

JONES SODA CO
Form 10KSB
March 30, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

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

For the fiscal year ended December 31, 2003

.. **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 000-28820

JONES SODA CO.

(Exact name of small business issuer as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

91-1696175
(I.R.S. Employer
Identification No.)

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234 Ninth Avenue North

Seattle, WA 98109

(Address of principal executive offices)

(206) 624-3357

(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act: (none)

Securities registered under Section 12(g) of the Exchange Act: **Common Stock, no par value per share**

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

Check if no disclosure of delinquent filers in response to Item 405 of Regulation S-B is contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB.

Issuer's revenues for its most recent fiscal year: \$20,100,864

As of March 22, 2004, there were 20,444,096 shares of the Company's common stock issued and outstanding, and the aggregate market value of such common stock held by non-affiliates was approximately \$5,221,733, based on the average of the bid (\$2.60) and ask (\$2.64) prices of such stock on that date of \$2.62.

Documents Incorporated By Reference: The information required by Part III of this Report, to the extent not set forth herein, is incorporated in this Report by reference to the Company's definitive proxy statement relating to its 2004 annual meeting of shareholders, to be held on May 19, 2004. The definitive proxy statement will be filed with the Securities and Exchange Commission within 120 days after the end of the 2003 fiscal year.

Transitional Small Business Disclosure Format (Check one): Yes No

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JONES SODA CO.

FORM 10-KSB ANNUAL REPORT

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** Items 9 through 12 and Item 14 of Part III are incorporated by reference from the definitive proxy statement for our 2004 annual meeting of shareholders, to be held on May 19, 2004, which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2003 fiscal year.

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EXPLANATORY NOTE

Unless otherwise indicated or the context otherwise requires, all references in this Annual Report on Form 10-KSB to we, us, our, and the Company are to Jones Soda Co., a Washington corporation, and its wholly owned subsidiaries Jones Soda Co. (USA) Inc., Jones Soda (Canada) Inc., myJones.com Inc. and Whoopass USA Inc.

In addition, unless otherwise indicated or the context otherwise requires, all references in this Annual Report to *Jones Soda* refers to our premium soda sold under the trademarked brand name *Jones Soda Co.*

CAUTIONARY NOTICE REGARDING FORWARD LOOKING STATEMENTS

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. This Annual Report on Form 10-KSB contains a number of forward-looking statements that reflect management's current views and expectations with respect to our business, strategies, products, future results and events and financial performance. All statements other than statements of historical fact, including future results of operations or financial position, made in this Annual Report on Form 10-KSB are forward looking. In particular, the words believe, expect, intend, anticipate, estimate, may, will, variations of such words, and similar expressions identify forward-looking statements, but the exclusive means of identifying such statements and their absence does not mean that the statement is not forward-looking. These forward-looking statements are subject to certain risks and uncertainties, including those discussed below. Our actual results, performance or achievements could differ materially from historical results as well as those expressed in, anticipated or implied by these forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect any future events or circumstances.

For a discussion of some of the factors that may affect our business, results and prospects, see ITEM 1. OUR BUSINESS Certain Factors That May Affect Future Results. Readers are urged to carefully review and consider the various disclosures made by us in this Report and in our other reports previously filed with the Securities and Exchange Commission, including our periodic reports on Forms 10-KSB and 10-QSB, and those described from time to time in our press releases and other communications, which attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

CURRENCY TRANSLATION

Unless otherwise stated, dollar figures stated in this Annual Report are in United States dollars. Our financial statements are reported in United States dollars.

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PART I

ITEM 1. OUR BUSINESS.

Overview

We develop, produce, market and distribute alternative or New Age beverages. We currently produce, market and distribute four unique beverage brands,

Jones Soda Co.[®], a premium soda (referred to in this Report as *Jones Soda*),

Jones Naturals, a non-carbonated juice & tea,

Jones Energy, a citrus energy drink and

WhoopAss, a citrus energy drink.

Our business strategy is to increase sales by expanding distribution of our internally developed brands in new and existing markets, stimulating consumer trial of our products and increasing consumer awareness of, and brand loyalty to, our unique brands and products. Key elements of our business strategy include:

creating strong distributor relationships and key accounts;

stimulating strong consumer demand for our existing brands and products with primary emphasis in the United States and Canada; and

developing unique alternative beverage brands and products.

We currently sell and distribute our products through our network of independent distributors throughout the United States and Canada. During the past two years, we have focused our sales and marketing resources on the expansion and penetration of our products through our independent distributor network in our core markets consisting of the U.S. Northwest, U.S. Southwest, U.S. Midwest and Western Canada. Although we continue to distribute product through existing distributors in the U.S. Northeast, U.S. Southeast and Eastern Canada, as part of our strategy in 2002, we cut our sale force in these regions to focus on our four core markets. In 2004, and through our independent distributor network, we will continue to focus on these four core markets, although in certain limited instances we may re-expand into the U.S. Northeast, U.S. Southeast and Eastern Canada with the right distributor partners.

