REEDS INC
Form 10-Q
May 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

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

For the transition period from__ to___

Commission file number

Commission file number: 001-32501

REED'S INC.

(Exact name of registrant as specified in its charter)

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

13000 South Spring St. Los Angeles, Ca. 90061

(Address of principal executive offices) (Zip Code)

(310) 217-9400

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes S No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes S 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 S

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: There were a total of 12,525,761 shares of Common Stock outstanding as of May 13, 2013.

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 of Part I of this report include forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as "may," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "proposed," "intended," or "continue" or the negative of these terms or other comparable terminology. You should read statements that contain these words carefully, because they discuss our expectations about our future operating results or our future financial condition or state other "forward-looking" information. There may be events in the future that we are not able to accurately predict or control. Before you invest in our securities, you should be aware that the occurrence of any of the events described in this Quarterly Report could substantially harm our business, results of operations and financial condition, and that upon the occurrence of any of these events, the trading price of our securities could decline and you could lose all or part of your investment. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, growth rates, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report to conform these statements to actual results.

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Part I – FINANCIAL INFORMATION

Item 1. Financial Statements

REED'S, INC.

CONDENSED BALANCE SHEETS

	March 31, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash	$726,000	$1,163,000
Inventory	6,301,000	5,794,000
Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of $300,000 and $399,000, respectively	2,228,000	1,961,000
Prepaid inventory	190,000	201,000
Prepaid and other current assets	251,000	212,000
Total Current Assets	9,696,000	9,331,000
Property and equipment, net of accumulated depreciation of $2,471,000 and $2,351,000, respectively	3,400,000	3,422,000
Brand names	1,029,000	1,029,000
Deferred financing fees, net of amortization of $38,000 and $26,000, respectively	42,000	54,000
Total assets	$14,167,000	$13,836,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$3,396,000	$3,368,000
Accrued expenses	209,000	233,000
Dividends payable	–	74,000
Line of credit	3,665,000	3,023,000
Current portion of long term financing obligation	95,000	90,000
Current portion of capital leases payable	72,000	69,000
Current portion of term loan	183,000	176,000
Total current liabilities	7,620,000	7,033,000
Long term financing obligation, less current portion, net of discount of $563,000 and $576,000, respectively	2,195,000	2,208,000
Capital leases payable, less current portion	79,000	98,000
Term loan, less current portion	350,000	399,000
Total Liabilities	10,244,000	9,738,000

Commitments and contingencies		
Stockholders' equity:		
Series A Convertible Preferred stock, $10 par value, 500,000 shares authorized, 10,411 and 10,411 shares issued and outstanding, respectively	104,000	104,000
Series B Convertible Preferred stock, $10 par value, 500,000 shares authorized, 0 and 45,062 shares issued and outstanding, respectively	–	456,000
Common stock, $.0001 par value, 19,500,000 shares authorized, 12,518,333 and 12,084,673 shares issued and outstanding, respectively	1,000	1,000
Additional paid in capital	24,680,000	23,996,000
Accumulated deficit	(20,862,000)	(20,459,000)
Total stockholders' equity	3,923,000	4,098,000
Total liabilities and stockholders' equity	$14,167,000	$13,836,000

The accompanying notes are an integral part of these condensed financial statements

REED'S, INC.

CONDENSED STATEMENTS OF OPERATIONS

For the Three Months Ended March 31, 2013 and 2012

(Unaudited)

	Three months ended March 31,	
	2013	2012
Sales	$8,126,000	$6,539,000
Cost of tangible goods sold	4,905,000	4,185,000
Cost of goods sold – idle capacity	686,000	369,000
Gross profit	2,535,000	1,985,000
Operating expenses:		
Delivery and handling expense	906,000	479,000
Selling and marketing expense	880,000	722,000
General and administrative expense	988,000	740,000
Total operating expenses	2,774,000	1,941,000
(Loss) income from operations	(239,000)	44,000
Interest expense	(164,000)	(168,000)
Net loss	(403,000)	(124,000)
Preferred stock dividend	–	(9,000)
Net loss attributable to common stockholders	$(403,000)	$(133,000)
Loss per share available to common stockholders - basic and diluted	$(0.03)	$(0.01)
Weighted average number of shares outstanding - basic and diluted	12,320,516	10,921,076

The accompanying notes are an integral part of these condensed financial statements

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REED'S, INC.

