REEDS INC
Form 10QSB/A
September 14, 2006

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

FORM 10-QSB/A

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

Commission file number: 333-120451

REED'S INC.

(Exact name of registrant as specified in its charter)

Delaware

(State of incorporation)

95-4348325

(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)

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 x No o

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

There were 5,335,482 shares of the registrant's common stock outstanding as of June 30, 2006.

Part I - Financial Information

Item 1. Financial Statements

REED'S, INC

CONDENSED BALANCE SHEETS

ASSETS

	June 30,2006 (Unaudited)	December 31, 2005
CURRENT ASSETS		
Cash	$ 54,768	$ 27,744
Inventory	1,275,819	1,208,019
Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of $101,000 as of June 30, 2006 and $70,000 as of December 31, 2005	982,484	534,906
Other receivables	6,267	10,563
Prepaid expenses	106,311	74,279
Total Current Assets	2,425,649	1,855,511
Property and equipment, net of accumulated depreciation of $566,449 as of June 30, 2006 and $508,136 as of December 31, 2005	1,864,011	1,885,354
OTHER ASSETS		
Brand names	800,201	800,201
Other intangibles, net of accumulated amortization of $4,095 as of June 30, 2006 and $3,723 as of December 31, 2005	14,519	14,891
Deferred stock offering costs	20,000	356,238
Total Other Assets	834,720	1,171,330
TOTAL ASSETS	**$** 5,124,380	$ 4,912,195
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)		
CURRENT LIABILITIES		
Accounts payable	$ 2,381,103	$ 1,644,491
Lines of credit	1,463,461	1,445,953
Current portion of long term debt	191,516	169,381
Accrued interest	154,191	136,240
Accrued expenses	75,769	54,204
Total Current Liabilities	4,266,040	3,450,269
Loans payable, related party	252,358	252,358
Long term debt, less current portion	984,568	1,060,573
Total Liabilities	5,502,966	4,763,200
COMMITMENTS AND CONTINGENCIES		

STOCKHOLDERS' EQUITY (DEFICIENCY)		
Preferred stock, $10.00 par value, 500,000 shares authorized, 58,940 outstanding	589,402	589,402
Common stock, $.0001 par value, 11,500,000 shares authorized, 5,335,482 shares issued and outstanding at June 30, 2006 and 5,042,197 at December 31, 2005	533	503
Common stock to be issued	—	29,470
Additional paid in capital	3,276,847	2,788,683
Accumulated deficit	(4,245,368)	(3,259,063)
Total stockholders' equity (deficiency)	(378,586)	148,995
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)	$ 5,124,380	$ 4,912,195

See accompanying Notes to Condensed Financial Statements

REED'S, INC.

CONDENSED STATEMENTS OF OPERATIONS
For the Three and Six Months Ended June 30, 2006 and 2005
(Unaudited)

	Three months ended (Unaudited)		Six months ended (Unaudited)	
	June 30, 2006	**June 30, 2005**	**June 30, 2006**	**June 30, 2005**
SALES	$ 3,157,818	$ 2,582,273	$ 5,137,089	$ 4,399,608
COST OF SALES	2,589,864	2,069,274	4,278,741	3,555,561
GROSS PROFIT	567,954	512,999	858,348	844,047
OPERATING EXPENSES				
Selling	313,462	236,218	600,619	521,116
General & Administrative	386,995	244,502	649,656	456,599
Expenses associated with rescission offer on prior sales of common stock	351,757	—	351,757	—
Legal fees	5,230	—	14,797	—
Total Operating Expenses	1,057,444	480,720	1,616,829	977,715
INCOME (LOSS) FROM OPERATIONS	(489,490)	32,279	(758,481)	(133,668)
OTHER EXPENSES				
Interest Expense	(97,748)	(90,327)	(198,354)	(161,534)
NET LOSS	(587,238)	(58,048)	(956,835)	(295,202)
Preferred stock dividend	(29,470)	(29,470)	(29,470)	(29,470)
Net loss attributable to common shareholders	$ (616,708)	$ (87,518)	$ (986,305)	$ (324,672)
LOSS PER SHARE — Basic and Diluted	$ (.12)	$ (.02)	$ (.19)	$ (.07)
WEIGHTED AVERAGE SHARES OUTSTANDING, BASIC AND DILUTED	5,322,755	4,812,710	5,239,913	4,769,640

See accompanying Notes to Condensed Financial Statements

REED'S INC.

