REEDS INC
Form 10QSB
November 14, 2007

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

FORM 10-QSB

(Mark One)
x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____
Commission file number

Commission file number: 001-32501

REED'S INC.
(Exact name of registrant as specified in its charter)

Delaware	35-2177773
(State of incorporation)	(I.R.S. Employer Identification No.)

13000 South Spring St. Los Angeles, California. 90061
(Address of principal executive offices) (Zip Code)

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

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

There were 8,749,721 shares of the registrant's common stock outstanding as of November 13, 2007.

Transitional Small Business Disclosure Format (Check one) Yes o No x

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Part I - Financial Information
Item 1. Financial Statements

REED'S, INC.
CONDENSED BALANCE SHEETS

	September 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
CURRENT ASSETS		
Cash	$ 2,399,060	$ 1,638,917
Restricted cash	-	1,580,456
Inventory	3,292,720	1,511,230
Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of $188,000 as of September 30, 2007 and $173,253 as of December 31, 2006	1,932,118	1,183,763
Note Receivable	300,000	-
Other receivables	145,172	24,811
Prepaid Expenses	82,082	164,462
Total Current Assets	8,151,152	6,103,639
Property and equipment, net of accumulated depreciation of $807,140 as of September 30, 2007 and $663,251 as of December 31, 2006	4,197,439	1,795,163
OTHER ASSETS		
Brand names	800,201	800,201
Other intangibles, net of accumulated amortization of $5,026 as of September 30, 2007 and $4,467 as of December 31, 2006	13,588	14,146
Total Other Assets	813,789	814,347
TOTAL ASSETS	**$ 13,162,380**	$ 8,713,149
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 2,302,684	$ 1,695,014
Lines of credit	-	1,355,526
Current portion of long term debt	26,537	71,860
Accrued interest	3,798	27,998
Accrued expenses	216,180	118,301
Total Current Liabilities	2,549,199	3,268,699
Long term debt, less current portion	775,574	821,362
Total Liabilities	3,324,773	4,090,061
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		

Preferred stock, $10 par value, 500,000 shares authorized, 49,121 shares outstanding at September 30, 2007 and 58,940 shares at December 31, 2006		491,212		589,402
Common stock, $.0001 par value, 11,500,000 shares authorized, 8,746,721 shares issued and outstanding at September 30, 2007 and 7,143,185 at December 31, 2006		874		714
Additional paid in capital		17,582,385		9,535,114
Accumulated deficit		(8,236,864)		(5,502,142)
Total stockholders' equity		9,837,607		4,623,088
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	13,162,380	$	8,713,149

See accompanying Notes to Condensed Financial Statements

REED'S, INC.
CONDENSED STATEMENTS OF OPERATIONS
For the Three and Nine months Ended September 30, 2007 and 2006
(Unaudited)

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
SALES	$ 3,881,328	$ 2,775,955	$ 10,366,378	$ 7,913,045
COST OF SALES	3,083,055	2,138,602	8,348,055	6,417,343
GROSS PROFIT	798,273	637,353	2,018,323	1,495,702
OPERATING EXPENSES				
Selling	1,606,938	407,074	3,049,207	1,007,693
General and Administrative	711,785	519,045	1,611,276	1,535,255
Total Operating Expenses	2,318,723	926,119	4,660,483	2,542,948
LOSS FROM OPERATIONS	(1,520,450)	(288,766)	(2,642,160)	(1,047,246)
OTHER INCOME (EXPENSE)				
Interest Income	45,898	—	98,498	—
Interest Expense	(51,407)	(112,197)	(163,290)	(310,551)
Total Other Income (Expense)	(5,509)	(112,197)	(64,792)	(310,551)
NET LOSS	(1,525,959)	(400,963)	(2,706,952)	(1,357,797)
Preferred stock dividend	—	—	(27,770)	(29,470)
Net loss attributable to common shareholders	$ (1,525,959)	$ (400,963)	$ (2,734,722)	$ (1,387,267)
LOSS PER SHARE- Available to Common Stockholders Basic and Diluted	$ (0.18)	$ (0.08)	$ (0.35)	$ (0.26)
WEIGHTED AVERAGE SHARES OUTSTANDING, BASIC AND DILUTED	8,714,050	5,335,482	7,759,425	5,269,878

See accompanying Notes to Condensed Financial Statements

REED'S INC.
STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
For the nine months ended September 30, 2007 (Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Preferred Stock Shares	Preferred Stock Amount	Accumulated Deficit	Total
Balance, January 1, 2007	7,143,185	$ 714	$ 9,535,114	58,940	$ 589,402	$ (5,502,142)	$ 4,623,088
Fair Value of Common stock issued for services	440	-	3,783	—	—	—	3,783
Preferred Stock Dividend	3,820	1	27,769	-	—	(27,770)	—
Preferred stock conversion	39,276	3	98,187	(9,819)	(98,190)	—	—
Exercise of Warrants	60,000	6	164,994	—	—	—	165,000
Common stock issued for cash, net of offering costs	1,500,000	150	7,626,392	—	—	—	7,626,392
Public offering expenses	—	—	(45,000)	—	—	—	(45,000)
Fair value of vested options issued to employees	—	—	171,296	—	—	—	171,296
Net Loss for the nine months ended September 30, 2007	—	—	—	—	—	(2,706,952)	(2,706,952)
Balance, September 30, 2007	8,746,721	$ 874	$ 17,582,385	49,121	$ 491,212	$ (8,236,864)	$ 9,837,607