CONDENSED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

For the Nine Months Ended March 31, 2013

(unaudited)

	Common Stock		Series A Preferred Stock		Series B Preferred Stock		Additional Paid-In	Accumulated	Total Stockholder
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Deficit	Equity
Balance, December 31, 2012	12,084,673	$1,000	10,411	$104,000	45,602	$456,000	$23,996,000	$(20,459,000)	$4,098,000
Fair Value of common stock issued for services	1,250	–	–	–	–	–	5,000	–	5,000
Cashless exercise of stock options	64,117	–	–	–	–	–	30,000	–	30,000
Proceeds from exercise of warrants	1,189	–	–	–	–	–	–	–	–
Common stock issued upon conversion of Series B preferred stock	319,214	–	–	–	(45,602)	(456,000)	456,000	–	–
Fair value vesting of options issued to employees	–	–	–	–	–	–	119,000	–	119,000
Common stock paid for Series B preferred stock dividend	47,890	–	–	–	–	–	74,000	–	74,000
Net loss	–	–	–	–	–	–	–	(403,000)	(403,000)
Balance, March 31, 2013	12,518,333	$1,000	10,411	$104,000	–	–	$24,680,000	$(20,862,000)	$3,923,000

The accompanying notes are an integral part of these condensed financial statements

REED'S, INC.

CONDENSED STATEMENTS OF CASH FLOWS

For the Three Months Ended March 31, 2013 and 2012

(Unaudited)

	Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net loss	$(403,000)	$(124,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	145,000	183,000
Fair value of stock options issued to employees	119,000	26,000
Fair value of common stock issued for services and bonus	5,000	15,000
Allowance for doubtful accounts and returns	40,000	–
Changes in assets and liabilities:		
Accounts receivable	(307,000)	(464,000)
Inventory	(507,000)	(113,000)
Prepaid inventory and prepaid other current assets	(28,000)	(97,000)
Accounts payable	28,000	233,000
Accrued expenses	(24,000)	(22,000)
Net cash used in operating activities	(932,000)	(363,000)
Cash flows from investing activities:		
Purchase of property and equipment	(98,000)	(110,000)
Net cash used in investing activities	(98,000)	(110,000)
Cash flows from financing activities:		
Proceeds from stock option exercises	30,000	–
Principal repayments on long term financing obligation	(21,000)	(15,000)
Principal repayments on capital lease obligation	(16,000)	(14,000)
Principal repayments on term loan	(42,000)	(36,000)
Net draw down (repayments) on lines of credit	642,000	(74,000)
Net cash provided by (used in) financing activities	593,000	(139,000)
Net decrease in cash	(437,000)	(612,000)
Cash at beginning of period	1,163,000	713,000
Cash at end of period	$726,000	$101,000
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$164,000	$168,000
Non cash investing and financing activities:		
Series B Preferred stock converted to common stock	$456,000	$81,000
Series B Preferred stock dividend payable in common stock	–	$9,000
Common stock issued in settlement of Series B preferred stock dividend	$74,000	$8,000

The accompanying notes are an integral part of these condensed financial statements

REED'S, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

Three Months Ended March 31, 2013 and 2012 (UNAUDITED)

1. Basis of Presentation

The accompanying interim condensed financial statements are unaudited, but in the opinion of management of Reeds, Inc. (the "Company"), contain all adjustments, which include normal recurring adjustments necessary to present fairly the financial position at March 31, 2013 and the results of operations and cash flows for the three months ended March 31, 2013 and 2012. The balance sheet as of December 31, 2012 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 condensed 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 on Form 10-K, as filed with the Securities and Exchange Commission on March 25, 2013 and amended on April 15, 2013.

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. Those estimates and assumptions include estimates for reserves of uncollectible accounts, inventory obsolescence, analysis of impairments of recorded intangibles, accruals for potential liabilities and assumptions made in valuing stock instruments issued for services.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2013.

