

REEDS INC
Form 10-K
March 30, 2010

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2009

Commission File Number 000-32501

REED'S, INC.

(Exact name of registrant as specified in its charter)

| | |
|--|---------------------------------------|
| Delaware | 35-2177773 |
| State or other jurisdiction of incorporation or organization | I.R.S. Employer Identification Number |

| | |
|--|----------|
| 13000 South Spring Street | 90061 |
| Los Angeles, California | Zip Code |
| Address of principal executive offices | |

(310) 217-9400
Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

| Title of Class | Name of each exchange where registered |
|---|--|
| Common Stock, \$.0001 par value per share | The NASDAQ Stock Market LLC |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer" and "small reporting company" 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

The aggregate market value of the voting and non-voting common equity held by non-affiliates (excluding voting shares held by officers and directors) as of June 30, 2009 was \$9,947,000

10,104,109 common shares, \$.001 par value, were outstanding on March 23, 2010.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS AND INFORMATION

This Annual Report on Form 10-K (“Annual Report”), the other reports, statements, and information that we have previously filed or that we may subsequently file with the Securities and Exchange Commission (“SEC”) and public announcements that we have previously made or may subsequently make include, may include, incorporate by reference or may incorporate by reference certain statements that may be deemed to be forward-looking statements. The forward-looking statements included or incorporated by reference in this Annual Report and those reports, statements, information and announcements address activities, events or developments that Reed’s, Inc. (together with its subsidiaries hereinafter referred to as “we,” “us,” “our” or “Reed’s”) expects or anticipates will or may occur in the future. Any statements in this document about expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and are forward-looking statements. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “will continue,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would” and “outlook,” and similar. Accordingly, these statements involve estimates, assumptions and uncertainties, which could cause actual results to differ materially from those expressed in them. Any forward-looking statements are qualified in their entirety by reference to the factors discussed throughout this document. All forward-looking statements concerning economic conditions, rates of growth, rates of income or values as may be included in this document are based on information available to us on the dates noted, and we assume no obligation to update any such forward-looking statements.

The risk factors referred to in this Annual Report could cause actual results or outcomes to differ materially from those expressed in any forward-looking statements made by us, and you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made and we do not undertake any obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Management cautions that these statements are qualified by their terms and/or important factors, many of which are outside of our control, involve a number of risks, uncertainties and other factors that could cause actual results and events to differ materially from the statements made, including, but not limited to, the following, and other factors discussed elsewhere in this Annual Report, including under the section entitled “Risk Factors:”

- Our ability to generate sufficient cash flow to support capital expansion plans and general operating activities,
- Decreased demand for our products resulting from changes in consumer preferences,
- Competitive products and pricing pressures and our ability to gain or maintain its share of sales in the marketplace,
- The introduction of new products,
- Our being subject to a broad range of evolving federal, state and local laws and regulations including those regarding the labeling and safety of food products, establishing ingredient designations and standards of identity for certain foods, environmental protections, as well as worker health and safety. Changes in these laws and regulations could have a material effect on the way in which we produce and market our products and could result in increased costs,

- Changes in the cost and availability of raw materials and the ability to maintain our supply arrangements and relationships and procure timely and/or adequate production of all or any of our products,
- Our ability to penetrate new markets and maintain or expand existing markets,

- Maintaining existing relationships and expanding the distributor network of our products,
- The marketing efforts of distributors of our products, most of whom also distribute products that are competitive with our products,
- Decisions by distributors, grocery chains, specialty chain stores, club stores and other customers to discontinue carrying all or any of our products that they are carrying at any time,
- The availability and cost of capital to finance our working capital needs and growth plans,
- The effectiveness of our advertising, marketing and promotional programs,
- Changes in product category consumption,
- Economic and political changes,
- Consumer acceptance of new products, including taste test comparisons,
- Possible recalls of our products, and
- Our ability to make suitable arrangements for the co-packing of any of our products.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements.

PART I

Item 1. Business

Background

We develop, manufacture, market, and sell natural non-alcoholic and “New Age” beverages, candies and ice creams. “New Age Beverages” is a category that includes natural soda, fruit juices and fruit drinks, ready-to-drink teas, sports drinks and water. We currently manufacture, market and sell eight unique product lines:

- Reed’s Ginger Brews,
- Virgil’s Root Beer, Cream Sodas and Real Cola, including diet sodas,
- China Colas,
- Reed’s Ginger Chews,
- Reed’s Ginger Ice Creams,
- Sonoma Sparkler Sparkling Juices,
- R(x)eed’s Nausea Relief, and
- Energy Elixir

In addition, we have a growing private label business and have two national chains that we deliver private labels products.

We sell most of our products in specialty gourmet and natural food stores (estimated at approximately 4,000 smaller or specialty stores and approximately 3,000 supermarket format stores), supermarket chains (estimated at approximately 7,000 stores), retail stores and restaurants in the United States and, to a lesser degree, in Canada, Europe and other international territories. We primarily sell our products through a network of natural, gourmet and independent distributors. We also maintain an organization of in-house sales managers who work mainly in the stores serviced by our natural, gourmet and mainstream distributors and with our distributors. We also work with regional, independent sales representatives who maintain store and distributor relationships in a specified territory.

We produce and co-pack our products in part at our facility in Los Angeles, California, known as the Brewery, and primarily at a contracted co-packing facility in Pennsylvania. The co-pack facility in Pennsylvania supplies us with soda products for the eastern half of the United States and nationally for soda products that we do not produce at The Brewery. Our ice creams are co-packed for us at a facility in upstate New York. We pack our candy products at the Brewery.

Key elements of our business strategy include:

- increase our relationship with and sales to the approximately 10,500 supermarkets that carry our products in natural and mainstream,
 - stimulate consumer demand and awareness for our existing brands and products,
- develop additional alternative and natural beverage brands and other products, including specialty packaging and alternative uses for our products, such as our new nausea relief product,
 - develop and produce private-label products for select customers,
 - lower our cost of sales for our products, and
- optimize the size of our sales force to manage our relationships with distributors.

Our current sales effort is focused on building our business in our approximately 10,500 natural and mainstream supermarket accounts in the U.S. and Canada.

We create consumer demand for our products by:

- supporting in-store sampling programs of our products,
- generating free press through public relations,
- advertising in store publications,
- maintaining a company website (www.reedsgingerbrew.com),
- participating in large public events as sponsors; and
- partnering with alcohol brands such as Dewar's and Bacardi to create co-branded cocktail recipes such as "Dewar's and Reeds" and a "Reed's Dark and Stormy."

Our principal executive offices are located at 13000 South Spring Street, Los Angeles, California 90061. Our telephone number is (310) 217-9400. Our Internet address is (www.reedsgingerbrew.com). Information contained on our website or that is accessible through our website should not be considered to be part of this Annual Report.

Historical Development

In June 1987, Christopher J. Reed, our founder and Chief Executive Officer, began development of Reed's Original Ginger Brew, his first beverage creation. After two years of development, the product was introduced to the market in Southern California stores in 1989. By 1990, we began marketing our products through natural food distributors and moved our production to a larger facility in Boulder, Colorado.

In 1991, we incorporated our business operations in the state of Florida under the name of Original Beverage Corporation and moved all of our production to a co-pack facility in Pennsylvania. We began exhibiting at national natural and specialty food trade shows, which brought national distribution in natural, gourmet and specialty foods and the signing of our first mainstream supermarket distributor. Our products began to receive trade industry recognition as an outstanding new product. The United States National Association of the Specialty Food Trade, or NASFT, named Original Ginger Brew as an "Outstanding Beverage Finalist" in the United States in 1997, and the Canadian Fancy Food Association, or CFFA, awarded us "Best Imported Food Product" in 1991.

Throughout the 1990's, we continued to develop and launch new Ginger Brew varieties. Reed's Ginger Brews reached broad placement in natural and gourmet foods stores nationwide through major specialty, natural/gourmet and mainstream food and beverage distributors.

In 1997, we began licensing the products of China Cola and eventually acquired the rights to that product in December 2000. In addition, we launched Reed's Crystallized Ginger Candy, a product which we manufacture in Fiji under a proprietary, natural, non-sulfured process. In 1999, we purchased the Virgil's Root Beer brand from the Crowley Beverage Company. The brand has won numerous gourmet awards. In 2000, we began to market three new products: Reed's Original Ginger Ice Cream, Reed's Cherry Ginger Brew and a beautiful designer 10-ounce gift tin of our Reed's Crystallized Ginger Candy. In December 2000, we purchased an 18,000 square foot warehouse property, the Brewery, in Los Angeles, California, to house our west coast production and warehouse facility. The Brewery now also serves as our principal executive offices. In 2001, pursuant to a reincorporation merger, we changed our state of incorporation to Delaware and also changed our name to Reed's, Inc. We also introduced our Reed's Chocolate Ginger Ice Cream and Reed's Green Tea Ginger Ice Cream products and expanded our confectionary line with two new candy products: Reed's Crystallized Ginger Baking Bits and Reed's Ginger Chews. In 2002, we launched our Reed's Ginger Juice Brew line, with four flavors of organic juice blends. In November 2002, we completed our first test runs of Reed's and Virgil's products at the Brewery and in January 2003, our first commercially available products came off the Los Angeles line. In 2003, we commenced our own direct distribution in Southern California and introduced sales of our 5-liter Virgil's party keg. In 2004, we expanded our product line to include Virgil's Cream Soda (including in a 5-liter keg), Reed's Spiced Apple Brew in a 750 ml. champagne bottle and draught Virgil's Root Beer and Cream Soda. In 2006, we expanded our product line to include Virgil's Black Cherry Cream Soda. Progressive Grocers, a top trade publication in the grocery industry voted this product as the best new beverage product of 2006. On December 12, 2006, we completed the sale of 2,000,000 shares of our common stock at an offering price of \$4.00 per share in our initial public offering. The public offering resulted in gross proceeds of \$8,000,000 to us.

In 2007, we executed several elements of our business plan, including the hiring of several key personnel such as a Chief Operating Officer, two Senior Vice Presidents of Sales, an Executive Vice President of Sales and several sales personnel. In addition, we developed and launched a line of diet sodas of the three flavors of the Virgil's brand and introduced a new 7 ounce package of our Extra Ginger Brew. We gained a warehouse immediately adjacent to our principal executive office and brewery in Los Angeles that serves as our finished goods warehouse. We executed

several agreements with distributors that service mainstream retailers that expand our product reach beyond our core reach of natural and specialty retailers through direct store distribution (known as DSD). The relationships with these distributors are supported, in large part, by one of our Senior Vice Presidents of Sales and newly hired sales staff. We hired a Senior Vice President of Sales to develop sales into national accounts, such as grocery store chains, club stores and other large retailers that can be serviced either directly or through our existing natural foods distributors or mainstream distributors. We also hired an Executive Vice President of Sales and reassigned an existing sales executive to co-lead our initiative to introduce our products to international customers in Europe, Asia, the Middle East and South America. Also in 2007, we raised a net of \$7,600,000 in a private placement.

In 2008, we refined our sales strategy to focus our sales efforts on the estimated 10,500 natural and mainstream supermarket grocery stores that carry our products. Our 2007 sales strategy had focused on a more global effort to hit all the accounts in certain regions of the Country. As part of our sales forces' new direction, we consolidated roles and reduced the sales staff by 16 people from 33 at the end of 2007 to 10 at end of 2008. We also launched our Peanut Butter Ginger Chews in 2008, the second candy in the Reed's Ginger Chew line.

In 2009, we continued our focus on natural and mainstream supermarket grocery stores that carry our products. We introduced our Energy Elixir and our Orange Cream Soda. We also began our initiative to produce and sell private-label products. We acquired an additional product line, the Sonoma Sparkler brand, which is anticipated to increase revenues during the holiday season. Sonoma Sparkler beverages are sparkling juices in 750ml and 12oz sizes.

In 2010, we launched our R(x)eed's Nausea Relief drink for the drug store channel in 5.5 oz cans in full wrapped four pack boxes.

Industry Overview

Our beverages fall within the New Age Beverage category, which we believe is growing rapidly. Consumer awareness of the health risks of too much sugar, in addition to studies evidencing the athletic performance benefits of proper hydration plus a variety of new beverages/serving sizes are, we believe, fueling robust sales in the New Age Beverage category that currently exceeds \$17 billion annually.

We also believe the non-chocolate candy segment, such as Reed's Ginger Chews, will continue to be a growth segment as well. Non-chocolate candy sales increased 4.2% from 2006 to 2007, according to the National Confectioners Association (NCA). Additionally, the annual confectionary retail sales (including chocolate, non-chocolate and gum sales) in the United States were approximately \$28.2 billion in 2006, of which approximately \$8.9 billion was non-chocolate candy.

Furthermore, we believe that the packaged ice cream industry, which includes economy, regular, premium and super-premium products has the potential for continued robust growth. According to Mintel International Group, the entire frozen market will grow 15% by 2012 through all retail channels. Furthermore, super-premium ice cream, such as Reed's Ginger Ice Creams, is generally characterized by a greater richness and density than other kinds of ice creams. This higher quality ice cream generally sells at a premium to the other ice cream segments due to its emphasis on quality, brand image, flavor selection and texture.

Our Products

We currently manufacture and sell 16 beverages, three candies and three ice creams. We make all of our products using premium all-natural ingredients.

We produce carbonated soda products. According to Spence Information Services ("SPINS"), a market research and consulting firm for the Natural Products Industry, which is the only sales information service catering to the natural food trade, for the 52 weeks ending December 1, 2007, Reed's products were the top five items based on dollar sales among all sugar/fructose sweetened sodas in the natural foods industry in the United States, with Reed's Extra Ginger Brew holding the number one position, Virgil's Root Beer being number two, Premium Ginger Brew being number three and Original Ginger Brew as number four.

Our carbonated products include six varieties of Reed's Ginger Brews, eight varieties of Virgil's Root Beer and Cream Sodas and Real Cola (including diet varieties), China Cola and Cherry China Cola. In 2009, we introduced our Natural Energy Elixir, and in 2010 our R(x)eed's Nausea Relief, both products being derivations of our Ginger Brew's.

Our candy products include Reed's Crystallized Ginger Candy, Reed's Peanut Butter Ginger Chews and Reed's Ginger Chews.

Our ice cream products include Reed's Original Ginger Ice Cream, Reed's Chocolate Ginger Ice Cream and Reed's Green Tea Ginger Ice Cream.

Beverages

Reed's Ginger Brews

Ginger ale is the oldest known soft drink. Before modern soft drink technology existed, non-alcoholic beverages were brewed at home directly from herbs, roots, spices, and fruits. These handcrafted brews were then aged like wine and highly prized for their taste and their tonic, health-giving properties. Reed's Ginger Brews are a revival of this home brewing art and we make them with care and attention to wholesomeness and quality, using the finest fresh herbs, roots, spices, and fruits. Our expert brew masters brew each batch and age it with great pride.

We believe that Reed's Ginger Brews are unique in their kettle brewed origin among all mass-marketed soft drinks. Reed's Ginger Brews contain between 8 and 26 grams of fresh ginger in every 12-ounce bottle. We use no refined sugars as sweeteners. Our products differ from commercial soft drinks in three particular characteristics: sweetening, carbonation and coloring for greater adult appeal. Instead of using injected-based carbonation, we produce our carbonation naturally, through slower, beer-oriented techniques. This process produces smaller, longer lasting bubbles that do not dissipate rapidly when the bottle is opened. We do not add coloring. The color of our products comes naturally from herbs, fruits, spices, roots and juices.

In addition, since Reed's Ginger Brews are pasteurized, they do not require or contain any preservatives. In contrast, modern commercial soft drinks generally are produced using natural and artificial flavor concentrates prepared by flavor laboratories, tap water, and highly refined sweeteners. Typically, manufacturers make a centrally processed concentrate that will lend itself to a wide variety of situations, waters, and filling systems. The final product is generally cold-filled and requires preservatives for stability. Colors are added that are either natural, although highly processed, or artificial.

In addition, while we make no claim as to any medical or therapeutic benefits of our products, we have found friends and advocates among alternative, holistic, naturopathic, and homeopathic medical practitioners, dieticians and medical doctors, who tell us that they recommend Reed's Extra Ginger Brew for their patients as a simple way to ingest a known level of ginger. The United States Food and Drug Administration (FDA) includes ginger on their GRAS (generally recognized as safe) list. However, neither the FDA nor any other government agency officially endorses or recommends the use of ginger as a dietary supplement.

We currently manufacture and sell seven varieties of Reed's Ginger Brews:

- Reed's Original Ginger Brew was our first creation, and is a Jamaican recipe for homemade ginger ale using 17 grams of fresh ginger root, lemon, lime, honey, fructose, pineapple, herbs and spices. Reed's Original Ginger Brew is 20% fruit juice.
- Reed's Extra Ginger Brew is the same approximate recipe, with 25 grams of fresh ginger root for a stronger bite. Reed's Extra Ginger Brew is 20% fruit juice.
- Reed's Premium Ginger Brew is the no-fructose version of Reed's Original Ginger Brew, and is sweetened only with honey and pineapple juice. Reed's Premium Ginger Brew is 20% fruit juice.
- Reed's Raspberry Ginger Brew is brewed from 17 grams of fresh ginger root, raspberry juice and lime. Reed's Raspberry Ginger Brew is 20% raspberry juice and is sweetened with fruit juice and fructose.
- Reed's Spiced Apple Brew uses 8 grams of fresh ginger root, the finest tart German apple juice and such apple pie spices as cinnamon, cloves and allspice. Reed's Spiced Apple Brew is 50% apple juice and sweetened with fruit juice and fructose.
- Reed's Cherry Ginger Brew is the newest addition to our Ginger Brew family, and is naturally brewed from: filtered water, fructose, fresh ginger root, cherry juice from concentrate and spices. Reed's Cherry Ginger Brew is brewed from 22 grams of fresh ginger root.
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Reed's Natural Energy Elixir, an energy drink infused with all natural ingredients designed to provide consumers with a healthy and natural boost to energy levels

All six of Reed's Ginger Brews are offered in 12-ounce bottles and are sold in stores as singles, in four-packs and in 24-bottle cases. Reed's Original Ginger Brew is sold by select retailers in a special 12-pack. Reed's Original Ginger Brew, Extra Ginger Brew and Spiced Apple Brew are now available in 750 ml. champagne bottles. The Reed's Extra Ginger Brew is also produced in a 7-ounce bottle and sold in eight-packs and 32-bottle cases. The Natural Energy Elixir is sold in a 10.5 oz can.

Virgil's Root Beer

Over the years, Virgil's Root Beer has won numerous awards and has a reputation among many as one of the best root beers made anywhere. Virgil's Root Beer won the "Outstanding Beverage" award at the NASFT's International Fancy Food and Confection Show in 1997.

Virgil's is a premium root beer. We use all-natural ingredients, including filtered water, unbleached cane sugar, anise from Spain, licorice from France, bourbon vanilla from Madagascar, cinnamon from Sri Lanka, clove from Indonesia, wintergreen from China, sweet birch and molasses from the southern United States, nutmeg from Indonesia, pimento berry oil from Jamaica, balsam oil from Peru and cassia oil from China.

We collect these ingredients worldwide and gather them together at the brewing and bottling facilities we use in the United States and Germany. We combine and brew these ingredients under strict specifications and finally heat-pasteurize Virgil's Root Beer, to ensure quality.

We sell Virgil's Root Beer in four packaging styles: 12-ounce bottles in a four-pack, a special swing-lid style pint bottle and a 5-liter self-tapping party keg.