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY(DEFICICENCY)
For the six months ended June 30, 2006 (Unaudited)

	Common Stock		Common Stock to be	Additional Paid in	Preferred Stock		Accumulated	
	Shares	Amount	Issued	Capital	Shares	Amount	Deficit	Total
Balance, January 1, 2006	5,042,197	$ 503	29,470	$ 2,788,683	58,940	$ 589,402	$ (3,259,063)	$ 148,995
Preferred Stock Dividend	7,373	1	—	29,469	—	—	(29,470)	—
Common stock issued in connection with the June 30, 2005 preferred stock dividend	7,362	1	(29,470)	29,469	—	—	—	—
Common stock issued for cash, net of offering costs	278,550	28	—	429,226	—	—	—	429,254
Net Loss for the six months ended June 30, 2006	—	—	—	—	—	—	(956,835)	(956,835)
Balance, June 30, 2006	5,335,482	$ 533	$ —	$ 3,276,847	58,940	$ 589,402	$ (4,245,368)	$ (378,586)

See accompanying Notes to Condensed Financial Statements

REED'S INC.

CONDENSED STATEMENTS OF CASH FLOWS
For the six months ended June 30, 2006 and 2005
(Unaudited)

	Six Months Ended (Unaudited)	
	June 30, 2006	June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	$ (956,835)	$ (295,202)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	58,684	46,610
Changes in operating assets and liabilities:		
Accounts receivable	(447,578)	(67,305)
Inventory	(67,800)	103,424
Prepaid Expenses	(32,032)	(33,264)
Other receivables	4,296	(5,631)
Accounts payable	736,612	252,032
Accrued expenses	21,565	(6,684)
Accrued interest	17,951	3,932
Net cash used in operating activities	(665,137)	(2,088)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(36,969)	(31,754)
Due from director	—	(25,013)
Net cash used in investing activities	(36,969)	(56,767)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of previous line of credit	—	(759,387)
Borrowings on new line of credit	—	1,109,543
Borrowings on debt	—	190,000
Principal payments on debt	(53,870)	(216,016)
Proceeds received on sale of common stock	1,002,779	—
Payments for stock offering costs	(237,287)	(134,481)
Net borrowing on lines of credit	17,508	78,112
Payments of debt to related parties	—	(21,000)
Net cash provided by financing activities	729,130	246,771
NET INCREASE IN CASH	27,024	187,916
CASH — Beginning of period	27,744	42,488
CASH — End of period	$ 54,768	$ 230,404
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest	$ 180,403	$ 157,602
Taxes	$ —	$ —

Noncash Investing and Financing Activities				
Common stock to be issued in settlement of accrued interest	$	—	$	5,250
Common stock to be issued in settlement of preferred stock dividend	$	29,470	$	29,470
Common stock issued in settlement of preferred stock dividend	$	29,470	$	—
Deferred stock offering costs charged to paid in capital	$	356,238	$	—

See accompanying Notes to Condensed Financial Statements

REED'S, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS
June 30, 2006 (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying interim condensed financial statements are unaudited, but in the opinion of management of Reeds, Inc. (the Company), contain all adjustments, which include normal recurring adjustments necessary to present fairly the financial position at June 30, 2006 and the results of operations and cash flows for the six months ended June 30, 2006 and 2005. The balance sheet as of December 31, 2005 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/A, as filed with the Securities and Exchange Commission on July 27, 2006.

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, 2006 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2006.

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 six month period ended June 30, 2006 and 2005, basic and diluted loss per share are the same because the inclusion of common share equivalents would be anti-dilutive.