Income (Loss) per Common Share

Basic earnings (loss) per share is computed by dividing the net income (loss) applicable to common stock holders by the weighted average number of shares of common stock outstanding during the year. Diluted earnings (loss) per share is computed by dividing the net income (loss) applicable to common stock holders by the weighted average number of common shares outstanding plus the number of additional common shares that would have been outstanding if all dilutive potential common shares had been issued, using the treasury stock method. Potential common shares are excluded from the computation when their effect is antidilutive.

For the three months ended March 31, 2013 and 2012 the calculations of basic and diluted loss per share are the same because potential dilutive securities would have an anti-dilutive effect. The potentially dilutive securities consisted of the following as of:

	March 31, 2013	March 31, 2012
Warrants	317,253	1,806,870
Series A Preferred Stock	41,644	186,484
Series B Preferred Stock	–	506,170
Options	839,669	1,097,000
Total	1,198,586	3,596,524

Recent Accounting Pronouncements

There are recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the Securities Exchange Commission (the "SEC"), such pronouncements are not believed by management to have a material impact on the Company's present or future financial statements.

Concentrations

The Company’s cash balances on deposit with banks are guaranteed by the Federal Deposit Insurance Corporation up to $250,000. 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 guarantee during the three months ended March 31, 2013.

During the three months ended March 31, 2013 and 2012, the Company had two customers, which accounted for approximately 35% and 10% of sales in 2013, and 32% and 14% of sales in 2012, respectively. No other customers accounted for more than 10% of sales in either period. As of March 31, 2013 the Company had accounts receivable due from a customer who comprised $707,000 (28%) of its total accounts receivable and as of December 31, 2012 the Company had accounts receivable due from two customers who comprised $580,000 (25%), and $340,000 (14%), respectively, of its total accounts receivable.

Advertising

Advertising costs are expensed as incurred. For the three months ended March 31, 2013 and 2012, advertising costs were $21,000 and $18,000, respectively.

Fair Value of Financial Instruments

The Company uses various inputs in determining the fair value of its investments and measures these assets on a recurring basis. Financial assets recorded at fair value in the balance sheets are categorized by the level of objectivity associated with the inputs used to measure their fair value. Authoritative guidance provided by the FASB defines the following levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these financial assets:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.

Level 3—Unobservable inputs based on the Company's assumptions.

The Company had no such assets or liabilities recorded to be valued on the basis above at March 31, 2013 or December 31, 2012.

2. Inventory

Inventory consists of the following as of:

	March 31, 2013	December 31, 2012
Raw Materials and Packaging	$3,984,000	$3,524,000
Finished Goods	2,317,000	2,270,000
	$6,301,000	$5,794,000

3. Property and Equipment

Property and equipment are comprised of the following as of:

	March 31, 2013	December 31, 2012
Land	$1,108,000	$1,108,000
Building	1,752,000	1,737,000
Vehicles	335,000	320,000
Machinery and equipment	2,238,000	2,174,000
Office equipment	438,000	434,000
	5,871,000	5,773,000
Accumulated depreciation	(2,471,000)	(2,351,000)
	$3,400,000	$3,422,000

Machinery and equipment at March 31, 2013 and December 31, 2012 includes equipment held under capital leases of $309,000. Accumulated depreciation on equipment held under capital leases was $179,000 and $149,000 at March 31, 2013 and December 31, 2012, respectively.

4. Line of Credit

At March 31, 2013 and December 31, 2012, the aggregate amount outstanding under the line of credit was $3,665,000 and $3,023,000 respectively, and the Company had approximately $211,000 of availability on this line of credit at March 31, 2013. The interest rate on the revolving line of credit is at the prime rate plus 3.75% (7% at March 31, 2013) The line of credit is based on 85% of eligible accounts receivable and 50% of eligible inventory. The line of credit expires on November 7, 2014 and is secured by substantially all of the Company’s assets.

5. Term Loan

The term loan bears interest at the prime rate plus 11.6%, which shall not be below 14.85%, is secured by all of the unencumbered assets of the Company, and is to be repaid in 48 equal installments of principal and interest of $21,000.