Virgil's Cream Soda

We launched Virgil's Cream Soda in January 2004. We make this product with the same attention to quality that makes Virgil's Root Beer so popular. Virgil's Cream Soda is a gourmet cream soda. We brew Virgil's Cream Soda the same way we brew Virgil's Root Beer. We use all-natural ingredients, including filtered water, unbleached cane sugar and bourbon vanilla from Madagascar.

Virgil's Cream Soda is currently sold in 12-ounce long neck bottles in colorful 4-packs and a 5-liter party keg version.

In 2006, we expanded our product line to include Virgil's Black Cherry Cream Soda in a 12-ounce bottle. In 2009, we introduced Virgil's Orange Cream Soda.

Virgil's Real Cola

We launched Virgil's Real Cola in February 2008. Virgil's Real Cola is a classic cola recipe made naturally using the finest ingredients and unbleached cane sugar. Virgil's Real Cola is made naturally without caffeine or preservatives.

Virgil's Real Cola is sold in 12-ounce bottles.

In 2007, we further expanded our Virgil's product line to include diet Root Beer, diet Black Cherry Cream Soda and diet Cream Soda. Our diet sodas are sweetened with Stevia and Xylitol. In April 2008, we introduced diet Real Cola.

China Cola

We consider China Cola to be the most natural cola in the world. We restored China Cola to its original delicious blend of raw cane sugar, imported Chinese herbs, essential oils and natural spices. China Cola contains no caffeine. It comes in two varieties, Original China Cola and Cherry China Cola. Original China Cola is made from filtered water, raw cane sugar Szechwan poeny root, cassia bark, Malaysian vanilla, oils of lemon and oil of orange, nutmeg, clove, licorice, cardamom, caramel color, citric acid and phosphoric acid. Cherry China Cola is made from the same ingredients as Original China Cola, with the addition of natural cherry flavor. China Cola and Cherry China Cola sell

as singles, in four-packs and in 24-bottle cases.

R(x)eed's Nausea Relief

We recently launched our Nausea Relief product for the Drug Store Channel. This product is based on our Ginger Brews with added B vitamins. Both ginger and B vitamins have been studied for their effectiveness in combating nausea. Our products have been designed with the FDA in mind and have the proper disclosure.

Sonoma Sparkler

Our Sonoma Sparkler products are sparkling juices in champagne-style bottles designed to be celebratory drinks for holidays and special occasions. We sell Natural Pear, Organic Apple, Peach and Lemon beverages.

Reed's Ginger Candies

Reed's Crystallized Ginger Candy

Reed's Crystallized Ginger was the first crystallized ginger on the market in the United States to be sweetened with raw cane instead of refined white sugar. Reed's Crystallized Ginger is custom-made for us in Fiji.

The production process is an ancient one that has not changed much over time. After harvesting baby ginger (the most tender kind), the root is diced and then steeped for several days in large vats filled with simmering raw cane syrup. The ginger is then removed and allowed to crystallize into soft, delicious nuggets. Many peoples of the Islands have long enjoyed these treats for health and pleasure.

We sell this product in 3.5-ounce bags, 10-ounce enameled, rolled steel gift tins, 16-ounce re-sealable Mylar bags, and in bulk. We also sell Reed's Crystallized Ginger Baking Bits in bulk.

Reed's Ginger Chews

For many years, residents of Southeast Asia from Indonesia to Thailand have enjoyed soft, gummy ginger candy chews. We sell Reed's Ginger Chews individually wrapped in hard-packs of ten candies and as individually wrapped loose pieces in bulk. The candies come in two flavors, Reed's Ginger Chews and Reed's Peanut Butter Ginger Chews. Reed's has taken them a step further, adding more ginger, using no gelatin (vegan), making the candies potentially more appealing to the vegan market, and making them slightly easier to unwrap than their Asian counterparts. Reed's Ginger Chews are made for us in Indonesia from sugar, maltose (malt sugar), ginger, and tapioca starch. In addition, the peanut butter version includes peanut butter.

Reed's Ginger Ice Creams

We make Reed's Ginger Ice Creams with 100% natural ingredients, using the finest hormone-free cream and milk. We combine fresh milk and cream with the finest natural ginger puree, Reed's Crystallized Ginger Candy and natural raw cane sugar to make a delicious ginger ice cream with a super premium, ultra-creamy texture and Reed's signature spicy-sweet bite. Our ice creams are made for us, according to our own recipes, at a dairy in upstate New York. We sell Reed's Ginger Ice Creams in pint containers and cases of eight pints.

New Product Development

We are always working on developments to continue expanding from our Reed's Ginger Brews, Virgil's product line, Reed's Ginger Ice Cream, and Reed's Ginger Candy product lines and packaging styles. However, research and development expenses in the last two years have been nominal. We intend to expend some, but not a significant amount, of funds on research and development for new products and packaging. We intend to introduce new products and packaging as we deem appropriate from time to time for our business plan.

Among the advantages of our self-operated Brewery are the flexibility to try innovative packaging and the capability to experiment with new product flavors at less cost to our operations or capital. Currently, we sell a half-liter Virgil's Root Beer swing-lid bottle that is made for us in Europe. We intend to produce several of our beverages in one-liter swing-lid bottles in the United States. Our Reed's Original Ginger Brew, Extra Ginger Brew and Spiced Apple Brew are available in a 750 ml champagne bottle and other products are planned to be available with this packaging in the near future.

During 2009, we started developing and producing private-label products in our Los Angeles Brewery. Based on strong demand and our ability to be nimble and innovative, we believe that this segment of our business will grow rapidly.

Manufacture of Our Products

We produce our carbonated beverages at two facilities:

- a facility in Los Angeles, California, known as The Brewery, at which we produce certain soda products for the western half of the United States, and
- a packing, or co-pack, facility in Pennsylvania which supplies us with product we do not produce at The Brewery. The term of our agreement with the co-packer terminates November 1, 2011 and grants Reed's the option to extend the contract for an additional one year period. The co-packer assembles our products and charges us a fee, generally by the case, for the products they produce.

Our west coast Brewery facility is running at about 60% of capacity. As we are able to make the Brewery become more fully utilized, we believe that we will experience improvements in gross margins due to freight and production savings.

We follow a “fill as needed” manufacturing model to the best of our ability and we have no significant backlog of orders. Substantially all of the raw materials used in the preparation, bottling and packaging of our products are purchased by us or by our contract packers in accordance with our specifications. Reed’s Crystallized Ginger is made to our specifications in Fiji. Reed’s Ginger Candy Chews are made and packed to our specifications in Indonesia.

Generally, we obtain the ingredients used in our products from domestic suppliers and each ingredient has several reliable suppliers. We have no major supply contracts with any of our suppliers. As a general policy, we pick ingredients in the development of our products that have multiple suppliers and are common ingredients. This provides a level of protection against a major supply constriction or calamity.

We believe that as we continue to grow, we will be able to keep up with increased production demands. We believe that the Brewery has ample capacity to handle increased West Coast business. To the extent that any significant increase in business requires us to supplement or substitute our current co-packers, we believe that there are readily available alternatives, so that there would not be a significant delay or interruption in fulfilling orders and delivery of our products. In addition, we do not believe that growth will result in any significant difficulty or delay in obtaining raw materials, ingredients or finished product that is repackaged at the Brewery.

In July 2007, the FDA issued a statement that warned that fresh ginger from a specific importer was contaminated with a banned pesticide. We import ginger from China, but from a different importer than was named by the FDA. Our importer requires a pre-shipment lab test in order to perform chemical analysis. In addition to the pre-shipment chemical analysis, our importer has indicated to us that they verify that every container of ginger shipped has passed the Chinese Photosanitary inspection. Upon arrival at the Port of Long Beach, California, the ginger we import undergoes a food safety inspection by the USDA’s Agricultural Quality Inspection Unit. We believe the ginger we use is certified clean and good for human consumption.

Our Primary Markets

We target a niche in the soft drink industry known as New Age beverages. The soft drink industry generally characterizes New Age Beverages as being made more naturally, with upscale packaging, and often creating and utilizing new and unique flavors and flavor combinations.

The New Age beverage segment is highly fragmented and includes such competitors as SoBe, Snapple, Arizona, Hansen’s and Jones Soda, among others. These brands have the advantage of being seen widely in the national market and being commonly well known for years through well-funded ad campaigns. Despite our products having a relatively high price for a premium beverage product, no mass media advertising and a relatively small presence in the mainstream market compared to many of our competitors, we believe that results to date demonstrate that Reed’s Ginger Brews and Virgil’s sodas are making market inroads among these significantly larger brands. See “Business - Competition.”

We sell the majority of our products in natural food stores, mainstream supermarket chains and foodservice locations, primarily in the United States and, to a lesser degree, in Canada and Europe.

Natural Food Stores

Our primary and historical marketing source of our products has been natural food and gourmet stores. These stores include Whole Foods Market, Wild Oats and Trader Joe's. We also sell in gourmet restaurants and delis. We believe that our products have achieved a leading position in their niche in the fast-growing natural food industry. With the advent of large natural food store chains and specialty merchants, the natural foods segment continues to grow each year in direct competition with the mainstream grocery trade.

Mainstream Supermarkets and Retailers

We sell our products to distributors who specialize in mainstream retailers, Natural Foods, and specialty stores; and directly to customers who have distribution centers that handle their own logistics.

Supermarkets, particularly supermarket chains and prominent local supermarkets, often impose slotting fees before permitting new product placements in their store or chain. These fees can be structured to be paid one-time only or in installments. We pursue broad-based slotting in supermarket chains throughout the United States and, to a lesser degree, in Canada. However, our direct sales team in Southern California and our national sales management team have been able to place our products without having to pay significant slotting fees. Slotting fees for new placements normally cost between \$10 and \$100 per store per new item placed.

We also sell our products to large national retailers who place our products within their national distribution streams. These retailers include Costco, Sam's Club, Cost Plus World Markets and Trader Joe's.

Foodservice Placement

We also market our beverage products to industrial cafeterias, bars and restaurants. We intend to place our beverage products in stadiums, sports arenas, concert halls, theatres, and other cultural centers as a long-term marketing plan.

International Sales

We have developed a limited market for our products in Canada, Europe and Asia. Sales outside of North America currently represent less than 1% of our total sales. Sales in Canada represent about 1.3% of our total sales. We are currently analyzing our international sales and marketing plan. Our analysis will explore options that may include outsourcing the international sales effort to third or related parties.

We have a export company that orders our products on a regular basis for distribution in Japan. We are holding preliminary discussions with other trading companies and import/ export companies for the distribution of our products throughout Asia, Europe and South America. We believe that these areas are a natural fit for Reed's ginger products, because of the importance of ginger in International, but especially the Asian diet and nutrition. Recently, we launched into the South African marketplace and Israel. Both of these markets are showing early signs of success.

Distribution, Sales and Marketing

We currently have a national network of mainstream, natural and specialty food distributors in the United States and Canada. We sell directly to our distributors, who in turn sell to retail stores. We also use our own sales group and independent sales representatives to promote our products for our distributors and direct sales to our retail customers. In Southern California, we previously maintained our own direct distribution in addition to other local distributors and are in the process of discontinuing our direct distribution and redirecting our customers to local distributors.

One of the main goals of our sales and marketing efforts is to increase sales and grow our brands. Our sales force consists of eight sales personnel (down from 33 at its peak in 2007) and several outside independent food brokerage companies. The reduction of our sales force from 2007 was instigated by the refocusing of our sales efforts from 2007's global effort to market to all accounts up and down the street in 20 markets nationally to 2008's refocus of expanding the sales to our existing approximately 7,000 supermarket customers. In addition, we are working to increase the number of stores that carry our products. To support our sales effort to our existing supermarket customers we are actively enlisting regional mainstream beverage distributors to carry our products. We are not abandoning our up and down the street sales marketing approach. But in most markets, we are delaying that effort until after we have expanded our sales and presence in supermarkets.

We have entered into agreements with our customers that commit us to fees if we terminate the agreements early or without cause. The agreements call for our customer to have the right to distribute our products to a defined type of retailer within a defined geographic region. As is customary in the beverage industry, if we should terminate the

agreement or not automatically renew the agreement, we would be obligated to make certain payments to our customers. We have no plans to terminate or not renew any agreement with any of our customers.

Our sales force markets existing products, run promotions and introduces new items. Our in-house sales managers are responsible for the distributor relationships and larger chain accounts that require headquarter sales visits and managing our independent sales representatives.

In addition, we distribute our products internationally through Reed's Brokerage, Inc., a company controlled by Mark Reed, and Robert T. Reed, both brothers of Christopher J. Reed.

We also offer our products and promotional merchandise directly to consumers via the Internet through our website, www.reedsgingerbrew.com.

Marketing to Distributors

We market to distributors using a number of marketing strategies, including direct solicitation, telemarketing, trade advertising and trade show exhibition. These distributors include natural food, gourmet food, and mainstream distributors. Our distributors sell our products directly to natural food, gourmet food and mainstream supermarkets for sale to the public. We maintain direct contact with the distributors through our in-house sales managers. In limited markets, where use of our direct sales managers is not cost-effective, we utilize food brokers and outside representatives.

Marketing to Retail Stores

The primary focus of our sales efforts is supermarket sales. We have a small highly trained sales force that is directly contacting supermarket chains and setting up promotional calendars. In addition, we market to retail stores by utilizing trade shows, trade advertising, telemarketing, direct mail pieces and direct contact with the store. Our sales managers and representatives visit these retail stores to sell directly in many regions. Sales to retail stores are coordinated through our distribution network and our regional warehouses.

Competition

The beverage industry is highly competitive. The principal areas of competition are pricing, packaging, development of new products and flavors and marketing campaigns. Our products compete with a wide range of drinks produced by a relatively large number of manufacturers. Most of these brands have enjoyed broad, well-established national recognition for years, through well-funded ad and other branding campaigns. In addition, the companies manufacturing these products generally have greater financial, marketing and distribution resources than we do.

Important factors affecting our ability to compete successfully include taste and flavor of products, trade and consumer promotions, rapid and effective development of new, unique cutting edge products, attractive and different packaging, branded product advertising and pricing. We also compete for distributors who will concentrate on marketing our products over those of our competitors, provide stable and reliable distribution and secure adequate shelf space in retail outlets. Competitive pressures in the New Age beverage categories could cause our products to be unable to gain or to lose market share or we could experience price erosion.

We believe that our innovative beverage recipes and packaging and use of premium ingredients and a trade secret brewing process provide us with a competitive advantage and that our commitments to the highest quality standards and brand innovation are keys to our success.

Our premium New Age beverage products compete generally with all liquid refreshments and in particular with numerous other New Age beverages, including: SoBe, Snapple, Mystic, IBC, Stewart's, Henry Weinhard, Arizona, Hansen's, Knudsen & Sons and Jones Sodas.

Our Virgil's and China Cola lines compete with a number of other natural soda companies, including Stewarts, IBC, Henry Weinhard, Blue Sky, A&W and Natural Brews.

We also generally compete with other traditional soft drink manufacturers and distributors, such as Coke, Pepsi and Cadbury Schweppes.

Reed's Crystallized Ginger Candy competes primarily with other candies and snacks in general and, in particular, with other ginger candies. The main competitors in ginger candies are Royal Pacific, Australia's Buderim Ginger Company, and Frontier Herbs. We believe that Reed's Crystallized Ginger Candy is the only one among these brands that is

sulfur-free.

Reed's Ginger Ice Creams compete primarily with other premium and super-premium ice cream brands. Our principal competitors in the ice cream business are Haagen-Dazs, Ben & Jerry's, Godiva, Starbucks, Dreyer's and a number of smaller natural food ice cream companies.

Proprietary Rights

We own trademarks that we consider material to our business. Three of our material trademarks are registered trademarks in the U.S. Patent and Trademark Office: Virgil's ®, Reed's Original Ginger Brew All-Natural Jamaican Style Ginger Ale ® and Tianfu China Natural Soda ®. Registrations for trademarks in the United States will last indefinitely as long as we continue to use and police the trademarks and renew filings with the applicable governmental offices. We have not been challenged in our right to use any of our material trademarks in the United States. We intend to obtain international registration of certain trademarks in foreign jurisdictions.

In addition, we consider our finished product and concentrate formulae, which are not the subject of any patents, to be trade secrets. Our brewing process is a trade secret. This process can be used to brew flavors of beverages other than ginger ale and ginger beer, such as root beer, cream soda, cola, and other spice and fruit beverages. We have not sought any patents on our brewing processes because we would be required to disclose our brewing process in patent applications.

We generally use non-disclosure agreements with employees and distributors to protect our proprietary rights.

Government Regulation

The production, distribution and sale in the United States of many of our Company's products are subject to the Federal Food, Drug, and Cosmetic Act, the Federal Trade Commission Act, the Lanham Act, state consumer protection laws, federal, state and local workplace health and safety laws, various federal, state and local environmental protection laws and various other federal, state and local statutes and regulations applicable to the production, transportation, sale, safety, advertising, labeling and ingredients of such products. Outside the United States, the distribution and sale of our many products and related operations are also subject to numerous similar and other statutes and regulations.

A California law requires that a specific warning appear on any product that contains a component listed by the State as having been found to cause cancer or birth defects. The law exposes all food and beverage producers to the possibility of having to provide warnings on their products. This is because the law recognizes no generally applicable quantitative thresholds below which a warning is not required. Consequently, even trace amounts of listed components can expose affected products to the prospect of warning labels. Products containing listed substances that occur naturally or that are contributed to such products solely by a municipal water supply are generally exempt from the warning requirement. No Company beverages produced for sale in California are currently required to display warnings under this law. We are unable to predict whether a component found in a Company product might be added to the California list in the future, although the state has initiated a regulatory process in which caffeine will be evaluated for listing. Furthermore, we are also unable to predict when or whether the increasing sensitivity of detection methodology that may become applicable under this law and related regulations as they currently exist, or as they may be amended, might result in the detection of an infinitesimal quantity of a listed substance in a beverage of ours produced for sale in California.

Bottlers of our beverage products presently offer and use nonrefillable, recyclable containers in the United States and various other markets around the world. Some of these bottlers also offer and use refillable containers, which are also recyclable. Legal requirements apply in various jurisdictions in the United States and overseas requiring that deposits or certain ecotaxes or fees be charged for the sale, marketing and use of certain nonrefillable beverage containers. The precise requirements imposed by these measures vary. Other types of beverage container-related deposit, recycling, ecotax and/or product stewardship statutes and regulations also apply in various jurisdictions in the United States and overseas. We anticipate that additional, similar legal requirements may be proposed or enacted in the future at local, state and federal levels, both in the United States and elsewhere.

All of our facilities and other operations in the United States are subject to various environmental protection statutes and regulations, including those relating to the use of water resources and the discharge of wastewater. Our policy is to comply with all such legal requirements. Compliance with these provisions has not had, and we do not expect such compliance to have, any material adverse effect on our capital expenditures, net income or competitive position.

Environmental Matters

Our primary cost environmental compliance activity is in recycling fees and redemption values. We are required to collect redemption values from our customers and remit those redemption values to the state, based upon the number of bottles of certain products sold in that state.

Employees

We have 43 full-time employees, as follows: three in general management, eight in sales and marketing support, six in admin and operations and 26 in production. We employ additional people on a part-time basis as needed. We have never participated in a collective bargaining agreement. We believe that the relationship with our employees is good.

Item 2. Property

We lease a facility of approximately 30,000 square feet, which serves as our principal executive offices, our West Coast Brewery and bottling plant and our Southern California warehouse facility. The lease commenced in June 2009, and is for a term of fifteen years.