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In addition, beginning in 2003, we launched our direct to retail business strategy as a complementary channel of distribution, targeting large national retail accounts. Through these programs, we negotiate directly with large national retailers, primarily premier food-service based businesses, to carry our products, and which are serviced by the retailer's appointed distribution system. During 2003, we entered into distribution arrangements with Barnes & Noble, Panera Bread Company and CostPlus World Markets to carry certain of our products in their stores nationwide in the United States. In addition, in March 2004 we entered into a distribution arrangement with Starbucks Coffee Company for two flavors of our *Jones Soda* product in all of its stores in the United States. This distribution arrangement with Starbucks in the United States is in addition to our existing arrangement for their stores in Canada that has been in place since 1999.

Our company is a Washington corporation and our principal place of business is located at 234 Ninth Avenue North, Seattle, Washington 98109 and our telephone number is (206) 624-3357.

The New Age or Alternative Beverage Industry

Jones Soda, *Jones Naturals*, *Jones Energy* and *WhoopAss*, which are classified as New Age or alternative beverages, as well as other unique brands and products that we may develop in the future, compete with beverage products of all types, including soft drinks, beer, fruit juices and drinks, bottled water, wine and spirits.

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In its annual beverage market survey for calendar year 2003, Beverage World magazine (www.beverageworld.com) estimated that the New Age or alternative beverage markets was approximately \$11.6 billion in total sales.

New Age or alternative beverages are distinguishable from mainstream carbonated soft drinks in that they tend to contain less sugar, less carbonation, and natural ingredients. As a general rule, three criteria have been established for such a classification: (1) relatively new introduction to the market-place; (2) a perception by consumers that consumption is healthful compared to mainstream carbonated soft drinks; and (3) the use of natural ingredients and flavors in the products. According to Beverage Marketing Corporation (www.beverageworld.com), for 2003, the New Age or alternative beverage category consists of the following segments:

Energy drinks

Premium soda

Ready-to-drink (RTD) coffee

RTD tea

RTD (nutrient-enhanced)

Shelf-stable dairy (regular/diet)

Shelf-stable dairy (nutrient-enhanced)

Single-serve-fruit beverages (regular/diet)

Single-serve-fruit beverages (nutrient enhanced)

Smoothies

Sparkling water

Sports drinks

Vegetable/fruit juice blends

Other New Age beverages

Business Strategy

In late 1995, we launched *Jones Soda*, our premium soda product under our trademarked brand. We made this decision after witnessing the proliferation of new ready-to-drink tea brands during the first half of the 1990s, anticipating what we believed to be a peak in the product life cycle for that segment of the New Age beverage category. By launching *Jones Soda*, we believed we were creating a new category in the New Age beverage market and that we were offering distributors something new to sell. In its January 1998 issue, Beverage Aisle magazine changed the name of the all-natural soda segment to the premium soda segment and cited *Jones Soda* as an example of a beverage in this category. Thus, we believe that the *Jones Soda* brand and product line have helped to create a new segment in the New Age or alternative beverage industry.

Utilizing creative but relatively low cost marketing and brand promotion techniques, we are currently focused on building a strong distributor network for our lead brand, *Jones Soda*. We believe that our experience as a distributor of licensed and non-licensed New Age beverage brands has given, and will continue to give, our company credibility in connection with our efforts to build a quality network of independent distributors. Moreover, we believe that our first hand experience watching other companies' fortunes rise and fall with a single New Age beverage brand has been incorporated into our business strategy. Five New Age beverage brands, including Sundance, New York Seltzer, Koala Springs, Clearly Canadian and Snapple, have each achieved a minimum of \$100,000,000 in revenues. Each of these brands was the first brand in a new segment of the New Age beverage category and each brand had a certain fashion or trend component. For instance, Koala Springs increased sales at a time when Australia was popular as a travel destination.

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In developing the *Jones Soda* brand, we believe we have created a leading brand in the premium soda segment of the New Age beverage category and have marketed the product with a distinct fashion component. The fashion component includes black and white photos on our labels, which is representative of current overall fashion trends. See *Products Jones Soda*.

Our business strategy is to attempt to increase sales by expanding product distribution in new and existing markets (primarily within North America), stimulating consumer trial of our products and creating and increasing consumer awareness of and brand loyalty to our unique brands and products. In 2002, working through our network of independent distributors, we refocused our resources on four core markets, namely the U.S. Northwest, U.S. Southwest, U.S. Midwest and Western Canada. In 2004, and through our independent distributor network, we will continue to focus on these four core markets, although in certain limited instances we may re-expand into the U.S. Northeast, U.S. Southeast and Eastern Canada with the right distributor partners. During 2003 and into 2004, we also launched and grew our direct to retail distribution strategy to large national retail accounts, currently consisting of Barnes & Noble, Panera Bread Company, CostPlus World Markets and Starbucks Coffee Company. During 2004, we will focus on servicing and expanding our direct to retail channel to national retail accounts.