	March 31, 2013	December 31, 2012
	(unaudited)	
Term loan	$533,000	$575,000
Less current portion	(183,000)	(176,000)
Long term debt	$350,000	$399,000

6. Long-term Financing Obligation

In 2009 the Company sold two buildings and its brewery equipment and concurrently entered into a long-term lease agreement for the same property and equipment. In connection with the lease the Company has the option to repurchase the buildings and brewery equipment from 12 months after the commencement date to the end of the lease term at the greater of the fair market value or an agreed upon amount. Since the lease contains a buyback provision and other related terms, the Company determined it had continuing involvement that did not warrant the recognition of a sale; therefore, the transaction has been accounted for as a long-term financing. The proceeds from the sale, net of transaction costs, have been recorded as a financing obligation in the amount of $3,056,000. Monthly payments under the financing agreement are recorded as interest expense and a reduction in the financing obligation at an implicit rate of 9.9%. The financing obligation is personally guaranteed up to a limit of $150,000 by the principal shareholder and Chief Executive Officer.

In connection with the financing obligation, the Company issued an aggregate of 400,000 warrants to purchase its common stock at $1.20 per share for five years. The 400,000 warrants were valued at $752,000 and reflected as a debt discount, using the Black Scholes option pricing model. The following assumptions were utilized in valuing the 400,000 warrants: strike price of $2.10 to $2.25; term of 5 years; volatility of 91.36% to 110.9%; expected dividends 0%; and discount rate of 2.15% to 2.20%. The 400,000 warrants were recorded as valuation discount and are being amortized over 15 years, the term of the purchase option. Amortization of valuation discount during the three months ended March 31, 2013 and 2012 was $13,000 and $12,000, respectively.

Long term financing obligation is comprised of the following as of:

	March 31, 2013 (unaudited)	December 31, 2012
Financing obligation	$2,853,000	$2,874,000
Valuation discount	(563,000)	(576,000)
	2,290,000	2,298,000
Less current portion	(95,000)	(90,000)
Long term financing obligation	$2,195,000	$2,208,000

7. Stockholders' Equity

Preferred Stock

During the three months ended March 31, 2013, the remaining 45,602 shares of Series B Convertible Preferred Stock were converted to 319,214 shares of common stock. Accrued dividends of $74,000 were paid by issuing 47,890 shares of common stock.

Common Stock

During the three months ended March 31, 2013, the Company issued 1,250 shares of common stock for services at $4.00 per share with a value of $5,000 for services rendered.

8. Stock Based Compensation

Stock Options

During the three months ended March 31, 2013, the Company issued 311,000 incentive stock options at the market price of $4.00 per share. Total stock-based compensation recognized on the Company's statement of operations for the three months ended March 31, 2013 was $119,000 as compared to 2012 expense of $26,000. As of March 31, 2013, the aggregate value of unvested options was $615,000, which will vest over an average period of two or three years. There were 78,331 stock options exercised in the three months ended March 31, 2013 at exercise prices between $0.75 and $2.02. The Company received $30,000 for 35,000 of such exercises and allowed cash-less exercise of 43,331 of such options and issued 29,117 shares of common stock.

Stock options granted under our equity incentive plans generally vest over 2 to 3 years from the date of grant, 1/2 and 1/3 per year, respectively; and expire 5 years from the date of grant. The following table summarizes stock option activity for the three months ended March 31, 2013:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2012	607,000	$ 1.27		
Granted	311,000	$ 4.00		
Exercised	(78,331)	$ 1.27		
Forfeited or expired	–	–		
Outstanding at March 31, 2013	839,669	$ 2.28	4.0	$1,502,000
Exercisable at March 31, 2013	383,252	$ 1.50	3.7	$982,000

The aggregate intrinsic value was calculated as the difference between the market price and the exercise price of the Company's common stock, which was $4.08 as of March 31, 2013.