See accompanying Notes to Condensed Financial Statements

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REED'S INC.
CONDENSED STATEMENTS OF CASH FLOWS
For the nine months ended September 30, 2007 and 2006 (Unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	$ (2,706,952)	$ (1,357,797)
Adjustments to reconcile net loss to net cash used in operating activities:		
Compensation expense from stock issuance	3,783	—
Fair value of stock options issued to employees	171,296	—
Depreciation and amortization	144,445	102,252
Changes in operating assets and liabilities:		
Accounts receivable	(748,355)	(600,154)
Inventory	(1,781,490)	(335,291)
Prepaid Expenses	82,380	(420)
Other receivables	(120,361)	5,331
Accounts payable	607,670	989,310
Accrued expenses	97,879	16,966
Accrued interest	(24,200)	23,821
Net cash used in operating activities	(4,273,905)	(1,155,982)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in Note Receivable	(300,000)	—
Purchase of property and equipment	(2,546,165)	(44,347)
Decrease in restricted cash	1,580,456	—
Net cash used in investing activities	(1,265,709)	(44,347)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds received from borrowings on long term debt	163,276	—
Principal payments on debt	(254,387)	(87,486)
Proceeds received on sale of common stock	9,000,000	1,002,779
Proceeds received from the exercise of warrants	165,000	—
Payments for stock offering costs	(1,418,606)	(237,287)
Net (payment) borrowing on lines of credit	(1,355,526)	571,883
Net cash provided by financing activities	6,299,757	1,249,889
NET INCREASE IN CASH	760,143	49,560
CASH — Beginning of period	1,638,917	27,744
CASH — End of period	$ 2,399,060	$ 77,304

See accompanying Notes to Condensed Financial Statements

REED'S INC.
CONDENSED STATEMENTS OF CASH FLOWS
(Continued)

For the nine months ended September 30, 2007 and 2006
(Unaudited)

	Nine Months Ended			
	September 30, 2007		September 30, 2006	
Supplemental Disclosures of Cash Flow Information				
Cash paid during the period for:				
Interest	$	187,490	$	286,731
Taxes	$	—	$	—
Noncash Investing and Financing Activities:				
Common stock to be issued in settlement of preferred stock dividend	$	27,770	$	29,470
Deferred stock offering costs charged to paid in capital	$	-	$	336,238
Preferred Stock converted to Common Stock	$	98,190	$	--

See accompanying Notes to Condensed Financial Statements

REED'S, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS
Nine months Ended September 30, 2007 and 2006 (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying interim condensed financial statements are unaudited, but in the opinion of management of Reeds, Inc. (the Company), contain all adjustments, which include normal recurring adjustments necessary to present fairly the financial position at September 30, 2007 and the results of operations and cash flows for the nine months ended September 30, 2007 and 2006. The balance sheet as of December 31, 2006 is derived from the Company's audited financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although management of the Company believes that the disclosures contained in these financial statements are adequate to make the information presented herein not misleading. For further information, refer to the financial statements and the notes thereto included in the Company's Annual Report, Form 10-KSB, as filed with the Securities and Exchange Commission on April 16, 2007.

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, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expense during the reporting period. Actual results could differ from those estimates.

The results of operations for the nine months ended September 30, 2007 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2007.

Income (Loss) per Common Share

Basic income (loss) per share is calculated by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the year. Diluted income per share is calculated assuming the issuance of common shares, if dilutive, resulting from the exercise of stock options and warrants. As the Company had a loss in the three and nine month periods ended September 30, 2007 and 2006, basic and diluted loss per share are the same because the inclusion of common share equivalents would be anti-dilutive. At September 30, 2007 and 2006, potentially dilutive securities consisted of convertible preferred stock, common stock options and warrants aggregating 2,612,220 and 1,276,159 common shares, respectively.

Adoption of New Accounting Policy

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes ("FIN 48") —an interpretation of FASB Statement No. 109, Accounting for Income Taxes." The Interpretation addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. At the date of adoption, and as of September 30, 2007, the Company does not have a liability for unrecognized tax

benefits.

The Company files income tax returns in the U.S. federal jurisdiction and various states. The Company is subject to U.S. federal or state income tax examinations by tax authorities for five years after 2002. During the periods open to examination, the Company has net operating loss and tax credit carry forwards for U.S. federal and state tax purposes that have attributes from closed periods. Since these NOLs and tax credit carry forwards may be utilized in future periods, they remain subject to examination.

The Company's policy is to record interest and penalties on uncertain tax provisions as income tax expense. As of September 30, 2007, the Company has no accrued interest or penalties related to uncertain tax positions.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. SFAS No. 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. SFAS No. 157 is effective for financial statements issued in fiscal years beginning after November 15, 2007 and to interim periods within those fiscal years. The adoption of this SFAS has not had a material change on the Company's results of operations, financial position, or cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB No. 115". This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective for years beginning after November 15, 2007. Management believes the adoption will not have a material impact on the Company's results of operations, financial position or cash flow.

Concentrations

The Company's cash balances on deposit with banks are guaranteed by the Federal Deposit Insurance Corporation up to $100,000. The Company may be exposed to risk for the amounts of funds held in one bank 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 $100,000 guarantee during the nine months ended September 30, 2007.

During the three months ended September 30, 2007 and 2006, the Company had two customers, which accounted for approximately 40% and 29% and 42% and 21% of sales, respectively. No other customers accounted for more than 10% of sales in either year.

During the nine months ended September 30, 2007 and 2006, the Company had two customers, which accounted for approximately 38% and 15% and 45% and 19% of sales, respectively. No other customers accounted for more than 10% of sales in either year. As of September 30, 2007, the Company had approximately $682,000 and $339,000, respectively, of accounts receivable from these customers.

2. Inventory

Inventory consists of the following at:

	September 30, 2007	December 31, 2006
Raw Materials	$ 1,289,813	$ 593,458
Finished Goods	2,002,907	917,772
	$ 3,292,720	$ 1,511,230

3. Long term debt

In February 2007, the Company originated a note payable with a bank in the amount of $130,000. The note matures in February 2008. The note requires 11 principal payments of $2,167 and one final payment in February 2008 of $106,674. The note carries a 5.50% interest rate and is secured by a certificate of deposit with the bank in the amount of $130,000. The bank may offset the certificate of deposit against the loan balance and the monies cannot be withdrawn until the loan is repaid in full. As of September 30, 2007, this loan had been paid in full and the certificate of deposit had been released of any restrictions.

In January and February 2007, the Company originated two car loans for $33,276. The loans have interest rates ranging from 8.85% to 9.4%. The loans have monthly payments of approximately $298 and $352 and mature in 2012 and 2013, respectively. As of September 30, 2007, these loans had been paid in full.