Going Concern

The accompanying condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. However, the Company had a net loss of $956,835 and utilized cash of $665,137 in operating activities during the six months ended June 30, 2006, and had a working capital deficiency of $1,840,391and stockholders' deficiency of $378,586 at June 30, 2006. In addition, the Company may have committed a violation of securities law which may require the rescission of common stock issued in 2005 and 2006 in the aggregate of approximately $1,324,624, see Note 6. These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from this uncertainty. The Company is conducting an initial public offering of its stock. The maximum amount of common stock to be sold is 2,000,000 shares at $4.00, of which 333,156 has been sold as of April 7, 2006. Management has received enough

interest in the offering which leads it to believe the maximum amount of the offering will be sold, however no assurance can be made that any additional shares will be sold as a result of the offering. See Note 5 for information related to the common stock offering.

Recent Accounting Pronouncements

In June 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections," a replacement of existing accounting pronouncements. SFAS 154 modifies accounting and reporting requirements when a company voluntarily chooses to change an accounting principle or correct an accounting error. SFAS 154 requires retroactive restatement of prior period financial statements unless it is impractical. Previous accounting guidelines allowed recognition by cumulative effect in the period of the accounting change. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

In February 2006, the FASB issued SFAS 155,"Accounting for Certain Hybrid Financial Instruments", an amendment of SFAS 133 and 140. These SFAS's deal with derivative and hedging activities, accounting for transfers and servicing of financial instruments and extinguishment of liabilities. SFAS 155 is effective for all financial instruments acquired or issued in an entity's first fiscal year beginning after September 15, 2006. The Company does not engage in the activities described in these SFAS's and does not have any intention of engaging in those activities when SFAS 155 becomes effective. The Company has evaluated the impact of the adoption of SFAS 155, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

2. 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, 2006.

During the six months ended June 30, 2006 and 2005 the Company had two customers, which accounted for approximately 18% and 46 % and 15% and 46 % of sales, respectively . No other customers accounted for more than 10% of sales in either year. As of June 30, 2006, the Company had $101,562 and $328,636 , respectively of accounts receivable from these customers.

3. Inventory

Inventory consists of the following at June 30, 2006

Raw Materials	$	649,873
Finished Goods		625,946
	$	1,275,819

4. Lines of credit

In June 2006, one of the Company's lines of credit expired. The Company renewed this line of credit with its current lender. The renewal line of credit is secured by accounts receivable and inventory in the maximum amounts of $1,400,000. The borrowing base on the accounts receivable are 80% of all eligible receivables, which are primarily accounts receivables under 90 days. The inventory borrowing base is 50% of eligible inventory. The interest rate to be charged on these borrowings is Prime plus 4.00%. As of June 30, 2006, the amounts borrowed on this line of credit was $751,861. The amount available to borrow was $385,901. No changes were made to other lines of credit agreements appearing in the Company's Annual Report, Form 10-KSB/A filed with the Securities and Exchange Commission on July 27, 2006.

5. Long term debt

In June 2006, the Company, in connection with its line of credit renewal described in Note 4, consolidated its equipment line of credit and its equipment installment loan with its lender. The interest rate on this consolidated loan is Prime plus 4.00% and is secured by certain equipment and property of the Company. The loan requires payments of principal of $7,500 per month, plus interest, until paid in full. No changes were made to other long

term debt agreements appearing in the Company's Annual Report, Form 10-KSB/A filed with the Securities and Exchange Commission on July 27, 2006.

6. Common Stock Offering

From August 3, 2005 through April 7, 2006, we issued 333,156 shares of our common stock in connection with our initial public offering pursuant to a Registration Statement on Form SB-2. Management has determined that the shares may have been issued in violation of securities laws. Management has made a rescission offer to purchase up to all of the shares sold to date in the offering, however, it is our intention that if any of the shares are tendered for rescission, the shares will be purchased by others and not from our funds. The amount to be paid pursuant to the rescission offer, if accepted by any shareholders, would be $4.00 per share, plus accrued interest at the applicable statutory rate. The rescission offer commenced in August 2006.