We believe that, in general, many products in the New Age beverage category, much like certain fashion trends, tend to have a limited life cycle of approximately five to nine years, although some products or flavors may have longer lives. We believe that our *Jones Soda* brand is a leader in the New Age beverage category and has significantly greater vitality beyond this limited five to nine years. Accordingly, we believe it is important to continually develop and introduce new flavors and brands to maintain the vitality of the product, and to generate and maintain consumer interest and demand for the product. As part of our business strategy, we intend to launch new brands, products or product extensions at approximately 18 to 30 month intervals. We believe we will be ready to launch new unique brands, products and product extensions through our distributor network if and when we determine that consumer demand for our products begins to decline. See *Brand and Product Development*, below.

Key elements of our business strategy include the following:

Brand Franchise

We believe the market for alternative beverages is dependent to a large extent on image more than taste, and that this market is driven by trendy, young consumers between the ages of 12 and 34. Accordingly, our strategy is to develop unique brand names, slogans and trade dress. In addition to unique labeling on our products, we provide each of our distributors with point-of-sale promotional materials and branded apparel items. We promote interaction with our customers through the use of these point-of-sale items, such as posters, stickers, table cards, shelf danglers, post cards, hats, pins, T-shirts, and our proprietary lighted display box. In addition, through the labels on our bottles, we invite consumers to access our website and to send in photographs to be featured on the *Jones Soda* and *Jones Naturals* labels. We believe that our labeling, marketing and promotional materials are important elements to creating and increasing distributor, retailer and consumer awareness of our brands and products.

Independent Distributor Network

We distribute our products through a network of independent distributors in the United States and Canada. We have also obtained listings for our *Jones Soda*, *Jones Naturals*, *Jones Energy* and *Whoopass* brands with certain key retail grocery accounts, including QFC, Meijer, Kroger, Albertsons and Safeway, which are serviced through our independent distributor network. We have pursued this strategy both in an effort to increase sales and to encourage distributors to distribute our brands and products to our key accounts and other accounts of our distributors.

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We usually grant independent distributors the right to distribute finished cases of one or more of our brands in a particular region, province, state or local territory, subject to our overall management directives. We select distributors who we believe will have the ability to get our unique brands and products on the street level retail shelves in convenience stores, delicatessens, sandwich shops and selected supermarkets. Ultimately, we have chosen, and will continue to choose, our distributors based upon their perceived ability to build our brand franchise. We currently maintain a network of approximately 135 distributors in 39 states in the United States and 7 provinces in Canada.

We have additionally pursued distribution to alternative or non-traditional beverage retailers. We have entered into agreements with approximately 250 independent non-traditional beverage retailers, including music stores, skateboard shops, comic book stores and clothing stores primarily in San Diego, Seattle and Vancouver, B.C., pursuant to which these retailers agree to carry our beverage products. We intend to selectively pursue distribution to these national and independent non-traditional beverage accounts as part of our distribution and marketing strategy.

Direct to Retail National Accounts

Beginning in 2003, we launched our direct to retail business strategy as a complementary channel of distribution, targeting large national retail accounts. Through these programs, we negotiate directly with large national retailers, primarily premier food-service based businesses, to carry our products, and which are serviced by the retailer's appointed distribution system. During 2003 and into 2004 we entered into distribution arrangements with four national retail accounts, currently consisting of the following:

Barnes & Noble launched in February 2003 for 5 flavors of *Jones Naturals* flavors in all Barnes & Noble café stores in the United States;

Panera Bread Company launched in June 2003 for 6 flavors of *Jones Soda* and 3 flavors of *Jones Naturals* in all Panera bakery cafés in the United States;

CostPlus World Markets launched in November 2003 for 6 flavors of *Jones Soda* in all of its stores in the United States; and

Starbucks Coffee Company launched in March 2004 for 2 flavors of *Jones Soda* in all of its stores in the United States.

This distribution arrangement with Starbucks in the U.S. is in addition to our existing distribution arrangement for their stores in Canada that has been in place since 1999.

Brand and Product Development

We have developed and intend to continue to develop our brands and products in-house. We used a similar process initially to create the *Jones Soda* brand, and we intend to continue utilizing this process in connection with the creation of our future brands. This process primarily consists of the following steps:

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Market Evaluation. First we perform a complete review of the beverage industry in general, including a review of existing beverage categories and segments, and the product life cycle stages of such categories and segments. In addition, we review the fashion industry and the consumer products industry to determine the general trends in such industries. Based on these findings, we also review and attempt to determine the direction of future fashion and consumer product trends. Finally, we evaluate the strengths and weaknesses of certain categories and segments of the beverage industry with a view to pinpointing potential opportunities.