4. Stockholders' Equity

From May 25, 2007 through June 15, 2007, the Company completed a private placement to accredited investors only, on subscriptions for the sale of 1,500,000 shares of common stock and warrants to purchase up to 749,995 shares of common stock, resulting in an aggregate of $9,000,000 of gross proceeds to the Company. The Company sold the shares at a purchase price of $6.00 per share. The warrants issued in the private placement have a five-year term and an exercise price of $7.50 per share. We paid cash commissions of $900,000 to the placement agent for the private placement and issued warrants to the placement agent to purchase up to 150,000 shares of common stock with an exercise price of $6.60 per share. We also issued additional warrants to purchase up to 15,000 shares of common stock with an exercise price of $6.60 per share and paid an additional $60,000 in cash to the placement agent as an investment banking fee. Total proceeds received, net of underwriting commissions and the investment banking fee and excluding other expenses of the private placement, was $8,040,000.

From April 1, 2007 through June 30, 2007, the following additional activity occurred with respect to our stockholders' equity: 40,000 shares of common stock were issued from the exercise of 40,000 warrants and the Company received $105,000 upon their conversion; 3,400 shares of preferred stock were converted into 13,600 shares of common stock in accordance with the conversion privileges of certain preferred stockholders; 440 shares of common stock were issued to employees as a bonus; and 3,820 shares of common stock were issued in payment of the $27,770 preferred stock dividend payable June 30, 2007.

From July 1, 2007 through September 30, 2007, the following additional activity occurred with respect to our stockholders' equity: 20,000 shares of common stock were issued from the exercise of 20,000 warrants and the Company received $60,000 upon their conversion; and 6,419 shares of preferred stock were converted into 25,676 shares of common stock in accordance with the conversion privileges of certain preferred stockholders.

5. Stock Based Compensation

The impact on our results of operations of recording stock-based compensation for the three-month period ended September 30, 2007 and 2006 was to increase selling expenses by $103,376 and $0, respectively, and increase general and administrative expenses by $19,500 and $0, respectively.

The impact on our results of operations of recording stock-based compensation for the nine-month period ended September 30, 2007 and 2006 was to increase selling expenses by $145,296 and $0, respectively, and increase general and administrative expenses by $26,000 and $0, respectively. As of September 30, 2007, the Company has unvested options of 469,000, which will be reflected as compensation cost of approximately $1,902,826 over the remaining vesting period of five years.

We calculated the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used for the nine months ended September 30, 2007:

Risk-free interest rate	4.49%
Expected lives (in years)	5.00
Dividend yield	0%
Expected volatilty	70%

Expected volatility is based on the volatilities of public entities which are in the same industry as the Company. For purposes of determining the expected life of the option, the full contract life of the option is used. The risk-free rate for periods within the contractual life of the options is based on the U. S. Treasury yield in effect at the time of the grant.

The following table summarizes stock option activity for the nine months ended September 30, 2007:

	Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2007	363,500	$ 3.84	-	-
Granted	424,000	$ 7.52	-	-
Exercised	-	-	-	-
Forfeited	(40,000)	$ 3.50		
Outstanding at September 30, 2007	747,500	$ 5.95	3.94	$ 1,208,725
Exercisable at September 30, 2007	278,500	$ 3.79	2.76	$ 906,925

Stock options granted under our equity incentive plans vest over two and three years from the date of grant, ½ and 1/3 per year, respectively, and generally expire five years from the date of grant. The weighted average exercise price of stock options granted during the period was $7.52 per share and the related weighted average grant date fair value was $4.62 per share.

The Company calculated the fair value of each warrant award on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used for the nine months ended September 30, 2007:

Risk-free interest rate	5.10%
Expected lives (in years)	5
Dividend yield	0%
Expected volatilty	70%

Expected volatility is based on the volatilities of public entities which are in the same industry as the Company. For purposes of determining the expected life of the warrant, the full contract life of the warrant is used. The risk-free rate for periods within the contractual life of the options is based on the U. S. Treasury yield in effect at the time of the grant.

The following table summarizes warrant activity for the nine months ended September 30, 2007 :

	Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2007	813,241	$ 3.74	-	-
Issued	914,995	$ 7.34	-	-
Exercised	(60,000)	$ 2.75	-	-
Outstanding at September 30, 2007	1,668,236	$ 5.75	3.59	$ 2,508,902
Exercisable at September 30, 2007	1,468,236	$ 5.63	3.51	$ 2,418,902

The warrants granted in 2007 were granted in connection with our private placement, see note 4, and were fully vested at issuance on June 15, 2007 and expire in June 2012. The weighted average exercise price of the warrants was $7.34. The weighted average issue date fair value was $4.26 per warrant, resulting in an aggregate fair value of $3,091,779. The accounting affect of this is to both include and deduct the amount from additional paid in capital. All of the warrants issued to the investors, 749,995 warrants, include a call provision which the Company may exercise and will require the warrant holder, within 20 days written notice of the call provision being exercised by the Company, to exercise the warrants or have them expire. The Company may exercise its call provision anytime the Company's common stock closes at or above $10.00 per share for a period of 10 consecutive trading days.

5. Subsequent Event

In October 2007, pursuant to conversion of 500 shares of Series A Preferred stock, the Company issued 2,000 shares and paid a consultant 1,000 shares of its common stock for services rendered valued at $73,000. In October 2007, options to purchase 50,000 shares of common stock were issued to an employee at an exercise price of $7.30 per share.

Item 2. Management's Discussion and Analysis or Plan of Operation

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes appearing elsewhere in this 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 included in our Annual Report on Form 10-KSB for the year ended December 31, 2006.

Overview

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

- Reed's Ginger Brews,
- Virgil's Root Beer and Cream Sodas,
- China Colas,
- Reed's Ginger Juice Brews,
- Reed's Ginger Candies, and
- Reed's Ginger Ice Creams

We sell most of our products in specialty gourmet and natural food stores, supermarket chains, retail stores and restaurants in the United States and, to a lesser degree, in Canada. We primarily sell our products through a network of natural, gourmet and independent distributors. We also maintain an organization of in-house sales managers who work mainly in the stores serviced by our natural, gourmet and mainstream distributors and with our distributors. We also work with regional, independent sales representatives who maintain store and distributor relationships in a specified territory. In Southern California, we have our own direct distribution system.

