

REEDS INC  
Form SB-2/A  
April 28, 2005

**Registration Statement No. 333-120451**

**As filed with the Securities and Exchange Commission on April 28, 2005**

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

**Amendment 3 to Form SB-2**

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

**Reed's, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction  
of incorporation or organization)*

**2086**

*(Primary Standard Industrial  
Classification Code Number)*

**95-4348325**

*(IRS Employer  
Identification No.)*

**Christopher J. Reed**

**Reed's, Inc.**

**13000 South Spring Street, Los Angeles, California 90061**

**Telephone: (310) 217-9400**

*(Name, address and telephone number of agent for service)*

***Copies of all communications to:***

**Lawrence W. Horwitz, Esq.**

**HORWITZ & CRON**

**Four Venture - Suite 390, Irvine, California 92618**

**Telephone: (949) 450-4942**

*(Name, address, and telephone number of registrant's counsel)*

**Approximate date of proposed sale to the public:** As soon as practicable after the effective date of this registration statement.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act of 1933, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

<b>Title of Each Class of Securities to be Registered</b>	<b>Amount to be Registered</b>	<b>Proposed Maximum</b>	<b>Proposed Maximum</b>	<b>Amount of Registration</b>
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			<b>Offering Price Per Share</b>		<b>Aggregate Offering Price<sup>(1)</sup></b>		<b>Fee</b>
Common stock, \$.0001 par value	2,000,000	\$	4.00	\$	8,000,000	\$	1,014
Underwriter's warrants to purchase shares of common stock, \$.001 par value <sup>(2)</sup>	200,000	\$	6.60		---		---
Shares of common stock underlying underwriter's warrants	200,000	\$	6.60	\$	1,320,000	\$	101
Totals	2,200,000		---	\$	9,320,000	\$	1,115

#### **CALCULATION OF REGISTRATION FEE**

(1) Estimated solely for purposes of calculating the registration fee in accordance with Rule 457(o) under the Securities Act of 1933, as amended.

(2) In connection with the sale of the common stock, we are granting to the underwriter a warrant to purchase up to 200,000 shares of common stock at a per share purchase price equal to 165% of the public offering price per share. No registration fee is required pursuant to Rule 457(g).

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

**The information in this Prospectus is not complete and may be changed. We may not sell these securities until the Registration Statement filed with the Securities and Exchange Commission is effective. This Prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED April 28, 2005****REED'S, INC.**

We develop, manufacture, market, and sell natural non-alcoholic beverages, as well as candies and ice creams.

We are offering up to 2,000,000 shares of our common stock. No public market currently exists for our shares. The public offering price is \$4.00 per share. This price has been arbitrarily set. The shares are being offered on a best efforts basis through Brookstreet Securities Corporation, our underwriter, a member of the National Association of Securities Dealers, Inc., for a commission equal to 6% of the gross sales made in this offering. In addition, Brookstreet will receive a lead underwriter's concession of 1% of gross sales made in this offering and a non-accountable expense allowance of 3% of gross sales made in this offering.

There is no current public market for our shares and there is no assurance that a public market for our shares will ever develop. In the event a public market for our shares does not develop, purchasers in this offering may be unable to sell the shares for an extended period of time. Our underwriter currently intends to apply for quotation of our common stock upon the Over the Counter Bulletin Board ("OTCBB") quotation system.

**Investing in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 3 to read about factors you should consider before buying shares of our common stock.**

	Per Share	If 200,000 Shares are Sold(1)	If 1,000,000 Shares are Sold(1)	If 2,000,000 Shares are Sold(1)
Proceeds to the Company	\$ 3.60	\$ 720,000	\$ 3,600,000	\$ 7,200,000
Underwriter Commission	\$ 0.40	\$ 80,000	\$ 400,000	\$ 800,000
Proceeds to the Company before estimated expenses of the offering	\$ 4.00	\$ 800,000	\$ 4,000,000	\$ 8,000,000
Proceeds to the Company after estimated expenses of the offering	---	\$ 520,017	\$ 3,375,017	\$ 6,925,017

(1) The amounts shown are for illustrative purposes only. The offering is a best efforts offering with no assurance that all or any shares will be sold.

Texas investors must meet minimum net worth standards having a minimum annual gross income of \$65,000.00 and a minimum net worth of \$65,000.00, exclusive of automobiles, home and home furnishings; or a minimum net worth of \$150,000.00 exclusive of automobiles, home and home furnishings. We will not accept subscriptions for shares from the District of Columbia, Texas, or Arizona unless and until at least 200,000 shares have been sold.

There is no minimum number of shares we must sell in this offering. Offering proceeds will not be placed in escrow. Upon receipt, offering proceeds will be deposited into the Company's operating account and used to conduct the Company's business affairs. The offering will terminate nine months after the effective date of this prospectus unless terminated sooner by us.

**Neither the Securities and Exchange Commission nor any state securities regulators have approved or disapproved these securities or determined if this prospectus is accurate or**

**complete. Any representation to the contrary is a criminal offense.**

Brookstreet Securities Corporation has been the subject of disciplinary actions taken by the NASD. For more information regarding these actions, please contact the NASD at (800) 289-9999.

**BROOKSTREET SECURITIES CORPORATION.**

The date of this Prospectus is \_\_\_\_\_, 2005

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**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is declared effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

[OUTSIDE BACK COVER]

**TABLE OF CONTENTS**

<b>Section</b>	<b>Page</b>
Prospectus Summary	1
Risk Factors	3
Forward Looking Statements	8
Use of Proceeds	9
Dividend Policy	10
Capitalization as of December 31, 2004	11
Dilution	12
Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Business	21
Legal Proceedings	37
Management	38
Certain Relationships and Related Transactions	42
Principal Stockholders	43
Description of Our Securities	44
Shares Available for Future Resale	46
Plan of Distribution	47
Legal Matters	50
Experts	50
Where You Can Find More Information	50
Index to Financial Statements	F-1

Dealers who solicit prospective investors in the subject offering are required to deliver a copy of this Prospectus commencing upon the effective date of the subject Registration Statement and terminating 40 days thereafter. The effective date of the Registration Statement, of which this Prospectus is a part, is \_\_\_\_\_2005.

## PROSPECTUS SUMMARY

This summary highlights information found in greater detail elsewhere in this prospectus. Prior to making an investment decision, you should read the entire prospectus carefully; including the section entitled "Risk Factors" beginning on page 3.

### About Our Company

We are a growing developer, manufacturer, marketer, and seller of New Age beverages, as well as 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 offer 14 beverages, 2 candies, and 3 ice creams.

We sell the majority of our products primarily in upscale gourmet and natural food stores and supermarket chains in the United States and, to a lesser degree, in Canada. Historically, most of our beverages were sold in the natural food industry.

