The \$80,252, or 31% increase is attributable to additional funding available from the new financial services company advancing 80% of qualified customer invoices to the Company. The new financial services company commenced funding during February 2011.

For the three months ended March 31, 2012, our cost of goods sold was \$302,863 compared to \$248,405 for the three months ended March 31, 2011.

For the three months ended March 31, 2012 and 2011, respectively, our gross margin was \$33,144 and \$7,350. The increased gross margin is attributable to the higher net sales and more efficient purchasing practices.

For the three months ended March 31, 2012, the Company had general and administrative (“G&A”) expenses of \$456,842 compared to \$1,075,467 for the three months ended March 31, 2011. The decrease in G&A expenses of \$618,625, or 58%, is primarily attributable to decreased share based compensation costs of approximately \$716,000 as no new shares were issued during the three months ended March 31, 2012, offset by increased payroll of approximately \$84,000 for the hiring of Barry Brookstein, CFO and Mark Zeller, North American Director of Sales.

For the three months ended March 31, 2012, our operating loss was \$423,698 compared to \$1,068,117 for the three months ended March 31, 2011. The \$644,419, or 60%, decrease is related to lower G&A expenses discussed above.

For the three months ended March 31, 2012, other expense was \$507,135 compared to \$104,873 for three months ended March 31, 2011. Interest expense was \$52,848 and \$32,313 on notes and loans payable for the three months ended March 31, 2012 and 2011, respectively, which also included \$34,625 and \$16,813, amortization of finance discount on notes payable, \$75,387 and \$7,881, amortization of derivative discount on notes payable and \$13,510 and \$7,294, related to factor advances, and a \$278,265 and 40,572 loss on derivative liability for convertible notes payable. Also included in the three months ended March 31, 2012 are finance fees of approximately \$53,000 for the \$375,000 sold under our agreement to sell secured promissory notes.

For the three months ended March 31, 2012, net loss was \$930,833, or \$0.05, basic and basic and diluted loss per share compared to \$1,172,990, or \$0.19, basic and diluted loss per share for the three months ended March 31, 2011. The \$242,157 or 21% decrease in net loss was primarily attributable to the factors described above.

### Liquidity and Capital Resources

The Company's operations to date have generated substantial losses that have been funded through the issuance of common stock and loans from related parties and others. The Company will require additional sources of outside capital to continue the Company's operations. The Company expects that the Company's primary source of cash in the future will be from the issuance of common stock, loans, accounts receivable factoring and a line of credit. On November 1, 2010, the Company signed a one year agreement with a financial services company for the purchase and sale of accounts receivables which expired on October 31, 2011. The agreement is continuing on a month to month basis. The financial services company advances up to 80% of qualified customer invoices less applicable discount fee, and holds the remaining 20% as a reserve until the customer pays the financial services company. The released reserves are used to fund other vendor purchases or returned to the Company. The Company is charged 3% for the first 30 days outstanding plus 1/10 of 1% for funds outstanding over 30 days. Uncollectable customer invoices are charged back to the Company. The new financial services company commenced funding during February 2011. As of March 31, 2012, the Company has withheld \$163,949 of payroll tax liabilities from wages paid which have yet to be remitted to the taxing authorities.

The consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America applicable for a going concern which assumes that the Company will realize its assets and discharge its liabilities in the ordinary course of business. As of March 31, 2012, the Company has limited cash, a working capital deficit of approximately \$5,223,000 and has accumulated losses of approximately \$14,386,000 since its inception.

Its ability to continue as a going concern is dependent upon the ability of the Company to obtain the necessary financing to meet its obligations and pay its liabilities arising from normal business operations when they come due and increasing its revenue in order to achieve profitable operations. The Company estimates a \$2,000,000 capital infusion will be required to continue operations through the end of 2012. The outcome of these matters cannot be predicted with any certainty at this time and raises 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.

Generally, the Company primarily has financed operations to date through the proceeds of the private placement of equity securities and the issuance of promissory notes.

For the period from inception (February 19, 2008) to March 31, 2012, the Company received approximately \$212,000 from the sale of our common stock and received proceeds from the notes payable of \$2,668,543, of which \$194,410



has been paid back and \$822,134 has been converted to shares of the Company's common stock as of March 31, 2012.

The Company has limited funding available for marketing and will rely solely on our ability to raise debt or equity funds in the immediate future.

Our contractual obligations consist of notes and loans payable in the amount of \$1,806,075, including accrued interest of \$154,076, for the notes at March 31, 2012.

On February 3, 2011, the Company signed a \$500,000 promissory note with a maturity date of August 2, 2012, and with an interest rate of 15% per annum.