Item 3. Legal Proceedings

From time to time, we are a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates our exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

From August 3, 2005 through April 7, 2006, we issued 333,156 shares of our common stock in connection with our initial public offering. These securities represented all of the shares issued in connection with the initial public offering prior to October 11, 2006. These shares issued in connection with the initial public offering may have been issued in violation of either Federal or State securities laws, or both, and may be subject to rescission.

On August 12, 2006, we made a rescission offer to all holders of the outstanding shares that we believe are subject to rescission, pursuant to which we offered to repurchase these shares then outstanding from the holders. At the expiration of the rescission offer on September 18, 2006, the rescission offer was accepted by 32 of the offerees to the extent of 28,420 shares for an aggregate of \$119,000, including statutory interest. The shares that were tendered for rescission were agreed to be purchased by others and not from our funds.

Federal securities laws do not provide that a rescission offer will terminate a purchaser's right to rescind a sale of stock that was not registered as required or was not otherwise exempt from such registration requirements. With respect to the offerees who rejected the rescission offer, we may continue to be liable under federal and state securities laws for up to an amount equal to the value of all shares of common stock issued in connection with the initial public offering plus any statutory interest we may be required to pay. If it is determined that we offered securities without properly registering them under federal or state law, or securing an exemption from registration, regulators could impose monetary fines or other sanctions as provided under these laws. However, we believe the rescission offer provides us with additional meritorious defenses against any future claims relating to these shares.

Except as set forth above, we believe that there are no material litigation matters at the current time. Although the results of such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of such claims and proceedings will not have a material adverse impact on our financial position, liquidity, or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

The 2008 Annual Meeting of Stockholders of the Company was held on November 20, 2009. At the meeting, the following individuals were elected as directors of the Company and received the number of votes set opposite their respective names:

| Director | Votes For | Votes | | Votes Withheld, Abstentions, Broker Non-Votes |
|---------------------|-----------|---------|--|--|
| | | Against | | |
| Christopher J. Reed | 6,542,104 | - | | 1,129,140 |
| Judy Holloway Reed | 6,504,155 | - | | 1,167,089 |

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| | | | |
|-----------------------------|-----------|---|-----------|
| Mark Harris | 6,500,566 | - | 1,170,678 |
| Dr. D.S.J. Muffoletto, N.D. | 6,500,120 | - | 1,171,124 |
| Michael Fischman | 6,500,566 | - | 1,170,678 |

In addition, at the meeting, our stockholders ratified the appointment by the board of directors of Weinberg & Company, P.A. as the Company's independent registered public accounting firm for the 2009 fiscal year; with 6,535,395 votes for, 63,906 votes against, and 1,071,941 Abstention/non-broker votes.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

Our common stock is listed for trading on the NASDAQ Capital Market trading under the symbol "REED". The following is a summary of the high and low bid prices of our common stock on the NASDAQ Capital Market for the periods presented:

| | Sales Price | |
|-------------------------------|-------------|---------|
| | High | Low |
| Year Ending December 31, 2008 | | |
| First Quarter | \$ 6.24 | \$ 1.50 |
| Second Quarter | 3.94 | 1.89 |
| Third Quarter | 3.30 | 1.45 |
| Fourth Quarter | 2.31 | 1.00 |
| | | |
| | Sales Price | |
| | High | Low |
| Year Ending December 31, 2009 | | |
| First Quarter | \$ 1.41 | \$ 0.75 |
| Second Quarter | 2.42 | 1.06 |
| Third Quarter | 2.50 | 1.80 |
| Fourth Quarter | 2.10 | 1.23 |

As of December 31, 2009, there were approximately 228 stockholders of record of the common stock (not including the number of persons or entities holding stock in nominee or street name through various brokerage firms) and approximately 9,606,127 outstanding shares of common stock.

Unregistered Sales of Equity Securities

During the fiscal year ended December 31, 2009, we sold the following equity securities that were unregistered under the Securities Act:

During 2009, the Company sold 50,000 shares of common stock for \$3.00 per share or \$150,000. The shares were issued pursuant to an exemption from registration under Section 4(2) of the Securities Act.

During 2009, the Company issued 197,647 shares of common stock in exchange for consulting and legal services. The value of the stock was based on the closing price of the stock on the issuance or agreed upon date. The total value of shares issued for services was \$260,000. The shares were issued pursuant to exemption from registration under Section 4(2) of the Securities Act.

During 2009, we granted options to purchase 120,000 shares of common stock under our employee stock option plan at exercise prices of \$0.75 to \$1.30 pursuant to exemption from registration under Section 4(2) of the Securities Act.

On December 22, 2009, we granted 38,750 shares of common stock to our employees as bonuses. The closing price of our common stock on that date was \$1.32 per share. The shares were issued pursuant to exemption from registration under Section 4(2) of the Securities Act.

Dividend Policy

We have never declared or paid dividends on our common stock. We currently intend to retain future earnings, if any, for use in our business, and, therefore, we do not anticipate declaring or paying any dividends in the foreseeable future. Payments of future dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including the terms of our credit facility and our financial condition, operating results, current and anticipated cash needs and plans for expansion.

We are obligated to pay a non-cumulative 5% dividend from lawfully available assets to the holders of our Series A and Series B preferred stock in either cash or additional shares of common stock at our discretion. In 2009 and 2008, we paid the dividend in an aggregate of 12,950 and 10,910 shares of common stock in each such year, respectively, and anticipate that we will be obligated to issue at least this many shares annually to the holders of the Series A preferred stock so long as such shares are issued and outstanding. Series B shareholders have not yet received annual dividends on the shares, as they were issued in December 2009.

Securities Authorized for Issuance Under Equity Compensation Plans

2001 Stock Option Plan and 2007 Stock Option Plan

We are authorized to issue options to purchase up to 500,000 shares of common stock under our 2001 Stock Option Plan, and we are authorized to issue options to purchase up to 1,500,000 shares of common stock under our 2007 Stock Option Plan. On August 28, 2001, our board of directors adopted the 2001 Stock Option Plan and the plan was approved by our stockholders. On October 8, 2007, our board of directors adopted the 2007 Stock Option Plan and the plan was approved by our stockholders on November 19, 2007.

The plans permit the grant of options to our employees, directors and consultants. The options may constitute either “incentive stock options” within the meaning of Section 422 of the Internal Revenue Code or “non-qualified stock options.” The primary difference between “incentive stock options” and “non-qualified stock options” is that once an option is exercised, the stock received under an “incentive stock option” has the potential of being taxed at the more favorable long-term capital gains rate, while stock received by exercising a “non-qualified stock option” is taxed according to the ordinary income tax rate schedule.

The plans are currently administered by the board of directors. The plan administrator has full and final authority to select the individuals to receive options and to grant such options as well as a wide degree of flexibility in determining the terms and conditions of options, including vesting provisions.

The exercise price of an option granted under the plan cannot be less than 100% of the fair market value per share of common stock on the date of the grant of the option. The exercise price of an incentive stock option granted to a person owning more than 10% of the total combined voting power of the common stock must be at least 110% of the fair market value per share of common stock on the date of the grant. Options may not be granted under the plan on or after the tenth anniversary of the adoption of the plan. Incentive stock options granted to a person owning more than 10% of the combined voting power of the common stock cannot be exercisable for more than five years.

When an option is exercised, the purchase price of the underlying stock will be paid in cash, except that the plan administrator may permit the exercise price to be paid in any combination of cash, shares of stock having a fair market value equal to the exercise price, or as otherwise determined by the plan administrator.

If an optionee ceases to be an employee, director, or consultant with us, other than by reason of death, disability, or retirement, all vested options must be exercised within three months following such event. However, if an optionee’s employment or consulting relationship with us terminates for cause, or if a director of ours is removed for cause, all unexercised options will terminate immediately. If an optionee ceases to be an employee or director of, or a consultant to us, by reason of death, disability, or retirement, all vested options may be exercised within one year following such event or such shorter period as is otherwise provided in the related agreement.

When a stock award expires or is terminated before it is exercised, the shares set aside for that award are returned to the pool of shares available for future awards.

No option can be granted under the plan after ten years following the earlier of the date the plan was adopted by the board of directors or the date the plan was approved by our stockholders.

2009 Consultant Stock Plan

We are authorized to issue up to 100,000 shares of common stock to employees, officers, directors, consultants, independent contractors, advisors, or other service providers to Reed’s under our 2009 Consultant Stock Plan. The

2009 Consultant Stock Plan was adopted by our board of directors on February 13, 2009 and is administered by a committee of the board of directors. The plan committee may from time to time, and subject to the provisions of the plan and such other terms and conditions as the plan committee may prescribe, grant to any eligible person one or more shares of common stock of Reed's ("Award Shares"). The grant of Award Shares or grant of the right to receive Award Shares shall be evidenced by either a written consulting agreement or a separate written agreement confirming such grant, executed by Reed's and the recipient, stating the number of Award Shares granted and stating all terms and conditions of such grant. During 2009, 60,416 shares of common stock were issued under the Plan.

The plan committee, in its sole discretion, may grant Award Shares in any of the following instances:

- (i) as a "bonus" or "reward" for services previously rendered and compensated, in which case the recipient of the Award Shares shall not be required to pay any consideration for such Award Shares, and the value of such Award Shares shall be the fair market value of such Award Shares on the date of grant; or
- (ii) as "compensation" for the previous performance or future performance of services or attainment of goals, in which case the recipient of the Award Shares shall not be required to pay any consideration for such Award Shares (other than the performance of his services).

Equity Compensation Plan Information

The following table provides information, as of December 31, 2009, with respect to options outstanding and available under the 2001 Plan and 2007 Plan and certain other outstanding options:

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in Column(a))(c) (c) |
|--|--|--|--|
| Equity compensation plans approved by security holders | 600,000 | \$ 1.74 | 1,310,000 |
| Equity compensation plans not approved by security holders | 2,091,690 | \$ 4.70 | Not applicable |
| TOTAL | 2,691,690 | \$ 3.94 | 1,310,000 |

Item 6. Selected Financial Data

As a smaller reporting company, Reed's is not required to provide disclosure pursuant to this Item 6.

Item 7. Management's Discussion and Analysis or Plan of Operation

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes appearing elsewhere in this Annual Report. This discussion and analysis may contain forward-looking statements based on assumptions about our future business. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including but not limited to those set forth under "Risk Factors" and elsewhere in this Annual Report.

Overview

We develop, manufacture, market, and sell natural non-alcoholic and "New Age" beverages, candies and ice creams. "New Age Beverages" is a category that includes natural soda, fruit juices and fruit drinks, ready-to-drink teas, sports drinks, and water. We currently manufacture, market and sell eight unique product lines:

- Reed's Ginger Brews,
- Virgil's Root Beer, Cream Sodas and Real Cola, including diet sodas
- China Colas,
- Reed's Ginger Chews,
- Reed's Ginger Ice Creams,
- Sonoma Sparkle Sparkling Juices,
- R(x)eed's Natural Ginger Nausea Relief, and
- Energy Elixir

In addition, we have a growing private label business that currently services two national chains. We sell most of our products in specialty gourmet and natural food stores, supermarket chains, retail stores and restaurants in the United States and, to a lesser degree, in Canada. We primarily sell our products through a network of natural, gourmet and independent distributors. We also maintain an organization of in-house sales managers who work mainly in the stores serviced by our natural, gourmet and mainstream distributors and with our distributors. We also work with regional, independent sales representatives who maintain store and distributor relationships in a specified territory.

Trends, Risks, Challenges, Opportunities That May or Are Currently Affecting Our Business

Our main challenges, trends, risks, and opportunities that could affect or are affecting our financial results include but are not limited to:

Low Carbohydrate Diets and Obesity - Most of our products are not geared for the low carbohydrate market. Consumer trends have reflected higher demand for lower carbohydrate products. We monitor these trends closely and have developed low-carbohydrate versions of some of our beverages namely the Virgil's line.

Distribution Consolidation - There has been a recent trend towards continued consolidation of the beverage distribution industry through mergers and acquisitions. This consolidation results in a smaller number of distributors to market our products and potentially leaves us subject to the potential of our products either being dropped by these distributors or being marketed less aggressively by these distributors. As a result, we initiated our own direct distribution to mainstream supermarkets and natural and gourmet foods stores in Southern California and to large national retailers. However, we are in the process of discontinuing our direct distribution and redirecting our customers to local distributors. Consolidation among natural foods industry distributors has not had an adverse affect on our sales.

Consumers Demanding More Natural Foods - The rapid growth of the natural foods industry has been fueled by the growing consumer awareness of the potential health problems due to the consumption of chemicals in the diet. Consumers are reading ingredient labels and choosing products based on them. We design products with these consumer concerns in mind. We feel this trend toward more natural products is one of the main trends behind our growth. Recently, this trend in drinks has not only shifted to products using natural ingredients, but also to products with added ingredients possessing a perceived positive function like vitamins, herbs and other nutrients. Our ginger-based products are designed with this consumer demand in mind.

Supermarket and Natural Food Stores - More and more supermarkets, in order to compete with the growing natural food industry, have started including natural food sections. As a result of this trend, our products are now available in mainstream supermarkets throughout the United States in natural food sections. Supermarkets can require that we spend more advertising money and they sometimes require slotting fees. We continue to work to keep these fees reasonable. Slotting fees in the natural food section of the supermarket are generally not as expensive as in other areas of the store.

Beverage Packaging Changes - Beverage packaging has continued to innovate, particularly for premium products. There is an increase in the sophistication with respect to beverage packaging design. While we feel that our current core brands still compete on the level of packaging, we continue to experiment with new and novel packaging designs such as the 5-liter party keg and 750 ml. champagne style bottles. We have further plans for other innovative packaging designs.

Packaging or Raw Material Price Increases - An increase in packaging or raw materials has caused our margins to suffer and has negatively impacted our cash flow and profitability. We continue to search for packaging and production alternatives to reduce our cost of goods.

Cash Flow Requirements - Our growth will depend on the availability of additional capital infusions. We have a financial history of losses and are dependent on non-banking sources of capital, which tend to be more expensive and charge higher interest rates. Any increase in costs of goods will further increase losses and will further tighten cash reserves.

Interest Rates - We use lines of credit as a source of capital and are negatively impacted as interest rates rise.

Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. GAAP requires us to make estimates and assumptions that affect the reported amounts in our financial statements including various allowances and reserves for accounts receivable and inventories, the estimated lives of long-lived assets and trademarks and trademark licenses, as well as claims and contingencies arising out of litigation or other transactions that occur in the normal course of business. The following summarize our most significant accounting and reporting policies and practices:

Revenue Recognition. Revenue is recognized on the sale of a product when the product is shipped, which is when the risk of loss transfers to our customers, and collection of the receivable is reasonably assured. A product is not shipped without an order from the customer and credit acceptance procedures performed. The allowance for returns is regularly reviewed and adjusted by management based on historical trends of returned items. Amounts paid by customers for shipping and handling costs are included in sales.

Trademark License and Trademarks. We own trademarks that we consider material to our business. Three of our material trademarks are registered trademarks in the U.S. Patent and Trademark Office: Virgil's ®, Reed's Original Ginger Brew All-Natural Jamaican Style Ginger Ale ® and Tianfu China Natural Soda ®. Registrations for trademarks in the United States will last indefinitely as long as we continue to use and police the trademarks and renew filings with the applicable governmental offices. We have not been challenged in our right to use any of our material trademarks in the United States. We intend to obtain international registration of certain trademarks in foreign jurisdictions.

We account for these items in accordance with Financial Accounting Standards Guidance and thus we do not amortize indefinite-lived trademark licenses and trademarks.

We evaluate our non-amortizing trademark license and trademarks quarterly for impairment. We measure impairment by the amount that the carrying value exceeds the estimated fair value of the trademark license and trademarks. The fair value is calculated by reviewing net sales of the various beverages and applying industry multiples. Based on our quarterly impairment analysis the estimated fair values of trademark license and trademarks exceeded the carrying value and no impairments were identified during the years ended December 31, 2009 or December 31, 2008.

Long-Lived Assets. Our management regularly reviews property, equipment and other long-lived assets, including identifiable amortizing intangibles, for possible impairment. This review occurs quarterly or more frequently if events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. If there is indication of impairment of property and equipment or amortizable intangible assets, then management prepares an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposition. If these cash flows are less than the carrying amount of the asset, an impairment loss is recognized to write down the asset to its estimated fair value. The fair value is estimated at the present value of the future cash flows discounted at a rate commensurate with management's estimates of the business risks. Quarterly, or earlier, if there is indication of impairment of identified intangible assets not subject to amortization, management compares the estimated fair value with the carrying amount of the asset. An impairment loss is recognized to write

down the intangible asset to its fair value if it is less than the carrying amount. Preparation of estimated expected future cash flows is inherently subjective and is based on management's best estimate of assumptions concerning expected future conditions. No impairments were identified during the years ended December 31, 2009 or December 31, 2008.

Management believes that the accounting estimate related to impairment of our long lived assets, including our trademark license and trademarks, is a "critical accounting estimate" because: (1) it is highly susceptible to change from period to period because it requires management to estimate fair value, which is based on assumptions about cash flows and discount rates; and (2) the impact that recognizing an impairment would have on the assets reported on our balance sheet, as well as net income, could be material. Management's assumptions about cash flows and discount rates require significant judgment because actual revenues and expenses have fluctuated in the past and we expect they will continue to do so.

In estimating future revenues, we use internal budgets. Internal budgets are developed based on recent revenue data for existing product lines and planned timing of future introductions of new products and their impact on our future cash flows.

Accounts Receivable. We evaluate the collectability of our trade accounts receivable based on a number of factors. In circumstances where we become aware of a specific customer's inability to meet its financial obligations to us, a specific reserve for bad debts is estimated and recorded which reduces the recognized receivable to the estimated amount our management believes will ultimately be collected. In addition to specific customer identification of potential bad debts, bad debt charges are recorded based on our historical losses and an overall assessment of past due trade accounts receivable outstanding.

Inventories. Inventories are stated at the lower of cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review our inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and/or our ability to sell the product(s) concerned and production requirements. Demand for our products can fluctuate significantly. Factors that could affect demand for our products include unanticipated changes in consumer preferences, general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by customers. Additionally, our management's estimates of future product demand may be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory.

Stock-Based Compensation. We periodically issue stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. We account for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board. We account for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance provided by the Financial Accounting Standards Board whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete.

We estimate volatility and forfeitures based upon historical data. As permitted by the authoritative guidance issued by the Financial Accounting Standards Board, we use the "simplified" method to determine the expected life of an option grant due to the Company's lack of sufficient historical exercise data to provide a reasonable basis, which is a result of the relative high turnover rates experienced in the past for positions granted options. All of these variables have an effect on the estimated fair value of our share-based awards.

Results of Operations

Year ended December 31, 2009 Compared to Year ended December 31, 2008

Sales of \$15,178,000 for the year ended December 31, 2009 represented a decrease of 1% or \$99,000, as compared to the 2008 sales of \$15,277,000. The decrease in revenues is primarily due to a promotional program in 2008, covering our 5-liter "party kegs" of root beer, which did not recur in 2009; resulting in approximately \$900,000 lower sales of that product. The decrease was mitigated by an increase in the volume and revenues from our primary 12-ounce products delivered in 2009, which was approximately 2% higher than the same 2008 period. A new brand contributed \$470,000 in revenues during 2009 that were not in 2008 revenues.