Our current business strategy is to maintain a firm marketing focus in the natural food marketplace while building a national direct sales and distribution force to take our proven products into mainstream market and distribution channels. We believe that the proceeds of this offering may greatly accelerate the success of this business strategy by providing working capital to finance an expanded sales and distribution network.

At this time, we produce our carbonated beverages at two facilities. Our Brewery in Los Angeles handles the western half of the United States and we have a contract with The Lion Brewery, Inc., a packing, or co-pack, facility in Pennsylvania for the eastern United States. Our Ginger Juice Brews are co-packed for us in Northern California. Our ice creams are co-packed for us at a dairy in upstate New York.

We have a national network of natural and specialty food distributors in the United States and Canada. We also have mainstream beverage distributors in select markets. In Southern California, we have our own direct distribution in addition to other local distributors. We currently rely upon one retailer for between 10-15% of our aggregate gross revenues. If we were to lose this retailer, our operations would be materially effected.

We currently maintain two separate sales organizations, one of which handles natural food sales and the other of which handles mainstream sales. Both sales forces consist of sales managers and sales representatives. The natural food sales force works mainly in the natural and gourmet food stores serviced by the natural and gourmet distributors. Representatives are responsible for the accounts in their territory and they stay on a focused schedule of visits to maintain store and distributor relationships. In the future, we intend to integrate both our distributions and sales forces.

In December 2000, we purchased an 18,000 square foot warehouse, the Brewery, at 13000 South Spring Street, Los Angeles, California 90061, in an unincorporated area of Los Angeles County near downtown Los Angeles. This facility serves as our principal executive offices, our West Coast bottling plant, and our Southern California warehouse facility. Our telephone number is 310.217.9400.

We have not generated a profit during our last two fiscal years and there is no assurance that we will develop profitable operations in the future. Our net operating loss for the calendar year 2004 was \$326,371 and for 2003 it was \$771,997. We are offering a maximum of 2,000,000 of our shares. In the event the maximum amount of this offering is sold, then the shares sold will represent 30% of the then outstanding common stock and Christopher Reed and his family members will own 51.7% of our outstanding common stock.

This offering is a best efforts offering through our underwriter, Brookstreet Securities Corporation. While there is no assurance, our underwriter currently intends to apply for quotation of our common stock upon the Over the Counter

Bulletin Board (“OTCBB”) quotation system. This will require that we complete certain filings and disclosures of information to the National Association of Securities Dealers and to the OTCBB itself. Our shares are currently not traded on the public securities markets and even if our shares of common stock become quoted on the OTCBB, there is no assurance that an active public market for our shares of stock will be established.

Our Internet address is [www.reedsgingerbrew.com](http://www.reedsgingerbrew.com). Information contained on our website or that is accessible through our website should not be considered to be part of this prospectus.

**The Offering**

Common Stock being offered	2,000,000 shares
Offering Price	\$ 4.00 per share
Common stock outstanding:	
Prior to this offering	4,726,091 shares
After this offering:	
if 200,000 shares are sold	4,926,091 shares
if 1,000,000 shares are sold	5,726,091 shares
if all 2,000,000 shares are sold	6,726,091 shares

**Use of Proceeds**

We plan to use the net proceeds to hire additional sales representatives, launch new products, pay for retail slotting, expand our brand advertising, update our West Coast production facility, the Brewery, to purchase fully-branded coolers, in-store displays, and hire a chief operating officer, and for working capital.

**Summary Financial Information**

The following historical financial information should be read in conjunction with the audited financial statements and the notes to those statements and the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus. The statements of operations with respect to the years ended December 31, 2004 and 2003, and the balance sheet data at December 31, 2004 are derived from, and are qualified by reference to, the audited financial statements included elsewhere in this prospectus. The historical results are not necessarily indicative of results to be expected for any future periods.

Statements of Operations Data:	Years Ended December 31,	
	2004	2003
Sales	\$ 8,978,365	\$ 6,781,776
Gross profit	1,875,328	1,319,571
Selling, general and administrative expenses	1,946,666	1,414,148
Loss from operations	(71,338)	(94,577)
Net Loss	(326,371)	(771,997)
Net Loss per share, basic and diluted	(0.07)	(0.16)
Weighted average shares used to compute net loss per share	4,726,091	4,724,488

	December 31, 2004
<b>Balance Sheet Data:</b>	
Total assets	\$ 5,098,403
Current liabilities	2,834,589
Long-term liabilities, less current portion	1,294,114
Stockholders' equity	969,700





## RISK FACTORS

An investment in our common stock is very risky. You should carefully consider the risk factors described below, together with all other information in this prospectus, before making an investment decision. The trading price of our common stock could decline due to any of these risks, and you could lose all or part of your investment. You also should refer to the other information set forth in this prospectus, including our financial statements and the related notes.

### Risks Relating to Our Business

***We have a history of operating losses. If we continue to incur operating losses, we eventually may have insufficient working capital to maintain operations as presently set forth in our business plan.***

As of December 31, 2004, we had an accumulated deficit of \$2,403,638. For the years ended December 31, 2004 and 2003, we incurred losses from operations of \$71,338 and \$94,577, respectively. If we are not able to begin to earn an operating profit at some point in the future, we eventually may have insufficient working capital to maintain our operations as we presently intend to conduct them. In addition, we may not be able to contribute profit from operations toward the expansion and other business plans discussed in this prospectus.

***The beverage business is highly competitive.***

We compete for distributors, shelf space, and customers primarily with other New Age beverage companies including:

- SoBe (owned by Pepsi)
- Snapple, Mistic, IBC and Stewart's (owned by Cadbury Schweppes)
  - Henry Weinhard (owned by Phillip Morris)
    - Arizona
    - Hansen's
  - Knudsen & Sons
    - Jones Sodas
  - A&W Root Beer
    - Blue Sky
  - Natural Brews

Several of our competitors and potential competitors have financial resources greater than ours, and Pepsi, Cadbury Schweppes, and Phillip Morris have substantially greater financial resources than ours. These greater resources permit our competitors to implement extensive advertising and promotional programs, which we have not been, and may not be, able to match. As competitors enter the field, our market share may fail to increase or may decrease despite our efforts to continue to produce superior products with higher quality ingredients and a brewing process that we believe remains a trade secret. See "Business — Competition."

Competitors in the soft drink industry include bottlers and distributors of nationally advertised and marketed products as well as chain store and private label soft drinks. The principal methods of competition include brand recognition, price and price promotion, retail space management, service to the retail trade, new product introductions, packaging changes, distribution methods, and advertising.

***The loss of our largest retailer would substantially reduce revenues.***

During 2003, Trader Joe's accounted for approximately 15% of our sales in 2003 and for 14% of our sales in 2004. The loss of Trader Joe's as a retailer would substantially reduce our revenues unless and until we replaced that source

of revenue.