The following table shows a breakdown of net sales with respect to our distribution channels for the fiscal years set forth in the table:

	Direct sales to large retailer accounts	% of total sales	Local direct distribution	% of total sales	Natural, gourmet and mainstream distributors	% of total	Total sales
2006	$ 1,853,439	18	$ 1,039,966	10	$ 7,590,948	72	$ 10,484,353
2005	1,536,896	16	751,999	8	7,181,390	76	9,470,285
2004	1,983,598	22	395,601	4	6,599,166	74	8,978,365

Historically, we have focused our marketing efforts on natural and gourmet food stores. More recently, we have expanded our marketing efforts to include more mainstream markets. These efforts included selling our products directly to:

- large retail accounts, such as Costco, BJ Wholesale, and Cost Plus World Markets, and
- the natural food section of mainstream national supermarket chains, such as Safeway, Kroger's, Ralph's and Albertsons.

In addition, we have introduced new products that include specialty beverage packaging options not typically available in the marketplace that have contributed to our growth in sales. These products include Virgil's Cream Soda in a 12 ounce bottle, 5-liter "party keg" version of our Virgil's Root Beer and Virgil's Cream Soda and 750 ml. size bottles of our Reed's Original Ginger Brew, Extra Ginger Brew and Spiced Apple Brew. In addition, in 2007, we launched Virgil's Black Cherry Cream Soda and diet versions of Virgil's Root Beer, Cream Soda and Black Cherry Cream Soda.

We gauge the financial success of our company using a number of different parameters. Because our industry typically values companies on a top-line basis, one of our main company goals is to increase net sales. Our net sales have increased each year during the period from 2002 to 2006, as follows:

	2002	2003	2004	2005	2006
Net sales	$ 6,400,000	$ 6,800,000	$ 9,000,000	$ 9,500,000	$ 10,500,000

For the nine months ended September 30, 2007, our sales increased approximately $2,453,000 over the comparable period of the prior year, from approximately $7,913,000 to approximately $10,366,000.

We believe that the increase in net sales over this period comes from two factors:

- increases in our core of national distribution to natural and gourmet food stores and mainstream supermarket chains, and increases in the mainstream distribution of our products. These include new distribution relationships in the following areas: Washington state, Oregon, New York, Massachusetts, New Hampshire, Connecticut, Pennsylvania, Ohio, Michigan, Minnesota and Colorado. We also are starting up a co branded marketing plan with these new distributors in these areas of the country. We hope to establish a sales force to cultivate and generate sales for these new distributorship relationships and other key geographic areas, as we identify them, by the end of 2008, and

- increases in our direct sales to large retailers.

Almost as important as increasing our net sales, is increasing our gross margin. We continue to work to reduce costs related to production of our products. However, while gross margins have increased, we have encountered difficulties in increasing our gross margins-due to certain factors, including:

- inefficiencies relating to the operation of the Brewery, our West Coast production facility, and

- higher freight, glass and production expenses due to the increase in the cost of fuel and increases in the price of ingredients in our products.

In 2002, we purchased and outfitted the Brewery, in part to help reduce both production costs and freight costs associated with our west coast sales. Gross margins decreased from 24.8% in 2002 to 19.5% in 2003 as a principal result of the start-up of the Brewery. Gross margins increased to 20.9% in 2004 as a principal result of attaining greater functionality and efficiencies in our operation of the Brewery by our own personnel and being able to produce and ship products in the western half of the United States from a west coast facility. However, in 2005, gross margins decreased to 18.2% as a principal result of increases in fuel prices, which put downward pressure on our margins due to increased freight expenses and increased glass and production costs, both of which are sensitive to fuel costs. In February 2006, we decided to raise our prices on the Ginger Brew line for the first time in 16 years. In 2006, gross margins recovered to 19.6% partially as a result of a price increase on our core Reed's Ginger Brew line and offset by increased pressure from more expensive production, ingredients and packaging expenses due to fuel related price increases. For the nine months ended September 30, 2007, our gross margins were 19.5% as compared to 18.9% for the nine months ended September 30, 2006.

Production costs are a significant portion of our “cost of goods” and a major factor in determining our gross margins. Greater production volumes increase our ability to negotiate more favorable production costs. We are attempting to negotiate production arrangements with third parties that may result in production costs savings, which, if successful, would improve our gross margins. In addition, our west coast Brewery facility is running at 50% of capacity. We have had difficulties with the flavor of our Ginger Brew products produced at the Brewery. As a result, we continue to supply our Ginger Brew products at the Brewery from our east coast co-packing facility, thereby causing us to incur increased freight and warehousing expenses on our products. Management is committed to selling a high quality, great tasting product and has elected to continue to sell certain of our Ginger Brew products produced from our east coast facility on the west coast, even though it negatively impacts our gross margins. We believe that increased production of our Virgil’s product line (non-Ginger Brew) has increased utilization of operating capacity at the Brewery. As we are able to more fully utilize the Brewery, we believe that we will experience improvements in gross margins due to freight and production savings. We are continuing to improve the Brewery’s operations and to work on the issue of our Ginger Brew product flavoring. In the nine months ended September 30, 2007, we expended approximately $195,000 for a conveyor system and pasteurizer to improve our packaging line and operations.

On December 12, 2006, we completed the sale of 2,000,000 shares of our common stock at an offering price of $4.00 per share in our initial public offering. The public offering resulted in gross proceeds of $8,000,000 to us. In connection with the public offering, we paid aggregate commissions, concessions and non-accountable expenses to the underwriters of $800,000, resulting in net proceeds of $7,200,000, excluding other expenses of the public offering. In addition, we agreed to issue, to the underwriters, warrants to purchase up to approximately an additional 200,000 shares of common stock at an exercise price of $6.60 per share (165% of the public offering price per share), at a purchase price of $0.001 per warrant. The underwriters’ warrants are exercisable for a period of five years commencing on the final closing date of the public offering. From August 3, 2005 through April 7, 2006, we had issued 333,156 shares of our common stock in connection with the public offering. We sold the balance of the 2,000,000 shares in connection with the public offering (1,666,844 shares) following October 11, 2006.