Cost of Goods Sold

Cost of goods sold consists primarily of the costs of our ingredients, packaging, production and freight. Cost of goods sold decreased by 3% to \$11,566,000 during the year ended December 31, 2009 from \$11,891,000 in 2008. The 3% decrease in cost of goods sold is consistent with the 1% decrease in sales during the same periods.

Gross Profit

Our gross profit increased to \$3,612,000 in the year ended December 31, 2009, from \$3,386,000 in 2008, an increase of \$226,000 or 7%. The gross profit as a percentage of sales improved to 24%, as compared to 22% in 2008, mostly due to lower freight and warehouse costs.

Selling and marketing expenses

Selling and marketing expenses consist primarily of direct charges for staff compensation costs, advertising, sales promotion, marketing and trade shows. Selling and marketing costs decreased to \$2,412,000 in the year ended December 31, 2009 from \$3,817,000 in 2008, a net decrease of \$1,405,000 or 37%. The decrease is primarily due to decreases in compensation and travel costs of \$1,217,000, decreases in advertising promotion and trade shows of \$416,000, and decreases in facilities-related costs of \$17,000; partially offset by an increase in stock option expense of \$245,000.

Our strategic direction in sales is to focus on our product placements in our estimated 10,500 supermarkets nationwide. This strategy replaces our strategy in 2008 that focused on both the supermarkets and a direct store delivery (DSD) effort. As a result, our sales organization has been reduced by 16 compared to the level we had in 2008. We have found that our most effective sales efforts are to grocery stores. We feel that the trend in grocery stores to offer their customers natural products can be served with our products. Our sales personnel are leveraging our success at natural food grocery stores to establish new relationships with mainstream grocery stores.

General and Administrative Expenses

General and administrative expense consists primarily of the cost of executive, administrative, and finance personnel, as well as professional fees. General and administrative expenses decreased to \$2,632,000 during the year ended December 31, 2009 from \$3,140,000 in the same period of 2008, a net decrease of \$508,000 or 16%. The decrease in 2009 is primarily due to a decrease in professional fees expense of \$331,000 and a decrease in compensation costs of \$296,000; partially offset by an increase in facilities-related costs of \$85,000, and an increase in stock option expense of \$34,000. In the 2008 period, we had a one-time non cash expense of approximately \$300,000 for professional consulting services, for which we issued stock.

We believe that our existing executive and administrative staffing levels are sufficient to allow for moderate growth without the need to add personnel and related costs for the foreseeable future.

Impairment Loss

In connection with the sale of our buildings and brewery equipment in June 2009, and the concurrent lease-back of the same property and equipment, we recognized an impairment loss on the assets of \$641,000. The loss recognized from impairment is a result of the lower net carrying values of the assets at the time of sale in relation to the market value of the property.

Loss from Operations

Our loss from operations decreased to \$2,073,000 in the year ended December 31, 2009 from \$3,571,000 in the same period of 2008. The reduced loss in 2009 is substantially a result of the lower operating costs in 2009.

Interest Expense

Interest expense increased to \$486,000 in the year ended December 31, 2009, compared to interest expense of \$244,000 in 2008. The increase is due to the increase in long-term debt, as a result of our sale-leaseback; and increased borrowing under a line of credit agreement, secured primarily by our inventory and accounts receivable.

Liquidity and Capital Resources

As of December 31, 2009, we had shareholders equity of \$4,377,000 and we had working capital of \$2,037,000, compared to shareholders equity of \$3,961,000 and working capital of \$636,000 at December 31, 2008. Cash and cash equivalents were \$1,306,000 as of December 31, 2009, as compared to \$229,000 at December 31, 2008. This increase in our working capital was primarily attributable to the proceeds from the financing transaction relating to our buildings and equipment, net of the repayment of long-term debt, and to the sales of our equity securities in the aggregate amount of \$1,542,000, net of costs. In addition to our cash position on December 31, 2009, we had availability under our line of credit of approximately \$221,000.

Our increase in cash and cash equivalents to \$1,306,000 at December 31, 2009 compared to \$229,000 at December 31, 2008 was the result of \$1,317,000 used in operating activities; \$356,000 used in investing activities; and \$2,750,000 provided by financing activities.

We believe that the Company currently has the necessary working capital to support existing operations through 2010. Our primary capital source will be cash flow from operations, as we reach profitability in 2010. During October 2009, we raised net proceeds of approximately \$563,000 from an offering of our shares. In November 2009, we entered into an agreement to replace our revolving line of credit, which more fully values our assets for collateral and enable increased borrowing for working capital purposes. In December 2009, we sold our Series B Preferred Stock for \$829,000, net of offering costs. We believe that the Company can become leaner if our sales goals do not materialize, and that our costs can be managed to produce profitable operations. Historically, we have financed our operations primarily through private sales of common stock, preferred stock, convertible debt, a line of credit from a financial institution, and cash generated from operations.

Net cash used in operations during 2009 was \$1,317,000 compared with \$2,468,000 used in operations during the same period in 2008. Cash used in operations during 2009 was primarily due to the net loss in the period and to a decrease in accounts payable.

Net cash used in investing activities of \$356,000 during 2009 compared with \$191,000 during 2008 is primarily the result of equipment purchases.

Net cash provided by financing activities of \$2,750,000 during 2009 was primarily due to proceeds from the sale of our buildings and equipment of \$3,056,000 and the sale of common and preferred stock of \$1,604,000, offset by principal payments on long-term debt of \$1,763,000. During the same period in 2008, we derived net proceeds from the refinancing of our land and buildings of \$1,770,000 and net borrowings on our revolving line of credit of \$1,354,000; offset by principal payments on debt of \$800,000. Our line of credit lender is a privately held, Senior Secured Commercial Lender.

On June 15, 2009, we closed escrow on the sale of our two buildings and its brewery equipment and concurrently entered into a long-term lease agreement for the same property and equipment. In connection with the lease we have the option to repurchase the buildings and brewery equipment from 12 months after the commencement date to the end of the lease term at the greater of the fair market value or an agreed upon amount. Since the lease contains a buyback provision and other related terms, we determined that we had continuing involvement that did not warrant the recognition of a sale; therefore, the transaction has been accounted for as a long-term financing. The proceeds from the sale, net of transaction costs, have been recorded as a financing obligation in the amount of \$3,056,000. Monthly payments under the financing agreement are recorded as interest expense and a reduction in the financing obligation at an implicit rate of 9.9%. The financing obligation is personally guaranteed by the principal shareholder and chief executive officer.

On October 8, 2009, we sold an aggregate of 364,189 units ("Units") consisting of one share of our common stock ("Share") and warrants to purchase shares of our common stock ("Warrants") at a price of \$1.80 per Unit pursuant to a public shelf registration on Form S-3. The Warrants consist of (i) Series A Warrants, for the purchase of a number of shares of common stock equal to 40% of a purchaser's Shares, which have an initial exercise price of \$2.25 per share and are exercisable for a period of five years commencing 183 days from the date of issuance, (ii) Series B Warrants, for the purchase of a number of shares of common stock equal to 50% of a purchaser's Shares, which have an exercise price equal to \$1.80 and are exercisable for 60 trading days commencing immediately, and (iii) Series C Warrants, for the purchase of a number of shares of common stock equal to 20% of a purchaser's Shares, which have an exercise price of \$2.25 and are exercisable for five years commencing 183 days from the date of issuance. The Series B Warrants and Series C Warrants were only issued to purchasers who purchased Units for an aggregate purchase price of at least \$125,000. The Company paid an 8% placement agent fee. The net proceeds to the Company from the shelf take-down, after deducting placement agent fees and estimated offering expenses, were approximately \$563,000. At the closing, the Company issued 364,189 shares of common stock, Series A Warrants to purchase 145,676 shares of common stock, Series B Warrants to purchase 69,445 shares of common stock, and Series C Warrants to purchase 27,778 shares of common stock.

In November 2009, we entered a revolver line commitment with GemCap Lending I, LLC to replace our existing line of credit. The senior revolver facility is for \$3,000,000, based on 80% of eligible accounts receivable and 50% of eligible inventory, with a maximum inventory advance of \$1,500,000. The line of credit bears interest of 18% per annum.

During December 2009, we sold 120,820 shares of Series B Preferred stock, for net proceeds of \$829,000, after offering costs.

Our operating losses have negatively impacted our liquidity and we are continuing to work on decreasing operating losses, while focusing on increasing net sales. We believe that our current cash position and lines of credit will be sufficient to enable us to meet our cash needs throughout 2010. We believe that if the need arises we can raise money through the equity markets.

We may not generate sufficient revenues from product sales in the future to achieve profitable operations. If we are not able to achieve profitable operations at some point in the future, we eventually may have insufficient working capital to maintain our operations as we presently intend to conduct them or to fund our expansion and marketing and product development plans. In addition, our losses may increase in the future as we expand our manufacturing capabilities and fund our marketing plans and product development. These losses, among other things, have had and will continue to have an adverse effect on our working capital, total assets and stockholders' equity. If we are unable to achieve profitability, the market value of our common stock will decline and there would be a material adverse effect on our financial condition.

If we continue to suffer losses from operations, our working capital may be insufficient to support our ability to expand our business operations as rapidly as we would deem necessary at any time, unless we are able to obtain additional financing. There can be no assurance that we will be able to obtain such financing on acceptable terms, or at all. If adequate funds are not available or are not available on acceptable terms, we may not be able to pursue our business objectives and would be required to reduce our level of operations, including reducing infrastructure, promotions, personnel and other operating expenses. These events could adversely affect our business, results of operations and financial condition. There can be no assurance that additional financing will be available on terms favorable to us, or at all. If adequate funds are not available or if they are not available on acceptable terms, our ability to fund the growth of our operations, take advantage of opportunities, develop products or services or otherwise respond to competitive pressures, could be significantly limited.

Recent Accounting Pronouncements

In August 2009, the FASB issued ASU 2009-05, which amends ASC 820 to provide further guidance on measuring the fair value of a liability. It primarily does three things: 1) sets forth the types of valuation techniques to be used to value a liability when a quoted price in an active market for the identical liability is not available, 2) clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability, and 3) clarifies that both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market, when no adjustments to the quoted price of the asset are required, are Level 1 fair value measurements. This standard became effective for the Company beginning in the fourth quarter of 2009. The Company's adoption of ASU 2009-05 did not have a material impact on its financial position, results of operations or liquidity.

In January 2010, the FASB issued Update No. 2010-6, "Improving Disclosures About Fair Value Measurements" ("ASU 2010-6"), which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. ASU 2010-6 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures, which are effective for annual periods beginning after December 15, 2010. The Company is currently evaluating the effect of this update on its financial position, results of operations and liquidity.

In October 2009, the FASB issued authoritative guidance on revenue recognition that will become effective for the Company beginning July 1, 2010, with earlier adoption permitted. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. We believe adoption of this new guidance will not have a material impact on our financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not or are not believed by management to have a material impact on the Company's present or future financial statements.

Inflation

Although management expects that our operations will be influenced by general economic conditions, we do not believe that inflation has a material effect on our results of operations.

Item 8. Financial Statements

| | |
|---|-----|
| Report of Independent Registered Public Accounting Firm | F-1 |
| Financial Statements: | |
| Balance Sheets as of December 31, 2009 and December 31, 2008 | F-2 |
| Statements of Operations for the years ended December 31, 2009 and 2008 | F-3 |
| Statements of Stockholders' Equity for the years ended December 31, 2009 and 2008 | F-4 |
| Statements of Cash Flows for the years ended December 31, 2009 and 2008 | F-5 |
| Notes to Financial Statements | F-6 |

Report of Independent Registered Public Accounting Firm

We have audited the accompanying balance sheets of Reed's, Inc. as of December 31, 2009 and 2008 and the related statements of operations, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of Reed's, Inc. as of December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ WEINBERG & COMPANY, P.A.

Weinberg & Company, P.A.
Los Angeles, California
March 17, 2010

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REED'S, INC.
BALANCE SHEETS

| | December 31, 2009 | December 31, 2008 |
|--|-------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$1,306,000 | \$229,000 |
| Inventory | 2,884,000 | 2,837,000 |
| Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of \$90,000 and \$97,000, respectively | 866,000 | 897,000 |
| Prepaid and other current assets | 99,000 | 68,000 |
| Total Current Assets | 5,155,000 | 4,031,000 |
| Property and equipment, net of accumulated depreciation of \$727,000 and \$1,150,000, respectively | 3,655,000 | 4,133,000 |
| Brand names | 1,029,000 | 800,000 |
| Deferred offering costs | - | 62,000 |
| Deferred financing fees, net of amortization of \$10,000 and \$40,000, respectively | 131,000 | 77,000 |
| Total assets | \$9,970,000 | \$9,103,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$954,000 | \$1,592,000 |
| Accrued expenses | 127,000 | 96,000 |
| Recycling fees payable | 456,000 | 337,000 |
| Line of credit | 1,415,000 | 1,354,000 |
| Current portion of long term debt | - | 16,000 |
| Current portion of long term financing obligation | 40,000 | - |
| Current portion capital leases | 24,000 | - |
| Current portion note payable | 102,000 | - |
| Total current liabilities | 3,118,000 | 3,395,000 |
| Long term financing obligation, less current portion, net of discount of \$726,000 | 2,274,000 | - |
| Capital leases payable, less current portion | 130,000 | - |
| Note payable, less current portion | 71,000 | - |
| Long term debt, less current portion | - | 1,747,000 |
| Total Liabilities | 5,593,000 | 5,142,000 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Series A Convertible Preferred stock, \$10 par value, 500,000 shares authorized, 46,621 and 47,121 shares issued and outstanding, respectively | 466,000 | 471,000 |
| Series B Convertible Preferred stock, \$10 par value, 500,000 shares authorized, 120,820 shares issued and outstanding at December 31, 2009 | 1,208,000 | - |
| Common stock, \$.0001 par value, 19,500,000 shares authorized, 9,606,127 and 8,979,341 shares issued and outstanding, respectively | 1,000 | 1,000 |

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| | | |
|--|--------------|--------------|
| Additional paid in capital | 20,203,000 | 18,408,000 |
| Accumulated deficit | (17,501,000) | (14,919,000) |
| Total stockholders' equity | 4,377,000 | 3,961,000 |
| Total liabilities and stockholders' equity | \$9,970,000 | \$9,103,000 |

The accompanying notes are an integral part of these financial statements

F-2

REED'S, INC.
 STATEMENTS OF OPERATIONS
 For the Years Ended December 31, 2009 and 2008

| | 2009 | 2008 |
|---|----------------|----------------|
| Sales | \$15,178,000 | \$15,277,000 |
| Cost of sales | 11,566,000 | 11,891,000 |
| Gross profit | 3,612,000 | 3,386,000 |
| Operating expenses: | | |
| Selling and marketing expense | 2,412,000 | 3,817,000 |
| General and administrative expense | 2,632,000 | 3,140,000 |
| Impairment of assets | 641,000 | - |
| Total operating expenses | 5,685,000 | 6,957,000 |
| Loss from operations | (2,073,000) | (3,571,000) |
| Interest income | - | 1,000 |
| Interest expense | (486,000) | (244,000) |
| Net loss | (2,559,000) | (3,814,000) |
| Preferred stock dividend | (23,000) | (24,000) |
| Net loss attributable to common stockholders | \$(2,582,000) | \$(3,838,000) |
| Loss per share available to common stockholders - basic and diluted | \$(0.28) | \$(0.43) |
| Weighted average number of shares outstanding - basic and diluted | 9,238,002 | 8,884,338 |

The accompanying notes are an integral part of these financial statements

REED'S, INC.
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 For the Years Ended December 31, 2009 and 2008

| | Common Stock | | Series A Preferred Stock | | Series B Preferred Stock | | Additional Paid-In Capital | Accumulated Deficit | Total Stockholders' Equity |
|---|--------------|---------|-----------------------------|-----------|-----------------------------|--------|----------------------------------|------------------------|----------------------------------|
| | Shares | Amount | Shares | Amount | Shares | Amount | | | |
| Balance, December 31, 2007 | 8,751,721 | \$1,000 | 48,121 | \$481,000 | - | \$- | \$17,838,000 | \$(11,081,000) | \$7,239,000 |
| Fair Value of Common Stock issued for bonus and services | 212,710 | - | - | - | - | - | 392,000 | - | 392,000 |
| Common stock issued in connection with the June 30, 2008 preferred stock dividend | 10,910 | - | - | - | - | - | 24,000 | (24,000) | - |
| Common stock issued upon conversion of preferred stock | 4,000 | - | (1,000) | (10,000) | - | - | 10,000 | - | - |
| Fair value vesting of options issued to employees | - | - | - | - | - | - | 144,000 | - | 144,000 |
| Net loss | - | - | - | - | - | - | - | (3,814,000) | (3,814,000) |
| Balance, December 31, 2008 | 8,979,341 | 1,000 | 47,121 | 471,000 | - | - | 18,408,000 | (14,919,000) | 3,961,000 |
| Fair Value of Common Stock issued for services and finance fees | 197,647 | - | - | - | - | - | 260,000 | - | 260,000 |
| Warrants issued in connection | - | - | - | - | - | - | 752,000 | - | 752,000 |

| | | | | | | | | | |
|---|-----------|---------|--------|-----------|---------|-------------|--------------|----------------|-------------|
| with purchase option Common stock issued in connection with the June 30, 2009 preferred stock dividend | 12,950 | - | - | - | - | - | 23,000 | (23,000) | - |
| Common stock issued upon conversion of preferred stock | 2,000 | - | (500) | (5,000) | - | - | 5,000 | - | - |
| Private sale of common stock | 50,000 | - | - | - | - | - | 150,000 | - | 150,000 |
| Sale of common stock in shelf offering | 364,189 | - | - | - | - | - | 563,000 | - | 563,000 |
| Sale of Series B preferred stock, net of offering costs | - | - | - | - | 120,820 | 1,208,000 | (379,000) | - | 829,000 |
| Fair value vesting of options issued to employees | - | - | - | - | - | - | 421,000 | - | 421,000 |
| Net loss | - | - | - | - | - | - | - | (2,559,000) | (2,559,000) |
| Balance, December 31, 2009 | 9,606,127 | \$1,000 | 46,621 | \$466,000 | 120,820 | \$1,208,000 | \$20,203,000 | \$(17,501,000) | \$4,377,000 |

The accompanying notes are an integral part of these financial statements

REED'S, INC.
 STATEMENTS OF CASH FLOWS
 For the Years Ended December 31, 2009 and 2008

| | 2009 | 2008 |
|---|---------------|---------------|
| Cash flows from operating activities: | | |
| Net loss | \$(2,559,000) | \$(3,814,000) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 469,000 | 355,000 |
| Loss on disposal of equipment | - | 5,000 |
| Fair value of stock options issued to employees | 421,000 | 144,000 |
| Fair value of common stock issued for services | 236,000 | 392,000 |
| Impairment loss on assets | 641,000 | - |
| Decrease in allowance for doubtful accounts | (7,000) | - |
| Changes in assets and liabilities: | | |
| Accounts receivable | 38,000 | 264,000 |
| Inventory | (37,000) | 191,000 |
| Prepaid expenses and other current assets | (31,000) | 25,000 |
| Accounts payable | (638,000) | (113,000) |
| Accrued expenses | 31,000 | 38,000 |
| Recycling Fees Payable | 119,000 | 45,000 |
| Net cash used in operating activities | (1,317,000) | (2,468,000) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (356,000) | (191,000) |
| Net cash used in investing activities | (356,000) | (191,000) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock in shelf offering | 563,000 | - |
| Proceeds from private sale of common stock | 150,000 | - |
| Proceeds from the issuance of preferred stock | 891,000 | - |
| Payments for offering costs | - | (77,000) |
| Payments for deferred financing fees | (117,000) | (102,000) |
| Proceeds received from long term financing obligation | 3,056,000 | - |
| Principal repayments on long term financing obligation | (16,000) | - |
| Principal repayments on capital lease obligation | (9,000) | - |
| Principal repayments on long term debt | (1,763,000) | - |
| Payoff of former line of credit | (1,354,000) | 1,354,000 |
| Net borrowings on existing lines of credit | 1,415,000 | - |
| Principal repayments on notes | (66,000) | (800,000) |
| Proceeds received from borrowings on long term debt | - | 1,770,000 |
| Net cash provided by financing activities | 2,750,000 | 2,145,000 |
| Net decrease in cash | 1,077,000 | (514,000) |
| Cash at beginning of year | 229,000 | 743,000 |
| Cash at end of year | \$1,306,000 | \$229,000 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash paid during the year for: | | |
| Interest | \$457,000 | \$248,000 |
| Taxes | \$- | \$- |
| Non Cash Investing and Financing Activities | | |