***Any decrease in the supply of ginger, other key ingredients or finished products, or increase in the prices of such ingredients, could significantly increase our costs, and thereby reduce our profits.***

We depend upon an uninterrupted supply of ginger and certain other ingredients, a significant portion of which we obtain overseas, principally from China and Brazil. We obtain almost all of our crystallized ginger from Fiji and our Ginger Chews from Indonesia. Any decrease in the supply of these ingredients or increase in the prices of these ingredients as a result of any adverse weather conditions, pests, crop disease, interruptions of shipment or political considerations, among other reasons, could substantially increase our costs and adversely affect our financial performance.

***The loss of any of our third-party suppliers or service providers could impair our operations and substantially reduce our financial results.***

We rely on third parties, called co-packers in our industry, to produce some of our beverages, to produce our glass bottles and to bottle some of our beverages. The loss of our third-party suppliers or service providers could impair our operations and adversely affect our financial performance.

***The loss of our third-party distributors could impair our operations and substantially reduce our financial results.***

We depend in large part on distributors to distribute our beverages and other products. Most of our outside distributors are not bound by written agreements with us and may discontinue their relationship with us on short notice. Most distributors handle a number of competitive products. In addition, our products are a small part of our distributors' businesses. The loss of our third-party beverage distributors could impair our operations and adversely affect our financial performance.

***Our manufacturing process is not patented.***

None of the manufacturing processes used in producing our products are subject to a patent or similar intellectual property protection. Our only protection against a third party using our recipes and processes is confidentiality agreements with the companies that produce our beverages and with some of our employees. If our competitors develop substantially equivalent proprietary information or otherwise obtain access to our knowledge, we will have greater difficulty in competing with them for business, and our market share could decline.

We regard the protection of our trademarks, trade dress, and trade secrets as critical to our future success. We have registered our trademarks in the United States. We also rely on a combination of laws and contractual restrictions, such as confidentiality agreements, to establish and protect our proprietary rights, trade dress, and trade secrets. However, laws and contractual restrictions may not be sufficient to protect the exclusivity of our intellectual property rights, trade dress, or trade secrets. Furthermore, enforcing our rights to our intellectual property could involve the expenditure of significant management and financial resources. See "Business — Proprietary Rights."

***We face risks associated with product liability claims and product recalls.***

Other companies in the beverage industry have experienced product liability litigation and product recalls arising primarily from defectively manufactured products or packaging. We maintain product liability insurance insuring our operations from any claims associated with product liability and we believe that the amount of this insurance is sufficient to protect us. We do not maintain product recall insurance. While we have to date not experienced any product liability or product recall claims, there is no assurance that we will not experience such claims in the future. In the event we were to experience a product liability or product recall claim, our business operations could be materially and adversely effected.

***If we are not able to retain the full-time services of Christopher J. Reed, it will be more difficult for us to manage our operations and our operating performance could suffer.***

Our business is dependent, to a large extent, upon the services of Christopher J. Reed, our founder, President, Chief Executive Officer, Chairman of the Board, and Chief Accounting Officer. We depend on Mr. Reed's creativity and leadership in running or supervising virtually all aspects of our day-to-day operations. We do not have a written employment agreement with Mr. Reed. In addition, we do not maintain key person life insurance on Mr. Reed. Therefore, in the event of the loss or unavailability of Mr. Reed to us, there can be no assurance that we would be able to locate in a timely manner or employ qualified personnel to replace him. The loss of the services of Mr. Reed or our failure to attract and retain other key personnel over time would jeopardize our ability to execute our business plan

and could have a material adverse effect on our business, results of operations and financial condition.

***Our Chief Executive Officer may lack the experience and formal training to serve as our Chief Financial Officer.***

Our company does not employ a Chief Financial Officer among its executive staff. Given the absence of formal financial training in our Chief Executive Officer's education and the increasing complexity of accountancy and cash management for reporting companies, CEO Chris Reed's lack of knowledge in this area may affect the future results of our operations.

***We need to manage our growth and implement and maintain procedures and controls during a time of rapid expansion in our business.***

The cost of manufacturing and packaging our products is approximately 80% of our aggregate revenues. This gross margin places pressure upon our cash flow and cash reserves when our sales increase. As we experience significant growth, such an expansion has placed, and is expected to continue to place, a significant strain on our management, operational and financial resources. Such growth will require improvements in our operational, accounting and information systems, procedures and controls. If we fail to manage this growth properly, it could divert our limited management, cash, personnel, and other resources from other responsibilities and could adversely affect our financial performance.

***Our management has broad discretion in the application of the net proceeds from this offering.***

Our Board of Directors and management presently intend to utilize a substantial portion of the net proceeds of this offering for the specific purposes set forth in “Use of Proceeds.” However, we have broad discretion with respect to redirecting the application and allocation of the net-proceeds of this offering in light of changes in circumstances and the availability of certain business opportunities. As a result, any return on investment to investors will be substantially dependent upon the discretion and judgment of our management with respect to the application and allocation of the net proceeds of the offering. See “Use of Proceeds.”

***We have operated without independent directors in the past***

We have not had two independent directors through a large portion of our history. This means that the material agreements between related parties have not been negotiated with the oversight of independent directors; this means that most agreements into which we have entered were at the absolute discretion of the majority shareholder, Chris Reed. Please see the “Certain Relationships and Related Transactions” section for specific details of these transactions.

**Risks Relating to This Offering**

***It may be a conflict of interest for Peter Sharma III to hold a position on the Board of Directors, while also being a primary selling agent, supervised by a separate broker/dealer, as well as being indebted to the issuer.***

As a director, Mr. Sharma has a fiduciary responsibility to our shareholders. Mr. Sharma’s position with Brookstreet Securities Corporation and his financial indebtedness may compromise his ability to make decisions in the best interest of our shareholders.

***We have previously been unsuccessful in a prior public offering***

We have previously tried to raise money in a public offering. This offering was declared effective on December 31, 2002 and was subsequently withdrawn on March 27, 2003. We withdrew the offering due to what we perceived as poor market conditions for an offering in the economic climate surrounding the 2003 Iraq War.

***We determined the offering price for the shares being offered arbitrarily. The market price for the common stock after the offering may vary from the offering price.***

Prior to this offering, there was no public market for our common stock. We arbitrarily determined the offering price for the shares being offered. The price bears no direct relationship to our assets, earnings, book value, or other such criteria of value. For this reason, the market price after the offering may vary from the initial offering price.

***There is not yet a public trading market for our securities and if a market develops for our securities, it could be limited, sporadic, and highly volatile.***

We cannot assure you that an active market for our shares will be established or maintained in the future. It is the intention of our underwriter to apply for quotation of our common stock on the Over The Counter Bulletin Board quotation system (the “OTCBB”). The OTCBB is not a national securities exchange, and many companies have experienced limited liquidity when traded through this quotation system. Therefore, if you purchase shares of our common stock and later decide to sell the shares, you may have difficulty selling the shares. Even if a market for our common stock is established, stockholders may have to sell our stock at prices substantially lower than the price they paid for it or might otherwise receive than if a broad public market existed.