From May 25, 2007 through June 15, 2007, we completed a private placement to accredited investors only, on subscriptions for the sale of 1,500,000 shares of common stock and warrants to purchase up to 749,995 shares of common stock, resulting in an aggregate of $9,000,000 of gross proceeds to the Company. The Company sold the shares at a purchase price of $6.00 per share. The warrants issued in the private placement have a five-year term and an exercise price of $7.50 per share. We paid cash commissions of $900,000 to the placement agent for the private placement and issued warrants to the placement agent to purchase up to 150,000 shares of common stock with an exercise price of $6.60 per share. We also issued additional warrants to purchase up to 15,000 shares of common stock with an exercise price of $6.60 per share and paid an additional $60,000 in cash to the placement agent as an investment banking fee.

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

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

Fuel Prices - As oil prices continue to increase, our packaging, production and ingredient costs will continue to rise. We have attempted to offset the rising freight costs from fuel price increases by creatively negotiating rates and managing freight. We will continue to pursue alternative production, packaging and ingredient suppliers and options to help offset the affect of rising fuel prices on these expenses.

Low Carbohydrate Diets and Obesity - Our products are not geared for the low carbohydrate market. Consumer trends have reflected higher demand for lower carbohydrate products. Despite this trend, we achieved an increase in our sales growth in 2006. We monitor these trends closely and have recently launched diet versions of our Virgil’s Root Beer, Cream Soda and Black Cherry Cream Soda.

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

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

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

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

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

Cash Flow Requirements - Our growth will depend on the availability of additional capital infusions. We have a financial history of losses and are dependent on non-banking sources of capital, which tend to be more expensive and charge higher interest rates. In addition, our initial public offering, subsequent private placement and our outstanding options and warrants, while providing capital, also dilute the ownership of common stockholders. Any increase in costs of goods will further increase losses and will further tighten cash reserves.

Interest Rates - We use lines of credit as a source of capital and are negatively impacted as interest rates rise. Our use of lines of credit have been reduced with the capital raised from our initial public offering and subsequent private placement of common stock.

Critical Accounting Policies

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

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

Trademark License and Trademarks. Trademark license and trademarks primarily represent the costs we pay for exclusive ownership of the Reed's® registered trademark in connection with the manufacture, sale and distribution of beverages and water and non-beverage products. We also own the China Cola® and Virgil's® registered trademarks. In addition, we own a number of other trademarks in the United States, as well as in a number of countries around the world. We account for these items in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Under the provisions of SFAS No. 142, we do not amortize indefinite-lived trademark licenses and trademarks.

In accordance with SFAS No. 142, we evaluate our non-amortizing trademark license and trademarks quarterly for impairment. We measure impairment by the amount that the carrying value exceeds the estimated fair value of the trademark license and trademarks. The fair value is calculated by reviewing net sales of the various beverages and applying industry multiples. Based on our quarterly impairment analysis the estimated fair values of trademark license and trademarks exceeded the carrying value and no impairments were identified during the nine months ended September 30, 2007 or 2006.

Long-Lived Assets. Our management regularly reviews property, equipment and other long-lived assets, including identifiable amortizing intangibles, for possible impairment. This review occurs quarterly or more frequently if events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. If there is indication of impairment of property and equipment or amortizable intangible assets, then management prepares an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposition. If these cash flows are less than the carrying amount of the asset, an impairment loss is recognized to write down the asset to its estimated fair value. The fair value is estimated at the present value of the future cash flows discounted at a rate commensurate with management's estimates of the business risks. Quarterly, or earlier if there is indication of impairment of identified intangible assets not subject to amortization, management compares the estimated fair value with the carrying amount of the asset. An impairment loss is recognized to write down the intangible asset to its fair value if it is less than the carrying amount. Preparation of estimated expected future cash flows is inherently subjective and is based on management's best estimate of assumptions concerning expected future conditions. No impairments were identified during the nine months ended September 30, 2007 or 2006.

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 estimated impact on our future cash flows.

Advertising. We account for advertising production costs by expensing such production costs the first time the related advertising is run.

Accounts Receivable. We evaluate the collectibility 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.

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

Results of Operations

Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006

Net sales increased by $1,105,373 or 39.8%, from $2,775,955 in the three months ended September 30, 2006 to $3,881,328 in the three months ended September 30, 2007. The increase in sales was primarily due to an increase in sales of our Virgil's product line of Root Beer and Cream Soda and our Reed's Ginger Brew and Candy product lines.

Sales of our Virgil's product line increased by $809,000, or 82.3%, from approximately $983,000 to $1,792,000. We realized a 68.3% increase in sales for Virgil's Root Beer and a 119.7% increase in our Virgil's Cream Soda products. We released a line of our Virgil's diet sodas in 2007, resulting in approximately $76,000 of sales in the three months ended September 30, 2007. Virgil's diet Root Beer soda comprised approximately $43,000 of the sales of our diet Virgil's products. Of the increase in Virgil's products, sales of five liter kegs represented an increase of approximately $120,000, or 107.1%, from $112,000 in the three months ended September 30, 2006 to $232,000 in the three months ended September 30, 2007.

Sales of our Reed's Ginger Brew product line increased by 14.9%, or $226,000, from $1,513,000 in the three months ended September 30, 2006 to $1,739,000 in the three months ended September 30, 2007. We realized an increase in sales of our Reed's Ginger Brew and Spiced Apple products, including an increase of 10.4% increase in sales of our Original Ginger Brew, a 10.8% increase in sales of our Extra Ginger Brew and a 9.8% increase in sales of our Premium Ginger Brew. Our Reed's Cherry Ginger Brew, Raspberry Ginger Brew and Spiced Apple soda collectively realized a 28.1% increase of sales.

Candy sales increased by $69,000, or 43.1%, from $160,000 in the three months ended September 30, 2006 to $229,000 in the three months ended September 30, 2007. Ice cream sales in the three months ended September 30, 2007 were $39,000, and remained relatively constant from the same period in 2006, but represent less than 1% of our total sales.

