

REEDS INC  
Form 10-Q  
August 19, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number \_\_\_\_\_  
Commission file number: 000-32501

\_\_\_\_\_  
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, Ca. 90061  
(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer ☐ Accelerated Filer ☐  
Non-accelerated filer ☐ Smaller reporting company ☒

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

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 8,928,591 shares of the registrant's common stock, \$0.0001 par value, outstanding as of August 19, 2008.

Transitional Small Business Disclosure Format (Check one) Yes ☐ No ☒

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## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements. All forward-looking statements are inherently uncertain as they are based on current expectations and assumptions concerning future events or future performance of the Company. Readers are cautioned not to place undue reliance on these forward-looking statements, which are only predictions and speak only as of the date hereof. Forward-looking statements usually contain the words “estimate,” “anticipate,” “believe,” “expect,” or similar expressions, and are subject to numerous known and unknown risks and uncertainties. In evaluating such statements, prospective investors should carefully review various risks and uncertainties identified in this Report, including the matters set forth under the captions “Trends, Risks, Challenges, Opportunities That May or Are Currently Affecting Our Business” and in the Company’s other SEC filings. These risks and uncertainties could cause the Company’s actual results to differ materially from those indicated in the forward-looking statements. The Company undertakes no obligation to update or publicly announce revisions to any forward-looking statements to reflect future events or developments.

Although forward-looking statements in this Quarterly Report on Form 10-Q reflect the good faith judgment of our management, such statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and actual results and outcomes may differ materially from the results and outcomes discussed in or anticipated by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those specifically addressed under the heading “Trends, Risks, Challenges, Opportunities That May or Are Currently Affecting Our Business” below, as well as those discussed elsewhere in this Quarterly Report. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report. We file reports with the SEC. You can read and copy any materials we file with the SEC at the SEC’s Public Reference Room, 100 F. Street, NE, Washington, D.C. 20549 on official business days during the hours of 10 a.m. to 3 p.m. You can obtain additional information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site ([www.sec.gov](http://www.sec.gov)) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including the Company.

*We undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this Quarterly Report. Readers are urged to carefully review and consider the various disclosures made throughout the entirety of this annual report, which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.*

**Part I – FINANCIAL INFORMATION****Item 1. Financial Statements****REED'S, INC  
CONDENSED BALANCE SHEETS**

|                                                                                                                                                                    | June 30, 2008<br>(Unaudited) | December 31, 2007    |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|----------------------|
| <b>ASSETS</b>                                                                                                                                                      |                              |                      |
| <b>CURRENT ASSETS</b>                                                                                                                                              |                              |                      |
| Cash                                                                                                                                                               | \$ 39,963                    | \$ 742,719           |
| Inventory                                                                                                                                                          | 3,739,678                    | 3,028,450            |
| Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of \$150,000 as of June 30, 2008 and \$407,480 as of December 31, 2007 | 1,543,839                    | 1,160,940            |
| Other receivables                                                                                                                                                  | 250                          | 16,288               |
| Prepaid Expenses                                                                                                                                                   | 135,634                      | 76,604               |
| Total Current Assets                                                                                                                                               | 5,459,364                    | 5,025,001            |
| Property and equipment, net of accumulated depreciation of \$1,019,087 as of June 30, 2008 and \$867,769 as of December 31, 2007                                   | 4,255,365                    | 4,248,702            |
| <b>OTHER ASSETS</b>                                                                                                                                                |                              |                      |
| Brand names                                                                                                                                                        | 800,201                      | 800,201              |
| Other intangibles, net of accumulated amortization of \$295 as of June 30, 2008 and \$5,212 as of December 31, 2007                                                | 35,105                       | 13,402               |
| Total Other Assets                                                                                                                                                 | 835,306                      | 813,603              |
| <b>TOTAL ASSETS</b>                                                                                                                                                | <b>\$ 10,550,035</b>         | <b>\$ 10,087,306</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                        |                              |                      |
| <b>CURRENT LIABILITIES</b>                                                                                                                                         |                              |                      |
| Accounts payable                                                                                                                                                   | \$ 2,770,797                 | 1,996,849            |
| Lines of credit                                                                                                                                                    | 879,205                      | —                    |
| Current portion of long term debt                                                                                                                                  | 10,738                       | 27,331               |
| Accrued interest                                                                                                                                                   | 20,267                       | 3,548                |
| Accrued expenses                                                                                                                                                   | 76,151                       | 54,364               |
| Total Current Liabilities                                                                                                                                          | 3,757,158                    | 2,082,092            |
| Long term debt, less current portion                                                                                                                               | 1,760,197                    | 765,753              |
| Total Liabilities                                                                                                                                                  | 5,517,355                    | 2,847,845            |
| <b>COMMITMENTS AND CONTINGENCIES</b>                                                                                                                               |                              |                      |
| <b>STOCKHOLDERS' EQUITY</b>                                                                                                                                        |                              |                      |

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|                                                                                                                                                            |                      |                      |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| Preferred stock, \$10 par value, 500,000 shares authorized, 47,121 shares outstanding at June 30, 2008 and 48,121 shares at December 31, 2007              | 471,212              | 481,212              |
| Common stock, \$.0001 par value, 19,500,000 shares authorized, 8,928,591 shares issued and outstanding at June 30, 2008 and 8,751,721 at December 31, 2007 | 892                  | 874                  |
| Additional paid in capital                                                                                                                                 | 18,146,466           | 17,838,516           |
| Accumulated deficit                                                                                                                                        | (13,585,890)         | (11,081,141)         |
| Total stockholders' equity                                                                                                                                 | 5,032,680            | 7,239,461            |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                          | <b>\$ 10,550,035</b> | <b>\$ 10,087,306</b> |