***Since there is no minimum number of shares which must be subscribed for before we can use the proceeds from sales, our expansion plans will be affected by the number of shares actually sold.***

The speed with which we implement our expansion plans will depend, to a large degree, on the amount of funds available for expansion. Such funds may be provided by the sale of common stock in this offering, our existing lines of credit, and revenues from sales, future loans or otherwise. If we sell less than all the shares in this offering, our ability to implement the expansion plans described under “Use of Proceeds” and elsewhere in this prospectus could be delayed, depending on the amount of other funds available to us for such purposes.

***You will experience immediate and substantial dilution in this offering.***

The initial public offering price is substantially higher than the net tangible book value of each outstanding share of common stock. Purchasers of common stock in this offering will suffer immediate and substantial dilution. The dilution will be \$2.98 per share, or approximately 75%, in the net tangible book value of the common stock from the public offering price if all 2,000,000 shares being offered are sold. The dilution will be \$3.42 per share (86%) if only 1,000,000 shares (50%) are sold, and \$3.91 per share (98%) if only 200,000 shares (10%) are sold. See “Dilution.”

***Our ability to obtain needed additional financing is uncertain.***

We currently believe that our available cash resources, combined with the net proceeds from this offering and cash flow from operations, will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least 12 months after the date of this prospectus. We may need to raise additional funds to respond to business contingencies, which may include the need to:

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

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

Our ability to implement our full business expansion plan is largely dependent upon the outcome of this offering. Assuming no funds from this offering were available, over the next 12 months, we would be able to launch the 750 ml. champagne bottle for approximately three to five of our products, including our Reed's Ginger Brew and swing-lid bottles for approximately two of our products. In addition, we would be able to hire approximately two additional sales representatives. Other elements of our expansion plan might have to be curtailed or delayed unless we could find alternative external sources of working capital.

***Future financings could adversely affect your ownership interest and rights in comparison with those of other security holders.***

Our board of directors has the power to issue additional shares of common or preferred stock without stockholder approval. If additional funds are raised through the issuance of equity or convertible debt securities, the percentage ownership of our existing stockholders will be reduced, and these newly issued securities may have rights, preferences, or privileges senior to those of existing stockholders, including, those persons acquiring shares in this offering.

If we issue any additional common stock or securities convertible into common stock, such issuance will reduce the proportionate ownership and voting power of each other stockholder. In addition, such stock issuances might result in a reduction of the book value of our common stock.

***Because Christopher J. Reed controls a majority of our stock, he can control the outcome, or greatly influence the outcome, of all matters on which stockholders vote.***

Christopher J. Reed, our President, CEO, Chairman of the Board, and Chief Accounting Officer currently owns approximately 68% of our outstanding voting stock. If all the shares in this offering are sold, Mr. Reed will own approximately 48% of our outstanding voting stock. If 1,000,000 shares in this offering (50%) are sold, Mr. Reed will own approximately 56% of our outstanding voting stock, and if only 200,000 shares in this offering (10%) are sold, he will own approximately 65% of our outstanding voting stock. Therefore, Mr. Reed will be able to control the outcome, or greatly influence the outcome, on all matters requiring stockholder approval, including the election of directors, amendment of our certificate of incorporation, and any merger, consolidation or sale of all or substantially all of our assets or other transactions resulting in a change of control of our company. See "Principal Stockholders."



***A substantial number of our shares will be available for sale in the public market after the offering and sales of those shares could adversely affect our stock price.***

Sales of a substantial number of shares of common stock into the public market after this offering, or the perception that such sales could occur, could substantially reduce our stock price in any public market, and could impair our ability to obtain capital through an offering of equity securities. After this offering, we will have 6,726,091 shares of common stock outstanding if all 2,000,000 shares in this offering are sold, 5,726,091 shares of common stock outstanding if 1,000,000 shares in this offering (50%) are sold, and 4,926,091 shares of common stock outstanding if 200,000 shares in this offering (10%) are sold. All the shares of common stock sold in this offering will be freely tradable without restriction or further registration required under federal securities laws.

Of the shares of our common stock currently outstanding, 4,277,416 shares are “restricted securities” under the Securities Act of 1933, as amended. Some of these “restricted securities” will be subject to restrictions on the timing, manner, and volume of sales of such shares. See “Shares Available For Future Resale.”

***Our common stock may become subject to “penny stock” regulations that may affect the liquidity for our common stock.***

Our common stock may become subject to the rules adopted by the Securities and Exchange Commission, or SEC, that regulate broker-dealer practices in connection with transactions in “penny stocks.” Penny stocks are generally equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the NASDAQ Stock Market, provided that current price and volume information with respect to transactions in such securities is provided by the exchange or system).

The penny stock rules require that a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from those rules, deliver a standardized risk disclosure document prepared by the SEC, which contains the following:

- a description of the nature and level of risk in the market for penny stocks in both public offerings and secondary trading
- a description of the broker’s or dealer’s duties to the customer and of the rights and remedies available to the customer with respect to violation to such duties or other requirements of Securities’ laws
- a brief, clear, narrative description of a dealer market, including “bid” and “ask” prices for penny stocks and significance of the spread between the “bid” and “ask” price
- a toll-free telephone number for inquiries on disciplinary actions; definitions of significant terms in the disclosure document or in the conduct of trading in penny stocks, and
- such other information and is in such form (including language, type, size and format), as the Commission shall require by rule or regulation.

Prior to effecting any transaction in penny stock, the broker-dealer also must provide the customer the following:

- the bid and offer quotations for the penny stock
- the compensation of the broker-dealer and its salesperson in the transaction
- the number of shares to which such bid and ask prices apply, or other comparable information relating to the depth and liquidity of the market for such stock
  - the liquidity of the market for such stock, and
- monthly account statements showing the market value of each penny stock held in the customer’s account.

In addition, the penny stock rules require that prior to a transaction in a penny stock not otherwise exempt from those rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser’s written acknowledgment of the receipt of a risk disclosure statement, a written agreement to transactions involving penny stocks, and a signed and dated copy of a written suitability statement. These disclosure requirements may have the effect of reducing the trading activity in the secondary market for a stock such as our common stock if it is subject to the penny stock rules.

**(The rest of this page left blank intentionally)**

## FORWARD LOOKING STATEMENTS

Some of the statements made in this prospectus, including certain statements made under “Prospectus Summary,” “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business” constitute forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” or “continue” or the negative of such terms or other comparable terminology.

Forward-looking 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 achievement expressed or implied by such forward-looking statements.