During the six months ended June 30, 2006, the Company sold 278,550 of common stock for proceeds of $1,002,779, net of commisions. During the six months ended June 30, 2006, previously deferred stock offering costs of $356,238 and additional stock offering costs incurred during the period of $217,287 were charged to additional paid in capital.

7. Preferred stock dividend

During the six months ended June 30, 2006, the Company issued 14,735 shares of common stock in accordance with the terms of the preferred stock agreement. 7,373 shares were associated with the $29, 469 dividend payable as of June 30, 2006 and 7,362 shares were associated with the $29,469 dividend payable as of June 30, 2005.

8. Legal Proceedings and Litigation Fees

During 2005 and 2006, the Company incurred litigation fees associated with a law suit which the Company has won. The Plaintiff has lost its appeal. The judgment in favor of the Company is to have the Plaintiff reimburse the Company for its legal defense costs. The Company is in the processing of perfecting its judgment and will record income from the judgment when the monies are collected.

On January 20 , 2006, Consac Industries, Inc. (dba Long Life Teas and Long Life Beverages) filed a lawsuit in the United States District Court for the Central District of California against Reed's Inc. and Christopher Reed, Case No. CV06-0376. The complaint asserts claims for negligence, breach of contract, breach of warranty, and breach of express indemnity relating to Reed's, Inc.'s manufacture of approximately 13,000 cases of "Prism Green Tea Soda" for Consac. Consac contends that we negligently manufactured the soda resulting in at least one personal injury. Consac seeks $2.6 million in damages, plus interest and attorneys fees. We contend that Consac was responsible for the soda's condition by providing a defective formula which had not been adequately tested. In May 2006 both parties agreed to a mediation proceeding which is expected to commence in the third quarter of 2006. We believe that we will successfully defend Consac's claims. While there is no assurance, we believe that the Consac litigation will have no material adverse effect upon our operations.

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

FORWARD LOOKING STATEMENTS

This report contains statements that involve expectations, plans or intentions (such as those relating to future business or financial results, new features or services, or management strategies). These statements are forward-looking and are subject to risks and uncertainties, so actual results may vary materially. You can identify these forward-looking statements by words such as "may," "should," "expect," "anticipate," "believe," "estimate," "intend," "plan" and other sin expressions. You should consider our forward-looking statements in light of the risks discussed under the heading "Risk Factors That May Affect Results of Operations and Financial Condition" below, as well as our financial statements, related notes, and the other financial information appearing elsewhere in this report and our other filings with the Securities and Exchange Commission. We assume no obligation to update any forward-looking statements.

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-QSB. This discussion and analysis contains forward-looking statements based on assumptions about our future business. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including but not limited to those set forth under "Risk factors" and elsewhere in this Form 10-QSB.

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 -Our freight rates were approximately 9.7% of net sales during 2005. We expect freight rates to increase by an additional 5% to 10% in 2006 as a result of the continuing increase in fuel prices. However, as we increase production at the Brewery for delivery of products in the western half of the United States, we expect to offset this trend, at least in part, by reducing our need for cross-country freight services from our eastern co-packing facility.

Low Carbohydrate Diets and Obesity - Our products are not geared for the low carbohydrate market. Consumer trends have reflected higher demand for lower carbohydrate products. Despite this trend, we achieved an increase in our sales growth in the first six months of 2006. 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.

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

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

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

Packaging or Raw Material Price Increases - An increase in packaging and 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. We intend to use the proceeds from our future stock offering to increase our liquidity to be able to make cash expenditures, as needed.

***Interest Rates* -** We use lines of credit as a source of capital and are negatively impacted as interest rates rise. Management believes our future offering will provide capital sufficient for us to reduce our debt level and allow us to lower our incremental borrowing costs.

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 six months ended June 30, 2006 or June 30, 2005.

