

REED'S, INC.  
Form 10-K  
March 23, 2016

**UNITED STATES**

**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, 2015**

**Commission File Number 000-32501**

**REED'S, INC.**

(Exact name of registrant as specified in its charter)

<b>Delaware</b>	<b>35-2177773</b>
State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification Number

<b>13000 South Spring Street</b>	
<b>Los Angeles, California</b>	<b>90061</b>
Address of principal executive offices	Zip Code

**(310) 217-9400**

Registrant's telephone number, including area code

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

<b>Title of Class</b>	<b>Name of each exchange where registered</b>
Common Stock, \$.0001 par value per share	NYSE MKT

**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

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

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.

Edgar Filing: REED'S, INC. - Form 10-K

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, 2015 was \$60,152,000.

13,160,860 common shares, \$.001 par value, were outstanding on December 31, 2015.

TABLE OF CONTENTS

	Page
<u>PART I</u>	5
Item 1. <u>Business</u>	5
Item 2. <u>Properties</u>	12
Item 3. <u>Legal Proceedings</u>	12
Item 4. <u>Mine Safety Disclosures.</u>	12
 <u>PART II</u>	 13
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	13
Item 6. <u>Selected Financial Data</u>	15
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	22
Item 8. <u>Financial Statements</u>	23
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	24
Item 9A. <u>Controls and Procedures</u>	24
Item 9B. <u>Other Information</u>	25
 <u>PART III</u>	 26
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	26
Item 11. <u>Executive Compensation</u>	31
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	33
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	33
Item 14. <u>Principal Accountant Fees and Services</u>	34
 <u>PART IV</u>	 36
Item 15. <u>Exhibits, Financial Statement Schedules</u>	36

## **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. (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,” “a,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would” and “outlook” and similar expressions. 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 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,

Our ability to make suitable arrangements for the co-packing of any of our products, and

Our ability to find alternative copacking and production facilities for our Kombucha and Private Label products if our Los Angeles production facility is damaged by a disaster.

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 carbonated soft drinks, Kombucha, candies and ice creams. We currently manufacture, license, market and sell several unique product lines:

Reed's Ginger Brews,

Virgil's Root Beer, Cream Sodas, Dr. Better and Real Cola, including ZERO diet sodas,

Culture Club Kombucha,

China Colas,

Reed's Ginger candy and ice creams,

Sonoma Sparkler and other juice based products.

We also have a private label business.

We sell our products throughout the US and in select international markets. We started in specialty gourmet and natural food stores and have moved more into mainstream over time. We estimate that our products are in approximately 40,000 accounts in the US with approximately 12,000 of those being mainstream supermarkets. We sell our products through a network of natural, gourmet and beer distributors and direct to certain large national retailers.

We produce and co-pack our beverage products in part at our facility in Los Angeles, California, known as the Brewery and at contracted co-packing facilities in Pennsylvania and Indiana. These co-pack facilities typically service the eastern half of the United States and nationally for certain products that we do not produce at The Brewery.

Key elements of our business strategy include:



increase our relationship with and sales to the approximately 15,000 supermarkets that carry our products in natural and mainstream and capture more of the 35,000 supermarkets nationwide,

expand our distribution network by adding regional direct store delivery (DSD's) and additional direct accounts,

stimulate consumer demand and awareness for our existing brands and products through promotions and advertising,

develop additional product flavors under our brands (brand extensions) and other new products, including specialty packaging and alternative uses for our products,

develop and produce private-label products for select customers,

lower our cost of sales for our products by gaining economies of scale in our purchasing, and

optimize the size and focus of our sales force to manage our relationships with distributors and retail outlets.

We create consumer demand for our products by:

supporting in-store sampling programs of our products, and

generating free press through public relations, and

advertising in store publications, and

maintaining a company website ([www.reedsinc.com](http://www.reedsinc.com)), and

active social media campaigns on facebook.com, twitter.com and youtube.com, and

participating in large public events as sponsors, and

in the recent past deployed a national television commercial on cable television networks.

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.reedsinc.com](http://www.reedsinc.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

Reed's Original Ginger Brew was created in 1987 by Christopher J. Reed, our founder and Chief Executive Officer, and was introduced to the market in Southern California stores in 1989. By 1990, we began marketing our products through United Natural Foods Inc. (UNFI) and other 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. 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 UNFI and other 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 2000. In 1999, we purchased the Virgil's Root Beer brand from the Crowley Beverage Company. In 2000, we moved into an 18,000 square foot warehouse property, the Brewery, in Los Angeles, California, to house our west coast production and warehouse facility. The Brewery 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."

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. Following the public offering, we expanded sales and operations dramatically, initially using a direct store delivery strategy in Southern California, along with other regional independent direct store distributors (DSD). The relationships with DSD's were supported by our sales staff. In 2007 we raised a net of \$7,600,000 in a private placement. We re-focused our sales strategy to eliminate company direct store delivery sales and to expand sales to DSD's and natural food distributors on a national level. We also started selling directly to supermarket grocery stores, which has become a significant portion of our business today.

We continually introduce new products and line extensions, such as our California Juice Company products in 2009, Virgil's diet line of ZERO beverages introduced in 2010 and Dr. Better and Light 55 Calories Extra Ginger Brew in 2011. We commenced offering private label products in 2010 and in 2012 we launched our Culture Club Kombucha line that has been expanded as sales have grown. In 2015 we launched Stronger Ginger Brew that contains 50% more fresh ginger than our best selling Reed's Extra Ginger Brew.

## Industry Overview

We offer natural premium carbonated soft drinks (CSD), which are a growing segment of the estimated \$10 billion CSD market nationwide. Within natural food store markets, we are among the top-selling natural soft drinks. This market is steady and growing. We also sell in major grocery chains nationally. The trend in grocery stores is to expand offerings of natural products and we have the scale and capability to develop these direct customer relationships.

## **Our Products**

We primarily manufacture and sell beverages and candies or other ginger related products. We make all of our products using premium all-natural ingredients and our beverage line is GMO free. Our primary brands are our Reed's ginger brew line, our Virgil's line of root beer and our Culture Club Kombucha. Our candy products that include Reed's Crystallized Ginger Candy and Reed's Chews represent a lesser portion of revenues. We have sold ginger ice cream in prior years.

### *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 highly prized for their taste and their tonic, health-giving properties. Reed's Ginger Brews are a revival of this lost art of home brewing sodas. We make them with care and attention to wholesomeness and quality, using the finest fresh herbs, roots, spices, and fruits.

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 39 grams of fresh ginger in every 12-ounce bottle. We use pure cane sugar as the sweetener. 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 and our beverages are GMO free.

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.

Our Reed's line contains the following products:

*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, raw cane sugar, pineapple, herbs and spices. Reed's Original Ginger Brew is 20% fruit juice.

*Reed's Premium Ginger Brew* is sweetened only with honey and pineapple juice. Reed's Premium Ginger Brew is 20% fruit juice and contains 17 grams of fresh ginger root.

*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.

*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.