The following table summarizes information about stock options at March 31, 2013:

	Options Outstanding at March 31, 2013			Options Exercisable at March 31, 2013	
Range of Exercise Price	Number of Shares Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number of Shares Exercisable	Weighted Average Exercise Price
$0.01 - $1.99	417,002	3.7	$1.07	277,834	$1.02
$2.00 - $4.99	422,667	4.4	$3.47	51,666	$2.06
$5.00 - $6.99	-	-	-	-	-
$7.00 - $8.50	-	-	-	-	-
	839,669			383,252	

Stock Warrants

During the three months ended March 31, 2013, 2,000 warrants were exercised at $2.25. The Company issued 1,189 shares of common stock. The following table summarizes stock warrant activity for the three months ended March 31, 2013:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2012	317,253	$ 2.40		
Granted	–	–		
Exercised	(2,000)	$ 2.25		
Forfeited or expired	–	–		
Outstanding at March 31, 2013	315,253	$ 2.40	2.7	$528,000
Exercisable at March 31, 2013	315,253	$ 2.40	2.7	$528,000

The intrinsic value was calculated as the difference between the market price and the exercise price of the Company's common stock, which was $4.08 as of March 31, 2013.

9. Income Taxes

For the three and three months ended March 31, 2013 and March 31, 2012, net loss was $354,000 and $133,000, respectively, and no income tax provision was recorded.

In accordance with Accounting Standards Codification ("ASC") 740-10, *Income Taxes*, the Company evaluates its deferred tax assets to determine if a valuation allowance is required based on the consideration of all available evidence using a "more likely than not" standard, with significant weight being given to evidence that can be objectively verified. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability; the length of statutory carryover periods for operating losses and tax credit carryovers; and available tax planning alternatives. Our deferred tax assets are composed primarily of U.S. federal net operating loss carryforwards. Based on available objective evidence, management believes it is more likely than not that these deferred tax assets are not recognizable and will not be recognizable until its determined that we have sufficient taxable income. Under ASC 740-10, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. ASC 740-10 also provides guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods, and disclosures. As of March 31, 2013 or 2012, the Company does not have a liability for unrecognized tax uncertainties.

10. Subsequent Events

On April 3, 2013, there were 10,334 incentive stock options exercised at prices of $2.00 and $1.14 per share.

On May 1, 2013 the term loan was increased from $533,000 to $750,000 under the same terms as the existing term loan. The Company was also granted an over advance on its revolving line of credit of $200,000.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes appearing elsewhere in this report. This discussion and analysis may contain forward-looking statements based on assumptions about our future business.

Overview

Our first quarter results reflect our continued sales growth in all products and regions. Our kombucha rollout is gaining sales momentum and the product line is anticipated to become a material part of our overall sales mix during 2013. We are addressing the challenges of kombucha production, which has used an inordinate portion of our plant production schedule. We are currently placing a strong focus on increasing our Los Angeles plant capacity so that we can accommodate our private label production, our kombucha production, and meet the west coast requirements for our Reed's and Virgil's products. Increased capacity can greatly mitigate the increases in delivery costs that we are currently experiencing from cross-country delivery of our products to the western regions.

We are investing in promotions at a higher rate than last year and we feel that this has helped lift our sales volumes without margin erosion. Our promotions have generally been concentrated at retail grocer level, along with incentives for distributors to feature our brands and reduce retail price points to drive incremental revenues.

Results of Operations

Three months ended March 31, 2013 Compared to Three months ended March 31, 2012

Sales

Sales of $8,126,000 for the three months ended March 31, 2013 represented an increase of 24% from $6,539,000 in the prior year same period. Sales growth was driven primarily by continued increases in sales volume in our branded products as we expand our distribution networks. We have been steadily adding distributors and expanding our product offerings to existing customers. Private label sales also increased at approximately the same rate and

comprised approximately 15% of overall sales in the both quarters ended March 31, 2013 and March 31, 2012. Kombucha sales comprised approximately 7% of case volume sales in the 2013 quarter, which were not a part of the 2012 sales.

Cost of Tangible Goods Sold

Cost of tangible goods sold consists of the costs of raw materials utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, as well as certain internal transfer costs. As a percentage of net sales, our Cost of Tangible Goods Sold decreased to 60% in the three months ended March 31, 2013 as compared to 64% in the three months ended March 31, 2012. The decrease in these costs, compared to sales, is primarily due to improved margins on our private label sales in 2013. The costs of our branded 12-ounce soft drink sales remained constant, as a percentage of sales. While our costs to produce kombucha are higher on a per-unit basis, the costs are lower than our carbonated soft drinks as a percentage of sales, due to the higher price point on kombucha.