See accompanying Notes to Condensed Financial Statements

**REED'S, INC.**  
**CONDENSED STATEMENTS OF OPERATIONS**  
**For the Three and Six Months Ended June 30, 2008 and 2007**  
**(Unaudited)**

|                                                               | <b>Three months ended</b> |                 | <b>Six months ended</b> |                 |
|---------------------------------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                                                               | <b>June 30,</b>           | <b>June 30,</b> | <b>June 30,</b>         | <b>June 30,</b> |
|                                                               | <b>2008</b>               | <b>2007</b>     | <b>2008</b>             | <b>2007</b>     |
| <b>SALES</b>                                                  | \$ 4,570,816              | \$ 3,472,360    | \$ 8,134,916            | \$ 6,485,050    |
| <b>COST OF SALES</b>                                          | 3,301,486                 | 2,791,932       | 6,345,773               | 5,265,000       |
| <b>GROSS PROFIT</b>                                           | 1,269,330                 | 680,428         | 1,789,143               | 1,220,050       |
| <b>OPERATING EXPENSES</b>                                     |                           |                 |                         |                 |
| Selling                                                       | 1,051,008                 | 888,104         | 2,175,136               | 1,442,269       |
| General and Administrative                                    | 659,596                   | 450,148         | 1,989,742               | 899,491         |
| Total Operating Expenses                                      | 1,710,604                 | 1,338,252       | 4,164,878               | 2,341,760       |
| <b>LOSS FROM OPERATIONS</b>                                   | (441,274)                 | (657,824)       | (2,375,735)             | (1,121,710)     |
| <b>OTHER INCOME (EXPENSE)</b>                                 |                           |                 |                         |                 |
| Interest Income                                               | 145                       | 29,109          | 975                     | 52,600          |
| Interest Expense                                              | (49,990)                  | (64,330)        | (106,428)               | (111,883)       |
| Total Other Income (Expense)                                  | (49,845)                  | (35,221)        | (105,453)               | 59,283          |
| <b>NET LOSS</b>                                               | (491,119)                 | (693,045)       | (2,481,188)             | (1,180,993)     |
| Preferred stock dividend                                      | (23,561)                  | (27,770)        | (23,561)                | (27,770)        |
| Net loss attributable to common stockholders                  | \$ (514,680)              | \$ (720,815)    | \$ (2,504,749)          | \$ (1,208,763)  |
| <b>LOSS PER SHARE-</b>                                        |                           |                 |                         |                 |
| Available to Common Stockholders                              |                           |                 |                         |                 |
| Basic and Diluted                                             | \$ (0.06)                 | \$ (0.10)       | \$ (0.28)               | \$ (0.17)       |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING, BASIC AND DILUTED</b> | 8,911,327                 | 7,403,777       | 8,837,956               | 7,274,201       |

See accompanying Notes to Condensed Financial Statements

**REED'S INC.**  
**STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**

For the six months ended June 30, 2008 (Unaudited)

|                                                    | Common<br>Shares | Stock<br>Amount | Additional<br>Paid in<br>Capital | Preferred<br>Shares | Stock<br>Amount | Accumulated<br>Deficit | Total        |
|----------------------------------------------------|------------------|-----------------|----------------------------------|---------------------|-----------------|------------------------|--------------|
| Balance, January 1, 2008                           | 8,751,721        | \$ 874          | \$ 17,838,516                    | 48,121              | \$ 481,212      | \$ (11,081,141)        | \$ 7,239,461 |
| Fair Value of Common stock<br>issued for services  | 161,960          | 16              | 335,439                          | -                   | -               | -                      | 335,455      |
| Preferred Stock Dividend                           | 10,910           | 1               | 23,560                           | -                   | -               | (23,561)               | -            |
| Preferred stock conversion                         | 4,000            | 1               | 9,999                            | (1,000)             | (10,000)        | -                      | -            |
| Fair value of options issued to<br>employees       | -                | -               | (61,048)                         | -                   | -               | -                      | (61,048)     |
| Net Loss for the six months<br>ended June 30, 2008 | -                | -               | -                                | -                   | -               | (2,481,188)            | (2,481,188)  |
| Balance, June 30, 2008                             | 8,928,591        | \$ 892          | \$ 18,146,466                    | 47,121              | \$ 471,212      | \$ (13,585,890)        | \$ 5,032,680 |

See accompanying Notes to Condensed Financial Statements

**REED'S INC.**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**For the six months ended June 30, 2008 and 2007**  
**(Unaudited)**

|                                                                             | <b>Six Months Ended</b>  |                          |
|-----------------------------------------------------------------------------|--------------------------|--------------------------|
|                                                                             | <b>June 30,<br/>2008</b> | <b>June 30,<br/>2007</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                 |                          |                          |
| Net Loss                                                                    | \$ (2,481,188)           | \$ (1,180,993)           |
| Adjustments to reconcile net loss to net cash used in operating activities: |                          |                          |
| Fair Value of Common Stock Issued for Services                              | 335,455                  | 3,783                    |
| Fair value of stock options issued to employees                             | (61,048)                 | 48,420                   |
| Depreciation and amortization                                               | 165,465                  | 81,907                   |
| Changes in operating assets and liabilities:                                |                          |                          |
| Accounts receivable                                                         | (382,899)                | (181,796)                |
| Inventory                                                                   | (711,228)                | (459,727)                |
| Prepaid Expenses                                                            | (59,030)                 | 31,163                   |
| Other receivables                                                           | 16,038                   | (118,576)                |
| Other intangibles                                                           | (35,400)                 |                          |
| Accounts payable                                                            | 773,948                  | (273,792)                |
| Accrued expenses                                                            | 21,787                   | (41,547)                 |
| Accrued interest                                                            | 16,719                   | (19,296)                 |
| Net cash used in operating activities                                       | (2,401,381)              | (2,110,454)              |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                |                          |                          |
| Purchase of property and equipment                                          | (158,431)                | (410,631)                |
| Increase in restricted cash                                                 | -                        | (10,473)                 |
| Net cash used in investing activities                                       | (158,431)                | (421,104)                |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                |                          |                          |
| Proceeds received from warrants exercised                                   | -                        | 105,000                  |
| Proceeds received from borrowings on long term debt                         | 1,770,000                | 163,276                  |
| Principal payments on debt                                                  | (792,149)                | (182,356)                |
| Proceeds received on sale of common stock                                   | -                        | 9,000,000                |
| Payments for stock offering costs                                           | -                        | (1,182,777)              |
| Net borrowing on lines of credit                                            | 879,205                  | 167,911                  |
| Net cash provided by financing activities                                   | 1,857,056                | 8,071,054                |
| <b>NET(DECREASE) INCREASE IN CASH</b>                                       | (702,756)                | 5,539,496                |
| <b>CASH — Beginning of period</b>                                           | 742,719                  | 1,638,917                |
| <b>CASH — End of period</b>                                                 | \$ 39,963                | \$ 7,178,413             |
| <b>Supplemental Disclosures of Cash Flow Information</b>                    |                          |                          |
| Cash paid during the period for:                                            |                          |                          |
| Interest                                                                    | \$ 89,709                | \$ 131,176               |