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| | | |
|--|-----------|----------|
| Preferred Stock converted to common stock | \$5,000 | \$10,000 |
| Fair value of warrants granted as valuation discounts | \$752,000 | \$- |
| Common Stock issued in settlement of preferred stock dividend | \$23,000 | \$24,000 |
| Property and equipment acquired through capital lease obligation | \$163,000 | \$- |
| Note payable issued for brand names | \$229,000 | \$- |
| Note payable issued for inventory | \$10,000 | \$- |
| Common stock issued for deferred financing fees | \$24,000 | \$- |
| Deferred stock offering costs charged to paid in capital | \$62,000 | \$- |

The accompanying notes are an integral part of these financial statements

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REED'S, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

(1) Operations and Summary of Significant Accounting Policies

A) Nature of Operations

Reed's, Inc. (the "Company") was organized under the laws of the state of Florida in January 1991. In 2001, the Company changed its name from Original Beverage Corporation to Reed's, Inc. and changed its state of incorporation from Florida to Delaware. The Company is engaged primarily in the business of developing, manufacturing and marketing natural non-alcoholic beverages, as well as candies and ice creams. The Company currently offers 6 Reed's Ginger Brew flavors (Original, Premium, Extra, Cherry Ginger, Raspberry Ginger and Spiced Apple Ginger), 7 Virgil's Root Beer, Cream Sodas and Real Cola beverages (Root Beer, Cream Soda, Black Cherry Cream Soda, Real Cola, the same four in a Diet version, plus the Special Edition Bavarian Nutmeg Root Beer), 2 China Cola beverages (regular and cherry), 3 kinds of ginger candies (crystallized ginger, ginger chews and peanut butter ginger chews), and 3 flavors of ginger ice cream (Original, Green Tea, and Chocolate). In 2009, the Company also introduced its Reed's Energy Elixir and acquired the Sonoma Sparkler brand product line. In 2010 we are introducing our R(x)eed's nausea relief product.

The Company sells its products primarily in upscale gourmet and natural food stores and supermarket chains in the United States and, to a lesser degree, in Europe and Canada.

B) Cash and Cash Equivalents

Cash and cash equivalents include unrestricted deposits and short-term investments with an original maturity of three months or less.

C) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

D) Accounts Receivable

The Company evaluates the collectability of its trade accounts receivable based on a number of factors. In circumstances where the Company becomes aware of a specific customer's inability to meet its financial obligations to the Company, a specific reserve for bad debts is estimated and recorded, which reduces the recognized receivable to the estimated amount the Company believes will ultimately be collected. In addition to specific customer identification of potential bad debts, bad debt charges are recorded based on the Company's historical losses and an overall assessment of past due trade accounts receivable outstanding.

The allowance for doubtful accounts and returns and discounts is established through a provision for returns and discounts charged against sales. Receivables are charged off against the allowance when payments are received or products returned. The allowance for doubtful accounts and returns and discounts as of December 31, 2009 was approximately \$90,000 and December 31, 2008 was approximately \$97,000.

E) Property and Equipment and Related Depreciation

Property and equipment is stated at cost. Depreciation is calculated using accelerated and straight-line methods over the estimated useful lives of the assets as follows:

| Property and Equipment Type | Years of Depreciation |
|-----------------------------|-----------------------|
| Building | 39 years |
| Machinery and equipment | 5-12 years |
| Vehicles | 5 years |
| Office equipment | 5-7 years |

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Management regularly reviews property, equipment and other long-lived assets for possible impairment. This review occurs quarterly, or more frequently if events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. If there is indication of impairment, management prepares an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposition. If these cash flows are less than the carrying amount of the asset, an impairment loss is recognized to write down the asset to its estimated fair value. Management believes that the accounting estimate related to impairment of its property and equipment is a “critical accounting estimate” because: (1) it is highly susceptible to change from period to period because it requires management to estimate fair value, which is based on assumptions about cash flows and discount rates; and (2) the impact that recognizing an impairment would have on the assets reported on our balance sheet, as well as net income, could be material. Management’s assumptions about cash flows and discount rates require significant judgment because actual revenues and expenses have fluctuated in the past and are expected to continue to do so.

F) Intangible Assets and Impairment Policy

The Company records intangible assets in accordance with Financial Accounting Standard Guidance. Intangible assets consist mostly of brand names and are deemed to have indefinite lives are not subject to annual amortization. The Company reviews, at least quarterly, its investment in brand names and other intangible assets for impairment and if impairment is deemed to have occurred the impairment is charged to expense. Intangible assets which have finite lives are amortized on a straight line basis over their remaining useful life; they are also subject to annual impairment reviews.

Management applies the impairment tests to determine if impairment has occurred. Accordingly, management compares the carrying value of the asset to its fair value in determining the amount of the impairment. No impairments were identified for the years ended December 31, 2009 and 2008.

Management believes that the accounting estimate related to impairment of its intangible assets, is a “critical accounting estimate” because: (1) it is highly susceptible to change from period to period because it requires management to estimate fair value, which is based on assumptions about cash flows and discount rates; and (2) the impact that recognizing an impairment would have on the assets reported on our balance sheet, as well as net income, could be material. Management’s assumptions about cash flows and discount rates require significant judgment because actual revenues and expenses have fluctuated in the past and are expected to continue to do so. Based on Management’s assessment, there are no indicators of impairment at December 31, 2009 or 2008.

G) Concentrations

The Company’s cash balances on deposit with banks are guaranteed by the Federal Deposit Insurance Corporation up to \$250,000 at December 31, 2009. The Company may be exposed to risk for the amounts of funds held in bank accounts in excess of the insurance limit. In assessing the risk, the Company’s policy is to maintain cash balances with high quality financial institutions. The Company had cash balances in excess of the guarantee during the years ended December 31, 2009 and 2008.

During the year ended December 31, 2009, the Company had two customers who accounted for approximately 31% and 15% of its sales, respectively; and during the year ended December 31, 2008 the same customers accounted for 32% and 14% of its sales, respectively. No other customer accounted for more than 10% of sales in either year. As of December 31, 2009 the Company had accounts receivable due from two customers who comprised \$134,000 (14%) and \$147,000 (15%), respectively, of its total accounts receivable; and at December 31, 2008 the Company had accounts receivable due from three customers who comprised \$135,000 (14%), \$183,000 (18%) and \$102,000 (10%), respectively, of its total accounts receivable.

The Company currently relies on a single contract packer for a majority of its production and bottling of beverage products. The Company has different packers available for their production of products. Although there are other packers and the Company has outfitted their own brewery and bottling plant, a change in packers may cause a delay in the production process, which could ultimately affect operating results.

H) Fair Value of Financial Instruments

The Company uses various inputs in determining the fair value of its investments and measures these assets on a recurring basis. Financial assets recorded at fair value in the consolidated balance sheets are categorized by the level of objectivity associated with the inputs used to measure their fair value. Authoritative guidance provided by the FASB defines the following levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these financial assets:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.

Level 3—Unobservable inputs based on the Company's assumptions.

The Company has no fair value items required to be disclosed.

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I) Cost of sales

The Company classifies shipping and handling costs, purchasing and receiving costs, inspection costs, warehousing costs, freight costs, internal transfer costs and other costs associated with product distribution as costs of sales. Certain of these costs become a component of the inventory cost and are expensed to costs of sales when the product to which the cost has been allocated is sold. Expenses not related to the production of our products are classified as operating expenses.

J) Income Taxes

Current income tax expense is the amount of income taxes expected to be payable for the current year. A deferred income tax asset or liability is established for the expected future consequences of temporary differences in the financial reporting and tax bases of assets and liabilities. The Company considers future taxable income and ongoing, prudent and feasible tax planning strategies, in assessing the value of its deferred tax assets. If the Company determines that it is more likely than not that these assets will not be realized, the Company will reduce the value of these assets to their expected realizable value, thereby decreasing net income. Evaluating the value of these assets is necessarily based on the Company's judgment. If the Company subsequently determined that the deferred tax assets, which had been written down, would be realized in the future, the value of the deferred tax assets would be increased, thereby increasing net income in the period when that determination was made.

K) Revenue Recognition

Revenue is recognized on the sale of a product when the product is shipped, which is when the risk of loss transfers to our customers, and collection of the receivable is reasonably assured. A product is not shipped without an order from the customer and credit acceptance procedures performed. The allowance for returns is regularly reviewed and adjusted by management based on historical trends of returned items. Amounts paid by customers for shipping and handling costs are included in sales.

The Company accounts for certain sales incentives, including slotting fees, as a reduction of gross sales. These sales incentives for the years ended December 31, 2009 and 2008 approximated \$847,000 and \$815,000, respectively.

L) Net Loss Per Share

Basic earnings (loss) per share is computed by dividing the net income (loss) applicable to Common Stockholders by the weighted average number of shares of Common Stock outstanding during the year. Diluted earnings (loss) per share is computed by dividing the net income (loss) applicable to Common Stockholders by the weighted average number of common shares outstanding plus the number of additional common shares that would have been outstanding if all dilutive potential common shares had been issued, using the treasury stock method. Potential common shares are excluded from the computation as their effect is antidilutive.

For the years ended December 31, 2009 and 2008 the calculations of basic and diluted loss per share are the same because potential dilutive securities would have an anti-dilutive effect. The potentially dilutive securities consisted of the following as of:

| | December 31, | |
|--------------------------|--------------|-----------|
| | 2009 | 2008 |
| Warrants | 1,991,690 | 1,868,236 |
| Series A Preferred Stock | 186,484 | 188,484 |
| Series B Preferred Stock | 845,740 | - |

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| | | |
|---------|-----------|-----------|
| Options | 690,000 | 702,500 |
| Total | 3,713,914 | 2,759,220 |

M) Advertising Costs

Advertising costs are expensed as incurred and are included in selling expense in the amount of \$291,000 and \$174,000, for the years ended December 31, 2009 and 2008, respectively.

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N) Stock Compensation Expense

The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance provided by the Financial Accounting Standards Board whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete.

We estimate volatility and forfeitures based upon historical data. As permitted by the authoritative guidance issued by the Financial Accounting Standards Board, we use the “simplified” method to determine the expected life of an option grant due to the Company’s lack of sufficient historical exercise data to provide a reasonable basis, which is a result of the relative high turnover rates experienced in the past for positions granted options. All of these variables have an effect on the estimated fair value of our share-based awards.

O) Deferred Offering Costs

The Company capitalizes costs incurred related to its issuance of common stock until such time as the stock is issued. These costs included attorney’s fees, accountant’s fees, SEC filing fees, state filing fees, and other specific incremental costs directly related to the public offering and related issuance of common stock. As proceeds are received from the offering, the deferred offering costs were charged to additional paid in capital. During the years ended December 31, 2009 and 2008, \$379,000 and \$0, respectively, of deferred offering costs were charged to additional paid in capital.

P) Recent Accounting Pronouncements

In August 2009, the FASB issued ASU 2009-05, which amends ASC 820 to provide further guidance on measuring the fair value of a liability. It primarily does three things: 1) sets forth the types of valuation techniques to be used to value a liability when a quoted price in an active market for the identical liability is not available, 2) clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability, and 3) clarifies that both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market, when no adjustments to the quoted price of the asset are required, are Level 1 fair value measurements. This standard became effective for the Company beginning in the fourth quarter of 2009. The Company’s adoption of ASU 2009-05 did not have a material impact on its financial position, results of operations or liquidity.

In January 2010, the FASB issued Update No. 2010-6, “Improving Disclosures About Fair Value Measurements” (“ASU 2010-6”), which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. ASU 2010-6 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures, which are effective for annual periods beginning after December 15, 2010. The Company is currently evaluating the effect of this update on its financial position, results of operations and liquidity.

In October 2009, the FASB issued authoritative guidance on revenue recognition that will become effective for the Company beginning July 1, 2010, with earlier adoption permitted. Under the new guidance on arrangements that

include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. We believe adoption of this new guidance will not have a material impact on our financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not or are not believed by management to have a material impact on the Company's present or future financial statements

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(2) Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market, and is comprised of the following as of:

| | December 31, 2009 | December 31, 2008 |
|--------------------------------|-------------------------|-------------------------|
| Raw Materials and Packaging | \$ 1,337,000 | \$ 755,000 |
| Finished Goods | 1,547,000 | 2,082,000 |
| | \$ 2,884,000 | \$ 2,837,000 |

(3) Fixed Assets

Fixed assets are comprised of the following as of:

| | December 31, 2009 | December 31, 2008 |
|-----------------------------|-------------------------|----------------------|
| Land | \$ 1,108,000 | \$ 1,410,000 |
| Building | 1,393,000 | 1,769,000 |
| Vehicles | 320,000 | 320,000 |
| Machinery and equipment | 1,169,000 | 1,398,000 |
| Office equipment | 392,000 | 386,000 |
| | 4,382,000 | 5,283,000 |
| Accumulated depreciation | (727,000) | (1,150,000) |
| | \$ 3,655,000 | \$ 4,133,000 |

During 2009, an impairment charge in the amount of \$641,000 was recorded in connection with a sale and lease-back of the Company's buildings and equipment (See Note 6), as it was determined that the carrying value of the buildings and brewery equipment was greater than the fair market value of those assets on the date of the transaction.

Depreciation expense for the years ended December 31, 2009 and 2008 was \$356,000 and \$302,000, respectively.

Machinery and equipment at December 31, 2009 includes equipment held under capital leases of \$163,000. Accumulated depreciation on equipment held under leases was \$13,000 as of December 31, 2009.

(4) Intangible Assets

Brand Names

Brand Names consist of three trademarks for natural beverages, two of which the Company acquired in previous years and one brand acquired in 2009. As long as the Company continues to renew its trademarks, these intangible assets will have an indefinite life. Accordingly, they are not subject to amortization. The Company determines fair value for Brand Names by reviewing the net sales of the associated beverage and applying industry multiples for which similar beverages are sold. As of December 31, 2009 and 2008, carrying amounts for Brand Names were \$1,029,000 and \$800,000, respectively.

Deferred Financing Fees

Deferred financing are comprised of the following as of:

| | December 31, 2009 | December 31, 2008 |
|------------------------------------|-------------------------|-------------------------|
| Loan fees relating to financing | \$ 141,000 | \$ 102,000 |
| Accumulated amortization | (10,000) | (40,000) |
| | \$ 131,000 | \$ 62,000 |

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Amortization expense for the years ended December 31, 2009 and 2008 was approximately \$89,000 and \$53,000 respectively.

Amortization of deferred financing fees is as follows for the years ending December 31:

| Year | Amount |
|-------|------------|
| 2010 | \$ 112,000 |
| 2011 | 5,000 |
| 2012 | 5,000 |
| 2013 | 5,000 |
| 2014 | 4,000 |
| Total | \$ 131,000 |

(5) Lines of Credit

| | December 31, | |
|--------------------|--------------|--------------|
| | 2009 | 2008 |
| Line of Credit (A) | \$ - | \$ 1,354,000 |
| Line of Credit (B) | 1,415,000 | - |
| | \$ 1,415,000 | \$ 1,354,000 |

(A) In May 2008 the Company entered into a Credit and Security Agreement under which the Company was provided with a \$2 million revolving credit facility. In July 2008, the line of credit was increased to \$3 million. Interest accrued and was paid monthly on outstanding loans under the credit facility at a rate equal to 5.75% per annum plus the greater of 2% or the LIBOR rate. The amount available to borrow was based on a calculation of eligible accounts receivable and inventory. Borrowings under the credit facility were secured by all of the Company's assets and the loan was personally guaranteed by the principal shareholder and Chief Executive Officer. The line of credit was closed in November 2009.

(B) On November 18, 2009, the Company executed a revolver line commitment with GemCap Lending I, LLC to replace its existing line of credit. The senior revolver facility is for \$3,000,000, based on 80% of eligible accounts receivable and 50% of eligible inventory, with a maximum inventory advance of \$1,500,000. The line of credit bears interest of 18% per annum.

At December 31, 2009, the aggregate amount outstanding under the line of credit was \$1,415,000 and the Company had approximately \$221,000 of availability on this line of credit.

(6) Lo3.Long Term Financing Obligation

| | December 31, | |
|--------------------------------|--------------|------|
| | 2009 | 2008 |
| Long term financing obligation | \$ 3,040,000 | \$ - |
| Valuation discount | (726,000) | - |
| | \$ 2,314,000 | \$ - |

On June 15, 2009, the Company closed escrow on the sale of its two buildings and its brewery equipment and concurrently entered into a long-term lease agreement for the same property and equipment. In connection with the lease the Company has the option to repurchase the buildings and brewery equipment from 12 months after the commencement date to the end of the lease term at the greater of the fair market value or an agreed upon amount.

Since the lease contains a buyback provision and other related terms, the Company determined it had continuing involvement that did not warrant the recognition of a sale; therefore, the transaction has been accounted for as a long-term financing. The proceeds from the sale, net of transaction costs, have been recorded as a financing obligation in the amount of \$3,056,000. Monthly payments under the financing agreement are recorded as interest expense and a reduction in the financing obligation at an implicit rate of 9.9%. The financing obligation is personally guaranteed up to a limit of \$150,000 by the principal shareholder and Chief Executive Officer, Christopher J. Reed.

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In connection with the financing obligation, the Company issued an aggregate of 400,000 warrants to purchase its common stock at \$1.20 per share for five years. The 400,000 warrants were valued at \$752,000 and reflected as a debt discount, using the Black Scholes option pricing model. The following assumptions were utilized in valuing the 400,000 warrants: strike price of \$2.10 to \$2.25; term of 5 years; volatility of 91.36% to 110.9%; expected dividends 0%; and discount rate of 2.15% to 2.20%. The 400,000 warrants were recorded as valuation discount and are being amortized over 15 years, the term of the purchase option. Amortization of valuation discount was \$25,000 and \$0, respectively, during the years ended December 31, 2009 and 2008.