Cost of Goods Sold – Idle Capacity

Cost of goods sold – idle capacity consists of direct production costs of our Los Angeles plant in excess of charges allocated to our finished goods in production. Plant costs include labor costs, production supplies, repairs and maintenance, and inventory write-off. Our charges for labor and overhead allocated to our finished goods are determined on a market cost basis, which is lower than our actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced. Idle capacity expenses increased to $686,000 in the three months ended March 31, 2013, from $369,000 in 2012. Our Los Angeles plant production has increased by over 20% in the first quarter, as compared to 2012. Plant costs, including labor, increased by approximately 50%. During the quarter, we continued to experience very slow overall copack rates on our Kombucha, due to filling and labeling methods. We are aggressively improving our methods and we believe that our plant capacity is increasing. As we refine our production methods, we feel that these costs will reduce in the future.

Gross Profit

Our gross profit of $2,535,000 in the three months ended March 31, 2013 represents an increase of $550,000, or 28% from 2012. As a percentage of sales, our gross profit increased to 31% in 2013 as compared to 30% in 2012. The improvement is primarily due to increased revenues and gross margin percentage on private label sales.

Delivery and Handling Expenses

Delivery and handling expenses consist of delivery costs to customers and warehouse costs incurred for handling our finished goods after production. Delivery costs increased by 89% in the three months ended March 31, 2013 to $906,000 from $479,000 in 2012. The increase is primarily due to a higher portion of our branded products being manufactured at our copacker in Pennsylvania for west coast customers, requiring additional freight costs for delivery. We also experienced stronger sales growth in the Pacific Northwest, the region of highest delivery freight cost. During the winter months, we are often required to use refrigerated shipping to prevent freezing in transit, causing higher freight rates. We anticipate that delivery costs will reduce in future quarters, as a percentage of sales, because we will only use refrigerated freight for our kombucha and because we are adding capacity to our plant, enabling more manufacturing of branded products on the west coast.

Selling and marketing expenses

Selling and marketing expenses consist primarily of direct charges for staff compensation costs, advertising, sales promotion, marketing and trade shows. Selling and marketing costs increased overall to $880,000 in the three months ended March 31, 2013 from $722,000 in 2012. The $158,000 increase is primarily due to increased compensation and travel costs of $55,000, increased stock option expense of $44,000, increased trade show promotion and advertising costs of $32,000, and increased delivery and facilities related costs of $23,000. Our sales staff has increased from 13 at March 31, 2012 to 19 at March 31, 2013. We believe that our sales staffing is adequate for our current business level; however, we will continue to add salespeople as our revenue base increases.

General and Administrative Expenses

General and administrative expenses consist primarily of the cost of executive, administrative, and finance personnel, as well as professional fees. General and administrative expenses increased to $988,000 during the three months ended March 31, 2013 from $740,000 in the same period of 2012. Compensation and related costs increased by $105,000, primarily due to an increase of one staff member and payment of bonuses in the first quarter of 2013. Stock

option expense increased by $44,000, and professional and legal costs increased by $56,000 and bad debt costs increased by $40,000.

We believe that our existing executive and administrative staffing levels are sufficient to allow for moderate growth without the need to add personnel and related costs for the foreseeable future.

Income/Loss from Operations

Our loss from operations was $239,000 in the three months ended March 31, 2013 as compared to income from operations of $44,000 in the same period of 2012. The loss was primarily a result of increases in delivery costs and idle plant capacity costs described above.

Interest Expense

Interest expense decreased to $164,000 in the three months ended March 31, 2013, compared to interest expense of $168,000 in the same period of 2012.