|       |    |   |    |   |
|-------|----|---|----|---|
| Taxes | \$ | — | \$ | — |
|-------|----|---|----|---|

|                                                               |    |        |    |        |
|---------------------------------------------------------------|----|--------|----|--------|
| Noncash Investing and Financing Activities:                   |    |        |    |        |
| Preferred Stock converted to Common Stock                     | \$ | 10,000 | \$ | 34,000 |
| Common stock issued in settlement of preferred stock dividend | \$ | 23,561 | \$ | 27,770 |

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**REED'S, INC.**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**  
**Six Months Ended June 30, 2008 and 2007**

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 June 30, 2008 and the results of operations and cash flows for the six months ended June 30, 2008 and 2007. The balance sheet as of December 31, 2007 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 15, 2008.

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 six months ended June 30, 2008 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2008.

**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 six month periods ended June 30, 2008 and 2007, basic and diluted loss per share are the same because the inclusion of common share equivalents would be anti-dilutive. At June 30, 2008 and 2007, potentially dilutive securities consisted of convertible preferred stock, common stock options and warrants aggregating 2,709,220 and 2,412,896 common shares, respectively.

**Fair Value of Financial Instruments**

The carrying amount of financial instruments, including cash, accounts and other receivables, accounts payable and accrued liabilities, approximate fair value because of their short maturity. The carrying amounts of notes payable approximate fair value because the related effective interest rates on these instruments approximate the rates currently available to the Company.

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements." This Statement defines fair value for certain financial and nonfinancial assets and liabilities that are recorded at fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This guidance applies to other accounting pronouncements that require or permit fair value measurements. On February 12, 2008, the FASB finalized FASB Staff Position (FSP) No. 157-2, Effective Date of FASB Statement No. 157. This Staff Position delays the effective date of SFAS No. 157 for nonfinancial assets and

liabilities to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS No. 157 had no effect on the Company's financial position or results of operations.

#### Recent Accounting Pronouncements

References to the "FASB", "SFAS" and "SAB" herein refer to the "Financial Accounting Standards Board", "Statement of Financial Accounting Standards", and the "SEC Staff Accounting Bulletin", respectively.

In December 2007, the FASB issued FASB Statement No. 141 (R), "Business Combinations" (FAS 141(R)), which establishes accounting principles and disclosure requirements for all transactions in which a company obtains control over another business. Statement 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51". SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 also requires that any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value when a subsidiary is deconsolidated. SFAS No. 160 also sets forth the disclosure requirements to identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. SFAS No. 160 must be applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements are applied retrospectively for all periods presented.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). The objective of SFAS No. 161 is to provide users of financial statements with an enhanced understanding of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 applies to all derivative financial instruments, including bifurcated derivative instruments (and nonderivative instruments that are designed and qualify as hedging instruments pursuant to paragraphs 37 and 42 of SFAS No. 133) and related hedged items accounted for under SFAS No. 133 and its related interpretations. SFAS No. 161 also amends certain provisions of SFAS No. 131. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption.

The Company does not believe the adoption of the above recent pronouncements, will have a material effect on the Company's results of operations, financial position, or cash flows.

#### 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 six months ended June 30, 2008.

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During the three months ended June 30, 2008 and 2007, the Company had two customers, which accounted for approximately 13% and 29% and 14% and 34% of sales, respectively. No other customers accounted for more than 10% of sales in either year.

During the six months ended June 30, 2008 and 2007, the Company had two customers, which accounted for approximately 13% and 30% and 15% and 36% of sales, respectively. No other customers accounted for more than 10% of sales in either year. As of June 30, 2008, the Company had approximately \$97,000 and \$305,000, respectively, of accounts receivable from these customers.

### 2. Inventory

Inventory consists of the following at:

|           | June 30, 2008 | December 31, 2007 |
|-----------|---------------|-------------------|
| Raw       |               |                   |
| Materials | \$ 1,008,881  | \$ 1,175,580      |
| Finished  |               |                   |
| Goods     | \$ 2,730,797  | \$ 1,848,870      |
|           | \$ 3,739,678  | \$ 3,028,450      |

3. Long term debt

In March 2008, the Company originated a note payable with a bank in the amount of \$1,770,000. The note matures in February 2038. The note carries an 8.41% per annum interest rate, requires a monthly payment of principal and interest of \$13,651, and is secured by all of the land and buildings owned by the Company. The previous debt of \$650,483 for the land and building and a building improvement loan of \$136,525 that were secured by land and building were paid off in March 2008 as a condition of obtaining this loan.

4. Line of Credit

In May 2008 the Company entered into a Credit and Security Agreement under which the Company was provided with a \$2 million revolving credit facility. In July 2008, the line of credit was increased to \$3 million. The amount available to borrow is based on a calculation of eligible accounts receivable and inventory. At June 30, 2008, aggregate amounts outstanding under the line of credit was \$879,206 and the Company had approximately \$164,000 of availability on this line of credit. Interest accrues on outstanding loans under the credit facility at a rate equal to 5.75% per annum plus the greater of 2% or the LIBOR rate. Borrowings under the credit facility are secured by all of the Company's assets. The agreement terminates May 2010, and the Company is subject to an early termination fee if the loan is terminated before such date.

The Company is required to comply with a number of affirmative, negative and financial covenants. Among other things, these covenants require the Company to achieve minimum quarterly net income as set forth in the Credit Agreement, require the Company to maintain a minimum Debt Service Coverage Ratio (as defined in the Credit Agreement), require the Company to maintain minimum levels of tangible net worth. As of June 30, 2008, the Company was not in compliance with all such covenants. The Company is in the process of obtaining a waiver.