Distributor Evaluation. We then prepare a thorough analysis of existing and potential distribution channels. This analysis addresses, among other things, which companies will distribute particular beverage brands and products, where such companies may distribute such brands and products, and what will motivate these distributors to distribute such brands and products.

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Production Evaluation. Next, we review all aspects of production in the beverage industry, including current contract packing capacity, strategic production locations, and quality control, and prepare a cost analysis of the various considerations that will be critical to producing our unique brands and products.

Image And Design. In light of our market, distributor and production evaluations, we then create and develop the concept for a beverage brand or product extension. Although we control all aspects of the creation of each brand or product extension, we contract with outside creative artists to help design our brands. We have used, and intend to continue to use, a different artist, or group of artists, whose portfolio of work best suits us with respect to the creation of a particular new brand or product extension. These artists work closely with us to finalize the creation of a new brand image and design. Our technical services department then works with various flavor concentrate houses to test, choose and develop product flavors for the brand.

Due to the limited life cycle of beverages in the New Age or alternative category, we believe that the ongoing process of creating new brands, products and product extensions will be an important factor in our long-term success.

Products

During 2003 and currently in 2004, we produce, market and distribute four unique beverage brands: *Jones Soda*, *Jones Naturals*, *Jones Energy* and *WhoopAss*.

Jones Soda

We believe that our trademarked *Jones Soda* brand and product line is a leader in the Premium Soda segment of the New Age beverage category. We originally launched *Jones Soda* in November 1995, and the *Jones Soda* product line currently consists of the following 15 flavors:

Cream Soda	Orange & Cream Soda	Vanilla Cola
Green Apple Soda	Root Beer	Lemon Drop Soda
Fufu Berry Soda	Cherry Soda	Fruit Punch Soda
Blue Bubblegum Soda	Crushed Melon	MF Grape Soda
Berry Lemonade Soda	Strawberry Lime Soda	Chocolate Fudge Soda

In 2003, we launched a sugar-free version of our *Jones Soda* line. These sugar-free sodas are sweetened with Splenda[®] and have zero calories and zero carbohydrates. We believe that the launch of our sugar-free *Jones Soda* provides a healthier alternative to our regular *Jones Soda* line and is an important product extension introduction, especially in light of the recent concern and media coverage regarding obesity in young people. We currently have 4 flavors of sugar-free *Jones Soda*:

- Sugar Free Cream Soda
- Sugar Free Ginger Ale
- Sugar Free Root Beer

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Sugar Free Black Cherry

In March 2004, we launched our new Watermelon Soda, which is the first mid-calorie premium soda on the market, with 50% less sugar, carbohydrates and calories than regular premium sodas and soft drinks. Our mid-calorie Watermelon Soda contains 90 calories and 21 grams of sugar per 12-ounce serving.

Our strategy is to introduce flavors each year and selectively retire those flavors not deemed as popular. In general, our target is to have at least 14 active flavors of our regular *Jones Soda* product, and at least 5 flavors of our sugar free sodas.

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Each of the current *Jones Soda* products is made from natural and artificial flavors. Some flavors distributed in the U.S. market may contain caffeine (whereas in Canada only Vanilla Cola and Root Beer contain caffeine). Each flavor has a different color profile that we believe is readily distinguishable on a retail shelf. All *Jones Soda* beverage products come in 12 ounce (355 ml) clear long-neck bottles with primarily black and white photos on our labels displaying a variety of urban images. We also encourage consumers of *Jones Soda*, through the labels on our bottles, to send in photographs that may potentially be used on one of the *Jones Soda* labels.

Jones Naturals

In April 2001, we launched *Jones Naturals*, our non-carbonated beverage, initially under the name *Jones Juice*. The *Jones Naturals* products have 100% natural flavors and contain ingredients such as ginseng, zinc, taurine, and various vitamins. *Jones Naturals* comes in 20 ounce (591 ml) clear bottles with primarily black and white photograph labels, similar to the *Jones Soda* product labels. Consumers are similarly encouraged to send in photographs that potentially may be used on one of the *Jones Naturals* labels. In order to promote a clearer and more integrated brand image, in March 2002 we re-labeled the *Jones Juice* product to resemble the black and white photo labels of *Jones Soda*, and we renamed the product *Jones Naturals*. The *Jones Naturals* line currently consists of the following 8 flavors:

Berry White
D Peach Mode
Strawberry Manilow

Limes with Orange
Bananaberry
Bohemian Raspberry

Dave
Bada Bing!

Jones Energy

In November 2001, we launched *Jones Energy*. *Jones Energy* is a citrus energy drink in an 8.4 ounce (250 ml) slim can containing vitamin B6, riboflavin, niacin, thiamin and coQ-10. In March 2003, we launched *Jones Energy* in a new 16 ounce can, as an alternative to our other energy products. In addition, in March 2004, we launched our sugar-free *Jones Energy* in the 16 ounce can. Our *Jones Energy* products compete in the Energy Drink category of the New Age beverage industry.