The product mix for our two most significant product lines, Reed's Ginger Brews and Virgil's sodas, for the three months ended September 30, 2007 was 45% and 46%, respectively, of total sales. The product mix for our Reed's Ginger Brews and Virgil's sodas for the three months ended September 30, 2006 was 54% and 35%, respectively, of total sales.

Cost of sales increased by $944,453, or 44.2%, from $2,138,602 in the three months ended September 30, 2006 to $3,083,055 in the three months ended September 30, 2007. As a percentage of net sales, cost of sales increased from 77.0% in the three months ended September 30, 2006 to 79.4% in the three months ended September 30, 2007.

Gross profit increased by $160,920, or 25.2%, from $637,353 in the three months ended September 30, 2006 to $798,273 in the three months ended September 30, 2007. As a percentage of net sales, gross profit decreased from 23.0% in the three months ended September 30, 2006 to 20.6% in the three months ended September 30, 2007. Our product mix and reduced freight costs resulted in the improvement in margins. However, in July 2007, some of the favorable results to gross margin were partially offset by our main co-pack production facility's increase in prices. We are looking at alternative co-pack production plants to reduce production costs, our largest expense, and hope to reach arrangements with alternative co-pack facilities by the end of the first quarter of 2008.

Operating expenses increased by $1,392,604, or 150.4%, from $926,119, in the three months ended September 30, 2006 to $2,318,723 in the three months ended September 30, 2007. Operating expenses increased as a percentage of net sales from 33.4% in the three months ended September 30, 2006 to 59.7% in the three months ended September 30, 2007. The increase was primarily due to an increase in selling costs and general and administrative costs. Selling costs increased $1,199,864, or 294.8%, from $407,074 for three months ended September 30, 2006 to $1,606,938 for

the three months ended September 30, 2007. Our focus on increasing revenues and diversifying our customer base from a high concentration of natural food marketplace to more mainstream and mass-merchants has increased our selling costs. Sales salaries and commissions for the three months ended September 30, 2007 was $911,000, compared to $238,000 for the three months ended September 30, 2006, or an increase of $673,000, or 282.7%. This increase resulted from increases in salaries and benefits for new sales and sales support staff and the related non-recurring costs of their recruitment and non-cash costs of employee stock options. Promotion expenses increased $292,000, or 297.9%, from $98,000 in the three months ended September 30, 2006 to $390,000 for the three months ended September 30, 2007. The increase was mainly due to a tour to demonstrate and sell our products with various Costco stores during the summer months in 2007 in an effort to promote our brand and products to a wider audience of consumers. Selling expenses increased to $306,000 in the three months ended September 30, 2007, or by $232,000, 315%, from $74,000 in the three months ended September 30, 2006. This increase was mainly due to increased travel related costs to cultivate relationships with new and recently signed distributors and retailers in support of the strategy to expand our brand and channels. General and administrative costs increased $192,740, or 37.1%, from $519,045 in the three months ended September 30, 2006 to $711,785 for the three months ended September 30, 2007. The increase was due to increased legal and accounting expenses associated with being a public company and costs of additional support in the form of personnel and computer systems to support the new sales and production efforts. These increased costs also included non-cash costs of employee stock options. The increase would have been higher but for the one-time charge in 2006 of $291,000 related to a rescission offer in connection with our recent initial public offering.

Interest expense decreased by $60,790, or 54.2%, from $112,197 in the three months ended September 30, 2006 to $51,407 in the three months ended September 30, 2007. Interest income increased from $0 in the three months ended September 30, 2006 to $45,898 in the three months ended September 30, 2007. The decrease in interest expense was principally due to the reduction of certain outstanding loans in the fourth quarter of 2006. The increase in interest income and other income was due to interest earned from a higher cash balance in 2007 compared to the same period in 2006.

As a result of the foregoing, we experienced a net loss of $1,525,959 in the three months ended September 30, 2007 compared to a net loss of $400,963 in the three months ended September 30, 2006. Our net loss attributable to common stockholders was $(0.18) per share for the three months ended September 30, 2007 and $(0.08) per share for the three months ended September 30, 2006.

Nine months Ended September 30, 2007 Compared to nine months Ended September 30, 2006

Net sales increased by $2,453,333 or 31.0%, from $7,913,045 in the nine months ended September 30, 2006 to $10,366,378 in the nine months ended September 30, 2007. The increase in sales was primarily due to an increase in sales of our Virgil's product line of Root Beer and Cream Soda and our Reed's Ginger Brew and Candy product lines.

Sales of our Virgil's product line increased by 66.1% from $2,710,000 to $4,499,000. We realized a 62.4% increase in sales for Virgil's Root Beer and a 72.9% increase in our Virgil's Cream Soda products. We released a line of our Virgil's diet sodas in 2007, resulting in approximately $220,000 of sales for the nine months ending September 30, 2007. Virgil's diet Root Beer soda comprised approximately $77,000 of the sales of our diet Virgil's products. Of the increase in Virgil's products, sales of five liter kegs represented an increase of approximately $418,000, or 198.3%, from $211,000 in the nine months ended September 30, 2006 to $629,000 in the nine months ended September 30, 2007.

Sales of our Reed's Ginger Brew product line increased by 12.1% from $4,301,000 in the nine months ended September 30, 2006 to $4,820,000 in the nine months ended September 30, 2007. We realized an increase in sales of our Reed's Ginger Brew and Spiced Apple products, including an increase of 7.4% increase in sales of our Original Ginger Brew, a 11.8% increase in sales of our Extra Ginger Brew and a 7.9% increase in sales of our Premium Ginger Brew. Our Reed's Cherry Ginger Brew, Raspberry Ginger Brew and Spiced Apple soda collectively realized a 24.0% increase of sales.

Candy sales increased by $100,000, or 17.8%, from $563,000 in the nine months ended September 30, 2006 to $663,000 in the nine months ended September 30, 2007. Ice cream sales in the nine months ended September 30, 2007 were $105,000, and remained relatively constant from the same period in 2006, but represent less than 1% of our total sales.