On April 28, 2011, the Company issued a \$70,588 convertible promissory note with an original issue discount of 15%. The convertible promissory note has a maturity date of the earlier of (i) the Company raising debt or equity financing of \$600,000 or more, or (ii) May 31, 2011. The note may be converted into the Company's common stock by the holder at \$0.05 per share. The Company received a waiver from the lender on September 1, 2011 that defers payment until May 31, 2012 and waives the provision for payment upon the Company closing a debt or equity financing of \$600,000 or more. The Company is currently negotiating an extension of such loan.

On June 15, 2011, the Company issued a \$57,500 convertible promissory note with an original issue discount of 15%. The convertible promissory note has a maturity date of the earlier of (i) the Company raising debt or equity financing of \$600,000 or more, or (ii) June 14, 2012. The note may be converted into the Company's common stock by the holder at \$0.05 per share. The Company received a waiver from the lender on September 1, 2011 that waives the provision for payment upon the Company closing a debt or equity financing of \$600,000 or more.

During June 2011, the Company entered into an agreement with a financial services company to provide deposits to suppliers not covered by the financial services company contracted with on November 1, 2010. The financial services company advances deposits to suppliers in return for 1/3 of the gross margin paid by the customer.

During July 2011, the Company entered into an agreement with a second financial services company to provide deposits to suppliers not covered by the financial services company contracted with on November 1, 2010. The financial services company advances deposits to suppliers in return for 1/3 of the gross margin paid by the customer.

On July 15, 2011, the Company issued a \$109,822 convertible promissory note with an original issue discount of 15% that consolidated various demand notes from September 2010 through July 2011. The convertible promissory note has a maturity date of the earlier of (i) the Company raising debt or equity financing of \$600,000 or more, or (ii) August 31, 2011. The note may be converted into the Company's common stock by the holder at \$0.05 per share. The Company is currently negotiating an extension of such loan.

On August 22, 2011, an employee advanced the Company \$6,000 which was evidenced by promissory note bearing interest at 5% per annum and payable on demand.

On October 10, 2011, an employee advanced the Company \$10,000, which was evidenced by promissory note bearing interest at 5% per annum and payable on demand.

On October 17, 2011, the Company issued a \$400,000 convertible multi-draw term loan facility ("loan") to an entity owned by a related party. The loan bears interest at 21% and has a maturity date of the earlier of an event of default or April 17, 2012. In addition, the related party received a warrant to purchase 2.5 shares of the Company's common stock for each \$1.00 of principal extended to the Company up to 1,000,000 shares. The Company is currently negotiating an extension of such loan. As of June 18, a total of \$400,000 has been advanced on the loan.

On February 28, 2012, the Company issued a \$50,000 convertible note to a related party. The loan bears interest at 21% and has a maturity date of the earlier of an event of default or August 28, 2012.

On March 2, 2012, the Company entered into an agreement to sell secured promissory notes for an aggregate principal amount of \$1,000,000, with warrants to purchase 2.5 shares the Company's common stock for each \$1 of the principal amount of the notes purchased. In addition, the Company will issue to the investment banker, warrants for the purchase of the number of shares of the Company's common stock equal to 10% of the common stock issuable in conjunction with the promissory notes sold in this offering. As of June 18, a total of \$850,000 has been raised by the offering.

#### Net Cash Flows

For the three months ended March 31, 2012, net cash used in operating activities was \$372,875 compared to \$731,384 for three months ended March 31, 2011. The decrease of \$358,509, or 49%, was primarily attributable to the payments of accounts payable from the proceeds provided from notes payable during the three months ended March 31, 2011, and improvements in account receivable collections, offset by accrued expense.

For the three months ended March 31, 2012, net cash provided by financing activities was \$468,842 compared to \$729,931 for three months ended March 31, 2011. The decrease of \$261,089, or 36%, was related to proceeds from notes payable issued to third parties and advances from factor.

At March 31, 2012 and 2011, respectively, the Company had 4,483,750 and 33,750 stock options and 7,505,890 and 1,643,078 common stock purchase warrants outstanding. The outstanding stock options have a weighted average exercise price of \$0.12 per share. The outstanding warrants have an exercise price from \$0.001 to \$0.25 per share. Accordingly, at March 31, 2012, the outstanding options and warrants represented a total of 11,989,640 shares issuable for a maximum of \$2,125,251 if all of the options and warrants were exercised. The exercise of these options and warrants is at the discretion of the holder. There is no assurance that any of these options or any additional warrants will be exercised.

#### Off Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

The Company's management team, under the supervision and with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act), as of the last day of the fiscal period covered by this report, March 31, 2012. The term disclosure controls and procedures means the Company's controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that the Company filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that the Company filed or submitted under the Exchange Act is accumulated and communicated to management, including the Company's principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

The Company's principal executive officer and principal financial officer are responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Management is required to base its assessment of the effectiveness of the Company's internal control over financial reporting on a suitable, recognized control framework, such as the framework developed by the Committee of Sponsoring Organizations (COSO). The COSO framework, published in Internal Control-Integrated Framework, is known as the COSO Report. The Company's principal executive officer and principal financial officer, has chosen the COSO framework on which to base its assessment. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were not effective as of March 31, 2012.