Management cautions that these statements are qualified by their terms and/or important factors, many of which are outside the control of the Company, involve a number of risks, uncertainties and other factors that could cause actual results and events to differ materially from the statements made, including, but not limited to, the following:

- The Company’s ability to generate sufficient cash flows to support capital expansion plans and general operating activities;
    - Decreased demand for our products resulting from changes in consumer preferences;
  - Competitive products and pricing pressures and the Company’s ability to gain or maintain its share of sales in the marketplace;
    - The introduction of new products;
  - The Company’s being subject to a broad range of evolving federal, state and local laws and regulations including those regarding the labeling and safety of food products, establishing ingredient designations and standards of identity for certain foods, environmental protections, as well as worker health and safety. Changes in these laws and regulations could have a material effect on the way in which the Company produces and markets its products and could result in increased costs;
  - Changes in the cost and availability of raw materials and the ability to maintain our supply arrangements and relationships and procure timely and/or adequate production of all or any of the Company’s products;
    - The Company’s ability to penetrate new markets and maintain or expand existing markets;
    - Maintaining existing relationship and expanding the distributor network of the Company’s products;
  - The marketing efforts of distributors of the Company’s products, most of whom also distribute products that are competitive with the Company’s products;
  - Decisions by distributors, grocery chains, specialty chain stores, club stores and other customers to discontinue carrying all or any of the Company’s products that they are carrying at any time;
    - The availability and cost of capital to finance the Company’s working capital needs and growth plans;
- The effectiveness of the Company’s advertising, marketing and promotional programs;
- Changes in product category consumption;
  - Economic and political changes;
  - Consumer acceptance of new products, including taste test comparisons;
  - Possible recalls of the Company’s products; and
  - The Company’s ability to make suitable arrangements for the co-packing of any of its products.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. Because the Company’s actual results could be materially different from the results described or anticipated by the Company’s forward-looking statements, due to the inherent uncertainty of estimates, forecasts and projections, you should not rely on the accuracy of forward-looking statements in this prospectus.

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## USE OF PROCEEDS

Estimated net proceeds from this offering, based on an offering price of \$4.00 per share and after deducting a 6% sales commission, a 1% lead underwriter's concession, a 3% non-accountable broker expense allowance and other offering expenses estimated to range from approximately \$200,000 to \$275,000, will range from \$0 to \$6,925,017, depending upon the number of shares we sell in this offering. The offering is being made on a best efforts basis, and we do not know how many shares, if any, will be sold in this offering.

The primary purposes of this offering are to obtain additional capital, create a public market for our common stock, and facilitate future access to public capital markets. In general, we intend to use the net proceeds from this offering to increase working capital, hire additional sales representatives, and launch new products. Depending upon the amount raised in this offering, we also plan to purchase and place coolers, in-store displays and other marketing tools; expand brand advertising, fund supermarket slotting fees where applicable, provide for improvements to our West Coast production facility, the Brewery, and hire a chief operating officer.

We presently expect to use the estimated net proceeds from the offering substantially as set forth in the table below, if the number of shares indicated are sold in the offering:

Proposed Use	Estimated Amount if 200,000 Shares are Sold (10% of Total)		Estimated Amount if 1,000,000 Shares are Sold (50% of Total)		Estimated Amount if 2,000,000 Shares are Sold (100% of Total)	
Gross Offering Receipt	\$ 800,000		\$ 4,000,000		\$ 8,000,000	
Underwriters' Compensation	80,000		400,000		800,000	
Offering Expenses	199,983		224,983		274,983	
Net Proceeds	520,017	(100)%	3,375,017	(100)%	6,925,017	(100)%
Additional Sales Representatives	250,000	(48)%	900,000	(27)%	2,100,000	(30)%
New product launches	100,000	(19)%	250,000	(7)%	375,000	(6)%
Retail Slotting	0	(0)%	750,000	(22)%	1,500,000	(22)%
Brand Advertising	0	(0)%	750,000	(22)%	1,500,000	(22)%
Cooler and in-store displays	103,017	(20)%	320,017	(10)%	640,017	(9)%
Chief Operating Officer	0	(0)%	100,000	(3)%	100,000	(1)%
West Coast Brewery	0	(0)%	150,000	(4)%	150,000	(2)%
Working Capital	67,000	(13)%	155,000	(5)%	560,000	(8)%
Total Estimated Net Proceeds	\$ 520,017	(100)%	\$ 3,375,017	(100)%	\$ 6,925,017	(100)%

*Additional Sales Representatives.* We will be able to hire from two to approximately 30 new sales representatives, depending upon the net proceeds of this offering.

*New Product Launches.* We will be able to launch from between five and approximately 20 new products, by which we mean SKUs, depending upon the net proceeds of this offering. Over the next 12 - 24 months we plan to launch as many as six new SKUs in the Ginger Brew line, five new SKUs in the Virgil's line, four new China Cola SKUs, three new frozen confections, and two new candies.

*Retail Slotting.* We plan to place our products in up to 30,000 new stores. Some stores, particularly chains, require slotting fees to place product on store shelves. Currently, we do not pay slotting fees to place a majority of our products in stores. However, in the future, we may have to pay slotting fees, depending upon the type of stores and chains where we place our products. See “Business — Our Primary Markets — Mainstream Supermarkets.”

*Brand Advertising.* We plan to use strategic consumer and trade targeted advertising to build brand awareness, and support existing and new product placements. Our advertising plans include print ads in magazine and newspapers, public relations events and consumer event sponsorships at which we offer samples of our products.

*Cooler and In-store Display Programs.* Our marketing plans include placing up to 2,000 Reed’s branded refrigerated coolers and Reed’s branded in-store displays, which we call Kegeators, throughout the United States and, to a lesser degree, in Canada. We consider coolers and in-store displays to be efficient and proven marketing tools.

*West Coast Brewery.* Depending upon the net proceeds of this offering, we intend to purchase packaging automation equipment for the Brewery. This will allow us to increase production capacity and reduce overall time that our products can be in production, while decreasing labor costs.

In June 2004, we entered into a revolving loan and security agreement pursuant to which we are able to borrow up to \$1,100,000. See “Management’s Discussion and Analysis and Results of Operations — Liquidity and Capital Resources.” We intend to use all or a portion of any funds borrowed pursuant to this loan agreement, in addition to the proceeds from the sale of the shares in this offering, for the uses described above.

If fewer than all 2,000,000 shares are sold in this offering, we will reduce or eliminate some proposed uses as described in the table above. The speed with which we expand our marketing and advertising for our products, and the number of products we offer to the public, depends in large part on the number of shares of common stock sold in this offering. If only a limited number of shares are sold, our expansion plans will take substantially longer to implement.

If fewer than 200,000 shares are sold, we will use most of the money to hire additional sales representatives.

Assuming no funds from this offering were available, over the next twelve months, we would be able to launch the 750 ml. champagne bottle for approximately three to five of our products, including our Reed’s Ginger Brew and swing-lid bottles for approximately two of our products. In addition, we would be able to hire approximately two additional sales representatives. Other elements of our expansion plan might have to be curtailed or delayed unless we could find alternative external sources of working capital.