The aggregate due under the financing obligation at December 31, 2009 was \$3,040,000. Aggregate future obligations under the financing obligation are as follows:

| Year | |
|------------|--------------|
| 2010 | \$ 40,000 |
| 2011 | 55,000 |
| 2012 | 71,000 |
| 2013 | 90,000 |
| 2014 | 111,000 |
| Thereafter | 2,673,000 |
| Total | \$ 3,040,000 |

(7) Lo4.Long Term Debt

Long-term debt consists of the following as of:

| | December 31, 2009 | December 31, 2008 |
|--|-------------------------|-------------------------|
| Note payable with a bank in the amount of \$1,770,000. The note matures in February 2038. The note carries an 8.41% per annum interest rate, requires a monthly payment of principal and interest of \$13,651, and is secured by all of the land and buildings owned by the Company, and is personally guaranteed by the majority stockholder. | \$- | \$1,763,000 |
| Note payable from acquisition of brand in the amount of \$239,000, recorded at an implicit rate of 5%, requires a monthly payment of \$9,000, and matures in August 2011. | 173,000 | - |
| Total | 173,000 | 1,763,000 |
| Less current portion | 102,000 | 16,000 |
| | \$71,000 | \$1,747,000 |

The aggregate maturities of long-term debt for each of the next five years and thereafter are as follows as of December 31:

| Year | Amount |
|-------|------------|
| 2010 | \$ 102,000 |
| 2011 | 71,000 |
| Total | \$ 173,000 |

(8) Obligations Under Capital Leases

The Company has entered into various capital leases for equipment with monthly payments ranging from \$438 to \$1,545 per month, including interest, at interest rates ranging from 17.27% to 17.32% per annum. At December 31, 2009, monthly payments under these leases aggregated \$4,081. The leases expire at various dates through 2014.

Future minimum lease payments under capital leases are as follows:

| Years Ending December 31, | |
|---|------------|
| 2010 | \$ 49,000 |
| 2011 | 49,000 |
| 2012 | 49,000 |
| 2013 | 49,000 |
| 2014 | 29,000 |
| Total payments | 225,000 |
| Less: Amount representing interest | 71,000 |
| Present value of net minimum lease payments | 154,000 |
| Less: Current portion | 24,000 |
| Non-current portion | \$ 130,000 |

(9) Stockholders' Equity

Preferred Stock

Series A

Series A Preferred stock consists of 500,000 shares authorized to Series A, \$10.00 par value, 5% non-cumulative, participating, preferred stock. As of December 31, 2009 and 2008 there were 47,121 and 48,121 shares outstanding respectively, with a liquidation preference of \$10.00.

These preferred shares have a 5% pro-rata annual non-cumulative dividend. The dividend can be paid in cash or, in the sole and absolute discretion of our board of directors, in shares of common stock based on its then fair market value. We cannot declare or pay any dividend on shares of our securities ranking junior to the preferred stock until the holders of our preferred stock have received the full non-cumulative dividend to which they are entitled. In addition, the holders of our preferred stock are entitled to receive pro rata distributions of dividends on an "as converted" basis with the holders of our common stock. During the year ended December 31, 2009 the Company accrued and paid a \$23,000 dividend payable to the preferred shareholders, which management elected to pay through the issuance of 12,950 shares of its common stock; and during the year ended December 31, 2008 the Company accrued and paid a \$28,000 dividend payable to the preferred shareholders, which management elected to pay through the issuance of 3,820 shares of its common stock.

In the event of any liquidation, dissolution or winding up of the Company, or if there is a change of control event, then, subject to the rights of the holders of our more senior securities, if any, the holders of our Series A preferred stock are entitled to receive, prior to the holders of any of our junior securities, \$10.00 per share plus all accrued and unpaid dividends. Thereafter, all remaining assets shall be distributed pro rata among all of our security holders. Since June 30, 2008, we have the right, but not the obligation, to redeem all or any portion of the Series A preferred stock by paying the holders thereof the sum of the original purchase price per share, which was \$10.00, plus all accrued and unpaid dividends.

The Series A preferred stock may be converted, at the option of the holder, at any time after issuance and prior to the date such stock is redeemed, into four shares of common stock, subject to adjustment in the event of stock splits, reverse stock splits, stock dividends, recapitalization, reclassification and similar transactions. We are obligated to reserve out of our authorized but unissued shares of common stock a sufficient number of such shares to effect the conversion of all outstanding shares of Series A preferred stock. During the year ended December 31, 2009, 500

shares of preferred stock were converted into 2,000 shares of common stock. During the year ended December 31, 2008, 10,819 shares of preferred stock were converted into 43,276 shares of common stock.

Except as provided by law, the holders of our Series A preferred stock do not have the right to vote on any matters, including, without limitation, the election of directors. However, so long as any shares of Series A preferred stock are outstanding, we shall not, without first obtaining the approval of at least a majority of the holders of the Series A preferred stock, authorize or issue any equity security having a preference over the Series A preferred stock with respect to dividends, liquidation, redemption or voting, including any other security convertible into or exercisable for any equity security other than any senior preferred stock.

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Series B

On April 23, 2009, the Board of Directors of the Company approved a new class of Preferred Stock for the purpose of selling the Preferred stock in the Corporation's rights offering. The Preferred Stock is designated as Series B Convertible Preferred Stock, with a number of shares authorized being shared with the Series A preferred stock. In the aggregate, both classes of preferred stock may not exceed 500,000 shares.

On November 13, 2009, the Company issued transferable rights to all common shareholders of record. Shareholders received one transferable right for each share held on the record date. Each transferable right entitled the investor to purchase one share of Series B preferred stock at the par value of \$10.00 per share. Each share of Series B Preferred carries a five percent (5%) annual dividend for a term of three (3) years, and is convertible into shares of common stock at a conversion ratio of seven (7) shares of common stock, or a conversion price of \$1.43. The shares carry a mandatory conversion feature when the Company's common stock exceeds a closing price of \$2.75 for five (5) consecutive trading days.

During December 2009, investors purchased 120,820 shares of Series B Preferred resulting in an aggregate of \$1,208,000 in gross proceeds to the Company. The Company paid commissions of \$88,000 and an expense allowance of \$10,000 to the placement agent for the Series B offering and issued warrants to the placement to purchase up to 33,796 shares of common stock with an exercise price of \$1.43 per share. The Company received proceeds after commissions and the expense allowance of approximately \$1,110,000 in the aggregate, of which approximately \$829,000 was received net of offering costs.

These preferred shares have a 5% pro-rata annual non-cumulative dividend payable quarterly for a period of three years. The dividend can be paid in cash or, in the sole and absolute discretion of our board of directors, in shares of common stock based on its then fair market value. We cannot declare or pay any dividend on shares of our securities ranking junior to the preferred stock until the holders of our preferred stock have received the full non-cumulative dividend to which they are entitled. During the year ended December 31, 2009, no dividends were accrued or paid. The first dividend date will be March 31, 2010.

In the event of any liquidation, dissolution or winding up of the Company, or if there is a change of control event, then, subject to the rights of the holders of our more senior securities, if any, the holders of our Series A preferred stock are entitled to receive, prior to the holders of any of our junior securities, \$10.00 per share plus all accrued and unpaid dividends. Thereafter, all remaining assets shall be distributed pro rata among all of our security holders.

The Series B preferred stock may be converted, at the option of the holder, at any time after issuance and prior to the date such stock is redeemed, into seven shares of common stock, subject to adjustment in the event of stock splits, reverse stock splits, stock dividends, recapitalization, reclassification and similar transactions. We are obligated to reserve out of our authorized but unissued shares of common stock a sufficient number of such shares to effect the conversion of all outstanding shares of Series B preferred stock. During the year ended December 31, 2009, no shares of preferred stock were converted into shares of common stock.

Except as provided by law, the holders of our Series B preferred stock do not have the right to vote on any matters, including, without limitation, the election of directors. However, so long as any shares of Series B preferred stock are outstanding, we shall not, without first obtaining the approval of at least a majority of the holders of the Series B preferred stock, authorize or issue any equity security having a preference over the Series B preferred stock with respect to dividends, liquidation, redemption or voting, including any other security convertible into or exercisable for any equity security other than any senior preferred stock.

Common Stock

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Common stock consists of \$.0001 par value, 19,500,000 shares authorized, 9,606,127 shares issued and outstanding as of December 31, 2009 and 8,979,341 shares issued and outstanding as of December 31, 2008.

During the year ended December 31, 2008, the Company issued 161,960 shares of common stock at stock prices ranging from \$1.99 to \$3.85 per share with a value of \$336,000 in exchange for consulting services and 50,750 shares of common stock at a share price of \$1.11 per share and a value of \$56,000 to employees as a bonus.

On October 8, 2009, the Company sold an aggregate of 364,189 units (“Units”) consisting of one share of our common stock (“Share”) and warrants to purchase shares of our common stock (“Warrants”) at a price of \$1.80 per Unit resulting in gross proceeds of \$656,000 to the Company pursuant to a public shelf registration on Form S-3. The Warrants consist of (i) Series A Warrants, for the purchase of a number of shares of common stock equal to 40% of a purchaser’s Shares, which have an initial exercise price of \$2.25 per share and are exercisable for a period of five years commencing 183 days from the date of issuance, (ii) Series B Warrants, for the purchase of a number of shares of common stock equal to 50% of a purchaser’s Shares, which have an exercise price equal to \$1.80 and are exercisable for 60 trading days commencing immediately, and (iii) Series C Warrants, for the purchase of a number of a shares of common stock equal to 20% of a purchaser’s Shares, which have an exercise price of \$2.25 and are exercisable for five years commencing 183 days from the date of issuance. The Series B Warrants and Series C Warrants were only issued to purchasers who purchased Units for an aggregate purchase price of at least \$125,000. The Company paid an 8% placement agent fee of \$52,000. The Company received proceeds from the shelf-registration, after deducting placement agent fees and offering expenses, of approximately \$563,000. At the closing, the Company issued 364,189 shares of common stock, Series A Warrants to purchase 145,676 shares of common stock, Series B Warrants to purchase 69,445 shares of common stock, and Series C Warrants to purchase 27,778 shares of common stock.

During 2009, the Company also sold 50,000 shares of common stock for \$3.00 per share or \$150,000.

During the year ended December 31, 2009, the Company issued 181,147 shares of common stock in exchange for consulting and legal services. The value of the stock was based on the closing price of the stock on the issuance or agreed upon date. The total value of shares issued for services was \$236,000. The Company issued 13,500 shares of common stock valued at \$24,000 for financial fees related to the capital leases entered into during the 2009 fiscal year. The value of these shares has been recorded as deferred financing fees and is being amortized over the term of the capital leases (see Note 4).

On December 22, 2009, the Company granted 38,750 shares of common stock valued at \$51,000, based upon the stock price on the date of grant, to its employees as bonuses. The shares of common stock were issued subsequent to year-end and have been included in accounts payable as of December 31, 2009.

(10) Stock Options and Warrants

A) Stock Options

In 2001, the Company adopted the Original Beverage Corporation 2001 Stock Option Plan and in 2007 the Company adopted the Reed's Inc 2007 Stock Option Plan (the "Plans"). The options under both plans shall be granted from time to time by the Compensation Committee. Individuals eligible to receive options include employees of the Company, consultants to the Company and directors of the Company. The options shall have a fixed price, which will not be less than 100% of the fair market value per share on the grant date. The total number of options authorized is 500,000 and 1,500,000, respectively for the Original Beverage Corporation 2001 Stock Option Plan and the Reed's Inc 2007 Stock Option Plan.

During the years ended December 31, 2009 and 2008, the Company issued 120,000 and 325,000 options, respectively, to purchase the Company's common stock at a weighted average price of \$1.18 and \$1.62, respectively, to employees under the Plans. On March 6, 2009, the Company repriced 420,000 employee options to an exercise price of \$0.75. Such options had previously been issued at exercise prices between \$1.99 per share and \$8.50 per share. The total increase in stock compensation expense, as a result of the repricing, was \$81,000; of which \$44,000 was recognized in the year ended December 31, 2009. The aggregate value of the options vesting, net of forfeitures, during the years ended December 31, 2009 and 2008 was \$421,000 and \$144,000, respectively, and has been reflected as compensation cost. As of December 31, 2009, the aggregate value of unvested options was \$286,000, which will be amortized as compensation cost as the options vest, over 3 years.

The weighted-average grant date fair value of options granted during 2009 and 2008 was \$1.18 and \$1.23, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. For purposes of determining the expected life of the option, the full contract life of the option is used. The risk-free rate for periods within the contractual life of the options is based on the U. S. Treasury yield in effect at the time of the grant.

| | Year ended December 31, | |
|-----------------------------|-------------------------|-----------|
| | 2009 | 2008 |
| Expected volatility | 89%- 97% | 107%-109% |
| Weighted average volatility | 91% | 109% |
| | — | — |

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| | | |
|---|-------|-------|
| E x p e c t e d dividends | | |
| E x p e c t e d average term (in years) | 2.82 | 4.3 |
| Risk free rate - average | 1.72% | 2.75% |
| Forfeiture rate | 0% | 0% |

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A summary of option activity as of December 31, 2009 and changes during the two years then ended is presented below:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Terms (Years) | Aggregate Intrinsic Value |
|----------------------------------|-----------|------------------------------------|---|---------------------------------|
| Outstanding at December 31, 2007 | 749,000 | \$6.02 | | |
| Granted | 325,000 | \$1.62 | | |
| Exercised | — | — | | |
| Forfeited or expired | (371,500) | \$6.83 | | |
| Outstanding at December 31, 2008 | 702,500 | \$3.55 | | |
| Granted | 120,000 | \$1.18 | | |
| Exercised | — | — | | |
| Forfeited or expired | (132,500) | \$2.38 | | |
| Outstanding at December 31, 2009 | 690,000 | \$1.74 | 3.0 | \$300,000 |
| Exercisable at December 31, 2009 | 334,999 | \$2.23 | 2.4 | \$141,000 |

The aggregate intrinsic value was calculated as the difference between the market price and the exercise price of the Company's stock, which was \$1.43 as of December 31, 2009.

A summary of the status of the Company's nonvested shares granted under the Company's stock option plan as of December 31, 2009 and changes during the year then ended is presented below:

| | Shares | Weighted-Average Grant Date Fair Value |
|--------------------------------|------------|--|
| Nonvested at December 31, 2008 | 495,833 | \$0.86 |
| Granted | 120,000 | \$0.66 |
| Vested | (217,500) | \$0.87 |
| Forfeited | (43,333) | \$1.23 |
| Nonvested at December 31, 2009 | 355,001 | \$0.74 |

Additional information regarding options outstanding as of December 31, 2009 is as follows:

| Range of Exercise Price | Options Outstanding at December 31, 2009 | | | Options Exercisable at December 31, 2009 | |
|----------------------------|--|---|---------------------------------------|---|---------------------------------------|
| | Number of Shares Outstanding | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Number of Shares Exercisable | Weighted Average Exercise Price |
| | 560,000 | 3.26 | \$0.89 | 221,666 | \$0.79 |

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| | | | | | |
|----------|---------|------|--------|---------|--------|
| \$0.01 - | | | | | |
| \$1.99 | | | | | |
| \$2.00 - | | | | | |
| \$4.99 | 80,000 | 1.30 | \$4.00 | 80,000 | \$4.00 |
| \$5.00 - | | | | | |
| \$6.99 | - | - | - | - | - |
| \$7.00 - | | | | | |
| \$8.50 | 50,000 | 2.42 | \$7.55 | 33,333 | \$7.55 |
| | 690,000 | | | 334,999 | |

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B) Warrants

During the year ended December 31, 2008, 200,000 warrants were granted in connection with a distribution agreement between the Company and a company which is owned by two brothers of Christopher Reed, President of the Company. The warrants are issuable only upon the attainment of certain international product sales goals. The warrants will be valued and a corresponding expense will be recorded upon the attainment of the sales goals identified when the warrants were granted. In April 2009, the 200,000 warrants were re-priced to \$1.35 from a weighted average price of \$2.77. Since these are performance-based warrants and no performance criteria have been met as of December 31, 2009, no expense was recognized in the re-pricing of these warrants. The value of the re-pricing was approximately \$5,000 and the value of the warrants after re-pricing was \$168,000, using the Black Scholes option pricing model. The following assumptions were utilized in valuing the 200,000 warrants: strike price of \$1.35; term of 3 years; volatility of 99.8%; expected dividends 0%; and discount rate of 1.89%.

In October 2009, the Company granted an aggregate 242,899 warrants at a price of \$2.25 in connection with an equity placement of its common stock (see Note 9). 69,445 of the warrants expired unexercised on January 4, 2010. The remaining 173,454 options expire in five years. The aggregate value of the warrants was approximately \$217,000, using the Black Scholes option pricing model. The following assumptions were utilized in valuing the 173,454 warrants: strike price of \$2.25; term of 5 years; volatility of 90.20%; expected dividends 0%; and discount rate of 2.16%. The value of the warrants has not been reflected in the Company's financial statements as it is a reclass between paid in capital accounts.

In December 2009, the Company granted 33,796 warrants at \$1.79 per share to a dealer-manager in connection with the placement of its Series B preferred stock (see Note 9). The warrants were valued at \$25,000, using the Black Scholes option pricing model. The following assumptions were utilized in valuing the 33,796 warrants: strike price of \$1.79; term of 5 years; volatility of 71.74%; expected dividends 0%; and discount rate of 2.62%. The value of the warrants has not been reflected in the Company's financial statements as it is a reclass between paid in capital accounts.

The following table summarizes warrant activity for the two years ended December 31, 2009:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Terms (Years) | Aggregate Intrinsic Value |
|----------------------------------|-----------|------------------------------------|---|---------------------------------|
| Outstanding at December 31, 2007 | 1,668,236 | \$5.75 | | |
| Granted | 200,000 | \$2.54 | | |
| Exercised | - | - | | |
| Forfeited or expired | - | - | | |
| Outstanding at December 31, 2008 | 1,868,236 | \$5.41 | | |
| Granted | 676,695 | \$1.56 | | |
| Exercised | - | - | | |
| Forfeited or expired | (553,241) | \$2.81 | | |
| Outstanding at December 31, 2009 | 1,991,690 | \$4.70 | 3.0 | \$108,000 |
| Exercisable at December 31, 2009 | 1,618,236 | \$5.38 | 2.8 | \$92,000 |

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The aggregate intrinsic value was calculated, as of December 31, 2009, as the difference between the market price and the exercise price of the Company's stock, which was \$1.43 as of December 31, 2009.

The fair value of each warrant is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatility is based on the historical volatility of the Company. For purposes of determining the expected life of the warrant, the full contract life of the warrant is used. The risk-free rate for periods within the contractual life of the warrants is based on the U. S. Treasury yield in effect at the time of the grant.

| | Year ended December 31, | |
|-----------------------------|-------------------------|-------|
| | 2009 | 2008 |
| Expected volatility | 72% - 111% | 108% |
| Weighted average volatility | 100% | 108% |
| Expected dividends | - | - |
| Expected term (in years) | 5 | 5 |
| Risk free rate | 2.18% | 5.10% |

The weighted-average grant date fair value of warrants granted during 2009 and 2008 was \$1.47 and \$1.88 respectively.

The following table summarizes the outstanding warrants to purchase Common Stock at December 31, 2009:

| Number | Exercise | |
|---------|----------|------------------|
| | Price | Expiration Dates |
| 400,000 | \$1.20 | May 2014 |
| 200,000 | \$1.35 | May 2013 |
| 33,796 | \$1.79 | December 2014 |
| | \$1.80 - | January 2010 - |
| 242,899 | \$2.25 | April 2015 |
| | | December 2011 - |
| 365,000 | \$6.60 | June 2012 |
| 749,995 | \$7.50 | June 2012 |

(11) Income Taxes

At December 31, 2009 and 2008, the Company had available Federal and state net operating loss carryforwards to reduce future taxable income. The amounts available were approximately \$16,000,000 and \$13,600,000 for Federal purposes, respectively, and \$11,500,000 and \$10,200,000 for state purposes respectively. The Federal carryforward expires in 2030 and the state carryforward expires in 2015. Given the Company's history of net operating losses, management has determined that it is more likely than not the Company will not be able to realize the tax benefit of the carryforwards. Accordingly, the Company has not recognized a deferred tax asset for this benefit.