Modified EBITDA

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

MODIFIED EBITDA SCHEDULE

	Three Months Ended March 31,	
	2013	2012
Net loss	$(403,000)	$(124,000)
Modified EBITDA adjustments:		
Depreciation and amortization	145,000	183,000
Interest expense	164,000	168,000
Stock option compensation	119,000	26,000
Other stock compensation for services	–	15,000
Total EBITDA adjustments	428,000	392,000
Modified EBITDA income from operations	$25,000	$268,000

Liquidity and Capital Resources

As of March 31, 2013, we had stockholders equity of $3,923,000 and we had working capital of $2,076,000, compared to stockholders equity of $4,098,000 and working capital of $2,298,000 at December 31, 2012. The decrease in our working capital of $22,000 was primarily a result of net losses and pay downs on our long-term debt.

Our decrease in cash and cash equivalents to $726,000 at March 31, 2013 compared to $1,163,000 at December 31, 2012 was primarily a result of cash used by operating activities of $932,000, costs of plant improvements of $98,000, and principal payments on debt of $79,000. Such cash used by operations was offset primarily by net drawdown on our revolving line of credit of $642,000 and proceeds from the exercise of stock options and warrants of $30,000. In addition to our cash position on March 31, 2013, we had availability under our line of credit of $211,000.

Our Loan and Security Agreement with PMC Financial Services Group, LLC provides a $4 million revolving line of credit and a $750,000 term loan. The revolving line of credit is based on 85% of eligible accounts receivable and 50% of eligible inventory. The interest rate on the revolving line of credit is at the prime rate plus 3.75% (7% at December 31, 2012). The term loan is for $750,000 and bears interest at the prime rate plus 11.6%, which shall not be below 14.85%, is secured by all of the unencumbered assets of the Company, and is to be repaid in 48 equal installments of principal and interest of $21,000. At March 31, 2013, out term loan balance was $533,000. On May 1, 2013 the term loan was increased to $750,000 under the same terms as the existing term loan. The Company was also granted an over advance on its revolving line of credit of $200,000.

We believe that the Company currently has the necessary working capital to support existing operations for at least the next 12 months. Our primary capital source will be positive cash flow from operations. If our sales goals do not

materialize as planned, we believe that the Company can reduce its operating costs and can be managed to maintain positive cash flow from operations. Historically, we have financed our operations primarily through private sales of common stock, preferred stock, convertible debt, a line of credit from a financial institution and cash generated from operations.

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

If we suffer losses from operations, our working capital may be insufficient to support our ability to expand our business operations as rapidly as we would deem necessary at any time, unless we are able to obtain additional financing. There can be no assurance that we will be able to obtain such financing on acceptable terms, or at all. If adequate funds are not available or are not available on acceptable terms, we may not be able to pursue our business objectives and would be required to reduce our level of operations, including reducing infrastructure, promotions, personnel and other operating expenses. These events could adversely affect our business, results of operations and financial condition. If adequate funds are not available or if they are not available on acceptable terms, our ability to fund the growth of our operations, take advantage of opportunities, develop products or services or otherwise respond to competitive pressures, could be significantly limited.

Critical Accounting Policies and Estimates

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

Revenue Recognition. Revenue is recognized on the sale of a product when the 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. The Company reimburses its wholesalers and retailers for promotional discounts, samples and certain advertising and promotional activities used in the promotion of the Company's products. The accounting treatment for the reimbursements for samples and discounts to wholesalers results in a reduction in the net revenue line item. Reimbursements to wholesalers and retailers for certain advertising activities are included in selling and marketing expenses.

Trademark License and Trademarks. We own trademarks that we consider material to our business. Three of our material trademarks are registered trademarks in the U.S. Patent and Trademark Office: Virgil's ®, Reed's Original Ginger Brew All-Natural Jamaican Style Ginger Ale ® and Tianfu China Natural Soda ®. Registrations for trademarks in the United States will last indefinitely as long as we continue to use and police the trademarks and renew filings with the applicable governmental offices. We have not been challenged in our right to use any of our material trademarks in the United States. We intend to obtain international registration of certain trademarks in foreign jurisdictions.

We account for these items in accordance with FASB guidance; we do not amortize indefinite-lived trademark licenses and trademarks.

In accordance with FASB guidance, 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 year ended December 31, 2012.

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 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 year ended December 31, 2012.