We cannot assure you that the above dollar amounts will be specifically allocated as set forth in the foregoing table. Our management has discretion in the application of the actual net proceeds of the offering. Allocation of net proceeds is further subject to future events including changes in general economic conditions, changes in our strategy and our response to competitive pressures and consumer preferences associated with the products we sell. Pending ultimate application, the net proceeds will be invested in an interest-bearing bank account or government securities.

The “Use of Proceeds” budget as laid out in the foregoing table represents our best estimate as to the amounts that will be spent on each category of expenditure listed. As we evaluate the effectiveness of each of the different expense categories to grow the business profitably, we expect to modify these amounts to most effectively use these funds. We may find that our sales representatives are selling mostly our core brands and do not need or want more new product launches but that funds are better used in purchasing more displays to fuel their sales activities. We may find that in-store displays create more cost effective advertising than straight brand advertising. The evaluation of the use of funds is an ongoing, interactive function of management.

#### **DIVIDEND POLICY**

We have never declared or paid any cash dividends on our common stock and do not anticipate paying cash dividends. We currently intend to retain future earnings, if any, to finance operations and expansion of our business.

We are obligated to pay a non-cumulative 5% dividend from lawfully available assets to the holders of our Series A preferred stock beginning on June 30, 2005 in either cash or additional shares of Series A preferred stock in our discretion. See “Description of Our Securities — Preferred Stock.”

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**CAPITALIZATION AS OF DECEMBER 31, 2004**

The following table sets forth our capitalization as of December 31, 2004 and as adjusted to reflect the sale by us of 2,000,000 shares of common stock in this offering and the application of the estimated net proceeds, assuming an offering price of \$4.00 per share, after deducting underwriter commissions and estimated offering expenses. The table also shows the effect if only 50% and 10% of the offering is completed. The information in the table below is qualified by, and should be read in conjunction with, our audited financial statements and related notes appearing elsewhere in this prospectus. The following table assumes that the underwriter does not exercise its over-allotment option and excludes the following shares:

- 17,500 shares of common stock issuable upon exercise of outstanding options issued by us under our 2001 Stock Option Plan at a weighted average exercise price of \$3.21;
  - 482,500 additional shares of common stock reserved for future issuance under our 2001 Stock Option Plan;
- 55,000 shares of common stock issuable upon exercise of outstanding options, other than outstanding options issued under our 2001 Stock Option Plan, at a weighted average exercise price of \$2.43;
- 848,876 shares of common stock issuable upon exercise of outstanding warrants at a weighted average exercise price of \$1.94; and
  - 200,000 shares reserved for future issuance under the underwriter's warrant.
    - 126,485 of common stock upon conversion of debt.
    - 235,760 of common stock issued upon conversion of preferred stock.

	December 31, 2004			
		As adjusted (Based on % of offering completed)		
Current Liabilities:		10%	50%	100%
Current portion of long-term debt	\$ 106,113	\$ 106,113	\$ 106,113	\$ 106,113
Note payable related party	21,000	21,000	21,000	21,000
Lines of credit	1,128,222	1,128,222	1,128,222	1,128,222
<b>Total current liabilities</b>	<b>1,255,335</b>	<b>1,255,335</b>	<b>1,255,335</b>	<b>1,255,335</b>
Long-term liabilities				
Long-term debt	1,041,756	1,041,756	1,041,756	1,041,756
Notes payable to related parties	252,358	252,358	252,358	252,358
<b>Total Long-term liabilities</b>	<b>1,294,114</b>	<b>1,294,114</b>	<b>1,294,114</b>	<b>1,294,114</b>
Stockholders' equity:				
Common stock — par value \$.0001 per share:				
Authorized — 11,500,000 shares				
Issued and outstanding —				
4,726,091 shares	472	492	572	672
Additional paid-in capital	2,783,464	3,303,444	6,158,364	9,708,264
Preferred stock	589,402	589,402	589,402	589,402
Accumulated deficit	( 2,403,638)	( 2,403,638)	( 2,403,638)	( 2,403,638)
<b>Total stockholders' equity</b>	<b>969,700</b>	<b>1,489,700</b>	<b>4,344,700</b>	<b>7,894,700</b>



Total Capitalization	\$	3,519,149	\$	4,039,149	\$	6,894,149	\$	10,444,149
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**DILUTION**

Our net tangible book value at December 31, 2004 was \$(66,091), or \$(0.01) per share. Our net tangible book value per share is determined by subtracting the total amount of our liabilities from the total amount of our tangible assets and dividing the remainder by the weighted average number of shares of our common stock outstanding.

The as adjusted net tangible book value after this offering will be \$6,858,909, or \$1.02 per share, after deducting estimated expenses of this offering, if all the shares in this offering are sold at an assumed offering price of \$4.00 per share. Therefore, purchasers of shares of common stock in this offering will realize a minimum dilution of \$2.98 per share, or about 75% of their investment. If fewer than all shares offered hereby are sold, the dilution will be greater. The following table illustrates this dilution, assuming 200,000 shares are sold, 1,000,000 shares are sold, and 2,000,000 shares in this offering are sold:

	If 200,000 Shares are Sold	If 1,000,000 Shares are Sold	If 2,000,000 Shares are Sold
Offering Price per Share	\$ 4.00	\$ 4.00	\$ 4.00
Net tangible book value per common share at December 31, 2004	(0.01)	(0.01)	(0.01)
Increase per common share attributable to new investors	0.10	0.59	1.03
Net tangible book value per share of common stock after the offering	0.09	0.58	1.02
Dilution per share of common stock to new investors	\$ 3.91	\$ 3.42	\$ 2.98

During the five years prior to the date of the prospectus, we sold shares of common stock for prices ranging from \$1.00 to \$4.00 per share.

Additional dilution, not reflected in the foregoing table, will result to the extent that outstanding options and warrants to purchase our common stock are exercised or convertible debt or our Series A convertible preferred stock is converted into shares of our common stock.

As of December 31, 2004, we had outstanding options and warrants to purchase an aggregate of 921,376 shares of common stock at a weighted average exercise price of \$2.04 per share.

As of December 31, 2004, we had outstanding an aggregate \$257,111 of convertible debt, including accrued and unpaid interest, to purchase an aggregate of 126,485 shares of common stock at a weighted average exercise price of \$2.03 per share.

As of December 31, 2004, we had 58,940 shares of preferred stock outstanding which can be converted into 4 shares of the Company's common stock, or 235,760 shares of common stock at \$2.50 per share of common stock.

We have not issued and will not issue options or warrants with an exercise price less than 85% of the fair market value of the underlying common stock on the day of the grant.

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**Comparative Data**

The following charts illustrate the pro forma proportionate ownership of our common stock upon completion of the Offering if 10%, 50%, and 100% of the Offering is sold. These charts compare the relative amounts paid, by the present shareholders, and by investors in this Offering, assuming no changes in net tangible book value other than those resulting from the Offering.