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 six months ended June 30, 2006 or 2005.

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, 2006 Compared to Three Months Ended June 30, 2005

Net sales increased by $575,545, or 22.3%, from $2,582,273 in the three months ended June 30, 2005 to $3,157,818 in the three months ended June 30, 2006. Sales of our core Reed's Ginger Brew itemsincreased from $1,319,000 in the three months ended June 30, 2005 to $1,634,000 in the three months ended June 30, 2006. Sales of our Virgil's Root Beer line increased from $934,000 in the three months ended June 30, 2005 to $1,075,000 in the three months ended June 30, 2006. The Virgil's Root Beer and Cream Soda 12 ounce bottles increased from $507,000 and $119,000, respectively, in the three months ended June 30, 2005 to $704,000 and $174,000, respectively, in the three months ended June 30, 2006. The new Virgil's Black Cherry Cream Soda launched at the end of May 2006 had sales for the three months ended June 30, 2006 of $107,000. Progressive Grocers, a top trade publication in the Grocer industry voted this product as the best new beverage product of 2006. We expect sales of this item to positively impact future sales. Sales of the Virgil's 5 liter party kegs continued to decline from $180,000 in the three months ended June 30, 2005 to $49,000 in the three months ended June 30, 2006. Candy sales decreased from $208,000 in the three months ended June 30, 2005 to $204,000 in the three months ended June 30, 2006. Ice cream sales decreased from $50,000 in the three months ended June 30, 2005 to $23,000 in the three months ended June 30, 2006. China Cola sales increased from $51,000 in the three months ended June 30, 2005 to $86,000 in the three months ended June 30, 2006. Canadian sales increased from $16,000 in the three months ended June 30, 2005 to $44,000 in the three months ended June 30, 2006. We have increased our focus on the Canadian market place in 2006 and the China cola brisk sales increase comes as somewhat of a surprise.

Cost of sales increased by $520,590, or 25.2%, from $2,069,274 in the three months ended June 30, 2005 to $2,589,864 in the three months ended June 30, 2006. As a percentage of net sales, cost of sales increased from 80.1% in the three months ended June 30, 2005 to 82.0% in the three months ended June 30, 2006. Costs of sales increased primarily as a result of increased warehouse expenses due to increased inventory levels (0.6%) and increased production expenses (0.5%) and freight costs (0.8%) due to fuel related cost increases.

Gross profit increased from $512,999 in the three months ended June 30, 2005 to $567,954 in the three months ended June 30, 2006. As a percentage of net sales, gross profit decreased from 19.9% in the three months ended June 30, 2005 to 18.0% in the three months ended

June 30, 2006. Effective February 1, 2006 we approved a price increase in a number of our product lines at an average of approximately 7% in order to attempt to increase our gross profit. The full implementation of the price increase is expected to be completed by the middle of the third quarter of 2006. We expect margins to increase by the end of 2006 due to this price increase.

Operating expenses increased by $576,724, or approximately 120%, from $480,720 in the three months ended June 30, 2005 to $1,057,444 in the three months ended June 30, 2006 and increased as a percentage of net sales from 18.6% in the three months ended June 30, 2005 to 33.5% in the three months ended June 30, 2006. The primary increase in expenses was due to the rescission offer that the Company undertook to satisfy a possible securities law violation associated with its sales of common stock. The Company had no rescission related expenses for the three months ended June 30, 2005 and $351,757 of rescission related expenses for the three months ended June 30, 2006. Other changes were: increased salaries due to a larger sales force (9.5%), increased sales expenses from increased fuel costs and increased telephone charges (7.0%), increased recycling fees expenses (6.6%) and increased legal and accounting costs due to the costs associated with being a public reporting company (13.8%). We also had increased consulting fees due to the one time usage of a marketing group to evaluate our marketing strategies (6.3%). Also, increased commissions due to increased reliance on outside reps in some markets (6.1%), offset by a reduction in promotional expenses due to less club store demos (-2.9%), resulted in the increase in these expenses.