Whoopass

We originally launched *Jones WhoopAss* in October 1999, and subsequently re-named it *WhoopAss*. *WhoopAss* is a citrus energy drink in an 8.4 ounce (250 ml) slim can containing riboflavin, niacin, vitamin B6 and thiamin. *WhoopAss* competes in the Energy Drink category of the New Age beverage industry.

Marketing, Sales and Distribution

Marketing

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Our pricing policies for the *Jones* and *Whoopass* brands take into consideration competitors' prices and our perception of what a consumer is willing to pay for the particular brand and product. The goal is to competitively price our unique products with the other New Age beverages. We attempt to work back through the distribution chain so that our suggested retail prices are proportional with respect to the anticipated profit margins of each step in the distribution process. The following table shows the suggested retail prices for our products in the United States and in Canada in the convenience and grocery channels of trade:

	<u>United States</u>		<u>Canada</u>	
Jones Soda	\$0.79	\$1.09	Cdn.\$0.99	Cdn.\$1.29
Jones Naturals	\$1.49		Cdn.\$1.89	Cdn.\$2.09
Jones Energy	\$1.99		N/A	
Whoopass	\$1.79	\$1.99	N/A	

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For our products sold through our national direct to retail channels, the suggested retail prices are approximately \$1.60 - \$1.75 for *Jones Soda* and \$1.75 - \$1.95 for *Jones Naturals*.

We primarily use point-of-sale materials such as posters, stickers, table cards, shelf danglers, post cards, hats, pins, T-shirts and jackets to create and increase consumer awareness of our proprietary products and brands. In response to consumer demand, we also sell *Jones* and *Whoopass* products and our wearables on our web site (<http://www.jonessodastore.com>). Through cooperative advertising, several of our independent distributors fund a portion of our marketing budget, based upon case sales. In selected cities, we participate on a grass roots level at certain events in an attempt to create and increase brand awareness and loyalty. We also have a program of sponsoring alternative sport athletes to promote *Jones* and *Whoopass*, and we have signed up several athletes in the skateboard, snowboard and mountain bike arenas. We also use two leased recreational vehicles painted with the *Jones* colors and logos to create consumer awareness and enthusiasm to assist distributors as they open new retail accounts and markets. In addition to these marketing techniques, we also pursue cross-promotional campaigns with other companies.

During 2003 we continued to maintain and utilize our unique website, www.myjones.com to allow our *Jones Soda* consumers to create their own personalized 12 pack of *Jones Soda* with their unique photo in the labels. The strategy of www.myjones.com is to provide a unique product offering to our consumers as well as provide a unique marketing opportunity for our *Jones Soda* brand. Consumers can scan their unique photo through the web and crop and create their own myjones labels. The unique labels are downloaded at our office in Seattle and we send out 12 packs of the personalized soda to the consumer. We believe this strategy has increased awareness for the *Jones Soda* brand as well as provided for increased consumer interactivity with the *Jones Soda* brand, and we anticipate that it will continue to do so. In December 2002, we received notice of issuance of a patent (Patent No. 6,493,677) from the U.S. Patent and Trademark Office for our myjones.com business operation. The patent is titled Method and Apparatus for Creating and Ordering Branded Merchandise over a Computer Network.

During 2002, we launched a new program, yourjones, which is the customization of the front panel of the label of *Jones Soda* similar to our myjones business, however on a larger, commercial scale. The premise behind yourjones is to create uniquely customized *Jones Soda* or *Jones Naturals* bottles, with a unique photo or brand image, for cross promotion and co-branding purposes or for sale in retail accounts. Like myjones.com, the *Jones Soda* name always appears on the labels and customers can add their own photo/brand and words. We have negotiated arrangements with our co-packing facilities to create short-run productions for these purposes.

Sales

Our products are sold in 39 states in the United States and 7 provinces in Canada primarily in convenience stores, delicatessens, sandwich shops and selected supermarkets, as well as through our national accounts with several large retailers. During the 2003 fiscal year, sales in the U.S. represented approximately 86.5% of total sales, while sales in Canada represented approximately 13.0%, and we had approximately 0.5% in other international sales.

During 2003, our sales force was organized into four regional groups, consisting of the U.S. Northwest, the U.S. Southwest, the U.S. Midwest and Western Canada. We maintain Vice Presidents of Sales for our Western and our Midwest/East regions. Regional Managers are ultimately responsible for the separate regions. Senior sales personnel are responsible for large retail grocery accounts located in their regions, the management of existing independent distributor relations and the selection of new independent distributors as may be required. Junior sales personnel work closely with our independent distributors and their sales representatives to help them open street level retail accounts and train them in our sales and marketing techniques. In addition, in 2003 we added sales personnel who are responsible for our direct to retail national accounts.