Accounting guidance requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. Due to restrictions imposed by Internal Revenue Code Section 382 regarding substantial changes in ownership of companies with loss carry-forwards, the utilization of the Company's net operating loss carry-forwards will likely be limited as a result of cumulative changes in stock ownership. The company has not recognized a deferred tax asset and, as a result, the change in stock ownership has not resulted in any changes to valuation allowances.

Upon the attainment of taxable income by the Company, management will assess the likelihood of realizing the tax benefit associated with the use of the carryforwards and will recognize a deferred tax asset at that time.

Significant components of the Company's deferred income tax assets are as follows as of:

| | December 31, 2009 | December 31, 2008 |
|----------------------------------|-------------------------|-------------------------|
| Deferred income tax asset: | | |
| Net operating loss carry forward | \$5,800,000 | \$5,000,000 |
| Valuation allowance | (5,800,000) | (5,000,000) |
| Net deferred income tax asset | — | — |

Reconciliation of the effective income tax rate to the U.S. statutory rate is as follows:

| | Year Ended December 31, | |
|-----------------------------------|----------------------------|--------|
| | 2009 | 2008 |
| Federal Statutory tax rate | (34%) | (34%) |
| State tax, net of federal benefit | (5%) | (5%) |

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| | | |
|---------------------|--------|--------|
| Change in valuation | (39%) | (39%) |
| Allowance | 39 % | 39 % |
| Effective tax rate | - % | - % |

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(12) Commitments and Contingencies

Lease Commitments

The Company leases machinery under non-cancelable operating leases. Rental expense for the years ended December 31, 2009 and 2008 was \$40,000 and \$48,000, respectively.

Future payments under these leases as of December 31, 2009 are as follows:

| Year ending December 31, | Amount |
|--------------------------------|-----------|
| 2010 | \$ 8,000 |
| 2011 | 7,000 |
| Total | \$ 15,000 |

Other Commitments

The Company has entered into contracts with customers with clauses that commit the Company to fees if the Company terminates the agreement early or without cause. The contracts call for the customer to have the right to distribute the Company's products to a defined type of retailer within a defined geographic region. If the Company should terminate the contract or not automatically renew the agreements, amounts would be due to the customer. As of December 31, 2009 and 2008, the Company has no plans to terminate or not renew any agreement with any of their customers; therefore no fees have been accrued in the accompanying financial statements.

(13) Legal Proceedings

From time to time, we are a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates our exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

From August 3, 2005 through April 7, 2006, we issued 333,156 shares of our common stock in connection with our initial public offering. These securities represented all of the shares issued in connection with the initial public offering prior to October 11, 2006. These shares issued in connection with the initial public offering may have been issued in violation of either federal or state securities laws, or both, and may be subject to rescission.

On August 12, 2006, we made a rescission offer to all holders of the outstanding shares that we believe are subject to rescission, pursuant to which we offered to repurchase these shares then outstanding from the holders. At the expiration of the rescission offer on September 18, 2006, the rescission offer was accepted by 32 of the offerees to the extent of 28,420 shares for an aggregate of \$119,000, including statutory interest. The shares that were tendered for rescission were agreed to be purchased by others and not from our funds.

Federal securities laws do not provide that a rescission offer will terminate a purchaser's right to rescind a sale of stock that was not registered as required or was not otherwise exempt from such registration requirements. With respect to the offerees who rejected the rescission offer, we may continue to be liable under federal and state securities laws for up to an amount equal to the value of all shares of common stock issued in connection with the initial public offering plus any statutory interest we may be required to pay. If it is determined that we offered securities without properly registering them under federal or state law, or securing an exemption from registration, regulators could impose monetary fines or other sanctions as provided under these laws. However, we believe the rescission offer provides us

with additional meritorious defenses against any future claims relating to these shares.

Except as set forth above, we believe that there are no material litigation matters at the current time. Although the results of such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of such claims and proceedings will not have a material adverse impact on our financial position, liquidity, or results of operations.

(14) Related Party Activity

During the year ended December 31, 2008, the Company employed two brothers of the majority shareholder and Chief Executive Officer of the Company in sales roles. They were paid approximately \$37,000 and \$113,000. Employment ended in 2008, so there were no payments during the year ended December 31, 2009.

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During the year ended December 31, 2008, the Company entered into an agreement for the distribution of its products internationally. The agreement is between the Company and a company controlled by the same two brothers of Christopher Reed, Chief Executive Officer of the Company. The agreement remains in effect until terminated by either party and requires the Company to pay 10% of the defined sales of the previous month. During the year ended December 31, 2009, the Company paid commissions on sales of \$10,000 and issued 52,420 shares of its common stock in satisfaction of \$66,000 due under this agreement. During the year ended December 31, 2008, the Company paid \$60,000 for these services and 200,000 warrants were granted in connection with this distribution agreement. The warrants are issuable only upon the attainment of certain international product sales. No warrants vested during the year ended December 31, 2009. The warrants will be valued and a corresponding expense will be recorded upon the attainment of the sales goals identified when the warrants were granted.

(15) Acquisition

On October 19, 2009, the Company executed an Asset Purchase Agreement with Sonoma Cider Mill, Inc., to acquire the Sonoma Sparkler brand. The aggregate purchase price under the Agreement was \$252,000 which was allocated by the Company to its brand name. Initial payments of \$45,000 were made prior to the Agreement and the balance of \$207,000 is payable in installments of \$9,000 over 23 remaining months, continuing on the first of every month. The Company recorded a note payable in the amount of \$239,000 in connection with this agreement (see Note 7).

(16) Subsequent Events

On February 5, 2010, the Company completed a standby offering of 12,780 shares of its Series B Preferred Stock at \$10.00 per share, for gross proceeds of \$127,800. In connection with the offering, the Company also issued warrants for 3,575 shares of common stock at \$1.78 per share for five years. The Company paid legal and broker fees of approximately \$11,000 in connection with the offering.

On February 18, 2010, the Company sold an aggregate of 277,359 shares of common stock at a price of \$1.70 per share for gross proceeds of \$472,000. Investors were also issued 83,208 Warrants, in connection with the transaction. The Warrants are exercisable at a price of \$2.10 per share of common stock for a period of five years commencing six months from the closing date of the offering. In connection with the sale, the Company paid legal and broker fees of approximately \$38,000.

In January 2010, the Company issued 22,231 shares of common stock for services rendered. During the period January 1, 2010 to March 23, 2010, 22,806 shares of Series B Preferred Stock were converted into 159,642 shares of common stock.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A(T). Controls and Procedures

Management's Annual Report on Internal Control over Financial Reporting

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Securities and Exchange Act of 1934 Rules 13a-15(f). Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2009.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the three months ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of 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 management and directors of the Company; and (iii) 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 statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. 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. Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework. Based on our assessment we concluded that, as of December 31, 2009, the Company's internal control over financial reporting was effective based on those criteria.

This Annual Report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act

General

Our directors currently have terms which will end at our next annual meeting of the stockholders or until their successors are elected and qualify, subject to their death, resignation or removal. Officers serve at the discretion of the board of directors. Except as described below, there are no family relationships among any of our directors and executive officers. Our board members are encouraged to attend meetings of the board of directors and the annual meeting of stockholders. The board of directors held 13 meetings in 2009. The following table sets forth certain information with respect to our current directors and executive officers:

| Name | Position | Age |
|------------------------|--|-----|
| Christopher J. Reed | President, Chief Executive Officer and Chairman of the Board | 51 |
| James Linesch | Chief Financial Officer | 55 |
| Thierry Foucaut | Chief Operating Officer | 45 |
| Judy Holloway Reed | Secretary and Director | 50 |
| Mark Harris | Director | 54 |
| Daniel S.J. Muffoletto | Director | 55 |
| Michael Fischman | Director | 54 |

Business Experience of Directors and Executive Officers

Christopher J. Reed founded our company in 1987. Mr. Reed has served as our Chairman, President and Chief Executive Officer since our incorporation in 1991. Mr. Reed also served as Chief Financial Officer during fiscal year 2007 until October 1, 2007 and again from April 17, 2008 to January 19, 2009. Mr. Reed has been responsible for our design and products, including the original product recipes, the proprietary brewing process and the packaging and marketing strategies. Mr. Reed received a B.S. in Chemical Engineering in 1980 from Rensselaer Polytechnic Institute in Troy, New York.

James Linesch was appointed as Chief Financial Officer effective January 19, 2009. Mr. Linesch served as the chief financial officer of AdStar, Inc., a public company providing ad placement services and payment processing software for publishers, from February 2006 until January 2009. He performed transaction intermediary services with MET Advisors, LLC from January 2005 until January 2006. From June 2000 to October 2004, he served as chief financial officer of DynTek, Inc., an information technology (IT) services company. From May 1996 until October 1999 he served as chief financial officer and president of CompuMed, Inc. He also served as chief financial officer of Universal Self Care, Inc. from June 1991 until May 1996. Mr. Linesch is a certified public accountant (CPA), having practiced with Price Waterhouse in Los Angeles. He earned a BS degree in finance from California State University, Northridge, and an MBA from the University of Southern California.

Thierry Foucaut has been our Chief Operating Officer since May 2007. Prior to joining us, Mr. Foucaut worked for six years as Chief Operating Officer of Village Imports, a \$30 million specialty foods and beverage distributor in California, where he created and launched a line of sparkling lemonades and managed the company's operations including multiple warehouses and fleets of DSD delivery trucks. Mr. Foucaut spent 2000 with Eve.com, a leading San Francisco website specializing in retail sales of high end cosmetics. Mr. Foucaut worked for L'Oréal Paris from

1994 through 1999 with growing marketing and sales responsibilities, including Product Manager from September 1994 to May 1996, South Europe Marketing Coordinator from June 1996 to July 1998 and Duty Free Key Account Executive from July 1998 to December 1999, managing large airport and airline clients over several European countries. He earned a Master of Science degree from Ecole Centrale Paris in 1988, and an MBA from Harvard Business School in 1994.

Judy Holloway Reed has been with us since 1992 and, as we have grown, has run the accounting, purchasing and shipping and receiving departments at various times since the 1990s. Ms. Reed has been one of our directors since June 2004, and our Secretary since October 1996. In the 1980s, Ms. Reed managed media tracking for a Los Angeles Infomercial Media Buying Group and was an account manager with a Beverly Hills, California stock portfolio management company. She earned a Business Degree from MIU in 1981. Ms. Reed is the wife of Christopher J. Reed, our Chairman, President and Chief Executive Officer.

Mark Harris has been a member of our board of directors since April 2005. Mr. Harris is an independent venture capitalist and has been retired from the work force since 2002. In late 2003, Mr. Harris joined a group of Amgen colleagues in funding NeoStem, Inc., a company involved in stem-cell storage, archiving, and research to which he is a founding investor. From 1991 to 2002, Mr. Harris worked at Amgen, Inc. (Nasdaq: AMGN), a preeminent biotech company, managing much of Amgen's media production for internal use and public relations. Mr. Harris spent the decade prior working in the aerospace industry at Northrop with similar responsibilities.

Daniel S.J. Muffoletto, N.D. has been a member of our board of directors from April 2005 to December 2006 and from January 2007 to the present. Dr. Muffoletto has practiced as a Naturopathic Physician since 1986. He has served as chief executive officer of Its Your Earth, a natural products marketing company since June 2004. From 2003 to 2005, Dr. Muffoletto worked as Sales and Marketing Director for Worthington, Moore & Jacobs, a Commercial Law League member firm serving FedEx, UPS, DHL and Kodak, among others. From 2001 to 2003, he was the owner-operator of the David St. Michel Art Gallery in Montreal, Québec. From 1991 to 2001, Dr. Muffoletto was the owner/operator of a Naturopathic Apothecary, Herbal Alter*Natives of Seattle, Washington and Ellicott City, Maryland. The apothecary housed Dr. Muffoletto's Naturopathic practice. Dr. Muffoletto received a Bachelors of Arts degree in Government and Communications from the University of Baltimore in 1977, and conducted postgraduate work in the schools of Public Administration and Publication Design at the University of Baltimore from 1978 to 1979. In 1986, he received his Doctorate of Naturopathic Medicine from the Santa Fe Academy of Healing, Santa Fe, New Mexico.

Michael Fischman has been a member of our board of directors since April 2005. Since 1998, Mr. Fischman has been President and chief executive officer of the APEX course, the corporate training division of the International Association of Human Values. In addition, Mr. Fischman is a founding member and the director of training for USA at the Art of Living Foundation, a global non-profit educational and humanitarian organization at which he has coordinated over 200 personal development instructors since 1997.

Family Relationships

Other than the relationship of Christopher J. Reed, and Judy Holloway Reed, Christopher Reed's wife and a board member, none of our directors or executive officers are related to one another.

Legal Proceedings

To the best of our knowledge, none of our executive officers or directors are parties to any material proceedings adverse to Reed's, have any material interest adverse to Reed's or have, during the past ten years:

- been convicted in a criminal proceeding or been subject to a pending criminal proceeding (excluding traffic violations and other minor offenses);
- had any bankruptcy petition filed by or against him/her or any business of which he/she was a general partner or executive officer, either at the time of the bankruptcy or within two years prior to that time;
- been subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his/her involvement in any type of business, securities, futures, commodities or banking activities;
- been found by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated;
- been subject to, or party to, any judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated, relating to an alleged violation of (i) any Federal or State securities or commodities law or regulation, (ii) any law or regulation respecting financial institutions or insurance companies including, but not limited to, a temporary or permanent injunction, order of disgorgement or restitution, civil money penalty or temporary or permanent cease-and-desist order, or removal or prohibition order or (iii) any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or been the subject of, or a party to,

any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26))), any registered entity (as defined in Section 1(a)(29) of the Commodity Exchange Act (7 U.S.C. 1(a)(29))), or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

Corporate Governance

We are committed to having sound corporate governance principles. We believe that such principles are essential to running our business efficiently and to maintaining our integrity in the marketplace.

There have been no changes to the procedures by which stockholders may recommend nominees to our Board of Directors.

Director Qualifications

We believe that our directors should have the highest professional and personal ethics and values, consistent with our longstanding values and standards. They should have broad experience at the policy-making level in business or banking. They should be committed to enhancing stockholder value and should have sufficient time to carry out their duties and to provide insight and practical wisdom based on experience. Their service on other boards of public companies should be limited to a number that permits them, given their individual circumstances, to perform responsibly all director duties for us. Each director must represent the interests of all stockholders. When considering potential director candidates, the board of directors also considers the candidate's character, judgment, diversity, age and skills, including financial literacy and experience in the context of our needs and the needs of the board of directors.

Director Independence

The board of directors has determined that three members of our board of directors, Mr. Harris, Dr. Muffoletto and Mr. Fischman, are independent under the revised listing standards of The Nasdaq Stock Market, Inc. We intend to maintain at least two independent directors on our board of directors in the future.

Code of Ethics

Our Chief Executive Officer and all senior financial officers, including the Chief Financial Officer, are bound by a Code of Ethics that complies with Item 406 of Regulation S-B of the Exchange Act. Our Code of Ethics is posted on our website at www.reedsinc.com.

Board Structure and Committee Composition

As of the date of this Annual Report, our board of directors has five directors and the following three standing committees: an Audit Committee, a Compensation Committee and a Nominations and Governance Committee. These committees were formed in January 2007.

US EURO Securities, Inc., the lead underwriter in our initial public offering, will have the right to designate an observer to our board of directors and each of its committees through the period ending December 12, 2011.

Audit Committee. Our Audit Committee oversees our accounting and financial reporting processes, internal systems of accounting and financial controls, relationships with independent auditors and audits of financial statements. Specific responsibilities include the following:

- selecting, hiring and terminating our independent auditors;
- evaluating the qualifications, independence and performance of our independent auditors;
- approving the audit and non-audit services to be performed by our independent auditors;
- reviewing the design, implementation, adequacy and effectiveness of our internal controls and critical accounting policies;
- overseeing and monitoring the integrity of our financial statements and our compliance with legal and regulatory requirements as they relate to financial statements or accounting matters;

- reviewing with management and our independent auditors, any earnings announcements and other public announcements regarding our results of operations; and
- preparing the audit committee report that the SEC requires in our annual proxy statement.

Our Audit Committee is comprised of Dr. Muffoletto, Mr. Harris and Mr. Fischman. Dr. Muffoletto serves as Chairman of the Audit Committee. The board of directors has determined that the three members of the Audit Committee are independent under the rules of the SEC and the Nasdaq National Market and that Dr. Muffoletto qualifies as an “audit committee financial expert,” as defined by the rules of the SEC. Our board of directors has adopted a written charter for the Audit Committee meeting applicable standards of the SEC and the Nasdaq National Market.

Compensation Committee. Our Compensation Committee assists our board of directors in determining and developing plans for the compensation of our officers, directors and employees. Specific responsibilities include the following:

- approving the compensation and benefits of our executive officers;
- reviewing the performance objectives and actual performance of our officers; and
- administering our stock option and other equity compensation plans.

Our Compensation Committee is comprised of Dr. Muffoletto, Mr. Harris and Mr. Fischman. The board of directors has determined that all of the members of the Compensation Committee are independent under the rules of the Nasdaq National Market. Our board of directors has adopted a written charter for the Compensation Committee.

Nominations and Governance Committee. Our Nominations and Governance Committee assists the board of directors by identifying and recommending individuals qualified to become members of our board of directors, reviewing correspondence from our stockholders, and establishing, evaluating and overseeing our corporate governance guidelines. Specific responsibilities include the following:

- evaluating the composition, size and governance of our board of directors and its committees and making recommendations regarding future planning and the appointment of directors to our committees;
- establishing a policy for considering stockholder nominees for election to our board of directors; and
- evaluating and recommending candidates for election to our board of directors.

Our Nominations and Governance Committee is comprised of Dr. Muffoletto and Mr. Fischman. The board of directors has determined that all of the members of the Nominations and Governance Committee are independent under the rules of the Nasdaq National Market. Our board of directors has adopted a written charter for the Nominations and Corporate Governance Committee.

Securities Authorized for Issuance under 2001 Stock Option Plan, 2007 Stock Option Plan and 2009 Consultant Stock Plan

For information regarding securities authorized for issuance under our 2001 Stock Option Plan, 2007 Stock Option Plan and 2009 Consultant Stock Plan see “Market for Common Equity and Related Stockholder Matters.”

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) requires our directors and executive officers and beneficial holders of more than 10% of our common stock to file with the SEC initial reports of ownership and reports of changes in ownership of our equity securities.

To our knowledge, based solely upon a review of Forms 3 and 4 and amendments thereto furnished to Reed’s under 17 CFR 240.16a-3(e) during our most recent fiscal year and Forms 5 and amendments thereto furnished to Reed’s with respect to our most recent fiscal year or written representations from the reporting persons, we believe that during the year ended December 31, 2009 our directors, executive officers and persons who own more than 10% of our common stock complied with all Section 16(a) filing requirements.