Interest expense increased by $7,421, or 8.2%, from $90,327 in the three months ended June 30, 2005 to $97,748 in the three months ended June 30, 2006. The increase in interest expense was due to increasing short term interest rates, increased borrowings on our available lines of credit and increasing our long term debt, which was used to purchase brewing equipment, vehicles and office equipment.

As a result of the foregoing, we experienced a net loss of $58,048 in the three months ended June 30, 2005 and $587,238 in the three months ended June 30, 2006. Our net loss was $0 .02 per share in the three months ended June 30, 2005 and $0.12 per share in the three months ended June 30, 2006, which included the value of our preferred stock dividend.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Net sales increased by $737,481, or 16.8%, from $4,399,608 in the first six months ended June 30, 2005 to $5,137,089 in the first six months ended June 30, 2006. Sales of our core Reed's Ginger Brew itemsincreased from $2,286,000 in the six months ended June 30, 2005 to $2,776,000 in the six months ended June 30, 2006. Sales of our Virgil's Root Beer line increased from $1,665,000 in the six months ended June 30, 2005 to $1,772,000 in the six months ended June 30, 2006. The Virgil's Root Beer and Cream Soda 12 ounce bottles increased from $1,018,000 and $224,000, respectively, in the six months ended June 30, 2005 to $1,185,000 and $281,000, respectively, in the six months ended June 30, 2006. The new Virgil's Black Cherry Cream Soda launched at the end of May 2006 had sales for the six months ended June 30, 2006 of $107,000. Progressive Grocers, a top trade publication in the Grocer industry voted this product as the best new beverage product of 2006. We expect sales of this item to positively impact future sales. Sales of the Virgil's 5 liter party kegs continued to decline from $275,000 in the six months ended June 30, 2005 to $100,000 in the six months ended June 30, 2006. Candy sales increased from $337,000 in the six months ended June 30, 2005 to $410,000 in the six months ended June 30, 2006. Ice cream sales decreased from $85,000 in the six months ended June 30, 2005 to $68,000 in the six months ended June 30, 2006. China Cola sales increased from $106,000 in the six months ended June 30, 2005 to $120,000 in the six months ended June 30, 2006. Canadian sales increased from $32,000 in the six months ended June 30, 2005 to $64,000 in the six months ended June 30, 2006. We have increased our focus on the Canadian market place in 2006.

Cost of sales increased by $723,180, or 20.3%, from $3,555,561 in the first six months ended June 30, 2005 to $4,278,741 in the first six months ended June 30, 2006. As a percentage of net sales, cost of sales increased from 80.8% in the first six months ended June 30, 2005 to 83.3% in the first six months ended June 30, 2006. Costs of sales

increased primarily as a result of increased warehouse expenses due to increased inventory levels (0.3%) and increased production expenses (1.9%) and freight costs (0.3%) due to fuel related cost increases.

Gross profit increased from $844,047 in the first six months ended June 30, 2005 to $858,348 in the first six months ended June 30, 2006. As a percentage of net sales, gross profit decreased from 19.2% in the first six months ended June 30, 2005 to 16.7% in the first six months ended June 30, 2006. Effective February 1, 2006 we approved a price increase in a number of our product lines at an average of approximately 7% in order to attempt to increase our gross profit. The full implementation of the price increase is expected to be completed by the middle of the third quarter of 2006. We expect margins to increase by the end of 2006 due to this price increase.

Operating expenses increased by $639,114, or 65.4%, from $977,715 in the first six months ended June 30, 2005 to $1,616,829 in the first six months ended June 30, 2006 and increased as a percentage of net sales from 22.2% in the first six months ended June 30, 2005 to 31.5% in the first six months ended June 30, 2006. The primary increase in expenses was due to the rescission offer that the Company undertook to satisfy a possible securities law violation associated with its sales of common stock. The Company had no rescission related expenses for the six months ended June 30, 2005 and $351,757 of rescission related expenses for the six months ended June 30, 2006. Other changes were: increased salaries due to a larger sales force (6.4%), increased sales expenses from increased fuel costs and increased telephone charges (7.1%), increased recycling fees expenses (3.7%) and increased legal and accounting costs due to the costs associated with being a public reporting company (8.5%). We had increased consulting fees due to the one time usage of a marketing group to evaluate our marketing strategies (3.6%). Also, increased commissions due to increased reliance on outside reps in some markets (2.5%) offset by a reduction in promotional expenses due to less club store demos (-3.7%), resulted in the increase in these expenses.