Management believes that the accounting estimate related to impairment of our long lived assets, including our trademark license and trademarks, is a "critical accounting estimate" because: (1) it is highly susceptible to change from period to period because it requires management to estimate fair value, which is based on assumptions about cash flows and discount rates; and (2) the impact that recognizing an impairment would have on the assets reported on our balance sheet, as well as net income, could be material. Management's assumptions about cash flows and discount rates require significant judgment because actual revenues and expenses have fluctuated in the past and we expect they will continue to do so.

In estimating future revenues, we use internal budgets. Internal budgets are developed based on recent revenue data for existing product lines and planned timing of future introductions of new products and their impact on our future cash flows.

Accounts Receivable. We evaluate the collectability of our trade accounts receivable based on a number of factors. In circumstances where we become aware of a specific customer's inability to meet its financial obligations to us, a specific reserve for bad debts is estimated and recorded which reduces the recognized receivable to the estimated amount our management believes will ultimately be collected. In addition to specific customer identification of potential bad debts, bad debt charges are recorded based on our historical losses and an overall assessment of past due trade accounts receivable outstanding.

Inventories. Inventories are stated at the lower of cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review our inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and/or our ability to sell the product(s) concerned and production requirements. Demand for our products can fluctuate significantly. Factors that could affect demand for our products include unanticipated changes in consumer preferences, general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by customers. Additionally, our management's estimates of future product demand may be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory.

Stock-Based Compensation. We periodically issue stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on FASB ASC Topic 718, "Compensation – Stock Compensation", whereas the award is measured at its fair value at the date of grant and is amortized ratably over the vesting period. We account for stock option and warrant grants issued and vesting to non-employees in accordance with ASC Topic 718 whereby the fair value of the stock compensation is based on the measurement date as determined at either (a) the date at which a performance commitment is reached, or (b) at the date at which the necessary performance to earn the equity instrument is complete.

We estimate the fair value of stock options using the Black-Scholes option-pricing model, which was developed for use in estimating the fair value of options that have no vesting restrictions and are fully transferable. This model requires the input of subjective assumptions, including the expected price volatility of the underlying stock and the expected life of stock options. Projected data related to the expected volatility of stock options is based on the historical volatility of the trading prices of the Company's common stock and the expected life of stock options is based upon the average term and vesting schedules of the options. Changes in these subjective assumptions can materially affect the fair value of the estimate, and therefore the existing valuation models do not provide a precise measure of the fair value of our employee stock options.

We believe there have been no significant changes, during the year ended December 31, 2012, to the items disclosed as critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

Recent Accounting Pronouncements

There were recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the Securities Exchange Commission (the "SEC"), such pronouncements are not believed by management to have a material impact on the Company's present or future financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

A smaller reporting company is not required to provide the information required by this Item.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Securities and Exchange Act of 1934 Rules 13a-15(f). Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2013.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the three months ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various legal proceedings from time to time in the ordinary course of business, none of which are required to be disclosed under this Item 1.

Item 1A. Risk Factors

A smaller reporting company is not required to provide the information required by this Item.

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

During the three months ended March 31, 2013, the Company issued 1,250 shares of common stock for services at a price of $4.00 with a value of $5,000. Such issuances are exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, on the basis of each recipient's pre-existing relationship with the Company and the fact that no public offering was involved.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

On May 1, 2013 the term loan was increased from $533,240 to $750,000 under the same terms as the existing term loan. The Company was also granted an over advance on its revolving line of credit of $200,000.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

101.INS	XBRL Instance Document*
101.SCH	XBRL Schema Document*
101.CAL	XBRL Calculation Linkbase Document*
101.DEF	XBRL Definition Linkbase Document*
101.LAB	XBRL Label Linkbase Document*
101.PRE	XBRL Presentation Linkbase Document*

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*filed herewith

In accordance with SEC Release 33-8238, Exhibits 32.1 and 32.2 are being furnished and not filed.

Furnished herewith, XBLR (Extensive Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Reed's, Inc.

(Registrant)

Date: May 14, 2013 /s/ Christopher J. Reed
Christopher J. Reed
President and Chief Executive Officer
(Principal Executive Officer)

/s/ James Linesch
Date: May 14, 2013
James Linesch
Chief Financial Officer

(Principal Financial Officer)

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