*Reed's Cherry Ginger Brew* is naturally brewed from 17 grams of fresh ginger root, cherry juice from concentrate and spices.

*Reed's Light 55 Calories Extra Ginger Brew* is a reduced calorie version of our top selling Reed's Extra Ginger Brew that was made possible by using Stevia. We use the same recipe of 26 grams of fresh ginger root, honey, pineapple, lemon and lime juices and exotic spices.

Reeds Extra Ginger Brew *is the same recipe as Original Ginger Brew, but has 26 grams of fresh ginger root for a stronger bite.*

Reeds Stronger Ginger Brew has 50% more ginger than the Extra Ginger Brew and has the highest ginger content of any of our beverage products.

*Reed's Natural Energy Elixir* is an energy drink infused with all natural ingredients designed to provide consumers with a healthy and natural boost to energy levels

*Reed's Nausea Relief* is based on our Ginger Brews with added B vitamins. Both ginger and B vitamins have been studied for their effectiveness in combating nausea.

*Virgil's Root Beer*

Virgil's is a premium craft 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 combine these ingredients under strict specifications and finally heat-pasteurize Virgil's Root Beer, to ensure quality. We sell Virgil's Root Beer in three packaging styles: 12-ounce bottles in a four-pack, a special swing-lid style pint bottle and a 5-liter self-tapping party keg. The Virgil's soda line is GMO free.

In addition to our Virgil's Root Beer, we also offer the following products under our Virgil's brand:

Virgil's Cream Soda,

Virgil's Orange Cream Soda,

Virgil's Black Cherry Cream Soda,

Virgil's Real Cola,

Virgil's Dr. Better,

Virgil's ZERO line, including Root Beer, Cream Soda, Real Cola, Dr. Better and Black Cherry Cream Soda. (Our ZERO line is naturally sweetened with Stevia), and

*Reed's Culture Club Kombucha*

We introduced our Culture Club Kombucha in 2012. Kombucha is a fermented tea that dates its origin back thousands of years. Among consumers, Kombucha is believed to have healing and cleansing characteristics. Sweetened tea is introduced to a "starter" culture and lightly fermented to produce an acetic drink. We make the finest Kombucha possible, using a combination of Oolong and Yerba Mate teas, spring water and a combination of ginger, organic juices and flavors. Initially, we produced four flavors, Goji Ginger, Hibiscus Ginger Grapefruit, Lemon Ginger Raspberry and Cranberry Ginger. We introduced four additional flavors in 2013, Pomegranate Ginger, Coconut Water Lime, Cabernet Grape, and Passion Mango Ginger. In 2014, we added the first Coffee Kombucha.

### *Other Beverage Brands*

We have other popular brands that currently have limited distribution, including China Cola, California Juice, Sonoma Sparkler and Flying Cauldron Butterscotch Beer. We are continually developing new brands and products.

### *Private Label Products*

We design and manufacture drinks for private label customers in multiple facilities. We are experts in flavor development and in matching existing products in the market. We develop the recipe and may design the label and/or the bottle style. We do not private label any of our own branded product recipes.

Our private label products have been primarily sparkling juices, waters and teas. We develop the sources for glass and ingredients. We have a variety of packaging options, including swing-lid bottles, foil capsules and various label types. Our Los Angeles facility is certified as SQF level 2 compliant.

### **New Product Development**

We are always working on ideas and products to continue expanding our Reed's Ginger Brews, Virgil's product line, Reed's Ginger Candy product lines and packaging styles. 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.

Our private label products require continual product development. We are able to be nimble and innovative, producing new products in a short amount of time.

### **Manufacture of Our Products**

We produce our carbonated beverages in multiple facilities:

a facility in Los Angeles, California, known as The Brewery, at which we currently produce Kombucha, certain soda products and our private label products, and

two packing, or co-pack facilities in Pennsylvania and an additional co-packer in Indiana which supplies us with product we do not produce at The Brewery. The co-packer assembles our products and charges us a fee, generally by the case, for the products they produce.

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. The LA Brewery is currently undergoing a major renovation that we believe will allow the Brewery 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 are developing a pre-qualification for all prospective co-packers, 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.

## **Our Primary Markets**

We target a niche in the estimated \$100 billion carbonated and non-carbonated soft drink markets in the US, Canada and International markets. Our brands are generally regarded as premium and natural, with upscale packaging and are loosely defined as the artisanal (craft), premium bottled carbonated soft drink category.

The soft drink industry is highly fragmented and the craft soft drink category consists of such competitors as, Henry Weinhardts, Thomas Kemper, Hansen's, Izze, Boylan and Jones Soda, to name a few. These brands have the advantage of being seen widely in the national market and being commonly known for years through well-funded ad campaigns. Despite our products having a relatively high price for an artisanal premium beverage product, minimal mass media advertising and a relatively small but growing 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 strong inroads and market share gains against some of the larger brands in the market.

Kombucha is the largest growth segment of the functional beverage category of drinks and foods, including coconut water, yogurt and fresh juices. Among this broader category, the refrigerated juices and functional beverages segment grew by approximately \$200 million in 2012 to an estimated market of approximately \$600 million (50% growth), according to SPINS data. Kombucha comprises the overwhelming majority share of this explosive growth and comprises most of the segment. It is generally believed that the segment will continue to expand at a strong rate over the next few years. Other functional drinks in this category are also expanding sales at healthy rates, primarily coconut water and fresh pressed juices. Consumer awareness and demand for functional drinks is increasing and we feel that Kombucha and other cultured drinks will be in the forefront of this expanding market category.

We sell the majority of our products in the natural food store, 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 and distribution source of our products has been natural food and gourmet stores throughout the US. These stores include Whole Foods Market, Trader Joe's, Sprouts, The Fresh Market, Earth Fare, and New Seasons, just to name a few. Our brands are also sold in gourmet restaurants and deli's nationwide. With the advent of large natural food store chains and specialty merchants, the natural foods segment continues to grow each year, helping fuel the continued growth of our brands.



*Mainstream Supermarkets and Retailers*

We also sell our products to direct store delivery distributors (DSD) who specialize in distributing and selling our products directly to mainstream retail channels, natural foods, and specialty retail stores. Our brands are further sold directly to some retailers who require that we sell directly to their distribution centers since they have developed their own logistics capabilities. Examples of chains that fall into the “direct” category are retailers such as, Costco, Trader Joe’s, some Whole Foods Market Regions and Kroger.

Supermarkets, particularly supermarket chains and prominent local/regional chains, often impose slotting fees in order to gain shelf presence within their stores. These fees can be structured to be paid one-time only or in installments. We utilize selective slotting in supermarket chains throughout the US and to a lesser degree, in Canada. However, our local and national sales team has been able to place our products without having to pay significant slotting fees. Slotting fees for new item placements on average have cost anywhere between \$10 to \$150 per store, per new item.

*Food Service Placement*

We also market our beverages to industrial cafeterias (corporate feeders), and to on premise bars and restaurants. As our business continues to mature, we intend to place our beverages in stadiums, sport arenas, concert halls, theatres, and other cultural centers as long-term marketing and pouring relationships are developed within this business segment.