	If 10% of Offering sold (200,000 shares)		Total Consideration (\$)		Average Price per Share Paid (\$)
	Shares Purchased	Percentage	Percentage	Percentage	
Existing Shareholders <sup>(1)</sup>	4,726,091	95.9%	2,783,936	77.7%	0.59
New Investors	200,000	4.1%	800,000	22.3%	4.00
<b>Total</b>	<b>4,926,091</b>	<b>100%</b>	<b>3,583,936</b>	<b>100%</b>	

	If 50% of Offering sold (1,000,000 shares)		Total Consideration (\$)		Average Price per Share Paid (\$)
	Shares Purchased	Percentage	Percentage	Percentage	
Existing Shareholders <sup>(1)</sup>	4,726,091	82.5%	2,783,936	41.1%	0.59
New Investors	1,000,000	17.5%	4,000,000	58.9%	4.00
<b>Total</b>	<b>5,726,091</b>	<b>100%</b>	<b>6,783,936</b>	<b>100%</b>	

	If 100% of Offering sold (2,000,000 shares)		Total Consideration (\$)		Average Price per Share Paid (\$)
	Shares Purchased	Percentage	Percentage	Percentage	
Existing Shareholders <sup>(1)</sup>	4,726,091	70.3%	2,783,936	25.8%	0.59
New Investors	2,000,000	29.7%	8,000,000	74.2%	4.00
<b>Total</b>	<b>6,726,091</b>	<b>100%</b>	<b>10,783,936</b>	<b>100%</b>	

<sup>(1)</sup> Based on the capital contribution from inception to December 31, 2004

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with our financial statements and related notes included elsewhere in this prospectus. Except for historical information, the following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. See "Forward Looking Statements," beginning at page 8 of this prospectus.

### Overview

We develop, manufacture, market, and sell "alternative" or "New Age" beverages and assorted foods. 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
- Reed's Ginger Ice Creams

We currently distribute and sell our products through a network of natural, gourmet, and independent distributors, as well as through our growing in-house direct sales and distribution team, throughout the United States and, to a lesser extent, in Canada. In 2003, we implemented direct sales to several large national retail accounts. These accounted for approximately 19% of our gross sales in 2003 and approximately 22% of our gross sales in 2004. In addition, in 2003 we created our own distribution system in southern California. This accounted for approximately 1% of our gross sales in 2003 and approximately 4% of our gross sales in 2004. The following table shows a breakdown of net sales with respect to the distribution channel.

Distribution Channel	2003 sales	Percentage sales	2004 sales	Percentage sales
Direct sales to large retailers	\$ 1,286,365	19%	\$ 1,983,598	22%
Our local direct distribution	\$ 90,121	1%	\$ 395,601	4%
Natural, Gourmet and Mainstream distributors	\$ 5,405,290	80%	\$ 6,599,166	74%
Total	\$ 6,781,776	100%	\$ 8,978,365	100%

New products, or SKUs, that we launched in 2003 include a 5-liter "party keg" version of our Virgil's Root Beer and Virgil's Cream Soda in 12-ounce long neck bottles. Both of these high-margin items continue to contribute to growth of our sales for 2003 and 2004.

In 2003, we expanded our marketing from our historical focus on natural and gourmet foods to include more mainstream markets. These efforts include selling our products directly to large retail accounts, primarily Costco, BJ Wholesale, and Cost Plus World Markets. In addition, through our current North American natural and gourmet distributors, we have focused sales to the natural food section of mainstream supermarket chains. This has resulted in our products now being sold in Safeway, Kroger's and numerous other national supermarket chains. Our local distribution in southern California is placing our products directly into accounts locally, including Ralph's, Bristol Farms, and many independent accounts.

We gauge the financial success of our company by a number of different parameters. Because our industry typically values companies on a top-line basis, one of our main company goals is to increase net sales. We continue to increase

net sales each year. Net sales have increased from \$6.2 million in 2001 to \$6.4 million in 2002 to \$6.8 million in 2003. In 2004 sales grew to \$9.0 million. We believe that the increase in net sales comes from three sources: successes in our new local distribution, increases in our core business and our new direct sales to large retailers.

Almost as important as increasing our net sales are increasing our gross margins. We continue to work to reduce costs related to production of our products. In 2002, we purchased and outfitted a West Coast production facility, the Brewery, in part to help reduce both production costs and freight costs associated with our West Coast sales. Gross profits declined after the construction of the Brewery. Gross margins decreased from 24.8% in 2002 to 19.5% in 2003. We believe that the inefficiencies commensurate with a start-up period for the Brewery have been a principal cause of the decline of our gross margins in 2003. Gross margins recovered to 20.9% in 2004, we believe that this increase in gross margin is because of the Brewery attaining greater functionality and efficiencies. As the Brewery continues to become more fully operational, we believe that we will see greater margin improvements due to freight and production savings. We expect to have the Brewery fully functional by the end of 2005. The following table shows the progress of productions at the Brewery and the savings being generated:

Year	Cases of candy produced at new brewery	Candy production savings (\$)	Cases of beverages produced at new brewery	Freight savings beverages (\$)	Total savings (\$)
2002	0	\$ 0	0	\$ 0	\$ 0
2003	33,514	\$ 33,514	16,835	\$ 22,390	\$ 55,904
2004	31,278	\$ 31,278	113,816	\$ 151,372	\$ 182,650

In addition, through the Brewery, we have increased our capability to offer specialty beverage packaging options not typically available in the marketplace, such as our new 5-liter party keg line and our new 750 ml. champagne bottle line. We also intend to manage general and administrative and selling expenses, in order to improve our profitability.

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

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

Fuel Prices - As oil prices continue to rise, our freight rates, which run at approximately 8% of net sales, have been increasing. We currently see freight rates increasing by an additional 5% to 10% in the near term. On the other hand, we expect that the Brewery will counter this trend, at least in part, by reducing our need for cross-country freight services.

Low Carbohydrate Diets and Obesity - Consumers have been demanding lower carbohydrate products. This trend did not seem to affect our sales growth in 2004. We are watching this trend closely and have started developing low-carbohydrate versions of some of our beverages.

Distribution Consolidation - The trend towards continued consolidation of the beverage distribution industry through mergers and acquisitions has inspired us to start our own direct distribution locally in southern California and to go to large national retailers. Consolidation among natural foods industry distributors has not had an affect on our sales. However, this consolidation may limit the distributor options outside natural foods to service mass-market food accounts.

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 shifted to products not only to using more natural ingredients but to add ingredients with a perceived positive function such as vitamins, herbs and other nutrients. Our products are designed with this consumer demand in mind, also.

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 supermarkets throughout the United States. Supermarkets can require more advertising monies to be spent and sometimes require slotting fees. We continue to work to keep these fees reasonable. The natural food section of the supermarket is generally not as expensive as other areas from a slotting fee perspective. See the "Business" section regarding supermarket marketing.