Distribution

We sell a majority of our products through our distribution network, and we currently have relationships with approximately 135 independent distributors throughout North America. Our policy is to grant our

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distributors rights to sell particular brands within a defined territory. We believe that substantially all of our distributors also carry other beverage products. Agreements with our distributors vary; we have entered into written agreements with many of our top distributors for varying terms of years; most of our other distribution relationships are oral (based solely on purchase orders) and are terminable by either party at will.

In addition, we also sell our products directly to certain large national retail accounts, such as Barnes & Noble, Panera Bread Company, CostPlus World Markets, and Starbucks. Distribution of our products into these accounts is handled by the retailer's distribution system or by their designated food-service or other distributors.

During the year ended December 31, 2003, the two top independent distributors of our products purchased approximately 13% and 12%, respectively, of the total number of cases sold. We anticipate that, as consumer awareness of our brands develops and increases, we will continue to upgrade and expand our distributor network, which may result in a decreased dependence on any one or more of our independent distributors.

We generally require our independent distributors to place their purchase orders for our products at least 10 days in advance of shipping. To the extent we have additional product available in inventory, we will fulfill other purchase orders when and as received. We contract with independent trucking companies to have product shipped from our contract packers to independent warehouses, and then on to our distributors. Distributors then sell and deliver our products either to sub-distributors or directly to retail outlets, and such distributors or sub-distributors stock the retailers' shelves with our products. We recognize revenue upon receipt by our distributors and customers of our products, net of discount and allowances, and all sales are final and we have a no return policy; however, in limited instances, due to credit issues or distributor changes, we may take back product.

Production

Contract Packing Arrangements

We currently use four main independent contract packers known as co-packers to prepare, bottle and package our products. Currently, our primary contract packers are located in Burnaby, British Columbia (*Jones Soda*), Woodbridge, Ontario (*Jones Soda* and *Jones Naturals*), Forest Grove, Oregon (*Jones Naturals*), and Cold Springs, Minnesota (*Jones Energy* and *Whoopass*). We continually review our contract packing needs in light of regulatory compliance and logistical requirements and may add or change co-packers based on those needs. A majority of our co-packing is handled in Canada, and with the recent strengthening of the Canadian dollar against the U.S. dollar, our co-packing costs have increased. As a result, we are actively looking for alternative co-packing arrangements for our *Jones Soda* product in the United States, as well as lower cost co-packers in Canada.

As is customary in the contract packing industry, we are expected to arrange for our contract packing needs sufficiently in advance of anticipated requirements. Accordingly, it is our business practice to require our independent distributors to place their purchase orders for our products at least 10 days in advance of shipping. Other than minimum case volume requirements per production run, we do not have any minimum production requirements.

Raw Materials

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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. The raw materials used in the preparation and packaging of our products consist primarily of concentrate, glass, labels, caps and packaging. These raw materials are purchased from suppliers selected by us or by our contract packers.

We believe that we have adequate sources of raw materials, which are available from multiple suppliers. Currently, we purchase our flavor concentrate from two flavor concentrate suppliers, Virginia Dare and Wild

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Flavors, Inc. During 2003, we settled our dispute with our other flavor concentrate supplier and terminated our supply arrangement with them. We anticipate that for future flavors and additional products, we may purchase flavor concentrate from other flavor houses with the intention of developing other sources of flavor concentrate for each of our products. The water used to produce our products is filtered and is also treated to reduce alkalinity.

Quality Control

Our products are made from high quality ingredients and natural and artificial flavors. We seek to ensure that all of our products satisfy our quality standards. Contract packers are selected and monitored by our own quality control representatives in an effort to assure adherence to our production procedures and quality standards. Samples of our products from each production run undertaken by each of our contract packers are analyzed and categorized in a reference library.

For every run of product, our contract packer undertakes extensive on-line testing of product quality and packaging. This includes testing levels of sweetness, carbonation, taste, product integrity, packaging and various regulatory cross checks. For each product, the contract packer must transmit all quality control test results to us on a daily basis. These test results are reviewed by our internal technical staff for compliance with our standards, which meet or exceed those established in the industry.

Testing includes microbiological checks and other tests to ensure the production facilities meet the standards and specifications of our quality assurance program. This information is then logged into a database for rapid statistical analysis and followed up with each contract packer. We believe our production facilities inspection program meets or exceeds industry standards. Water quality is monitored during production and at scheduled testing times to ensure compliance with applicable government regulatory requirements. Flavors are pre-tested before shipment to contract packers from the flavor manufacturer. We are committed to an on-going program of product improvement with a view toward ensuring the high quality of our product.

We believe we source and select only those suppliers that use only quality components. We also inspect packaging suppliers' production facilities and monitor their product quality.