### *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 believe that there are good opportunities for expansion of sales in Canada and we are increasing our marketing focus on that market. Other international sales become cost prohibitive, except in specialty sales circumstances, since our premium sodas are packed in glass, which involves substantial freight to move overseas. We are open to opportunities to export and to co-pack internationally and expand our brands into foreign markets, and we are holding preliminary discussions with 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 markets, especially the Asian market where ginger is a significant part of diet and nutrition.

### *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 internal sales force and independent sales representatives to promote our products for our distributors and direct sales to our retail customers. One of the main goals of our sales and marketing efforts is to increase sales and grow our brands. Our sales force consists of senior sales representatives in five geographic regions across the country who are supported in their region by local Reeds sales staff. Generally, our sales managers are responsible for all activities related to the sales, distribution and marketing of our brands to our entire distributor and retail partner network in North America. We distribute our products primarily through several national natural foods distributors and an increasing number of regional mainstream DSD distributors. We have entered into agreements with some of our distributors that commit us to "termination fees" if we terminate our agreements early or without cause. These 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 are in constant review of our distribution agreement with our partners across North America. We also offer our products and promotional merchandise directly to consumers via the Internet through our website, [www.reedsgingerbrew.com](http://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 our distributor partners through our in-house sales managers. From time to time and in very limited markets, when use of our own sales force is not cost effective, we will utilize independent sales 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 company's 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 soft drink category could cause our products to be unable to gain or to lose market share or we could experience price erosion. We believe that our all natural innovative beverage recipes, packaging, 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.

The Kombucha market is dominated by a few producers who sell their products nationally. The remainder of the producers is comprised of mostly fragmented regional or local companies. There are companies that gain market share in certain regions; however, most do not have the scale and capability to effectively sell and distribute on a national basis. We believe that Reed's Kombucha market share was achieved in a relatively short period of time, by leveraging our existing distribution channels and customer relationships to expand our sales volume quickly. We also have in-house production capabilities that can be scaled up as needed to make this a primary brand for Reed's. We believe that our existing infrastructure creates a competitive advantage, including product design, manufacturing & production and a network of sales & distribution.

### **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: Reed's Original Ginger Brew All-Natural Jamaican Style Ginger Ale ®, Virgil's ®, and China Cola ®. 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 non-refillable, 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 taxes or fees be charged for the sale, marketing and use of certain non-refillable beverage containers. The precise requirements imposed by these measures vary. Other types of beverage container-related deposit, recycling, tax 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 36 full-time employees on our corporate staff, as follows: 4 in general management, 4 in manufacturing, research and development, 17 in sales and marketing support, and 11 in accounting, administration and operations. We also have approximately 40 production employees that work both full and part time and work flexible hours based on volume demands. 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 76,000 square feet, which serves as our principal executive offices, our West Coast Brewery and bottling plant and our Southern California warehouse facility. Approximately 30,000 square feet of the total space is leased under a long-term lease expiring in 2024. We also lease a warehouse of approximately 18,000 square feet under a lease expiring in 2017, a warehouse of approximately 13,000 square feet under a lease

expiring in 2017, and a warehouse of 15,000 square feet on a month-to-month basis.

### **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.

### **Item 4. Mine Safety Disclosures**

Not applicable.

**PART II****Item 5. Market for Common Equity and Related Stockholder Matters**

Our common stock is listed for trading on the NYSE MKT trading under the symbol “REED”. The following is a summary of the high and low bid prices of our common stock on the NYSE MKT Capital Markets for the periods presented:

	<b>Sales Price</b>	
	<b>High</b>	<b>Low</b>
<b>Year Ending December 31, 2014</b>		
First Quarter	\$8.57	\$5.69
Second Quarter	5.71	4.29
Third Quarter	6.47	5.00
Fourth Quarter	7.53	5.63

	<b>Sales Price</b>	
	<b>High</b>	<b>Low</b>
<b>Year Ending December 31, 2015</b>		
First Quarter	\$7.00	5.32
Second Quarter	6.64	5.08
Third Quarter	6.39	4.44
Fourth Quarter	5.90	4.50

As of December 31, 2015, there were approximately 4,481 stockholders of record of the common stock (including only non-objecting beneficial owners of record) and 13,147,815 outstanding shares of common stock.

**Unregistered Sales of Equity Securities**

During the fiscal year ended December 31, 2015, we issued the following equity securities that were unregistered under the Securities Act:

We issued 247 shares of common stock in exchange for Reeds Board of Director 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 \$1,350 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 preferred stock in additional shares of common stock at our discretion. In 2015 and 2014, we paid dividends on our Series A preferred stock in an aggregate of 751 and 1,057 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.

### **Securities Authorized for Issuance Under Equity Compensation Plans**

#### **2007 Stock Option Plan and 2015 Incentive and Non-statutory stock option plan**

On October 8, 2007, our board of directors adopted the 2007 Stock Option Plan for 1,500,000 shares and the plan was approved by our stockholders on November 19, 2007. All of the shares granted under our 2007 Stock Option Plan have been issued. Forfeited options issued under the 2007 plan can be reissued prior to expiration of the plan. On April 6, 2015, our board of directors adopted the 2015 Incentive and Non-statutory Stock Option Plan for 500,000 shares and the plan was approved by our stockholders on December 30, 2015. Forfeited options issued under the 2015 plan cannot be reissued.

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.

For the 2007 plan, 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. For the 2015 plan, when a stock award expires or is terminated before it is exercised, the shares are canceled and cannot be reissued.

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.



**Equity Compensation Plan Information**

The following table provides information, as of December 31, 2015, with respect to equity securities authorized for issuance under compensation plans:

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)
Equity compensation plans approved by security holders	980,000	\$ 4.52	291,834
Equity compensation plans not approved by security holders	341,261	\$ 5.17	-
<b>TOTAL</b>	<b>1,321,261</b>	<b>\$ 4.69</b>	<b>291,834</b>

**Item 6. Selected Financial Data**

As a smaller reporting company, Reed's is not required to provide the information required by this Item 6.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*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.*

**Results of Operations**

The following table sets forth key statistics for the years ended December 31, 2015 and 2014, respectively.

