

Nasdaq: REED

Final

June 18, 2010

Rating: **None**  
(Changed from Speculative Buy)

Recent Price: **\$2.04**  
(6/17/10)

Price Target: **None**  
(Changed from \$5.25)

#### MARKET DATA

52-Week High/Low	\$3.08 - \$1.12
Ave. Daily Volume (6-mos.)	138 K
Shares Outstanding	10.2 M
Inside Ownership	31.5%
Institutional Ownership	<1%
Float	7.0 M
Short Interest (% of float)	<1%

#### FINANCIAL DATA

Market Capitalization	\$20.9 M
- Cash & Equivalents	\$ 0.2 M
+ Preferred Stock	\$ 1.6 M
+ Long-term Debt	\$ 3.3 M
Enterprise Value	\$25.6 M
Book Value	\$4.8 M
Working Capital	\$2.5 M
Dividend Yield	nil

Balance sheet figures pro forma as of 3/31/10

	SALES	NET LOSS	CFO	LPS
2008A	\$15.3	(\$3.8)	(\$2.5)	(\$0.43)
2009A	\$15.2	(\$2.9)	(\$1.3)	(\$0.28)
1Q10A	\$ 4.0	(\$0.3)	(\$1.0)	(\$0.03)

Dollars in millions, except EPS; Fiscal year ends Dec.

#### VALUATION

Price/Sales	1.3 X
Price/CFO	Neg
Price/Trailing 12-mo. Earnings	Neg
Price/Book Value	4.4 X
Consensus EPS Estimate 2010	NA
Forward PE	NA
Consensus EPS Estimate 2011	NA
Forward PE	NA

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## Reed's, Inc.

Consumer; Specialty Beverages

*Reed's is an emerging producer of distinguishing non-alcoholic beverages and specialty candies and ice creams. It is the only commercial beverage producer in the U.S. to produce and market "brewed" ginger, root beer and cola products. The Reed's brand can be found on the shelves of specialty gourmet and natural food stores, such as Whole Foods, Wild Oats and Trader Joes as well as supermarket chains such as Ralph's.*

#### HIGHLIGHTS

- **Strong Quarter Sales, Profits.** Reed's reported \$4.0 million in total sales in the March quarter compared to \$3.4 million in the same period a year ago. Revenue increased on private label sales and improved same store sales of Reed's and Virgil's brands. Reed's earned a 27.5% gross margin in the recent quarter compared to 24.8% a year ago.
- **Market Penetration.** A strategy to elevate the Reed's, Virgil's and Sparkling Sonoma brands among national and regional store chains appears to be working as the Company has an increasing presence in more stores. In our view, the addition of the Fresh and Easy Division of Tesco Plc as a retailer of the Reed's and Virgil's brands is a major win as it opens the door to one of the largest food retailers in the world and a dominant force in the U.K. and Europe.
- **Outlook.** We expect improving quarterly comparables to serve as a catalyst for the stock in the coming quarters as private label revenue increases on increased volumes and new relationships. We also expect to see additional leverage at the operating level as the Company becomes even more adept at targeting their promotional budget at those projects and products yielding the highest return.
- **Final Report.** Our coverage of Reed's is concluded for reasons not related to fundamental developments. While we withdraw our rating and price target, we continue to view Reed's as an interesting play in the specialty brand sector.

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## SUMMARY

Reed's reported strong first quarter 2010 results in mid-May amidst a string of announcements detailing new distribution and private label customers. The Company appears to have reached an inflection point in building the scale needed to achieve profitability. With the hubbub subsiding over the proposed acquisition of Jones Soda, Inc. (JSDA: Nasdaq), Reed's management can get back to executing on the Company's strategic growth plan. Elevation of the *Reed's*, *Virgil's* and *Sparkling Sonoma* brands among national and regional store chains appears to be working as the Company has an increasing presence in more stores. In our view, the addition of the Fresh and Easy Division of Tesco Plc as a retailer of the *Reed's* and *Virgil's* brands is a major win as it opens the door to one of the largest food retailers in the world and a dominant force in the U.K. and Europe.

Our coverage of Reed's is concluded for reasons not related to fundamental developments. While we are withdrawing our rating and price target, we continue to view Reed's as an interesting play in the specialty brand sector.