5. Stockholders' Equity

For the six months ended June 30, 2008, the following stock transactions occurred:

The Company issued 161,960 shares of common stock in exchange for consulting services. The value of the stock was based on the closing price of the stock on the issuance date. The total value of \$335,455 was charged to consulting expenses.

The Company issued 10,910 shares of common stock valued at \$23,561 to its preferred stockholders, in accordance with the dividend provision of the preferred stock agreement.

The Company issued 4,000 of common stock, resulting from the conversion of 1,000 shares of preferred stock

6. Stock Based Compensation

The impact on our results of operations of recording stock-based compensation for the three-month period ended June 30, 2008 was to reduce selling expenses by \$52,565, and increase general and administrative expenses by \$19,500. The impact on our results of operations of recording stock-based compensation for the three-month period ended June 30, 2007 was to increase selling expenses by \$16,793, and increase general and administrative expenses by \$6,500.

The impact on our results of operations of recording stock-based compensation for the six-month period ended June 30, 2008 was to decrease selling expenses by \$100,048 and increase general and administrative expenses by \$39,000. The impact on our results of operations of recording stock-based compensation for the six-month period ended June 30, 2007 was to increase selling expenses by \$41,920 and increase general and administrative expenses by \$6,500.

The reduction in compensation expense resulted from a change in estimated forfeitures of our total expected stock option compensation expense. In accordance with FAS 123R, the company recalculated its expected compensation for all options outstanding at June 30, 2008 and compared it to previously recorded compensation expense for options in that option pool. The change in forfeiture assumption resulted from a significant forfeiture of stock options due to many of the option holders leaving the employ of the company before they became vested in those options.

The amount of the cumulative adjustment to reflect the effect of the forfeited options is approximately \$238,000. The amount of compensation expense which would have been recognized if the cumulative adjustment was not made would have been approximately \$177,000.

As of June 30, 2008, the Company has unvested options of 423,333, which will be reflected as compensation cost of approximately \$860,054 over the remaining vesting period of three years. .

We calculated the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The weighted average grant date fair value of options granted during the six months ended June 30, 2008 was \$1.59. The following weighted average assumptions were used for the six months ended June 30, 2008:

|                           |         |
|---------------------------|---------|
| Risk-free interest rate   | 3.76%   |
| Expected lives (in years) | 5.00    |
| Dividend yield            | 0%      |
| Expected volatility       | 109.81% |

Expected volatility is based on the actual volatility based on the closing price of the Company's stock. 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 six months ended June 30, 2008:

|                                | Shares    | Weighted<br>Average<br>Exercise Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (Years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------|-----------|---------------------------------------|------------------------------------------------------------------|---------------------------------|
| Outstanding at January 1, 2008 | 749,000   | \$ 6.02                               | -                                                                | -                               |
| Granted                        | 275,000   | \$ 1.99                               | -                                                                | -                               |
| Exercised                      | -         | -                                     | -                                                                | -                               |
| Forfeited                      | (371,500) | \$ 6.83                               | -                                                                | -                               |
| Outstanding at June 30, 2008   | 652,500   | \$ 3.85                               | 3.75                                                             | \$ 90,250                       |
| Exercisable at June 30, 2008   | 229,167   | \$ 4.01                               | 2.17                                                             | \$ 10,500                       |

Stock options granted under our equity incentive plans vest over two and three years from the date of grant, 1/2 and 1/3 per year, respectively, and generally expire five years from the date of grant.

We calculated the fair value of each warrant award on the date of grant using the Black-Scholes option pricing model.

The following table summarizes warrant activity for the six months ended June 30, 2008:

|                                | Shares    | Weighted<br>Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual<br>Term (Years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------|-----------|---------------------------------------|--------------------------------------------------------------|---------------------------------|
| Outstanding at January 1, 2008 | 1,688,236 | \$ 5.75                               | -                                                            | -                               |
| Granted                        | 200,000   | \$ 2.54                               | -                                                            | -                               |
| Exercised                      | -         | -                                     | -                                                            | -                               |
| Outstanding at June 30, 2008   | 1,868,236 | \$ 5.41                               | 3.10                                                         | \$ 29,365                       |
| Exercisable at June 30, 2008   | 1,668,236 | \$ 5.75                               | 2.89                                                         | \$ 29,365                       |



The 200,000 warrants granted during the six months ended June 30, 2008, were granted in connection with a distribution agreement between the Company and a company which is owned by two brothers of Christopher Reed, President and Chief Financial Officer of the Company. The warrants are issuable only upon the attainment of certain international product sales. No warrants vested during the six months ended June 30, 2008. Accordingly, no expense was recorded for these warrants. The warrants will be valued and a corresponding expense will be recorded upon the attainment of the sales goals identified when the warrants were granted.

7. Related Party Activity

As of December 31, 2007, the Company had a \$300,000 note receivable from an entity that is partly owned by an advisor to the board of directors. The note is secured by all the entity's assets and intellectual property. The note is payable on March 25, 2008 and bears interest at 7.50% per annum with quarterly interest payments. As of June 30, 2008, the Company has determined that the note is deemed uncollectible and the collateral worthless, and has written off the entire balance and associated accrued interest.

For the three months ended March 31, 2008 the Company employed one family member of the majority shareholder, Chief Executive Officer and Chief Financial Officer of the Company in a sales role. He was paid approximately \$56,250. No stock options were granted to him during the three months ended March 31, 2008 and \$112,500 for the six months ended June 30, 2008.