	Year Ended		Pct. Change
	December 31, 2015	2014	
Gross sales, net of discounts & returns (a)	\$49,713,000	\$48,061,000	3%
Less: Promotional and other allowances (b)	3,765,000	4,639,000	(19%)
Net sales	\$45,948,000	43,422,000	5%
Cost of tangible goods sold (c)	32,295,000	28,141,000	15%
<i>As a percentage of:</i>			
<i>Gross sales</i>	65%	58	%
<i>Net sales</i>	70%	65	%
Cost of goods sold – idle capacity (d)	2,048,000	2,275,000	(10%)
<i>As a percentage of net sales</i>	4%	5	%
Gross profit	\$11,605,000	\$13,006,000	(11%)
Gross profit margin as a percentage of net sales	25%	30	%

*(a) Gross sales is used internally by management as an indicator of and to monitor operating performance, including sales performance of particular products, salesperson performance, product growth or declines and overall Company performance. The use of gross sales allows evaluation of sales performance before the effect of any promotional items, which can mask certain performance issues. We therefore believe that the presentation of gross sales provides a useful measure of our operating performance. Gross sales is not a measure that is recognized under Generally Accepted Accounting Principles “GAAP” and should not be considered as an alternative to net sales, which is determined in accordance with GAAP, and should not be used alone as an indicator of operating performance in place of net sales. Additionally, gross sales may not be comparable to similarly titled measures used by other companies, as gross sales has been defined by our internal reporting practices. In addition, gross sales may not be realized in the form of cash receipts as promotional payments and allowances may be deducted from payments received from certain customers.*

*(b) Although the expenditures described in this line item are determined in accordance with GAAP and meet GAAP requirements, the disclosure thereof does not conform with GAAP presentation requirements. Additionally, our definition of promotional and other allowances may not be comparable to similar items presented by other companies. Promotional and other allowances primarily include consideration given to the Company's distributors or retail customers including, but not limited to the following: (i) reimbursements given to the Company's distributors for agreed portions of their promotional spend with retailers, including slotting, shelf space allowances and other fees for both new and existing products; (ii) the Company's agreed share of fees given to distributors and/or directly to retailers for in-store marketing and promotional activities; (iii) the Company's agreed share of slotting, shelf space allowances and other fees given directly to retailers; (iv) incentives given to the Company's distributors and/or retailers for achieving or exceeding certain predetermined sales goals; and (v) discounted or free products. The presentation of promotional and other allowances facilitates an evaluation of their impact on the determination of net sales and the spending levels incurred or correlated with such sales. Promotional and other allowances constitute a material portion of our marketing activities. The Company's promotional allowance programs with its numerous distributors and/or retailers are executed through separate agreements in the ordinary course of business. These agreements generally provide for one or more of the arrangements described above and are of varying durations, ranging from one week to one year.*

*(c) Cost of tangible goods sold consists of the costs of raw materials and packaging utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, inventory adjustments, as well as certain internal transfer costs. Cost of tangible goods sold is used internally by management to measure the direct costs of goods sold, aside from unallocated plant costs. Cost of tangible goods sold is not a measure that is recognized under GAAP and should not be considered as an alternative to cost of goods sold, which is determined in accordance with GAAP, and should not be used alone as an indicator of operating performance in place of cost of goods sold.*

*(d) Cost of goods sold – idle capacity consists of direct production costs in excess of charges allocated to our finished goods in production. Plant costs include labor costs, production supplies, repairs and maintenance, and inventory write-off. Our charges for labor and overhead allocated to our finished goods are determined on a market cost basis, which is lower than our actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced. Cost goods sold – idle capacity is not a measure that is recognized under GAAP and should not be considered as an alternative to cost of goods sold, which is determined in accordance with GAAP, and should not be used alone as an indicator of operating performance in place of cost of goods sold.*

*Year ended December 31, 2015 Compared to Year ended December 31, 2014*

**Gross Sales**

Gross sales for all of Reeds products increased 3% to \$49,713,000 for the year ended December 31, 2015 from \$48,061,000 in the prior year.

Our total gross sales for beverages increased 3.4% led by Reeds branded beverages which increased 19%. All other beverage categories were flat or down due to the third quarter supply chain interruption. Specifically the Virgil brand decreased 5% and Kombucha decreased 12%. Private label brands were flat year over year.

The company continues to be a leader in portfolio offerings and beverage packaging design with multiple container volumes. To reflect this volume diversity, Reeds has adopted the industry standard of 8 ounce servings. In the rest of the document whenever case is referred to it is in eight ounce equivalents. In 2015, Reeds beverage 8oz. case volume, consisting of 8-ounce servings per case, increased 9.1% to 3.9M cases. Beverage case gross sales dollars decreased 5.2%. to \$12.90 per/case.

Gross sales of items such as candy, ingredients, packaging and mail order are not included in the discussion above. These items as a group totaled \$1,739,000 in gross sales, a decrease of \$433,000 or 20% over 2014. The decrease was the direct result of a California lawsuit that has required the Company to find alternative suppliers. The Company successfully engaged new suppliers in 2016.

**Promotional and other allowances**

Promotions and allowances for beverage products decreased 19% to \$3,765,000 (7.6% of gross sales) for the year ended December 31, 2015 from \$4,639,000 (9.7% of gross sales) in the prior year.

The promotional discounts decreased 20% or \$0.25/case to \$0.97/case from \$1.22/case in 2014. This decrease is primarily attributable to a decline in the promotional programs and discounts offered in the third quarter and fourth quarters of 2015 as our supply of products for sale decreased and we experienced a reduction in Kombucha related discounts throughout the year.

## Net Sales

Net sales of all items increased 5.8% or \$2,526,000 to \$45,948,000 for the year ended December 31, 2015 from \$43,422,000 in the prior year.

For beverage products, net sales by 8oz case equivalents increased in 2015 by 3.9% to \$11.93/case from \$11.46/case from the prior year.

## Cost of Goods Sold

Cost of goods sold consists of the costs of raw materials and packaging utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, inventory adjustments, as well as certain internal transfer costs. Cost of goods sold also consists of direct production costs in excess of charges allocated to our finished goods in production. Plant costs include labor costs, production supplies, and repairs and maintenance. Our charges for labor and overhead allocated to our finished goods are determined on a market cost basis, which is lower than our actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced.

Our total cost of goods sold increased to \$34,343,000 in the year ended December 31, 2015, an increase of approximately \$3,927,000 or 12.9% from 2014. The increase was due to net volume increases of 9.1%, and increases in cost of production. Specific production costs were: packaging cost increases of \$0.35/cs. and ingredient cost increases of \$0.25/cs. These increases were partially offset by labor productivity decreases of \$0.25/cs.

During the year, Reeds experienced supply chain interruptions. During 2015, direct write off of inventories increased \$518,000 or \$0.13/case over \$53,000 or \$0.01/case in 2014. Additionally, during 2015, the company adjusted the reserve for obsolescence by \$200,000 over 2014 or \$0.05/cs.



## **Gross Profit**

Our gross profit of \$11,605,000 in the year ended December 31, 2015 represents a decrease of \$1,401,000, or 10.8% from 2014. As a percentage of sales, our gross profit decreased to 25.3% in 2015 as compared to 30.0% in 2014. The gross profit percentage decrease is primarily driven by the direct write off of inventory and the increase in obsolescence reserve of \$644,000 that are included in the cost of production cost above.

## **Delivery and Handling Expenses**

Delivery and handling expenses consist of delivery costs to customers and warehouse costs incurred for handling our finished goods after production. Delivery and handling costs increased to \$5,100,000 in the year ended December 31, 2015 compared to \$4,478,000 in 2014. The \$622,000 (14%) increase is due to increased distance traveled with lower volumes per delivery due primarily to supply chain issues in the third quarter. Current rates of 9% are comparable to historic rates. The company expects costs to decrease further when the L.A. Brewery upgrade is complete.