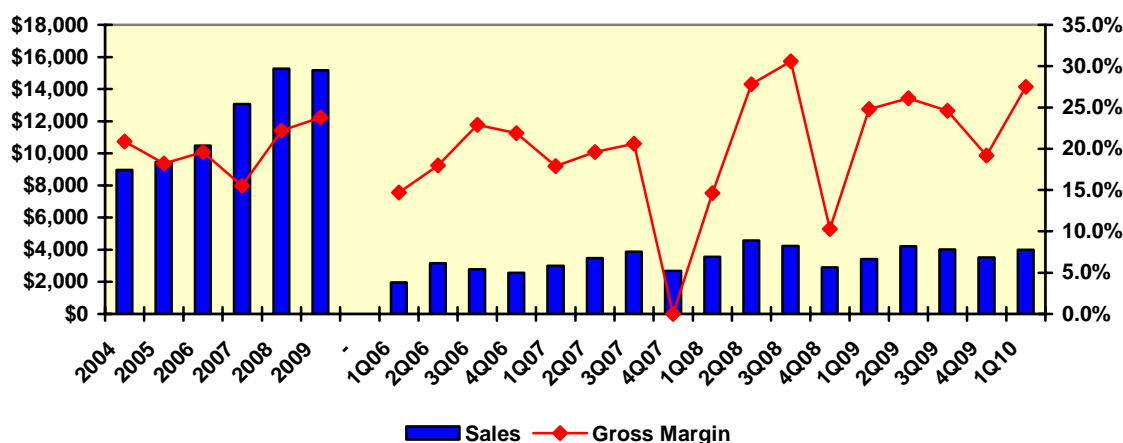
## HIGHLIGHTS FROM FIRST QUARTER 2010 RESULTS

Reed's reported \$4.0 million in total sales in the quarter compared to \$3.4 million in the year-ago period. Revenue increased on private label sales and improved same store sales of *Reed's* and *Virgil's* brands. Reed's earned a 27.5% gross margin in the quarter compared to 24.8% in the year-ago period. The improvement in profitability was driven in part by better coverage of fixed costs on higher volumes, particularly the Company's branded products.

The Company reported an operating loss of \$110,000 or 2.8% of sales. General and administrative expenses were \$652,000 or 16.3% of total sales. This compares to a spending rate of 17.7% in the same quarter last year. Selling and marketing expenses were \$524,000 or 13.1% of total sales in the recent quarter compared to a spending rate of 19.3% in the same quarter last year. We estimate that after adjusting for non-cash expenses including depreciation, amortization of intangibles and stock compensation, we estimate the Company earned \$220,000 in operating profit in the quarter.

The reported net loss for the quarter before payment of \$14,000 in dividends on the Company's outstanding preferred was \$259,000 or \$0.03 per share. After adjustments to exclude non-cash expenses, we estimate net income would have been \$73,000.

**Chart I: Historic Sales and Gross Margin**



Source: Company Reports and Crystal Equity Research Estimates.

### Cash Flows and Balances

Reed's operations used \$973,000 in cash during the March 2010 quarter. Cash usage was primarily for working capital reserves.

The Company ended the quarter with \$235,000 in cash on the balance sheet. Working capital totaled \$2.5 million at the end of March 2010. Including current portions due within the next twelve months, Reed's outstanding debt and credit lines total \$3.3 million. The Company reported \$1.6 million in total preferred stock at the end of March 2010. Stock holders equity increased to \$4.8 million from \$4.4 million at the end of December 2009.

### OUTLOOK

Following report of first quarter 2010 Reed's management provided bullish guidance for the year. Top-line growth is expected to reach 20% in 2010, resulting in a net profit for the year. According to comments made by CEO Chris Reed during the Company's first quarter earnings conference call private label sales are just getting started and the pipeline of prospects is building. There appears to be a synergy between the branded sales effort and building private label relationships. Management expects private label revenue to equal branded revenue by calendar year 2011.

We expect improving quarterly comparisons to serve as a catalyst for the stock price in the coming quarters as private label revenue increases on increased volumes and new relationships. We also expect to see additional leverage at the operating level as the Company becomes even more adept at targeting their promotional budget at those projects and products that yield the highest return. We believe Reed's balance sheet remains strained as the Company attempts to drive growth with limited resources and that will remain a concern for investors until operations are consistently generating cash.