Interest expense increased by $36,820, or 22.8%, from $161,534 in the first six months ended June 30, 2005 to $198,354 in the first six months ended June 30, 2006. The increase in interest expense was due to increasing short term interest rates, increased borrowings on our available lines of credit and increasing our long term debt, which was used to purchase brewing equipment, vehicles and office equipment.

As a result of the foregoing, we experienced a net loss of $295,202 in the first six months ended June 30, 2005 and $956,835 in the first six months ended June 30, 2006. Our net loss was $0.07 per share in the first six months ended June 30, 2005 and $0.19 per share in the first six months ended June 30, 2006, which included the value of our preferred stock dividend.

Liquidity and Capital Resources

Historically, we have financed our operations primarily through private sales of common stock, preferred stock, convertible debt, a line of credit from a financial institution, and cash generated from operations. We have a "best efforts" commitment from an underwriter to assist us in continuing the process of raising capital through a public offering of our common stock, which we had commenced in 2005. Management believes it will be successful in raising additional funds from the public offering, however it can not predict the exact amount which will be raised. We intend to recommence the offering upon completion of a rescission offer to persons who have purchased shares in the offering to date. Management expects the offering to commence during the summer of 2006. Until the commencement of the offering, we will continue to experience challenges with managing cash flow, but management believes it has enough liquidity to operate the business in the short term. The addition of cash from the public offering , if successful, would provide us the ability to improve our liquidity position and provide capital to continue to expand the business. The remaining amount of common stock that we can sell in connection with the offering is 1,666,844 shares at an anticipated offering price of $4.00 per share. If the remainder of the shares were sold, we would receive approximately $6,000,000, after underwriter commissions.

As of June 30, 2006, we had a working capital deficit of $1,840,391, compared to a working capital deficit of $1,594,758 as of December 31, 2005.

As of June 30, 2006, we had outstanding borrowings of $1,463,461 under our lines of credit agreements and we continue to approach maximum borrowing capacity based on the terms of the lines of credit.

From August 3, 2005 through April 7, 2006, we issued 333,156 shares of our common stock in connection with our initial public offering pursuant to a Registration Statement on Form SB-2. Management has determined that the shares may have been issued in violation of securities laws. Management intends to make a rescission offer to purchase up to all of the shares sold to date in the offering, however, it is our intention that if any of the shares are tendered for rescission, the shares will be purchased by others and not from our funds. The amount to be paid pursuant to the rescission offer, if accepted by any shareholder, would be $4.00 per share, plus accrued interest at the applicable statutory rate. The rescission offer commenced in August 2006.

During the six months ended June 30, 2006, the Company sold 278,550 of their shares for $1,002,779, net of commisions.

During the six months ended June 30, 2006, previously deferred stock offering expenses of $356,238 and additional stock offering costs incurred during the period of $217,287 were charged to additional paid in capital.

The accompanying condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. However, the Company had a net loss of $956,835 and utilized cash of $665,137 in operating activities during the six months ended June 30, 2006, and had a working capital deficiency of $1,840,391and stockholders' deficiency of $378,586 at June 30, 2006. In addition, the Company may have committed a violation of securities law which may require the rescission of common stock issued in 2005 and 2006 in the aggregate of approximately $1,324,624. These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from this uncertainty. The Company is

conducting an initial public offering of its stock. The maximum amount of common stock to be sold is 2,000,000 shares at $4.00, of which 333,156 has been sold as of April 7, 2006. Management has received enough interest in the offering which leads it to believe the maximum amount of the offering will be sold, however no assurance can be made that any additional shares will be sold as a result of the offering