## **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 for 2015 were \$4,867,000 or relatively flat when compared to \$4,838,000 in 2014.

During the year, the \$29,000 increase is the result of increases in utilization of sales consultants of \$139,000, stock option expenses of \$157,000, trade show participation of \$109,000 and \$87,000 in compensation related expenses. These increases were offset by a decrease in advertising costs of \$523,000 which included \$431,000 for a national cable television advertising campaign in the summer of 2014 and \$289,000 attributed to decreases in promotions of bonuses of \$77,000, promotional expenses of \$86,000, public relations of \$68,000 and broker's commissions of \$58,000.

Our sales staff decreased to 17 members at December 31, 2015, from 19 at December 31, 2014.

## **General and Administrative Expenses**

General and administrative expenses include executive, administrative, and finance personnel costs as well as professional fees. General and administrative expenses increased \$954,000 to \$4,368,000 in fiscal 2015 when compared to fiscal 2014 expenses of \$3,414,000.

This increase is due to an increase in wage related expenses of \$362,000, stock compensation of \$245,000, bad debt expense of \$156,000 and legal settlement costs of \$108,000. These increases were offset in part by decreases in professional fees and consultants' of \$128,000.

Our G & A staff increased to 16 members at December 31, 2015, from 12 at December 31, 2014 as two positions were reclassified from production and sales support to G & A staff and an additional two new positions were added.

### **Income (Loss) from Operations**

Loss from operations was \$2,730,000 in the year ended December 31, 2015, as compared to income from operations of \$276,000 in 2014. The increase in the operating loss is due to the supply chain production interruption, the resulting loss of sales and the attendant costs directly resulting from the production interruption of inventory waste and delivery expenses.

### **Interest Expense**

Interest expense increased to \$1,231,000 in the year ended December 31, 2015, compared to interest expense of \$1,028,000 in the same period of 2014. During 2015 the company incurred liquidity shortages that required a renegotiation with our bank PMC. A new loan was obtained for \$1,500,000 that also changed the terms of the existing line of credit and term loan. Later both term loan expiration dates were extended to April 1, 2017 that did not involve any further changes in the terms of all loans. As a direct consequence of the term change and the additional borrowing, the company's net interest charge increased.

**Modified EBITDA**

The Company defines modified EBITDA (a non-GAAP measurement) as net income (loss) before interest, taxes, depreciation and amortization, and non-cash share-based compensation expense. Other companies may calculate modified EBITDA differently. Management believes that the presentation of modified EBITDA provides a measure of performance that approximates cash flow before interest expense, and is meaningful to investors.

**MODIFIED EBITDA SCHEDULE**

	<b>Year ended December 31,</b>	
	<b>2015</b>	<b>2014</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
Net loss	\$(3,961,000)	\$(754,000 )
Modified EBITDA adjustments:		
Depreciation and amortization	933,000	755,000
Interest expense	1,231,000	1,028,000
Stock option and warrant compensation	877,000	396,000
Stock compensation for services	1,000	13,000
Taxes		2,000
Total EBITDA adjustments	3,042,000	2,194,000
Modified EBITDA income from operations	\$(919,000)	\$1,440,000

***Liquidity and Capital Resources***

As of December 31, 2015, we had stockholders equity of \$785,000 and working capital of \$730,000, compared to stockholders equity of \$3,652,000 and working capital of \$2,207,000 at December 31, 2014. The decrease in our working capital of \$1,477,000 was primarily a result of cash flow from operations.

Our increase in cash and cash equivalents to \$1,816,000 at December 31, 2015 compared to \$959,000 at December 31, 2014, an increase of \$857,000 was primarily a result of cash generated by financing activities of \$2,737,000 less cash used for costs of plant improvements of \$532,000 and use of cash for operations of \$1,348,000.

On September 1, 2015 Reed's Inc. (the "Company") entered into an additional Term Loan (Term Loan B) with a principal balance of \$1,500,000 at prime plus 11.60% (currently 14.85%) with PMC Financial Services Group, LLC.

Concurrently, the conditions for a rate change involving Term Loan A of \$1,500,000 from December 5, 2014 have been modified. The payment terms have not been modified. Under the new conditions, the rate charge will be calculated on a sliding scale based on the trailing 6 month EBITDA. If the EBITDA measuring point stays below \$1,000,000 where it was at the time of financing, the rate would rise to 12% from the current rate of 9%. If EBITDA rises to \$1,500,000 then the rate will remain at 9%.

Notwithstanding the other borrowing terms above, if Excess Borrowing Availability under the \$6 million Revolving working capital loan remains more than \$1,500,000 at all times during the preceding month (currently Reed's Borrowing Availability is zero) the Interest Rate shall remain unchanged for the asset based lending that includes the Revolving working capital loan, CAPEX capital improvement loan and Term Loan A. The six month Term Loan B rates are to remain the same at 14.85%.

In order to accumulate cash for the LA plant upgrade, on November 9, 2015, the company granted PMC 125,000 warrants to extend the expiration dates of both Term Loans to April 1, 2017. The warrant value of \$141,000 was calculated using the Black-Scholes method using the following values: stock price \$4.99, exercise price \$4.50, volatility rate of 56% and a term 5.5 years.

For the year ended December 31, 2015, the Company recorded a net loss of \$3,961,000 and utilized cash in operations of \$1,348,000. During 2015, the company experienced a major disruption in our east coast production facilities. By October of 2015, the Company had qualified another two co-packers for a total of three co-packers enabling the Company to avoid supply chain interruptions in 2016. We believe that if this disruption had not occurred, the Company would have been able to fill purchase orders and avoid the additional costs related to delivery and raw materials.

We estimate the Company currently has sufficient cash and liquidity to meet its anticipated working capital for the next twelve months. The Company's secured working capital facility will expire in December 2016, which we believe will be renewed or can be replaced. The Company has no other debt that becomes due until the second quarter of 2017. The Company believes it can successfully restructure its debt before that time, if necessary.

We believe that the Company currently has the necessary working capital to support existing operations for at least the next 12 months. Our primary capital source will be positive cash flow from operations. If our sales goals do not materialize as planned, we believe that the Company can reduce its operating costs and can be managed to maintain positive cash flow from 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.

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 may 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 would decline and there would be a material adverse effect on our financial condition.

If we 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. 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.

## Critical Accounting Policies and Estimates

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 risk of loss transfers to our customers, and collection of the receivable is reasonably assured, which generally occurs when the product is shipped. 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 reimburses its wholesalers and retailers for promotional discounts, samples and certain advertising and promotional activities used in the promotion of the Company's products. The accounting treatment for the reimbursements for samples and discounts to wholesalers results in a reduction in the net revenue line item. Reimbursements to wholesalers and retailers for certain advertising activities are included in selling and marketing expenses.