During the six months ended June 30, 2008, the Company entered into an agreement for the distribution of its products internationally. The agreement is between the Company and a company controlled by two brothers of Christopher Reed, President and Chief Financial Officer of the Company. The agreement remains in effect until terminated by either party and requires the Company to pay the greater of \$10,000 per month or 10% of the defined sales of the previous month. During the six months ended June 30, 2008, the Company paid \$10,000 for these services. 200,000 warrants were granted during the six months ended June 30, 2008, in connection with this distribution agreement. The warrants are issuable only upon the attainment of certain international product sales. No warrants vested during the six months ended June 30, 2008. Accordingly, no expense was recorded for these warrants. The warrants will be valued and a corresponding expense will be recorded upon the attainment of the sales goals identified when the warrants were granted.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q, or the Report, are "forward-looking statements." These forward-looking statements include, but are not limited to, statements about the plans, objectives, expectations and intentions of Reed's, Inc., a Delaware corporation (referred to in this Report as "we," "us," or "our") and other statements contained in this Report that are not historical facts. Forward-looking statements in this Report or hereafter included in other publicly available documents filed with the Securities and Exchange Commission, or the Commission, reports to our stockholders and other publicly available statements issued or released by us involve known and unknown risks, uncertainties and other factors which could cause our actual results, performance (financial or operating) or achievements to differ from the future results, performance (financial or operating) or achievements expressed or implied by such forward-looking statements. Such future results are based upon management's best estimates based upon current conditions and the most recent results of operations. When used in this Report, the words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate" and similar expressions are generally intended to identify forward-looking statements, because these forward-looking statements involve risks and uncertainties. There are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including our plans, objectives, expectations and intentions and other factors that are discussed under the section entitled "Risk Factors," in our Annual Report on Form 10-KSB for the year ended December 31, 2007.

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed financial statements and the related notes appearing elsewhere in this Form 10-Q.*

**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.

**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. We monitor these trends closely and have started developing low-carbohydrate versions of some of our beverages, although we do not have any currently marketable low-carbohydrate products.

**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.

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

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

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

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

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

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

### **Critical Accounting Policies**

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

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

**Trademark License and Trademarks.** Trademark license and trademarks primarily represent the costs we pay for exclusive ownership of the Reed's® trademark in connection with the manufacture, sale and distribution of beverages and water and non-beverage products. We also own the Virgil's® trademark and the China Cola® trademark. 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 three months ended March 31, 2008 or March 31, 2007.

**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 three months ended March 31, 2008 or 2007.

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.

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 June 30, 2007 Compared to Three Months Ended June 30, 2008*

Net sales increased by \$1,098,456, or 31.6%, from \$3,472,360 in the three months ended June 30, 2007 to \$4,570,816 in the three months ended June 30, 2008. The increase in net sales was primarily due to an increase in our Virgil’s product line and our Reed’s Ginger Brews line. The increase in sales was also primarily due to an increase in net sales due to newly introduced mainstream distributors and an increase in our existing distribution channels of natural food distributors and retailers.

The Virgil's brand, which includes Root Beer, Real Cola, Cream Soda and Black Cherry Cream soda, Diet Root Beer, Diet Real Cola, Diet Cream Soda and Diet Black Cherry Cream Soda, realized an increase in net sales of \$788,000, or 54% to \$2,246,000 in the three months ended June 30, 2008 from \$1,458,000 in the three months ended June 30, 2007. The increase was the result of increased sales in 12 ounce Root Beer of \$225,000 or 32% from \$714,000 in the three months ended June 30, 2007 to \$939,000 in the three months ended June 30, 2008, increased sales in Cream Soda of \$109,000 or 62% from \$175,000 in the three months ended June 30, 2007 to \$284,000 in the three months ended June 30, 2008, and increased sales in Black Cherry Cream Soda of \$31,000 or 31% from \$101,000 in the three months ended June 30, 2007 to \$132,000 in the three months ended June 30, 2008. Also, the Virgil's Root Beer five-liter party kegs increased \$321,000 or 106%, from \$304,000 in the three months ended June 30, 2007 to \$625,000 in the three months ended June 30, 2008. In addition, the increase in sales in the Virgil's Brand was the result of launch of Virgil's Real Cola in 2008 which realized net sales of \$95,000 in the three months ended June 30, 2008.

The Reeds Ginger Brew Line increased \$312,000 or 20 % to \$1,837,000 in the three months ended June 30, 2008 from \$1,525,000 in the three months ended June 30, 2007.

Net sales of candy increased \$48,000, or 27% to \$229,000 in the three months ended June 30, 2008 from \$181,000 in the three months ended June 30, 2007.

The product mix for our two most significant product lines, Reed's Ginger Brews and Virgil's sodas was 51.1% and 41.8%, respectively of net sales in the three months ended June 30, 2008 and was 46.4% and 44.4%, respectively of net sales in the three months ended June 30, 2007.

Cost of sales increased by \$509,554, or 18.3%, to \$3,301,486 in the three months ended June 30, 2008 from \$2,791,932 in the three months ended June 30, 2007. As a percentage of net sales, cost of sales decreased to 72.2% in the three months ended June 30, 2008 from 80.4% in the three months ended June 30, 2007. Cost of sales as a percentage of net sales decreased by 7.6%, primarily as a result of the price increase on April 1, 2008 for the Reed's Ginger Brew line of beverages offset by fuel and commodity price increases which have caused an increase in our costs of production from our co-packer. Fuel price increases have also increased our costs of delivery. In addition, we had increased costs of packaging. If fuel and commodity prices continue to increase, we will have more pressure on our margins.

Gross profit increased \$588,902 or 86.5% to \$1,269,330 in the three months ended June 30, 2008 from \$680,428 in the three months ended June 30, 2007. As a percentage of net sales, gross profit increased to 27.8% in the first three months of 2008 from 19.6% in the first three months of 2007.

To improve gross margins in 2008, we have raised prices on the Reed's Ginger Brew line by 20% bringing it more in line with our competitors in the natural soda category. In addition, we are implementing systems to track and manage the approval and use of promotions and discounting to maintain a higher net gross margin. Finally, we are performing a competitive bidding process for our third party co-packing production. We expect to select a co-packer by the third quarter 2008. We expect to lower our costs of production, thus further improving our gross margin while maintaining our product quality.

Operating expenses increased by \$372,352, or 27.8%, to \$1,710,604 in the three months ended June 30, 2008 from \$1,338,252 in the three months ended June 30, 2007 and decreased as a percentage of net sales to 37.4% in the three months ended June 30, 2008 from 38.5% in the three months ended June 30, 2007. The increase was primary the result of increased selling and general and administrative expenses. In March of 2008, we reduced our staff by 17 employees, mostly from the sales staff. During the first quarter of 2008, we implemented a cost reduction strategy to reduce unnecessary expenses and revised our budget for 2008. We reduced selling expenses by reducing our work force by 17 employees. We expect to save approximately \$2,000,000 in annual expense with this reduction. We experienced a \$743,640 reduction in operating expenses over the first quarter of 2008 in the three months ending March 31, 2008 expenses were \$2,454,274.