### Exhibit I: REED Price Chart



Source: Stockcharts.com

**Table I: Historic Sales and Earnings** (dollars in thousands except per share earnings)

Dollars in Thousands Except EPS

	2007	2008	2009	1Q09	2Q09	3Q09	4Q09	1Q10
Sales	13,059	15,277	15,178	3,417	4,214	4,027	3,520	4,012
Cost of sales	11,040	11,891	11,566	2,570	3,114	3,038	2,844	2,946
Gross profit	2,019	3,386	3,612	847	1,100	989	676	1,066
Selling expense	4,587	3,817	2,412	659	548	646	559	524
General & admin. Expense	2,621	3,140	2,632	603	670	623	736	652
Other expense	300	-	641	-	641	-	-	-
Income from operations	(5,489)	(3,571)	(2,073)	(415)	(759)	(280)	(619)	(110)
Net interest income (expense)	(62)	(243)	(486)	(83)	(114)	(122)	(167)	(149)
Income before taxes	(5,551)	(3,814)	(2,559)	(498)	(873)	(402)	(786)	(259)
Provision for taxes	-	-	-	-	-	-	-	-
Net income	(5,551)	(3,814)	(2,559)	(498)	(873)	(402)	(786)	(259)
Preferred dividend	(28)	(24)	(23)	-	(23)	-	-	(14)
Net income for shareholders	(5,579)	(3,838)	(2,582)	(498)	(896)	(402)	(786)	(273)
Diluted earnings per share	(\$0.70)	\$0.43	(\$0.28)	(\$0.06)	(\$0.10)	(\$0.04)	(\$0.08)	(\$0.03)
Wtd shares outstanding	8,009	8,884	9,238	9,041	9,119	9,215	9,200	9,835
SELECTED MEASURES								
Sales growth, yr/yr	24.6%	17.0%	-0.6%					
Net income growth, yr/yr	150.7%	-31.3%	-32.9%					
EPS growth, yr/yr	70.7%	-161.4%	-165.1%					
Gross margin	15.5%	22.2%	23.8%	24.8%	26.1%	24.6%	19.2%	26.6%
Operating margin	-42.0%	-23.4%	-13.7%	-12.1%	-18.0%	-7.0%	-17.6%	-2.7%
Net margin	-42.5%	-25.0%	-16.9%	-14.6%	-20.7%	-10.0%	-22.3%	-6.5%
Direct costs as a % of sales	84.5%	77.8%	76.2%	75.2%	73.9%	75.4%	80.8%	73.4%
SG&A as a % of sales	55.2%	45.5%	33.2%	36.9%	28.9%	31.5%	36.8%	29.3%

Source: Company reports and Crystal Equity Research measures

**Table II: Historic Balances** (dollars in thousands)

	12/31/2007	12/31/2008	12/31/2009	3/31/2010
Current assets				
Cash and equivalents	743	229	1,306	235
Accounts receivable	1,161	897	866	3,177
Inventory	3,028	2,837	2,884	1,197
Prepaid expenses	77	68	99	534
Other current assets	16	-	-	-
<b>Total current assets</b>	<b>5,025</b>	<b>4,031</b>	<b>5,155</b>	<b>5,143</b>
PP&E	4,249	4,133	3,655	3,602
Other long-term assets	814	939	1,160	1,129
<b>Total assets</b>	<b>10,088</b>	<b>9,103</b>	<b>9,970</b>	<b>9,874</b>
Current liabilities				
Accounts payable	1,997	1,929	954	936
Lines of credit	-	1,354	1,415	881
Current portion of long-term debt/financing	27	16	166	172
Accrued liabilities	58	96	583	628
<b>Total current liabilities</b>	<b>2,082</b>	<b>3,395</b>	<b>3,118</b>	<b>2,617</b>
Long-term debt, less current portion	766	1,747	2,345	2,319
Capital leases	-	-	130	123
Stockholders' equity				
Preferred stock	481	471	1,674	1,574
Common stock	1	1	1	1
Paid-in-capital	17,838	18,408	20,203	21,014
Retained earnings (deficit)	(11,081)	(14,919)	(17,501)	(17,774)
<b>Stockholders' equity</b>	<b>7,239</b>	<b>3,961</b>	<b>4,377</b>	<b>4,815</b>
<b>Total liabilities and equity</b>	<b>10,087</b>	<b>9,103</b>	<b>9,970</b>	<b>9,874</b>