Regulation

The production and marketing of our licensed and proprietary beverages are subject to the rules and regulations of various federal, provincial, state and local health agencies, including in particular Health Canada, Agriculture and Agri-Food Canada and the U.S. Food and Drug Administration. The FDA and Agriculture and Agri-Food Canada also regulate labeling of our products. From time to time, we may receive notifications of various technical labeling or ingredient reviews with respect to our licensed products. We believe that we have a compliance program in place to ensure compliance with production, marketing and labeling regulations on a going-forward basis. There are no regulatory notifications or actions currently outstanding. See [Certain Factors That May Affect Future Results](#), below.

Trademarks, Flavor Concentrate Trade Secrets and Patent

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We own a number of trademarks, including, in the United States and Canada, *Jones Soda Co.*[®], *Jones Natural*, *Jones Energy* and *WhoopAss*. In the United States our trademarks expire 10 years from the registration date and in Canada 15 years from the registration date, although in both Canada and the United States, they may be renewed for a nominal fee. In addition, we have trademark protection in the United States and Canada for a number of other trademarks for slogans and product designs, including *Wet Yourself*[®], *I've Got A Jones For A Jones*[®], *Jones Soda Co. and Design*, *Whoopass and Design* and *My Jones*[®]. We have also applied for trademark protection for several marks, including *Jones Soda Co.*[®], in the United Kingdom, Germany, Japan, and other foreign jurisdictions.

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We have the exclusive rights to 30 flavor concentrates developed with our current flavor concentrate suppliers, which we protect as trade secrets. We will continue to take appropriate measures, such as entering into confidentiality agreements with our contract packers and exclusivity agreements with our flavor houses, to maintain the secrecy and proprietary nature of our flavor concentrates.

We have a patent on our myjones.com business operation. In December 2002, the U.S. Patent and Trademark Office issued us Patent No. 6,493,677, titled Method and Apparatus for Creating and Ordering Customized Branded Merchandise over a Computer Network . We originally created the myjones.com system in mid-1999 and applied for this patent in January 2000. The term of U.S. patents is 20 years from the date of filing and this patent can be viewed by accessing the U.S. Patent Office s website at www.uspto.gov. We intend to explore potential licensing arrangements with third parties to commercialize this patented methodology.

We consider our trademarks, patent and trade secrets to be of considerable value and importance to our business. No successful challenges to our registered trademarks have arisen and we have no reason to believe that any such challenges will arise in the future. See Certain Factors That May Affect Future Results, below.

Competition

The beverage industry is highly competitive. Principal methods of competition in the beverage industry include

brand name,

brand image,

price,

labeling and packaging,

advertising,

product quality and taste,

trade and consumer promotions, and

the development of new brands, products and product extensions.

We compete with other beverage companies not only for consumer acceptance but also for shelf space in retail outlets and for marketing focus by our distributors, all of who also distribute other beverage brands. Our products compete with all non-alcoholic beverages, most of which are

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marketed by companies with substantially greater financial resources than we have. We also compete with regional beverage producers and private label soft drink suppliers. Our direct competitors in the alternative beverage industry include Cadbury Schweppes (Snapple, Stewart, Nantucket Nectar, Mystic), Thomas Kemper, Boylans and Hansens. We also compete against Coke, Pepsi, and other traditional beverage manufacturers and distributors.

In order to compete effectively in the beverage industry, we believe that we must convince independent distributors that *Jones Soda* is a leading brand in the premium soda segment of the alternative or New Age beverage industry. In connection with or as a follow-up to the establishment of an independent distributor relationship for the *Jones Soda* brand, we sell *Jones Naturals*, *Jones Energy* and *WhoopAss* as complementary products that may replace other non-carbonated single-serve fruit beverages or ready-to-drink (RTD) teas or energy drinks. As a means of maintaining and expanding our distribution network, we intend to introduce new products and product extensions, and when warranted, new brands. Although we believe that we will be able to continue to create unique, exciting and fashionable brands, there can be no assurance that we will be able to do so or that other companies will not be more successful in this regard over the long term. See Certain Factors That May Affect Future Results, below.

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In addition, in light of the competition for product placement with independent distributors, during 2003 we also targeted several national retail accounts as an additional distribution channel for our products. We currently have such distribution arrangements with Barnes & Noble, Panera Bread Company, CostPlus World Markets and Starbucks. We believe that this diversification strategy is helpful in alleviating the risk inherent in competition for independent distributors.

Pricing of the products is also important. We believe that our *Jones Soda*, *Jones Naturals*, *Jones Energy* and *Whoopass* brands are priced in the same price range as competitive New Age beverage brands and products.

Employees

As of December 31, 2003, we had 38 full-time employees, 23 of whom were employed in sales and marketing capacities, 11 were employed in administrative capacities, and 4 were employed in manufacturing and quality control capacities. None of our employees is represented by labor unions. We believe that our relationships with our employees are good.