Recent Accounting Pronouncements

In June 2005, the FASB issued SFAS 154, “Accounting Changes and Error Corrections,” a replacement of existing accounting pronouncements. SFAS 154 modifies accounting and reporting requirements when a company voluntarily chooses to change an accounting principle or correct an accounting error. SFAS 154 requires retroactive restatement of prior period financial statements unless it is impractical. Previous accounting guidelines allowed recognition by cumulative effect in the period of the accounting change. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

In February 2006, the FASB issued SFAS 155,“Accounting for Certain Hybrid Financial Instruments”, an amendment of SFAS 133 and 140. These SFAS’s deal with derivative and hedging activities, accounting for

transfers and servicing of financial instruments and extinguishment of liabilities. SFAS 155 is effective for all financial instruments acquired or issued in an entity's first fiscal year beginning after September 15, 2006. The Company does not engage in the activities described in these SFAS's and does not have any intention of engaging in those activities when SFAS 155 becomes effective. The Company has evaluated the impact of the adoption of SFAS 155, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

Item 3. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures.

As of June 30, 2006, we carried out an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of the design and operations of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934.

Our chief executive officer and chief financial officer concluded that as of the evaluation date, such 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 Securities and Exchange Commission, and is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls.

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) identified in connection with the evaluation of our internal control performed during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II

Item 1. Legal Proceedings

On January 20, 2006, Consac Industries, Inc. (dba Long Life Teas and Long Life Beverages) filed a lawsuit in the United States District Court for the Central District of California against Reed's Inc. and Christopher Reed, Case No. CV06-0376. The complaint asserts claims for negligence, breach of contract, breach of warranty, and breach of express indemnity relating to Reed's, Inc.'s manufacture of approximately 13,000 cases of "Prism Green Tea Soda" for Consac. Consac contends that we negligently manufactured the soda resulting in at least one personal injury. Consac seeks $2.6 million in damages, plus interest and attorneys fees. We contend that Consac was responsible for the soda's condition by providing a defective formula which had not been adequately tested. We believe that we will successfully defend Consac's claims. While there is no assurance, we believe that the Consac litigation will have no material adverse effect upon our operations. In May 2006 both parties agreed to a mediation proceeding which is expected to commence in the third quarter of 2006.

From August 3, 2005 through April 7, 2006, we issued 333,156 shares of our common stock in connection with our initial public offering pursuant to a Registration Statement on Form SB-2. Management has determined that the shares may have been issued in violation of securities laws. Management intends to make a rescission offer to purchase up to all of the shares sold to date in the offering, however, it is our intention that if any of the shares are tendered for rescission, the shares will be purchased by others and not from our funds. The amount to be paid pursuant to the rescission offer, if accepted by any shareholders, would be $4.00 per share, plus accrued interest at the applicable statutory rate.
The rescission offer commenced in August 2006.

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

From August 3, 2005 through April 7, 2006, we issued 333,156 shares of our common stock in connection with our initial public offering pursuant to a Registration Statement on Form SB-2. Management has determined that the shares may have been issued in violation of securities laws. Management intends to make a rescission offer to purchase up to all of the shares sold to date in the offering. The amount to be paid pursuant to the rescission offer, if accepted by any shareholders, would be $4.00 per share, plus accrued interest at the applicable statutory rate.

We received net proceeds of approximately $1,200,000 from the sale of the 333,156 shares, after underwriter commissions. The net proceeds were used to meet our liquidity needs primarily as working capital and costs relating to the offering.

Item 3. Defaults Upon Senior Securities

Not applicable

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

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

Exhibit Number	Description of Document
31	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

SIGNATURE

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.

REEDS, INC.

Date: September 13, 2006

By: /s/ CHRISTOPHER J. REED

Name: Christopher J. Reed
Title: Chief Executive Officer, President and Chief Financial Officer