*Long-Lived Assets.* Management assesses the carrying value of property and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If there is indication of impairment, management prepares an estimate of future cash flows 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. For the years ended December 31, 2015 and 2014, the Company did not recognize any impairments for its property and equipment.

Intangible assets are comprised of indefinite-lived brand names acquired and have been assigned an indefinite life as we currently anticipate that these brand names will contribute cash flows to the Company perpetually. These indefinite-lived intangible assets are not amortized, but are assessed for impairment annually and evaluated annually to determine whether the indefinite useful life is appropriate. As part of our impairment test, we first assess qualitative factors to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. If further testing is necessary, we compare the estimated fair value of our indefinite-lived intangible asset with its book value. If the carrying amount of the indefinite-lived intangible asset exceeds its fair value, as determined by its discounted cash flows, an impairment loss is recognized in an amount equal to that excess. For the years ended December 31, 2015 and 2014, the Company did not recognize any impairment charges for its indefinite-lived intangible assets.

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.* 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 (FASB) whereas the value of the award is measured on the date of grant and recognized as compensation on the straight-line basis over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the FASB 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. Options granted to non-employees are revalued each reporting period to determine the amount to be recorded as an expense in the respective period. As the options vest, they are valued on each vesting date and an adjustment is recorded for the difference between the value already recorded and the then current value on the date of vesting. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company's stock option and warrant grants are estimated using the Black-Scholes-Merton Option Pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the stock options or warrants, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes Option Pricing model, and based on actual experience. The assumptions used in the Black-Scholes-Merton Option Pricing model could materially affect compensation expense recorded in future periods.



We believe there have been no significant changes, during the year ended December 31, 2015, to the items disclosed as critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

### **Recent Accounting Pronouncements**

See Note 2 of the financial statements for a discussion of recent accounting pronouncements.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

As a smaller reporting company, Reed's is not required to provide the information required by this Item 7A.

**Item 8. Financial Statements**

<u>Report of Independent Registered Public Accounting Firm</u>	F-1
Financial Statements:	
<u>Balance Sheets as of December 31, 2015 and December 31, 2014</u>	F-2
<u>Statements of Operations for the years ended December 31, 2015 and 2014</u>	F-3
<u>Statements of Changes in Stockholders' Equity for the years ended December 31, 2015 and 2014</u>	F-4
<u>Statements of Cash Flows for the years ended December 31, 2015 and 2014</u>	F-5
<u>Notes to Financial Statements for the years ended December 31, 2015 and 2014</u>	F-6

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

Reed's, Inc.

We have audited the accompanying balance sheets of Reed's, Inc. as of December 31, 2015 and 2014, 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 audit 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 audit 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, 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, 2015 and 2014, 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.*

Los Angeles, California  
March 23, 2016

F-1

**REED'S INC.****BALANCE SHEETS**

	December 31, 2015	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash	\$ 1,816,000	\$ 959,000
Inventory, net of reserves of \$290,000 and \$90,000, respectively	7,927,000	6,306,000
Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of \$356,000 and \$253,000, respectively	2,894,000	2,500,000
Prepaid inventory	47,000	1,287,000
Prepaid and other current assets	769,000	447,000
Total Current Assets	13,453,000	11,499,000
Property and equipment, net of accumulated depreciation of \$4,216,000 and \$3,405,000, respectively	5,369,000	4,572,000
Brand names	1,029,000	1,029,000
Total assets	\$ 19,851,000	\$ 17,100,000
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 7,458,000	\$ 5,894,000
Accrued expenses	168,000	130,000
Line of credit	4,443,000	3,009,000
Current portion of long term financing obligation	160,000	134,000
Current portion of capital leases payable	153,000	125,000
Term loans	341,000	-
Total current liabilities	12,723,000	9,292,000
Long term financing obligation, less current portion, net of discount of \$935,000 and \$1,031,000, respectively	1,443,000	1,508,000
Capital leases payable, less current portion	490,000	476,000
Capital Expansion Loan	1,542,000	672,000
Term loan, less current portion, net of discount of \$132,000 and \$0, respectively	2,868,000	1,500,000
Total Liabilities	19,066,000	13,448,000
Commitments and contingencies		
Stockholders' equity:		
Series A Convertible Preferred stock, \$10 par value, 500,000 shares authorized, 9,411 and 9,411 shares issued and outstanding, respectively	94,000	94,000
Common stock, \$.0001 par value, 19,500,000 shares authorized, 13,160,860 and 13,068,058 shares issued and outstanding, respectively	1,000	1,000
Additional paid in capital	27,399,000	26,300,000

Accumulated deficit	(26,709,000)	(22,743,000)
Total stockholders' equity	785,000	3,652,000
Total liabilities and stockholders' equity	\$19,851,000	\$17,100,000

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, 2015 and 2014**

	2015	2014
Sales, net	\$45,948,000	\$43,422,000
Cost of goods sold	34,343,000	30,416,000
Gross profit	11,605,000	13,006,000
Operating expenses:		
Delivery and handling expenses	5,100,000	4,478,000
Selling and marketing expenses	4,867,000	4,838,000
General and administrative expenses	4,368,000	3,414,000
Total operating expenses	14,335,000	12,730,000
Income (Loss) from operations	(2,730,000 )	276,000
Interest expense	(1,231,000 )	(1,028,000 )
Loss before provision for income taxes	(3,961,000 )	(752,000 )
Income taxes	-	(2,000 )
Net loss	(3,961,000 )	(754,000 )
Preferred stock dividend	(5,000 )	(5,000 )
Net loss attributable to common stockholders	\$(3,966,000 )	\$(759,000 )
Loss per share attributable to common stockholders - basic and diluted	\$(0.30 )	\$(0.06 )
Weighted average number of shares outstanding - basic and diluted	13,147,815	13,043,927

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, 2015 and 2014**

	Common Stock		Series A Preferred Stock		Additional Paid In Capital	Accumulated Deficit	Total Shareholder Equity
	Shares	Amount	Shares	Amount			
Balance, January 1, 2013	\$ 12,922,832	\$ 1,000	\$ 9,411	\$ 94,000	\$ 25,276,000	\$(21,984,000)	\$ 3,387,000
Fair Value of common stock issued for services	2,807	-	-	-	13,000		13,000
Exercise of stock options	141,362	-	-	-	26,000		26,000
Fair value of warrants granted as valuation discount	-	-	-	-	584,000		584,000
Fair value vesting of options issued to employees	-	-	-	-	396,000		396,000
Series A preferred stock dividend	1,057	-	-	-	5,000	(5,000)	-
Net Loss						(754,000)	(754,000)
Balance, December 31, 2014	\$ 13,068,058	\$ 1,000	\$ 9,411	\$ 94,000	\$ 26,300,000	\$(22,743,000)	\$ 3,652,000
Fair Value of common stock issued for services	247				1,000		1,000
Exercise of stock options	57,112						
Exercise of stock warrants	34,692				75,000		75,000
Fair value of warrants granted as valuation discount					141,000		141,000
Fair value vesting of options issued to employees					877,000		877,000
Series A preferred stock dividend	751				5,000	(5,000)	-
Net Loss						(3,961,000)	(3,961,000)
Balance, December 31, 2015	\$ 13,160,860	\$ 1,000	\$ 9,411	\$ 94,000	\$ 27,399,000	\$(26,709,000)	\$ 785,000