Certain Factors That May Affect Future Results

The following discussion in this Annual Report on Form 10-KSB contains forward-looking statements regarding our business, prospects and results of operations that involve risks and uncertainties. Our actual results could differ materially from the results that may be anticipated by such forward-looking statements and discussed elsewhere in this Report. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below, as well as those discussed under the captions Business and Management's Discussion and Analysis of Financial Condition and Results of Operations as well as those discussed elsewhere in this Report. In evaluating our business, prospects and results of operations, readers should carefully consider the following factors in addition to other information presented in this Report and in our other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations. See Cautionary Notice Regarding Forward Looking Statements above.

Factors Relating to Our Company and Our Business

We rely heavily on our independent distributors, and this could affect our ability to efficiently and profitably distribute and market our products, and maintain our existing markets and expand our business into other geographic markets

Our ability to establish a market for our unique brands and products in new geographic distribution areas, as well as maintain and expand our existing markets, is dependent on our ability to establish and maintain successful relationships with reliable independent distributors strategically positioned to serve those areas. Many of our larger distributors sell and distribute competing products, including non-alcoholic and alcoholic beverages, and our products may represent a small portion of their business. To the extent that our distributors are distracted from selling our products or do not employ sufficient efforts in managing and selling our products, our sales and profitability will be adversely affected. Our ability to maintain our distribution network and attract additional distributors will depend on a number of factors, many of which are outside our control. Some of these factors include

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the level of demand for our brands and products in a particular distribution area,

our ability to price our products at levels competitive with those offered by competing products, and

our ability to deliver products in the quantity and at the time ordered by distributors.

We cannot ensure that we will be able to meet all or any of these factors in any of our current or prospective geographic areas of distribution. Our inability to achieve any of these factors in a geographic distribution area

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will have a material adverse effect on our relationships with our distributors in that particular geographic area, thus limiting our ability to expand our market, which will likely adversely effect our revenues and financial results.

We generally do not have long-term agreements with our distributors, and we incur significant time and expense in attracting and maintaining key distributors.

Our marketing and sales strategy presently, and in the future, will rely on the availability and performance of our independent distributors. We have entered into written agreements with many of our top distributors for varying terms and duration; however, most of our other distribution relationships are oral (based solely on purchase orders) and are terminable by either party at will. We currently do not have, nor do we anticipate in the future that we will be able to establish, long-term contractual commitments from many of our distributors. In addition, despite the terms of the written agreements with many of our top distributors, there are no assurances as to the level of performance under those agreements, or that those agreements will not be terminated early. There is no assurance that we will be able to maintain our current distribution relationships or establish and maintain successful relationships with distributors in new geographic distribution areas. Moreover, there is the additional possibility that we may have to incur additional expenditures to attract and maintain key distributors in one or more of our geographic distribution areas in order to profitably exploit our geographic markets.

Because our distributors are not required to place minimum orders with us, we need to carefully manage our inventory levels, and it is difficult to predict the timing and amount of our sales.

Our independent distributors are not required to place minimum monthly or annual orders for our products. In order to reduce inventory costs, independent distributors endeavor to order products from us on a just in time basis in quantities, and at such times, based on the demand for the products in a particular distribution area. Accordingly, there is no assurance as to the timing or quantity of purchases by any of our independent distributors or that any of our distributors will continue to purchase products from us in the same frequencies and volumes as they may have done in the past. There can be no assurance as to the number of cases sold by any of our distributors.

The bankruptcy, cessation of operations, or decline in business of a significant distributor could adversely affect our revenues, and could result in increased costs in obtaining a replacement.

For the year ended December 31, 2003, two distributors (out of our network of approximately 135 distributors) accounted for approximately 25% of the total number of cases of our beverage products sold. If these primary distributors were to stop selling our products or decrease the number of cases purchased, this could have an adverse impact on our revenues and financial results. In fact, in 2001 three of our top five distributors either filed for bankruptcy or went out of business. Although we subsequently entered into distribution agreements or letters of intent with new distribution partners for these three markets in late 2001 and early 2002, our revenues were adversely affected by downtime, transition costs and expenses resulting from the initial deployment of our products in each new distributor's network. There can be no assurance that in the future we will be successful in finding new or replacement distributors if any of our existing significant distributors cease operations, file for bankruptcy or terminate their relationship with us.

Our business plan and future growth is dependent in part on our distribution arrangements with national retail accounts. There are risks associated with this new distribution strategy.

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During 2003 and into 2004, we entered into distribution arrangements with several large national retail accounts to distribute our products directly through their stores. Although we believe that our new direct to retail program will increase our national visibility among consumers, there are several risks associated with implementing our new distribution strategy. First, there is no assurance that we will be able to maintain continuing relationships with these national accounts, or that the arrangements may not be terminated early. The

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