The product mix for our two most significant product lines, Reed's Ginger Brews and Virgil's sodas, for the nine months ended September 30, 2007 was 46% and 43%, respectively, of total sales. The product mix for our Reed's Ginger Brews and Virgil's sodas for the three months ended September 30, 2006 was 54% and 34%, respectively, of total sales.

Cost of sales increased by $1,930,712, or 30.1%, from $6,417,343 in the nine months ended September 30, 2006 to $8,348,055 in the nine months ended September 30, 2007. As a percentage of net sales, cost of sales decreased from 81.1% in the nine months ended September 30, 2006 to 80.5% in the nine months ended September 30, 2007.

Gross profit increased by $522,621 or 34.9% from $1,495,702 in the nine months ended September 30, 2006 to $2,018,323 in the nine months ended September 30, 2007. As a percentage of net sales, gross profit increased from 18.9% in the nine months ended September 30, 2006 to 19.5% in the nine months ended September 30, 2007. Our product mix and reduced freight costs resulted in the improvement in margins. However, in July 2007, some of the favorable results to gross margin were partially offset by our main co-pack production facility's increase in prices. We are looking at alternative co-pack production plants to reduce production costs, our largest expense and hope to reach arrangements with alternative co-pack facilities by the end of the first quarter of 2008.

Operating expenses increased by $2,117,535 or 83.3% from $2,542,948, in the nine months ended September 30, 2006 to $4,660,483 in the nine months ended September 30, 2007. Operating expenses increased as a percentage of net sales from 32.1% in the nine months ended September 30, 2006 to 45.0% in the nine months ended September 30, 2007. The increase was primarily due to an increase in selling costs and general and administrative costs. Selling costs increased $2,041,514, or 202.6% from $1,007,693 for the nine months ended September 30, 2006 to $3,049,207 for the nine months ended September 30, 2007. Our focus on increasing revenues and diversifying our customer base to more mainstream and mass merchants has increased our selling costs. Sales salaries and commissions for the nine months ended September 30, 2007 were $1,751,000 compared to $640,000 for the nine months ended September 30, 2006, or an increase of $1,111,000 or 173.6%. This increase resulted from an increase in salaries and benefits for new sales and sales support staff and the non-recurring costs of their recruitment and non-cash costs of their employee stock options granted. Promotion expenses increased $552,000, or 303.3%, from $182,000 in the nine months ended September 30, 2006 to $734,000 for the nine months ended September 30, 2007. The increase was mainly due to a tour to demonstrate and sell our products with various Costco stores during the summer months in 2007 in an effort to promote our brand and products to a wider audience of consumers. Selling expenses increased to $480,000 in the nine months ended September 30, 2007 or by $292,000 or 155.3% from $188,000 in the nine months ended September 30, 2006. This increase was mainly due to increased travel related costs to cultivate relationships with new and recently signed distributors and retailers in support of the strategy to expand our brand and channels. General and administrative costs increased $76,021, or 5.0%, from $1,535,255 in the nine months ended September 30, 2006 to $1,611,276 for the nine months ended September 30, 2007. The increase was due to increased professional fees such as legal and accounting expenses associated with being a public company, additional support in the form of personnel and computer systems to support the new sales and production efforts. These costs also included the non-cash cost of employee stock options. The increase would have been higher but for the one-time charge in 2006 of $660,000 related to a rescission offer in connection with our recent initial public offering.

Interest expense decreased by $147,261, or 47.4%, from $310,551 in the nine months ended September 30, 2006 to $163,290 in the nine months ended September 30, 2007. Interest income increased from $0 in the nine months ended September 30, 2006 to $98,498 in the nine months ended September 30, 2007. The decrease in interest expense was due principally due to the reduction of certain outstanding loans in the fourth quarter of 2006. The increase in interest

income and other income was due to interest earned from a higher cash balance in 2007 compared to the same period in 2006.

As a result of the foregoing, we experienced a net loss of $2,706,952 in the nine months ended September 30, 2007 compared to a net loss of $1,357,797 in the nine months ended September 30, 2006. Our net loss attributable to common stockholders was $(0.35) per share for the nine months ended September 30, 2007 and $(0.26) per share for the nine months ended September 30, 2006, inclusive of the value of our preferred stock dividend.

Liquidity and Capital Resources

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. On December 12, 2006, we completed the sale of 2,000,000 shares of our common stock at an offering price of $4.00 per share in our initial public offering. The public offering resulted in gross proceeds of $8,000,000 to us. In connection with the public offering, we paid aggregate commissions, concessions and non-accountable expenses to the underwriters of $800,000, resulting in net proceeds of $7,200,000, excluding other expenses of the public offering. In addition, we issued, to the underwriters, warrants to purchase up to approximately an additional 200,000 shares of common stock at an exercise price of $6.60 per share (165% of the public offering price per share), at a purchase price of $0.001 per warrant. The underwriters' warrants are exercisable for a period of five years commencing on the final closing date of the public offering. From August 3, 2005 through April 7, 2006, we had issued 333,156 shares of our common stock in connection with the public offering. We sold the balance of the 2,000,000 shares in connection with the public offering (1,666,844 shares) following October 11, 2006.

From May 25, 2007 through June 15, 2007, we completed a private placement to accredited investors only, on subscriptions for the sale of 1,500,000 shares of common stock and warrants to purchase up to 749,995 shares of common stock, resulting in an aggregate of $9,000,000 of gross proceeds to us. We sold the shares at a purchase price of $6.00 per share. The warrants issued in the private placement have a five-year term and an exercise price of $7.50 per share. We paid cash commissions of $900,000 to the placement agent for the private placement and issued warrants to the placement agent to purchase up to 150,000 shares of common stock with an exercise price of $6.60 per share. We also issued additional warrants to purchase up to 15,000 shares of common stock with an exercise price of $6.60 per share and paid an additional $60,000 in cash to the placement agent as an investment banking fee. Total proceeds received, net of underwriting commissions and the investment banking fee and excluding other expenses of the private placement, was $8,040,000.