Selling expensed increased by \$162,904 or 18.3%, to \$1,051,008 in the three months ended June 30, 2008 from \$888,104 in the three months ended June 30, 2007. The increase in selling expenses is due to increased promotional and advertising expenses, public relations expenses, trade show expenses, travel expenses, and increased usage of brokerage firms for sales offset by lower option expenses and contract services expenses. Promotional and advertising expenses increased \$100,938 or 108.2% to \$194,204 in the three months ended June 30, 2008 from \$93,266 in the three months ended June 30, 2007. This increase was due to the increased use of advertising and promotions with our supermarket customers as we move into more mainstream accounts. Public relations expenses increased \$31,280 or 299.3% to \$41,730 in the three months ended June 30, 2008 from \$10,450 in the three months ended June 30, 2007. The increase in public relations expenses was due to the increased use. Trade show expenses increased \$20,795 or 134.2%, to \$36,292 in the three months ended June 30, 2008 from \$15,497 in the three months ended June 30, 2007. The increase in trade show expenses was due to an increase in trade shows as we start marketing to new channels of trade such as the drug store channel. Travel expenses increased \$50,969 or 356.6%, to \$65,263 in the three months ended June 30, 2008 from \$14,294 in the three months ended June 30, 2007. The increase in travel expenses was due

to increased air travel as our sales force focus is redirected to visiting supermarket headquarters and key retailer around the country. Brokerage commission expenses increased \$86,478 or 103.2%, to \$170,312 in the three months ended June 30, 2008 from \$83,834 in the three months ended June 30, 2007. The increase in brokerage commission expenses was due to increased use of outside food brokers to represent us to the supermarket trade. Non-cash stock option compensation expense decreased \$69,357 or 413% to (\$52,565) in the three months ended June 30, 2008 from \$16,792 in the three months ended June 30, 2007. This decrease is due to options which were forfeited as we reduced our sales force in the first quarter of 2008. Contract services expense decreased \$18,735 or 43.7% to \$24,108 in the three months ended June 30, 2008 from \$42,843 in the three months ended June 30, 2007. This decrease is due to the reduction of use of contract services. In March 2008, we announced our new strategic direction in sales, whereby our focus is to strengthen our product placements in our estimated 10,500 supermarkets nationwide. This strategy replaces our strategy in the three months ended June 30, 2007 that focused on both the supermarkets and a direct store delivery (DSD) effort. Since March 2008, our sales organization has been reduced by 16 compared to the level we had at December 31, 2007. We have found that the most effective sales efforts are to grocery stores. We have our products in more than 10,500 supermarket stores across the country and our new direction for 2008 is to remain focused on these accounts while opening new business with other grocery stores leveraging our brand equity. We feel that the trend in grocery stores to offer their customers natural products can be served with our products. Our sales personnel are leveraging our success at natural food grocery stores to establish new relationships with mainstream grocery stores.

General and administrative expenses increased by \$209,448 or 46.5% to \$659,596 in the three months ended June 30, 2008 from \$450,148 in the first three months of 2007. The increase in general and administrative expenses is due to increased legal, accounting and investor relations expenses and officer salaries. Legal, accounting and investor relations expenses increased \$152,651 or 571.6% to \$179,357 in the three months ended June 30, 2008 from \$26,706 in the three months ended June 30, 2007. The increase in legal, accounting and investor relation expenses was due to increased legal and accounting costs mostly related to the increased costs of reporting and compliance with the Securities and Exchange Commission and NASDAQ. Officer salaries increased by \$33,806 or 90.1% to \$71,306 in the three months ended June 30, 2008 from \$37,500 in the three months ended June 30, 2007. The increase was due to the hiring of a Chief Operating Officer in May 2007.

Interest expense was \$49,990 in the three months ended June 30, 2008, compared to interest expense of \$64,330 in the three months ended June 30, 2007. Interest income dropped to \$145 in the three months ended June 30, 2008, compared to interest income of \$29,109 in the three months ended June 30, 2007.

Interest income decreased because of our overall decrease in cash and corresponding decrease in interest bearing cash accounts. Interest expenses will probably increase due to the increased reliance of the Company to finance operations with its \$3,000,000 inventory and accounts receivable line of credit with First Capital LLC.

*Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2008*

Net sales increased by \$1,649,866, or 25.4%, from \$6,485,050 in the first six months ended June 30, 2007 to \$8,134,916 in the first six months ended June 30, 2008. The increase in net sales was primarily due to an increase in our Virgil's product line and our Reed's Ginger Brews line. The increase in sales was also primarily due to an increase in net sales due to newly introduced mainstream distributors and an increase in our existing distribution channels of natural food distributors and retailers.

The Virgil's brand, which includes Root Beer, Real Cola, Cream Soda and Black Cherry Cream soda, Diet Root Beer, Diet Real Cola, Diet Cream Soda and Diet Black Cherry Cream Soda, realized an increase in net sales of \$1,364,000, or 57% to \$3,742,000 in first six months ended June 30, 2008 from \$2,378,000 in first six months ended June 30, 2007. The increase was the result of increased sales in 12 ounce Root Beer of \$449,000 or 35% from \$1,296,000 in first six months ended June 30, 2007 to \$1,745,000 in first six months ended June 30, 2008, increased sales in Cream Soda of \$157,000 or 51% from \$306,000 in the first six months of 2007 to \$463,000 in the first six months of 2008, and increased sales in Black Cherry Cream Soda of \$72,000 or 44% from \$164,000 in the first six months of 2007 to \$236,000 in the first six months of 2008. Also, the Virgil's Root Beer five-liter party kegs increased \$531,000 or 135%, from \$392,000 in first six months ended June 30, 2007 to \$923,000 in first six months ended June 30, 2008. In addition, the increase in sales in the Virgil's Brand was the result of launch of Virgil's Real Cola in 2008 which realized net sales of \$100,000 in the first six months ended June 30, 2008.