Item 11. Executive Compensation

The following table summarizes all compensation for fiscal years 2009 and 2008 received by our principal executive officer, principal financial officer and chief operating officer, who are the only executive officers of the Company in fiscal year 2009, our “Named Executive Officers”.

| Name and Principal Position | Year | Salary | Bonus | Stock Awards | Option Awards (\$)(1) | Non-Equity Qualified Incentive Compensation | Non-Deferred Compensation Earnings | All Other Compensation | Total |
|---|------|------------|-----------|--------------|-----------------------|---|------------------------------------|------------------------|------------|
| Christopher J. Reed, Chief Executive Officer | 2009 | \$ 150,000 | - | \$ 7,920 | - | - | - | \$ 4,616 (3) | \$ 162,536 |
| | 2008 | \$ 150,000 | - | - | - | - | - | \$ 4,616 (3) | \$ 154,616 |
| James Linesch, Chief Financial Officer (2) | 2009 | \$ 151,983 | - | \$ 7,920 | \$ 55,500 | - | - | - | \$ 215,403 |
| Thierry Foucaut, Chief Operating Officer | 2009 | \$ 130,000 | \$ 57,600 | \$ 7,920 | - | - | - | - | \$ 195,520 |
| | 2008 | \$ 130,000 | \$ 57,600 | - | \$ 41,000 | - | - | - | \$ 228,600 |

- (1) The amounts represent the compensation expense for all share-based payment awards based on estimated fair values, computed in accordance with Financial Accounting Standards, excluding any impact of assumed forfeiture rates. We record compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black Scholes option pricing model. See discussion of valuation assumptions in the financial statement Note 10.(A) Stock Options.
- (2) Mr. Linesch was hired in January 2009. Amounts represent payments pursuant to an at will employment agreement since his hire date.
- (3) Represents value of automobile provided to Christopher J. Reed.

Employment Agreements

We entered into an at-will employment agreement with Thierry Foucaut, our Chief Operating Officer, which provides for an annualized salary of approximately \$130,000 per year. In addition, we have granted Mr. Foucaut options to purchase up to 50,000 shares of common stock which vest over a three year period ending in 2010.

Further, we entered into an at-will employment agreement with James Linesch, our Chief Financial Officer, which provided for an annual salary of \$156,000 per year commencing January 19, 2009. In addition, we have granted Mr. Linesch options under our 2007 Stock Option Plan to purchase up to 75,000 shares of common stock which vest over a three year period ending January 19, 2012. In the event of a sale of Reed’s, Inc., should Mr. Linesch’s employment terminate during the first 12 months after the sale, he will be entitled to three months severance.

Except as set forth above, there are no written employment agreements with any of our officers or key employees, including Christopher J. Reed. We do not have any agreements which provide for severance upon termination of employment, whether in context of a change of control or not.

Outstanding Equity Awards At Fiscal Year-End

The following table sets forth information regarding unexercised options and equity incentive plan awards for each Named Executive Officer outstanding as of December 31, 2009.

| Name and Position | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options | Option Exercise Price | Option Expiration Date |
|--|---|---|--|-----------------------|------------------------|
| Christopher J. Reed, Chief Executive Officer | - | - | - | | |
| James Linesch, Chief Financial Officer | - | 75,000(1) | | \$ 1.30 | 01/04/14 |
| Thierry Foucaut, Chief Operating Officer | 33,333 16,667 | 16,667 (2) 33,333(3) | | \$ 7.55 \$ 1.34 | 06/03/12 12/07/13 |

Notes:

- (1) Vest as follows: 25,000 options vest on January 3, 2010 and 25,000 will vest on January 3, 2011 and January 3, 2012 .
- (2) Vest as follows: 16,666 options will vest on June 3, 2010.
- (3) Vest as follows: 16,667 will vest on December 6, 2010 and 16,667 will vest on December 6, 2011.

Director Compensation

The following table summarizes the compensation paid to our directors for the fiscal year ended December 31, 2009:

| Name | Fees Earned or Paid in Cash | Stock Awards | Option Awards | Non-Equity Incentive Plan Compensation | All Other Compensation | Total |
|------------------------|-----------------------------|--------------|---------------|--|------------------------|-----------|
| Judy Holloway Reed | \$ 2,025 | | | | | \$ 2,025 |
| Mark Harris | \$ 0 | | | | | \$ 0 |
| Daniel S.J. Muffoletto | \$ 12,204(1) | | | | | \$ 12,204 |
| Michael Fischman | \$ 1,650 | | | | | \$ 1,650 |

- (1) Since November 2007, Dr. Muffoletto receives \$833 per month to serve as the Chairman of the Audit Committee.

Item 12. Security Ownership of Certain Beneficial Owners, Management and Related Stockholder Matters

The following table reflects, as of the date of this Annual Report, the beneficial common stock ownership of: (a) each of our directors, (b) each of our current named executive officers, (c) each person known by us to be a beneficial holder of 5% or more of our common stock, and (d) all of our executive officers and directors as a group.

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Except as otherwise indicated below, the persons named in the table have sole voting and investment power with respect to all shares of common stock held by them. Unless otherwise indicated, the principal address of each listed executive officer and director is 13000 South Spring Street, Los Angeles, California 90061.

| Name of Beneficial Owner | Number of Shares Beneficially Owned | Percentage of Shares Beneficially Owned(1) |
|--|-------------------------------------|--|
| Directors and Named Executive Officers | | |
| Christopher J. Reed (2) | 3,153,238 | 31.2 |
| Judy Holloway Reed (2) | 3,153,238 | 31.2 |
| Mark Harris (3) | 319 | * |
| Daniel S.J. Muffoletto, N.D. | 0 | * |
| Michael Fischman | 0 | * |
| James Linesch (4) | 31,000 | * |
| Thierry Foucaut (5) | 61,000 | * |
| Directors and executive officers as a group (7 persons) | 3,245,557 | 31.8 |
| 5% or greater stockholders | | |
| Joseph Grace (5) | 500,000 | 4.9 |
| Pearl Elias (6) | 666,363 | 6.6 |

* Less than 1%.

- (1) Beneficial ownership is determined in accordance with the rules of the SEC. Shares of common stock subject to options or warrants currently exercisable or exercisable within 60 days of March 23, 2010 are deemed outstanding for computing the percentage ownership of the stockholder holding the options or warrants but are not deemed outstanding for computing the percentage ownership of any other stockholder. Unless otherwise indicated in the footnotes to this table, we believe stockholders named in the table have sole voting and sole investment power with respect to the shares set forth opposite such stockholder's name. Percentage of ownership is based on approximately 10,104,109 shares of common stock outstanding as of March 23, 2010.
- (2) Christopher J. Reed and Judy Holloway Reed are husband and wife. The same number of shares of common stock is shown for each of them, as they may each be deemed to be the beneficial owner of all of such shares.
- (3) The address for Mr. Harris is 160 Barranca Road, Newbury Park, California 91320.
- (4) Consists of 6,000 shares of common stock and options to purchase 25,000 shares of common stock. Does not include options to purchase 50,000 shares of common stock that vest over two years.
- (5) Consists of 11,000 shares of common stock and options to purchase up to 50,000 shares of common stock. Does not include options to purchase up to 50,000 shares of common stock which vest over two years.
- (5) The address for Mr. Grace is 1900 West Nickerson Street, Suite 116, PMB 158, Seattle, Washington 98119.
- (6) The address for Mrs. Elias is P.O. Box 340, Merion Station PA, 19066.

Item 13. Certain Relationships and Related Transactions, and Director Independence

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Our board of directors has adopted written policies and procedures for the review of any transaction, arrangement or relationship between Reed's and one of our executive officers, directors, director nominees or 5% or greater stockholders (or their immediate family members), each of whom we refer to as a "related person," in which such related person has a direct or indirect material interest.

If a related person proposes to enter into such a transaction, arrangement or relationship, defined as a "related party transaction," the related party must report the proposed related party transaction to our Chief Financial Officer. The policy calls for the proposed related party transaction to be reviewed and, if deemed appropriate, approved by the Governance Committee. If practicable, the reporting, review and approval will occur prior to entry into the transaction. If advance review and approval is not practicable, the Governance Committee will review, and, in its discretion, may ratify the related party transaction. Any related party transactions that are ongoing in nature will be reviewed annually at a minimum. The related party transactions listed below were reviewed by the full board of directors. Prior to August 2005, we did not have independent directors on our Board to review and approve related party transactions. The Governance Committee shall review future related party transactions.

During the years December 31, 2009 and 2008, we have participated in the following transactions in which a related person had or will have a direct or indirect material interest:

Judy Holloway Reed, our Secretary and director, is Christopher J. Reed's spouse.

During the year ended December 31, 2008, the Company employed two family members of the majority shareholder and Chief Executive Officer of the Company in sales roles. They were paid approximately \$37,000 and \$113,000. Employment ended in 2008, so there were no payments during the year ended December 31, 2009.

During the year ended December 31, 2008, the Company entered into an agreement for the distribution of its products internationally. The agreement is between the Company and a company controlled by two brothers of Christopher Reed, Chief Executive Officer of the Company. The agreement remains in effect until terminated by either party and requires the Company to pay 10% of the defined sales of the previous month. During the year ended December 31, 2009, the Company paid commissions on sales of \$10,000 and issued 52,420 shares of its common stock in satisfaction of \$65,000 due under this agreement. During the year ended December 31, 2008, the Company paid \$60,000 for these services and 200,000 warrants were granted in connection with this distribution agreement. The warrants are issuable only upon the attainment of certain international product sales. No warrants vested during the year ended December 31, 2009. The warrants will be valued and a corresponding expense will be recorded upon the attainment of the sales goals identified when the warrants were granted.

Item 14. Principal Accounting Fees and Services

Weinberg & Company, P.A. ("Weinberg") was our independent registered public accounting firm for the years ended December 31, 2009 and 2008.

The following table shows the fees paid or accrued by us for the audit and other services provided by Weinberg for the years ended December 31, 2009 and 2008.

| | 2008 | 2008 |
|--------------------|------------|------------|
| Audit Fees | \$ 120,000 | \$ 153,000 |
| Audit-Related Fees | 0 | 0 |
| Tax Fees | 0 | 0 |
| All Other Fees | 0 | 0 |
| Total | \$ 120,000 | \$ 153,000 |

As defined by the SEC, (i) "audit fees" are fees for professional services rendered by our principal accountant for the audit of our annual financial statements and review of financial statements included in our Form 10-K, or for services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years; (ii) "audit-related fees" are fees for assurance and related services by our principal accountant that are reasonably related to the performance of the audit or review of our financial statements and are not reported under "audit fees;" (iii) "tax fees" are fees for professional services rendered by our principal accountant for tax compliance, tax advice, and tax planning; and (iv) "all other fees" are fees for products and services provided by our principal accountant, other than the services reported under "audit fees," "audit-related fees," and "tax fees."

Audit Fees

Services provided to us by Weinberg with respect to such periods consisted of the audits of our financial statements and limited reviews of the financial statements included in Quarterly Reports on Form 10-Q. Weinberg also provided

services with respect to the filing of our registration statements in 2009 and 2008.

Audit Related Fees

Weinberg did not provide any professional services to us with which would relate to “audit related fees.”

Tax Fees

Weinberg did not provide any professional services to us with which would relate to “tax fees.”

All Other Fees

Weinberg did not provide any professional services to us with which would relate to “other fees.”

Audit Committee Pre-Approval Policies and Procedures

Under the SEC's rules, the Audit Committee is required to pre-approve the audit and non-audit services performed by the independent registered public accounting firm in order to ensure that they do not impair the auditors' independence. The Commission's rules specify the types of non-audit services that an independent auditor may not provide to its audit client and establish the Audit Committee's responsibility for administration of the engagement of the independent registered public accounting firm.

Consistent with the SEC's rules, the Audit Committee Charter requires that the Audit Committee review and pre-approve all audit services and permitted non-audit services provided by the independent registered public accounting firm to us or any of our subsidiaries. The Audit Committee may delegate pre-approval authority to a member of the Audit Committee and if it does, the decisions of that member must be presented to the full Audit Committee at its next scheduled meeting. Accordingly, all audit services and non-audit services described in this Item 14 were pre-approved by the Audit Committee.

There were no hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees.

PART IV

Item 15. Exhibits and Financial Statements

(a) 1. Financial Statements

See Index to Financial Statements in Item 8 of this Annual Report on Form 10-K, which is incorporated herein by reference.

2. Financial Statement Schedules

All other financial statement schedules have been omitted because they are either not applicable or the required information is shown in the financial statements or notes thereto.

3. Exhibits

See the Exhibit Index which follows the signature page of this Annual Report on Form 10-K, which is incorporated herein by reference.

(b) Exhibits

See Item 15(a) (3) above.

(c) Financial Statement Schedules

See Item 15(a) (2) above.

SIGNATURES

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

Date: March 30, 2010

REED'S, INC.
a Delaware corporation

By: /s/ Christopher J. Reed
Christopher J. Reed
Chief Executive Officer

In accordance with the Exchange Act, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|--|--|----------------|
| /s/ CHRISTOPHER J. REED Christopher J. Reed | Chief Executive Officer, President and Chairman of the Board of Directors (Principal Executive Officer) | March 30, 2010 |
| /s/ JAMES LINESCH James Linesch | Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer) | March 30, 2010 |
| /s/ JUDY HOLLOWAY REED Judy Holloway Reed | Director | March 30, 2010 |
| /s/ MARK HARRIS Mark Harris | Director | March 30, 2010 |
| /s/ DANIEL S.J. MUFFOLETTO Daniel S.J. Muffoletto | Director | March 30, 2010 |
| /s/ MICHAEL FISCHMAN Michael Fischman | Director | March 30, 2010 |

EXHIBIT INDEX

- 3.1 Certificate of Incorporation of Reed's, Inc. as filed September 7, 2001 (Incorporated by reference to Exhibit 3.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.2 Certificate of Amendment of Certificate of Incorporation of Reed's, Inc. as filed September 27, 2004 (Incorporated by reference to Exhibit 3.2 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.3 Certificate of Amendment of Certificate of Incorporation of Reed's, Inc. as filed December 18, 2007 (Incorporated by reference to Exhibit 3.3 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 3.4 Certificate of Designations, Preferences and Rights of Series A Preferred Stock of Reed's, Inc. as filed October 12, 2004 (Incorporated by reference to Exhibit 3.3 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.5 Certificate of Correction to Certificate of Designations as filed November 10, 2004 (Incorporated by reference to Exhibit 3.4 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.6 Amended Certificate of Designation of Series B Convertible Preferred Stock, filed December 4, 2009. Filed herewith.
- 3.7 Bylaws of Reed's Inc., as amended (Incorporated by reference to Exhibit 3.5 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 4.1 Form of common stock certificate (Incorporated by reference to Exhibit 4.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 4.2 Form of Series A preferred stock certificate (Incorporated by reference to Exhibit 4.2 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 10.1 Brewing Agreement between Reed's, Inc. and The Lion Brewery, Inc. dated May 15, 2001 (Incorporated by reference to Exhibit 10.2 to Reed's, Inc.'s Registration Statement on Form SB-2. Portions of the exhibit have been omitted pursuant to a request for confidential treatment. (File No. 333-120451))
- 10.2 Note in favor of the U.S. Small Business Administration dated December 11, 2000 (Incorporated by reference to Exhibit 10.3 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 10.3 Note in favor of the U.S. Small Business Administration dated December 11, 2000 (Incorporated by reference to Exhibit 10.4 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 10.4 Loan Agreement between Reed's Inc. and California United Bank dated November 29, 2006 (Incorporated by reference to Exhibit 10.5 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-146012))
- 10.5 Brewing Agreement between Reed's Inc. and The Lion Brewery, Inc. dated November 1, 2008 (Incorporated by reference to Exhibit 10.1 to Reed's, Inc.'s Form 10Q/A filed December 18, 2009)
- 10.8* Employment Agreement between Reed's, Inc. and Neal Cohane dated August 1, 2007 (Incorporated by reference to Exhibit 10.8 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 10.9* Employment Agreement between Reed's, Inc. and Thierry Foucaut dated May 5, 2007 (Incorporated by reference to Exhibit 10.9 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 10.10* Employment Agreement between Reed's, Inc. and James Linesch dated December 29, 2008 (Incorporated by reference to Exhibit 10.10 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 10.13 Promissory Note in favor of Lehman Brothers Bank, FSB dated February 22, 2008 (Incorporated by reference to Exhibit 10.13 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 10.15 Loan and Security Agreement between Reed's Inc. and First Capital Western Region LLC dated May 30, 2008 (Incorporated by reference to Exhibit 10.3 to Reed's, Inc.'s Form 10Q/A December 7, 2009)
- 10.16 Amendment Number One to Loan and Security Agreement between Reed's Inc. and First Capital Western Region LLC dated June 16, 2008 (Incorporated by reference to Exhibit 10.1 to Reed's, Inc.'s Current Report on Form 8K dated July 23, 2008)
- 10.17 Amendment Number Two to Loan and Security Agreement between Reed's Inc. and First Capital Western Region LLC dated June 16, 2008 (Incorporated by reference to Exhibit 10.17 to Reed's, Inc.'s Registration

Statement on Form S-1 (File No. 333-156908))

- 10.18 Amendment Number Three to Loan and Security Agreement between Reed's Inc. and First Capital Western Region LLC dated September 24, 2008 (Incorporated by reference to Exhibit 10.18 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))

- 10.19 Waiver to Loan and Security Agreement dated January 5, 2009 (Incorporated by reference to Exhibit 10.19 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 10.20* 2001 Stock Option Plan (Incorporated by reference to Exhibit 4.3 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 10.21 Reed's Inc. Master Brokerage Agreement between Reed's, Inc. and Reed's Brokerage, Inc. dated May 1, 2008 (Incorporated by reference to Exhibit 10.21 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 10.22* 2007 Stock Option Plan (Incorporated by reference to Exhibit 10.22 to Reed's, Inc.'s Form 10K filed March 27, 2009)
- 10.23* 2009 Consultant Stock Plan (Incorporated by reference to Exhibit 4.1 to Reed's, Inc.'s Registration Statement on Form S-8 (File No. 333-157359))
- 10.24 Amendment Number Four to loan and Security Agreement between Reed's Inc. and First Capital Western Region LLC dated March 27, 2009 (Incorporated by reference to Exhibit 10.24 to Reed's, Inc.'s Form 10K filed March 27, 2009)
- 10.25 Standard Offer, Agreement, and Escrow Instructions for Purchase of Real Estate dated April 23, 2009, as amended (Incorporated by reference to Exhibit 10.1 to Reed's, Inc.'s Form 10Q/A as filed August 18, 2009)
- 10.26 Standard Industrial Commercial Lease Agreement dated May 7, 2009, as amended (Incorporated by reference to Exhibit 10.2 to Reed's, Inc.'s Form 10Q/A as filed August 18, 2009)
- 10.27 Asset Purchase Agreement between Reed's, Inc. and Sonoma Cider Mill, Inc. dated October 19, 2009 (Incorporated by Reference to Exhibit 10.1 to Reed's, Inc.'s Form 10Q/A as filed December 7, 2009)
- 10.28 Loan and Security Agreement by and between GemCap Lending I, LLC and Reed's Inc. dated November 18, 2009 (Filed herewith)
- 14.1 Code of Ethics (Incorporated by reference to Exhibit 14.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-157359))
- 21 Subsidiaries of Reed's, Inc., filed herewith.
- 23.1 Consent of Weinberg & Co., P.A., to the incorporation by reference to the previously filed Registration Statement (SEC File No. 333-157359), filed herewith
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1** Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2** Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Indicates a management contract or compensatory plan or arrangement.

** The certifications attached as Exhibits 32.1 and 32.2 accompany the Annual Report on Form 10-K pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed "filed" by Reed's, Inc. for purposes of Section 18 of the Securities Exchange Act