As of September 30, 2007, we had an accumulated deficit of $8,236,864 and we had working capital of $5,601,953, compared to an accumulated deficit of $5,502,142 and working capital of $2,834,940 as of December 31, 2006. Cash and cash equivalents were $2,399,060 as of September 30, 2007, as compared to $1,638,917 as of December 31, 2006. This increase in our working capital and cash position was primarily attributable to the completion of our private placement in the second quarter of 2007. In addition to our cash position, we have availability under our lines of credit of approximately $751,000.

Net cash used in operating activities during the nine months ended September 30, 2007 was $4,237,905 which was due primarily to our net loss of $2,706,952, net increases in our accounts receivable, inventory and other receivables, net of a decrease in accounts payable.

In the nine months ended September 30, 2007, we used $1,265,709 of cash in investing activities, which was due primarily to the purchase of a building and various equipment to support business growth, net of the release of restricted cash used as collateral for a line of credit that we paid in full and an unsecured loan of $300,000 to an unrelated third party.

Net cash provided by financing activities during the nine months ended September 30, 2007 was $6,299,757. The primary components of that were: the proceeds of our private placement of $9,000,000 and proceeds from the exercise of common stock purchase warrants of $165,000, which were partially offset by related expenses directly associated with the private placement, and payments of our lines of credit.

As of September 30, 2007, we had no outstanding borrowings under our lines of credit agreements:

- We have an unsecured $50,000 line of credit with US Bank which expires in December 2009. Interest is payable monthly at the prime rate, as published in the Wall Street Journal, plus 12% per annum. Our outstanding balance was $-0- at September 30, 2007 and there was $50,000 available under the line of credit. The interest rate in effect at September 30, 2007 was 20.25%.

- We have a line of credit with Merrill Lynch. Robert T. Reed, Jr., our Vice President and National Sales Manager - Mainstream and a brother of our Chief Executive Officer, Christopher J. Reed, has pledged certain securities (which do not include any of our securities which are owned by Mr. Reed) in his personal securities account on deposit with Merrill Lynch as collateral for repayment of the line of credit. The amount of the line of credit is based on a percentage value of such securities. At September 30, 2007, the outstanding balance on the line of credit was $-0-, and there was approximately $701,000 available under the line of credit. The line of credit bears interest at a rate of 3.785% per annum plus LIBOR (9.06% as of September 30, 2007). In consideration for Mr. Reed's pledging his stock account at Merrill Lynch as collateral, we have agreed to pay Mr. Reed 5% per annum of the amount we borrow from Merrill Lynch, as a loan fee. In addition, Christopher J. Reed has pledged all of his shares of common stock to Robert T. Reed, Jr. as collateral for the shares pledged by Robert T. Reed, Jr.

In the nine months ended September 30, 2007, we expended approximately $195,000 for a conveyor system and pasteurizer to improve our packaging line and operations, but do not consider these improvements to have been a material capital expenditure for the purpose of improving plant capacity at the Brewery. In August 2007, we purchased the adjacent land and building to our Los Angeles location for approximately $1,730,000 in cash. We use the facility to store some of our finished goods inventory. No major renovations were needed to be made to the property in order for us to attain the intended use of the property.

Management recognizes that operating losses negatively impact liquidity and is working on decreasing operating losses, while focusing on increasing net sales. Management believes that our current cash position and lines of credit will be sufficient to enable us to meet our cash needs through at least the second quarter of 2008.

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

If we continue to suffer losses from operations, the proceeds from our public offering and private placement 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.

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In addition, some or all of the elements of our expansion plan may have to be curtailed or delayed unless we are able to find alternative external sources of working capital. We would need to raise additional funds to respond to business contingencies, which may include the need to:

- fund more rapid expansion,
- fund additional marketing expenditures,
- enhance our operating infrastructure,
- respond to competitive pressures, and
- acquire other businesses.

We cannot assure you that additional financing will be available on terms favorable to us, or at all. If adequate funds are not available or if they are not available on acceptable terms, our ability to fund the growth of our operations, take advantage of opportunities, develop products or services or otherwise respond to competitive pressures, could be significantly limited.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. SFAS No. 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. SFAS No. 157 is effective for financial statements issued in fiscal years beginning after November 15, 2007 and to interim periods within those fiscal years. The adoption of this SFAS has not had a material change on our results of operations, financial position, or cash flows.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB No. 115”. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective for years beginning after November 15, 2007. Management believes the adoption will not have a material impact on our results of operations, financial position or cash flow.

Inflation

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

Item 3. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

As of September 30, 2007, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended).

Based on our evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls.

There were no changes in our internal controls over financial reporting during the quarter ended September 30, 2007 that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Part II OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to Item 3, part I, ***Legal Proceedings***, in our Annual Report on Form 10-KSB for the year ended December 31, 2006 for descriptions of our legal proceedings.

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Recent Sale of Unregistered Equity Securities

In August 2007, we issued 20,000 shares of common stock upon the exercise of outstanding warrants at an exercise price of $3.00, resulting in gross proceeds to us of $60,000. In September 2007, 4,619 shares of Series A preferred stock were converted into 25,676 shares of common stock. In October 2007, 500 shares of Series A preferred stock were converted into 2,000 shares of common stock. In October 2007, we issued 1,000 shares to a consultant for services rendered valued at $73,000.

In the three months ended September 30, 2007, we issued 285,000 options to purchase shares of common stock to our employees, including 110,000 options under the 2001 Stock Option Plan with an exercise price range of $7.80 to $10.01 per share, and 175,000 options outside of the 2001 Stock Option Plan with an exercise price of $8.50 per share. In October 2007, we issued 50,000 options to purchase shares of common stock to an employee with an exercise price of $7.30 per share outside of the 2001 Stock Option Plan.

The securities were issued in reliance on exemptions from registration pursuant to Section 4(2) and Regulation D under the Securities Act.

Item 3. Defaults Upon Senior Securities

Not applicable

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

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

Exhibit Number	Description of Document
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Officer's Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

In accordance with requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REEDS, INC.

By /s/ Christopher J. Reed

Christopher J. Reed
Chief Executive Officer and President

November 13, 2007

By /s/ David M. Kane

David M. Kane
Chief Financial Officer

November 13, 2007