The controls designed were adequate for financial disclosures required for the preparation of the 10-Q filing; however due to lack of resources in the Company's accounting department the controls were not operating effectively. The remediation plan for improving the effectiveness over financial disclosure controls, which caused the material weakness over financial disclosures required in the 10-K, include the creation of a financial disclosures roll-forward model in accordance with the disclosures contained in the 10-Q report. This model will be maintained and updated by Company staff and management as new business transactions require additional financial disclosures. As the

Company obtains additional resources these financial disclosures will be reviewed by an outside financial disclosure expert for completeness and accuracy earlier in the financial statement closing process cycle in order to help ensure completeness and accuracy for reporting financial disclosures. During October 2011, the Company hired Barry Brookstein as Chief Financial Officer to augment the Company's internal controls procedures and expand the Company's accounting staff.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable and not absolute assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of certain events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

## Management's Annual Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a set of processes designed by, or under the supervision of, a company's principal executive and principal financial officers, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the Company's transactions and dispositions of the Company's assets;
- provide reasonable assurance that The Company's transactions are recorded as necessary to permit preparation of the Company's financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of the Company's management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statement.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. It should be noted that any system of internal control, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on criteria established in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), as of December 31, 2011.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of annual or interim financial statements will not be prevented or detected. In connection with the assessment described above, management identified the following control deficiency that represents a material weakness at December 31, 2011:

- Due to the limited number of Company personnel, a lack of segregation of duties and responsibilities with respect to our cash and control over the disbursements related thereto. An essential part of internal control is for certain procedures to be properly segregated and the results of their performance are adequately reviewed. This is normally accomplished by assigning duties so that no one person handles a transaction from beginning to end and incompatible duties between functions are not handled by the same person.

As a result of this material weakness described above, management has concluded that, as of December 31, 2011, the Company's internal control over financial reporting was not effective based on the criteria in "Internal Control-Integrated Framework" issued by COSO. The Company intends to augment the Company's internal controls procedures and expand the Company's accounting staff. The Company intends to initiate measures to remediate and refine the Company's internal controls to address this identified material weakness as the Company grows and obtains a stronger cash position that would justify additional expenditures.



#### Changes in internal control over financial reporting

Based on the evaluation of the Company's management as required by paragraph (d) of Rule 13a-15(f) or 15d-15(f) under the SEC Act of 1934 the Company believes that there were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

#### PART II-OTHER INFORMATION

##### ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, the Company is, and in the future may be, subject to various disputes, claims, lawsuits, and administrative proceedings arising in the ordinary course of business with respect to commercial, product liability, employment, and other matters, which could involve substantial amounts of damages. In the opinion of management, any liability related to any such known proceedings would not have a material adverse effect on the business or financial condition of the Company. Additionally, from time to time, the Company may pursue litigation against third parties to enforce or protect our rights under our trademarks, trade secrets and our intellectual property rights generally.

During 2010, the Company was served with three lawsuits for past due liabilities of the Company. The first lawsuit was Peri & Sons, plaintiff, vs. Organic Alliance, Inc. and Parker Booth, defendants, for past due produce liabilities. An agreement was reached and OAI has been making payments to the plaintiff. OAI was dismissed from the action and signed a confession of judgment. Over half of the past due amount has been paid with a balance of approximately \$21,000 remaining. The second lawsuit filed in the US. District Court, Northern California District by a group of plaintiffs: Full Circle Sales, Inc., Growers Express LLC, Steinbeck County Produce Inc., Steve Almquist Sales and Brokerage, Dan Andrews Farms, Fresh Networks, LLC and Quebec Distributing Co., Inc., vs. Organic Alliance, Inc., defendant, for approximately \$97,000 plus attorney fees and interest. These plaintiffs are produce suppliers of the Company. An agreement was reached and three of the plaintiffs were paid in full for \$31,000. The balance of \$66,000 remains unpaid. The third lawsuit was filed in Monterey County Superior Court by RE Transportation, plaintiff, vs. Organic Alliance, Inc., defendant, seeking approximately \$30,000 principal plus interest at 18% per annum and attorney's fees. The plaintiff provided transportation services for the Company. An agreement was reach with the plaintiff receiving \$10,000 a month for three months starting May 2012.

ITEM 1A. RISK FACTORS

Not applicable.

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

None.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURE

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See accompanying index to exhibits included after the signature page of this report for a list of exhibits filed or furnished with this report.

- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act



SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

ORGANIC ALLIANCE, INC.

By: /s/ Parker Booth  
Parker Booth  
Chief Executive Officer, and Director

Date: June 18, 2012

By: /s/ Barry Brookstein  
Barry Brookstein  
Chief Financial Officer

Date: June 18, 2012

INDEX TO EXHIBIT

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