The accompanying notes are an integral part of these financial statements

**REED'S, INC.****STATEMENTS OF CASH FLOWS****For the Years Ended December 31, 2015 and 2014**

	2015	2014
Cash flows from operating activities:		
Net loss	\$(3,961,000)	\$(754,000 )
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	933,000	755,000
Fair value vesting of stock options issued to employees	877,000	396,000
Fair value of common stock issued for services	1,000	13,000
(Decrease) increase in allowance for doubtful accounts	103,000	71,000
Changes in operating assets and liabilities:		
Accounts receivable	(497,000 )	(428,000 )
Inventory	(1,621,000)	(13,000 )
Prepaid inventory	1,240,000	(1,031,000)
Prepaid expenses and other current assets	(25,000 )	(269,000 )
Accounts payable	1,564,000	2,282,000
Accrued expenses	38,000	(6,000 )
Net cash provided by (used in) operating activities	(1,348,000)	1,016,000
Cash flows from investing activities:		
Purchase of property and equipment	(532,000 )	(330,000 )
Net cash used in investing activities	(532,000 )	(330,000 )
Cash flows from financing activities:		
Proceeds from stock option and warrant exercises	75,000	26,000
Payments for deferred financing fees	-	(7,000 )
Principal repayments on note term loan	-	(150,000 )
Borrowing on term loan	1,500,000	1,003,000
Principal repayments on long term financing obligation	(134,000 )	(111,000 )
Principal repayments on capital lease obligation	(138,000 )	(77,000 )
Net borrowings (repayments) on existing line of credit	1,434,000	(1,515,000)
Net cash provided by (used in) financing activities	2,737,000	(831,000 )
Net (decrease) in cash	857,000	(145,000 )
Cash at beginning of year	959,000	1,104,000
Cash at end of year	\$1,816,000	\$959,000
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the year for:		
Interest	\$1,187,000	\$693,000
Taxes	\$-	\$2,000
Non Cash Investing and Financing Activities		
Series B preferred stock dividend payable in common stock	\$5,000	\$5,000
Property and equipment acquired through capital lease obligation	\$179,000	\$493,000
Fair value of warrants granted as valuation discount	\$141,000	\$584,000



Edgar Filing: REED'S, INC. - Form 10-K

Property and Equipment acquired through Capital Expansion loan	\$915,000	\$672,000
Other current assets acquired through Capital Expansion loan	\$297,000	\$-

The accompanying notes are an integral part of these financial statements

F-5

**REED'S, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014**

**(1) Operations and Liquidity**

*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. We currently manufacture, market and sell seven unique product lines:

Reed's Ginger Brews,

Virgil's Root Beer, Cream Sodas, Dr. Better and Real Cola, including ZERO diet sodas,

Culture Club Kombucha,

China Colas,

Reed's Ginger candy and ice creams,

Sonoma Sparkler and other juice based products.

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

*B) Cash and Liquidity*

The accompanying financial statements have been prepared under the assumption that the Company will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. For the year ended December 31, 2015, the Company recorded a net loss of \$3,961,000 and

utilized cash in operations of \$1,348,000. During 2015, the company experienced a major disruption in our east coast production facilities. By October of 2015, the Company had qualified another two co-packers for a total of three co-packers enabling the Company to avoid supply chain interruptions in 2016. We believe that if this disruption had not occurred, the Company would have been able to fill purchase orders and avoid the additional costs related to delivery and raw materials.

We estimate the Company currently has sufficient cash and liquidity to meet its anticipated working capital for the next twelve months. The Company's secured working capital facility will expire in December 2016, which we believe will be renewed or can be replaced. The Company has no other debt that becomes due until the second quarter of 2017. The Company believes it can successfully restructure its debt before that time, if necessary.

Historically, we have financed our operations primarily through private sales of common stock, preferred stock, a line of credit from a financial institution and cash generated from operations. We anticipate that our primary capital source will be positive cash flow from operations. If our sales goals do not materialize as planned, we believe that the Company can reduce its operating costs and achieve positive cash flow from operations. However, 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 may have insufficient working capital to maintain our operations as we presently intend to conduct them or to fund our expansion, marketing, and product development plans.. There can be no assurance that we will be able to obtain such financing on acceptable terms, or at all.

## **(2) Significant Accounting Policies**

### ***A) 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. Those estimates and assumptions include estimates for reserves of uncollectible accounts, inventory obsolescence, depreciable lives of property and equipment, analysis of impairments of recorded intangibles, accruals for potential liabilities and assumptions made in valuing stock instruments issued for services.

### ***B) 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 reducing the carrying value of receivables. At December 31, 2015 and 2014, the allowance for doubtful accounts and returns and discounts was approximately \$356,000 and \$253,000, respectively.

### ***C) 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.

***D) Property and Equipment and Related Depreciation***

Property and equipment is stated at cost. Expenditures for major renewals and improvements that extend the useful lives of property and equipment or increase production capacity are capitalized, and expenditures for repairs and maintenance are charged to expense as incurred. 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

Management assesses the carrying value of property and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If there is indication of impairment, management prepares an estimate of future cash flows 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. For the years ended December 31, 2015 and 2014, the Company did not recognize any impairment for its property and equipment.

***E) Intangible Assets and Impairment Policy***

Intangible assets are comprised of indefinite-lived brand names acquired and have been assigned an indefinite life as we currently anticipate that these brand names will contribute cash flows to the Company perpetually. These indefinite-lived intangible assets are not amortized, but are assessed for impairment annually and evaluated annually to determine whether the indefinite useful life is appropriate. As part of our impairment test, we first assess qualitative factors to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. If further testing is necessary, we compare the estimated fair value of our indefinite-lived intangible asset with its book value. If the carrying amount of the indefinite-lived intangible asset exceeds its fair value, as determined by its discounted cash flows, an impairment loss is recognized in an amount equal to that excess. For the years ended December 31, 2015 and 2014, the Company did not recognize any impairment charges for its indefinite-lived intangible assets.

***F) 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, 2015. 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, 2015 and 2014.

During the year ended December 31, 2015, the Company had two customers who accounted for approximately 28% and 14% of its sales, respectively; and during the year ended December 31, 2014, the Company had two customers who accounted for approximately 33% and 14% of its sales, respectively. No other customer accounted for more than 10% of sales in either year. As of December 31, 2015 the Company had accounts receivable due from two customers who comprised \$782,000 (24%) and \$373,000 (12%) of its total accounts receivable; and as of December 31, 2014 the Company had accounts receivable due from two customers who comprised \$630,000 (25%) and \$255,000 (10%), respectively, of its total accounts receivable.

At the beginning of the fiscal year 2015, the Company relied on a single east coast co-pack contract packer for a majority of its production and bottling of beverage products. By year end, the Company had multiple co-packers available for their production needs. 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.