## SELECTED MEASURES

Working capital	2,943	636	2,037	2,526
Debt to equity	0.1	0.4	0.6	0.5
Productivity measures				
Growth in sales	24.6%	17.0%	-0.6%	
Growth in inventory	100.4%	-6.3%	1.7%	
Growth in accounts receivable	-1.9%	-22.7%	-3.5%	

Source: Company reports and Crystal Equity Research measures

**Table III: Historic Cash Flows** (dollars in thousands)

	2007	2008	2009	3/31/2010
<b>Cash flows from operations</b>				
Net income	(5,551)	(3,814)	(2,559)	(259)
Depreciation & amortization	205	355	469	148
Stock compensation expense	425	536	657	184
Write-off of note receivable	300	-	-	-
Loss on disposal of equipment	-	5	-	-
Impairment loss on assets	-	-	641	-
Working capital changes	(1,185)	450	(525)	(1,046)
Net cash provided by operations	(5,806)	(2,468)	(1,317)	(973)
<b>Cash flows from investing activities</b>				
Capital expenditures	(2,650)	(191)	(356)	(51)
Other investments	(300)	-	-	-
Net cash used by investing activities	(2,950)	(191)	(356)	(51)
<b>Cash flows from financing activities</b>				
Proceeds (payments) on debt, net	(100)	970	1,202	(40)
Proceeds (payments) on line of credit	(1,356)	1,354	61	(534)
Proceeds from issuance of equity	7,626	-	1,604	527
Proceeds from issuance of warrants	165	-	-	-
Decrease (increase) in restricted stock	1,580	-	-	-
Offering costs	(55)	(179)	(117)	-
Net cash from financing activities	7,860	2,145	2,750	(47)
Cash and equivalents, beginning of the year	1,638	743	229	1,306
Cash and equivalents, end of the year	742	229	1,306	235
<b>Selected Measures:</b>				
Free cash flow	(8,456)	(2,659)	(1,673)	(1,024)
Conversion ratio (CFO to sales)	-44.5%	-16.2%	-8.7%	-49.2%

Source: Company reports and Crystal Equity Research measures

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## ANALYST

Debra Fiakas, CFA is a seasoned, credentialed investment professional with a diversified and successful track record as a research analyst and as an investment banker. Her decade-plus career includes solid experience in all aspects of the equity capital markets with particular emphasis on emerging growth companies operating in the technology sectors. Ms. Fiakas is also the principal member of Crystal Equity Research, LLC.

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Speculative Buy	1	60%	Unproved business model; catalysts exist to generate higher returns
Accumulate	2	40%	Long-term return potential above 10%; near-term catalysts may not exist
Hold	0	0%	Total return potential below 10%; an acceptable long-term holding
Sell	0	0%	Potential return greater than negative 10%; take profits or stem losses
Not Rated	1	0%	No rating
Total	4	100%	

*\*Research universe categorized by rating only; Crystal Equity Research provides no investment banking services.*

## HISTORICAL RECOMMENDATIONS AND TARGET PRICE: Reed's, Inc. / REED

<u>Report</u>	<u>Date</u>	<u>Price</u>	<u>Rating</u>	<u>Target Price</u>
Initial	4/24/08	\$2.85	Speculative Buy	\$5.25
Update	5/22/08	\$2.40	Speculative Buy	\$5.25
Update	8/21/08	\$2.95	Speculative Buy	\$5.25
Update	11/14/08	\$1.59	Speculative Buy	\$5.25
Update	4/1/09	\$0.99	Speculative Buy	\$5.25
Update	5/14/09	\$2.12	Speculative Buy	\$5.25
Update	8/19/09	\$2.16	Speculative Buy	\$5.25
Update	11/19/09	\$1.50	Speculative Buy	\$5.25
Update	3/23/10	\$1.65	Speculative Buy	\$5.25
Update	4/5/10	\$1.66	Speculative Buy	\$5.25
Final	6/18/10	\$2.04	None	None

**DISCLOSURES**

<u>Name</u>	<u>Symbol: Exchange</u>	<u>Disclosures</u>
Reed's, Inc.	REED: Nasdaq	D*

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- E The company has a convertible issue outstanding.
- F The securities covered in this report can be optioned.
- G The securities covered in this report can be margined.

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