The Reeds Ginger Brew Line increased \$773,000 or 26% to \$3,779,000 in first six months ended June 30, 2008 from \$3,006,000 in first six months ended June 30, 2007.

Net sales of candy increased \$44,000, or 10% to \$482,000 in first six months ended June 30, 2008 from \$438,000 in first six months ended June 30, 2007.

The product mix for our two most significant product lines, Reed's Ginger Brews and Virgil's sodas was 46.2% and 45.7%, respectively of net sales in first six months ended June 30, 2008 and was 49.7% and 39.4%, respectively of net sales in first six months ended June 30, 2007.

Cost of sales increased by \$1,080,773, or 20.5%, to \$6,345,773 in first six months ended June 30, 2008 from \$5,265,000 in first six months ended June 30, 2007. As a percentage of net sales, cost of sales decreased to 78.0% in first six months ended June 30, 2008 from 81.2% in first six months ended June 30, 2007. Cost of sales as a percentage of net sales decreased by 3.2%, primarily as a result of the price increase on April 1, 2008 for the Reed's Ginger Brew line of beverages offset by fuel and commodity price increases which have caused an increase in our costs of production from our co-packer. Fuel price increases have also increased our costs of delivery. In addition, we had increased costs of packaging. If fuel and commodity prices continue to increase, we will have more pressure on our margins.

Gross profit increased \$569,093 or 46.6% to \$1,789,143 in first six months ended June 30, 2008 from \$1,220,050 in first six months ended June 30, 2007. As a percentage of net sales, gross profit increased to 22.0% in the first six months of 2008 from 18.8% in the first six months of 2007.

To improve gross margins in 2008, we have raised prices on the Reed's Ginger Brew line by 20% on April 1, 2008 bringing it more in line with our competitors in the natural soda category. In addition, we are implementing systems to track and manage the approval and use of promotions and discounting to maintain a higher net gross margin. Finally, we are performing a competitive bidding process for our third party co-packing production. We expect to select a co-packer by the third quarter 2008. We expect to lower our costs of production, thus further improving our gross margin while maintaining our product quality. Our current co-packer producing the bulk of our products is charging us considerably over the market.

Operating expenses increased by \$1,832,118 or 77.8%, to \$4,164,878 in first six months ended June 30, 2008 from \$2,341,760 in first six months ended June 30, 2007 and increased as a percentage of net sales to 51.2% in first six months ended June 30, 2008 from 36.1% in first six months ended June 30, 2007. The increase was primary the result of increased selling and general and administrative expenses. In March of 2008, we reduced our staff by 17 employees, mostly from the sales staff. During the first quarter of 2008, we implemented a cost reduction strategy to reduce unnecessary expenses and revised its budget for 2008. We reduced selling expenses by reducing our work force by 17 employees. We expect to save approximately \$2,000,000 in annual expense with this reduction. We believe our operating expenses will decrease approximately \$300,000 per month beginning in April 2008.

Selling expensed increased by \$732,867 or 50.8%, to \$2,175,136 in first six months ended June 30, 2008 from \$1,442,269 in first six months ended June 30, 2007. The increase in selling expenses is due to increased salaries of sales personnel, brokerage expenses, promotional and advertising costs, trade show expenses, and travel expenses offset by lower non-cash stock option expense, lower demo expenses, lower contract services and lower auto expenses. Salaries of sales personnel increased \$714,045 or 132.1% to \$1,254,562 in first six months ended June 30, 2008 from \$540,517 in first six months ended June 30, 2007. This increase was due to increased personnel to support the initiative to increase sales of our product to the mainstream consumer through mainstream stores and distributors that support mainstream retailers. Brokerage expenses increased \$122,809 or 111.1% to \$233,396 in first six months ended June 30, 2008 from \$110,587 in first six months ended June 30, 2007. The increase in brokerage commission expenses was due to increased use of outside food brokers to represent us to the supermarket trade. Promotional and advertising expenses increased \$105,025 or 88.0%, to \$224,360 in first six months ended June 30, 2008 from \$119,335 in first six months ended June 30, 2007. This increase was due to the increased use of advertising and promotions with our supermarket customers as we move into more mainstream accounts. Trade show expenses increased \$40,599 or 90.6%, to \$85,406 in first six months ended June 30, 2008 from \$44,807 in first six months ended June 30, 2007. The increase in trade show expenses was due to an increase in trade shows as we start marketing to new channels of trade such as the drug store channel. Travel expenses increased \$170,169 or 289.8%, to \$228,890 in first six months ended June 30, 2008 from \$58,721 in first six months ended June 30, 2007. The increase in travel expenses was due to the build up of the sales force at the end of 2007 and their increased activities. These increases were offset by reductions in the following expenses. Non-cash stock option compensation expense decreased \$2,919 or 7.0% to \$39,000 in first six months ended June 30, 2008 from \$41,919 in first six months ended June 30, 2007. This decrease is due to options which were forfeited. Contract services expense decreased \$49,636 or 59.6% to \$33,677 in first six months ended June 30, 2008 from \$83,313 in first six months ended June 30, 2007. This decrease is due to reduced use of outside services. Auto expenses decreased \$168,516 or 61.2% to \$43,392 in first six months ended June 30, 2008 from \$111,908 in first six months ended June 30, 2007. This decrease is due to a reduction of our delivery systems in Southern California in 2008. In March 2008, we announced our new strategic direction in sales, whereby our focus is to strengthen our product placements in our estimated 10,500 supermarkets nationwide. This strategy replaces our strategy in first six months ended June 30, 2007 that focused on both the supermarkets and a direct store delivery (DSD) effort. Since March 2008, our sales organization has been reduced by 16 compared to the level we had at December 31, 2007. We have found that the most effective sales efforts are to grocery stores. We have our products in more than 10,500 supermarket stores across the country and our new direction for 2008 is to remain focused on these accounts while opening new business with other grocery stores leveraging our brand equity. We feel that the trend in grocery stores to offer their customers natural products can be served with our products. Our sales personnel are leveraging our success at natural food grocery stores to establish new relationships with mainstream grocery stores