During the years ended December 31, 2015 and 2014, the Company had one vendor which accounted for approximately 25% and 27%, respectively of purchases. At December 31, 2015 and 2014, the Company had accounts payable due to a vendor who comprised 14% and 32% of its total accounts payable, respectively. No other account was in excess of 10% of the balance of accounts payable as of December 31, 2015 and December 31, 2014.

***G) 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 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 carrying amounts of financial assets and liabilities, such as cash and cash equivalents, accounts receivable, short-term bank loans, accounts payable, notes payable and other payables, approximate their fair values because of the short maturity of these instruments. The carrying values of capital lease obligations and long-term financing obligations approximate their fair values due to the fact that the interest rates on these obligations are based on prevailing market interest rates.

***H) Cost of sales***

Cost of goods sold is comprised of the costs of raw materials and packaging utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, as well as certain internal transfer costs. Additionally, cost of goods sold consists of direct production costs in excess of charges allocated to finished goods in production. Plant costs include labor costs, production supplies, repairs and maintenance, direct inventory write-off charges and adjustments to the inventory reserve. Charges for labor and overhead allocated to finished goods are determined on a market cost basis, which may be lower than the actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced. Expenses not related to the production of our products are classified as operating expenses.

***I) Delivery and Handling Expenses***

Shipping and handling costs are comprised of purchasing and receiving costs, inspection costs, warehousing costs, transfer freight costs, and other costs associated with product distribution after manufacture and are included as part of operating expenses.

***J) Income Taxes***

The Company uses an asset and liability approach for financial accounting and reporting for income taxes that allows recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain. The Company's policy is to recognize interest and/or penalties related to income tax matters in income tax expense.

***K) Revenue Recognition***

Revenue is recognized on the sale of a product when the risk of loss transfers to our customers, and collection of the receivable is reasonably assured, which generally occurs when the product is shipped. 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 for customers, including slotting fees, as a reduction of gross sales. These sales incentives for the years ended December 31, 2015 and 2014 were approximately \$3,765,000 and \$4,199,000, 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 if their effect is antidilutive.

For the years ended December 31, 2015 and 2014, 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,	
	2015	2014
Warrants	341,261	301,963
Series A Preferred Stock	37,644	37,644
Options	980,000	705,333
Total	1,358,905	1,044,940

***M) Advertising Costs***

Advertising costs are expensed as incurred and are included in selling expense in the amount of \$105,000 and \$649,000, for the years ended December 31, 2015 and 2014, respectively. The company spent \$431,000 in 2014 for national cable television advertising.

***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 (FASB) whereas the value of the award is measured on the date of grant and recognized as compensation expense on the straight-line basis over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the FASB 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. Options granted to non-employees are revalued each reporting period to determine the amount to be recorded as an expense in the respective period. As the options vest, they are valued on each vesting date and an adjustment is recorded for the difference between the value already recorded and the then current value on the date of vesting. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company's stock option and warrant grants are estimated using the Black-Scholes-Merton Option Pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the stock options or warrants, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes-Merton Option Pricing model, and based on actual experience. The assumptions used in the Black-Scholes-Merton Option Pricing model could materially affect compensation expense recorded in future periods.

***O) Reclassification***

In presenting the Company's statement of operations for the year ended December 31, 2014, the Company previously included \$235,000 of banking fees as general and administrative expenses. In presenting the Company's statement of operations for the years ended December 31, 2015 and 2014, the Company has reclassified these expenses to interest expense.

***P) Recent Accounting Pronouncements***

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09 (ASU 2014-09), Revenue from Contracts with Customers. ASU 2014-09 will eliminate transaction- and industry-specific revenue recognition guidance under current U.S. GAAP and replace it with a principle based approach for determining revenue recognition. On August 12, 2015, FASB delayed the required implementation to fiscal years ending after December 15, 2017 but now permitted organizations such as Reeds to adopt earlier. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. The ASU also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. Management has determined to adopt ASU 2014-09 in Fiscal 2017 and has not determined the effect of the standard on our ongoing financial reporting.

F-10

In June 2014, the FASB issued Accounting Standards Update No. 2014-12, *Compensation – Stock Compensation*. The pronouncement was issued to clarify the accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. The pronouncement is effective for reporting periods beginning after December 15, 2015. The adoption of ASU 2014-12 will not have a significant impact on the Company's consolidated financial position or results of operations.

In February 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-02, *Leases*. ASU 2016-02 requires a lessee to record a right of use asset and a corresponding lease liability on the balance sheet for all leases with terms longer than 12 months. ASU 2016-02 is effective for all interim and annual reporting periods beginning after December 15, 2018. Early adoption is permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is in the process of evaluating the impact of ASU 2016-02 on the Company's financial statements and disclosures.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15 (ASU 2014-15), *Presentation of Financial Statements - Going Concern (Subtopic 205-10)*. ASU 2014-15 provides guidance as to management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued when applicable). Substantial doubt about an entity's ability to continue as a going concern exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued). ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company will adopt ASU 2014-15 on the Company's financial statement presentation and disclosures beginning in 2016.

Other recent accounting pronouncements issued by the FASB, including its Emerging Issues Task Force, the American Institute of Certified Public Accountants, and the Securities and Exchange Commission did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

### **(3) Inventory**

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

Edgar Filing: REED'S, INC. - Form 10-K

	December 31, 2015	December 31, 2014
Raw Materials and Packaging	\$4,364,000	\$3,395,000
Finished Goods	3,563,000	2,911,000
	\$7,927,000	\$6,306,000

F-11

In 2014, the Company prepaid for glass raw materials for \$1,287,000 that was used in 2015 resulting in a balance of \$47,000 for prepaid inventory of as of December 31, 2015. The Company also increased its reserve for obsolescence for the year ended December 31, 2015 by \$200,000 to \$290,000 from \$90,000, respectively.

#### **(4) Property and Equipment**

Property and equipment is comprised of the following as of:

	December 31, 2015	December 31, 2014
Land	\$1,107,000	\$1,108,000
Building	1,875,000	1,868,000
Vehicles	500,000	338,000
Machinery and equipment	3,800,000	3,312,000
Equipment under capital leases	857,000	903,000
Office equipment	469,000	448,000
Construction In Progress	977,000	
	9,585,000	7,977,000
Accumulated depreciation	(4,216,000)	(3,405,000)
	\$5,369,000	\$4,572,000

Depreciation expense for the years ended December 31, 2015 and 2014 was \$828,000 and \$609,000, respectively.

Accumulated depreciation on equipment held under capital leases was \$461,000 and \$326,000 as of December 31, 2015 and 2014, respectively. (See note 8).

#### **(5) Intangible Assets**

##### ***Brand Names***

Brand names consist of the following three trademarks for natural beverage as of December 31, 2015 and 2014:

Virgil's	\$576,000
----------	-----------

Edgar Filing: REED'S, INC. - Form 10-K

China Cola	224,000
Sonoma Sparkler	229,000