General and administrative expenses increased by \$1,090,251 or 121.2% to \$1,989,742 in first six months ended June 30, 2008 from \$899,491 in the first six months of 2007. The increase in general and administrative expenses is due to increased legal, accounting and investor relations expenses, officer salaries, general liability insurance, outside services, and office supplies. Legal, accounting and investor relations expenses increased \$326,492 or 266.4% to \$449,036 in first six months ended June 30, 2008 from \$122,544 in first six months ended June 30, 2007. The increase in legal, accounting and investor relation expenses was due to increased legal and accounting costs mostly related to the increased costs of reporting and compliance with the Securities and Exchange Commission and NASDAQ. Salaries increased by \$243,914 or 219.6% to \$354,981 in first six months ended June 30, 2008 from \$111,067 in first six months ended June 30, 2007. Officer salaries increased by \$116,848 or 155.8% to \$191,848 in the three months ended June 30, 2008 from \$75,000 in the three months ended June 30, 2007. The increase was due to the hiring of a Chief Operating Officer in May 2007 and a Chief Financial Officer in October 2007. Liability insurance expenses increased \$62,451 or 155.0% to \$70,262 in first six months ended June 30, 2008 from \$29,752 in first six months ended June 30, 2007. This increase was mainly due to increased sales and coverage. Outside services expenses increased \$40,512 or 136.2% to \$70,262 in first six months ended June 30, 2008 from \$29,752 in first six months ended June 30, 2007. This increase was due increased use of outside services. Office supplies expenses increased

\$14,419 or 80.6% to \$32,304 in first six months ended June 30, 2008 from \$17,885 in first six months ended June 30, 2007. This increase was due to increased staff in general. In addition, we had a one-time non cash expense of \$320,762 for consulting services, for which we issued stock.

Interest expense was \$106,428 in the six months ended June 30, 2008, compared to interest expense of \$111,883 in the six months ended June 30, 2007. Interest income dropped to \$975 in the six months ended June 30, 2008, compared to interest income of \$52,600 in the six months ended June 30, 2007.

Interest income decreased because of our overall decrease in cash and corresponding decrease in interest bearing cash accounts. Interest expenses will probably increase due to the increased reliance of the company to finance operations with its \$3,000,000 inventory accounts receivable line of credit with First Capital LLC.

### *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 June 30, 2008, we had an accumulated deficit of \$13,585,890 and we had working capital of \$1,702,206, compared to an accumulated deficit of \$11,081,141 and working capital of \$2,942,909 as of December 31, 2007. Cash and cash equivalents were \$39,963 as of June 30, 2008, as compared to \$742,719 as of December 31, 2007. This decrease in our working capital and cash position was primarily attributable to our net loss for the six months ended June 30, 2008 offset by an increase in our inventory at June 30, 2008. In addition to our cash position on June 30, 2008, we had availability under our lines of credit of approximately \$164,000.

Net cash used in operating activities during the six months ended June 30, 2008 was \$2,401,381 which was due primarily to our net loss of \$2,481,188. In the six months ended June 30, 2008, we used \$158,431 of cash in investing activities, which was due primarily to the purchase of various equipment to support business growth.

Net cash provided by financing activities during the six months ended June 30, 2008 was \$1,857,056. The primary components of that were the net proceeds from the refinancing of our land and buildings and our obtaining of a line of credit.

As of June 30, 2008, we had outstanding borrowings of \$879,205 under our line of credit agreement:

We recognize that operating losses negatively impact liquidity and we are working on decreasing operating losses, while focusing on increasing net sales. We are currently borrowing near the maximum on our line of credit. We have approximately \$500,000 to \$1,000,000 in excess inventory over our normal inventory levels. We believe the operations of the company are running at approximately breakeven, after adjusting for non-cash expenses. Between the reduction of our inventory to more normal levels and our current breakeven operating status, we believe that our current cash position and lines of credit will be sufficient to enable us to meet our cash needs through at least the end of 2008. We're planning on registering a S-3 shelf offering in the next 2-3 months. We believe that if the need arises

we can raise money through the equity markets.

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

If we continue to suffer losses from operations, 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.

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

References to the “FASB”, “SFAS” and “SAB” herein refer to the “Financial Accounting Standards Board”, “Statement of Financial Accounting Standards”, and the “SEC Staff Accounting Bulletin”, respectively.

In December 2007, the FASB issued FASB Statement No. 141 (R), “Business Combinations” (FAS 141(R)), which establishes accounting principles and disclosure requirements for all transactions in which a company obtains control over another business. Statement 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51”. SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent’s equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 also requires that any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value when a subsidiary is deconsolidated. SFAS No. 160 also sets forth the disclosure requirements to identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. SFAS No. 160 must be applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements are applied retrospectively for all periods presented.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133” (“SFAS No. 161”). SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS No. 133”). The objective of SFAS No. 161 is to provide users of financial statements with an enhanced understanding of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 applies to all derivative financial instruments, including bifurcated derivative instruments (and nonderivative instruments that are designed and qualify as hedging instruments pursuant to paragraphs 37 and 42

of SFAS No. 133) and related hedged items accounted for under SFAS No. 133 and its related interpretations. SFAS No. 161 also amends certain provisions of SFAS No. 131. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption.

The Company does not believe the adoption of the above recent pronouncements, will have a material effect on the Company's results of operations, financial position, or cash flows

### **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. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

Item 4. CONTROLS AND PROCEDURES

(a) Management's Evaluation of Disclosure Controls and Procedures.

As of June 30, 2008, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our "disclosure controls and procedures," as such term is defined under Exchange Act Rules 13a-15(e) and 15d-15(e).

Our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2008, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and 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 June 30, 2008 that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## Part II

### Item 1. Legal Proceedings

There has been no change to our disclosure regarding legal proceeding as set forth in our Annual Report on Form 10-KSB for the year ended December 31, 2007.

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 1A. RISK FACTORS

Not applicable

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

Not applicable

### Item 3. Defaults Upon Senior Securities

As of June 30, 2008, the Company was in default of a financial covenant of its line of credit. The Company is in the process of obtaining a waiver for this covenant violation.

### 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 | Officer's Certification 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 |
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**SIGNATURE**

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 Reed  
Chief Executive Officer, President  
and Chief Financial Officer

August 19, 2008