Beverage Packaging Changes - Beverage packaging has continued to innovate. 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. See the business section for new product developments.

Cash Flow Requirements - Growth of our company will depend on the availability of additional capital infusions to finance. 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 feel that we could raise prices to offset this problem if it occurs. We haven't increased our prices since inception and we feel that the market has been increasing in terms of beverage prices in the last ten years.

Packaging or Raw Material Price Increases - An increase in packaging or raw materials could be adverse to our cash flow and income. We have not had a significant increase in any of these costs for many years but the effect of the US dollar dropping in value with respect to other major world currencies and rising fuel prices could possibly increase costs of the raw materials and packaging making up the cost of goods manufactured. We continue to search for packaging and production alternatives to reduce our cost of goods.

### **Critical Accounting Policies**

Our consolidated 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 consolidated 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:

*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 years ended December 31, 2004 or 2003.

*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 years ended December 31, 2004 or 2003.

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 consolidated 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 are expected to 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.

### **Recent Accounting Pronouncements**

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4". The amendments made by Statement 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. The Company has evaluated the impact of the adoption of SFAS 151, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions." The amendments made by Statement 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. Opinion 29 provided an exception to its basic measurement principle (fair value) for exchanges of similar productive assets. The Board believes that exception required that some nonmonetary exchanges, although commercially substantive, be recorded on a carryover basis. By focusing the exception on exchanges that lack commercial substance, the Board believes this Statement produces financial reporting that more faithfully represents the economics of the transactions. The Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of this Statement shall be applied prospectively. The Company has evaluated the impact of the adoption of SFAS 152, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment". Statement 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. Statement 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply Statement 123(R) as of the first

interim or annual reporting period that begins after June 15, 2005. The Company has evaluated the impact of the adoption of SFAS 123(R), and does not believe the impact will be significant to the Company's overall results of operations or financial position.

We do not believe that the adoption of the above recent pronouncements will have a material effect on our consolidated financial position or results of operations.

## Results of Operations

### *Twelve Months Ended December 31, 2004 Compared to Twelve Months Ended December 31, 2003*

Net sales increased by \$2,196,589, or 32.4%, to \$8,978,365 in 2004 from \$6,781,776 in 2003. The net sales increase was primarily the result of sales growth of existing products (13.5%), and new products (18.9%). Existing product growth came from the Virgil's Root Beer 12 ounce bottle sales (5.6%) and from the core Reed's Ginger Brew products (7.9%) consisting of Reed's Original, Reed's Extra and Reed's Premium Ginger Brew. While we keep limited data on the following, we believe these existing product sales increases were due to increased sales in existing outlets and the expansion of the number of outlets carrying these products. New product growth came from the 5 liter Virgil's Root Beer party keg (13.7%) and from the new Virgil's Cream Soda (5.2%). These new product launches did not employ any special promotional discounts above and beyond our normal promotional activity for any of our products. Sales of these new items have continued to be steady and growing.

As a percentage of net sales, gross profit increased to 20.9% in 2004 from 19.5% in 2003. This increase was due to reduced ingredient expenses (0.2%), reduced warehouse expenses (0.3%) as a result of the West Coast brewery reducing the need for outside warehouse services, reduced depreciation as a percentage of sales (0.5%) and reduced production costs (2.2%) associated with savings generated from the West Coast brewery continuing to come on line. These increases were offset by higher freight costs (-1.8%) due to increased fuels costs being passed on to the company.

Selling expenses increased by \$136,085 or 20.7% to \$791,975 in 2004 from \$655,890 in 2003 and decreased as a percentage of net sales to 8.7% in 2004 from 9.7% in 2003. The increase in selling expenses was primarily due to increased sales wages due to a larger sales force (19.5%) and more commissions due to increased number of outside sales brokers (18.7%) offset by reduced selling expenses (-8.4%) and reduced promotional expenses (-10.2%). Selling expenses reduced due to cheaper telephone services and increased coordination between the company's two sales forces to reduce duplicity in travel needs. Promotional expenses reduced because the company reduced trade shows and advertising expenses. The focus of our marketing is shifting to more in store promotions and more direct selling than trade show selling.

General and administrative expenses increased by \$316,277 or 41.7%, to \$1,074,535 in 2004 from \$758,258 in 2003 and increased as a percentage of net sales to 12.0% in 2004 from 11.2% in 2003. The increase in general and administrative expenses was primarily due to in to increased payroll expenses (23.1%) due to a larger staff to handle the increased business, increased transportation expenses (17.3%) due to the expansion of the local direct distribution, increased depreciation expenses (9.0%) due to equipment being used for local distribution, increased tax expenses (10.1%) due to the company paying state franchise taxes for two years. The remaining expense increases (40.5%) were spread evenly over the other expenses categories and were a direct result of the increased sales during 2004.

Legal Defense costs for 2004 were \$80,156. These expenses were pursuant defense versus a lawsuit brought against us by a consultant alleging funds due him from us. We mounted a successful defense in this action. We filed a post trial motion for attorney fees and costs and were awarded \$64,895. The case is in appeal and we project that we may incur additional legal expenses up to \$35, 000 over the next 12 months in pursuit of further defense in this case.

Interest expense was \$250,738 in 2003, compared to interest expense of \$255,033 in 2004. We had slightly higher interest expense in 2004 due to increased borrowing on our receivable line of credit with our lender, Bay Business Credit.

In addition, in 2003, we expensed \$426,546 for a public offering of our common stock, which offering was withdrawn. The public offering was filed on October 25, 2001, became effective on December 31, 2002 and was withdrawn on March 26, 2003 and we did not complete the offering. We had a nine-month window to sell shares and

because the initial stock sales were slow and the stock market was depressed due to the Iraq war we withdrew the offering.

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## 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.

As of December 31, 2004, we had a working capital deficit of \$684,647, compared to a working capital deficit of \$589,659 as of December 31, 2003. This increase in our working capital deficit was primarily attributable to losses from operations, and increased receivables offset by money raised in the sale of preferred stock, increased borrowing on our existing line of credit, increased payables, and a new loan with Merrill Lynch.

As of December 31, 2004, cash was \$42,488, compared to \$12,930 as of December 31, 2003. Net cash used in operating activities was approximately \$220,060 for the twelve months ended December 31, 2004, primarily due to an increase in the receivables and loss from operations, offset by an increase in accounts payable. We used \$204,147 in investing activities for the twelve months ended December 31, 2004, primarily for the purchase of equipment for our West Coast Brewery. Cash flow from financing activities was \$453,765 for the twelve months ended December 31, 2004 as a result of increased borrowing from our line of credit and the collection of \$334,400 of proceeds in connection with our offering of preferred stock in 2004. In addition, we borrowed on our new line of credit at Merrill Lynch and a loan on equipment from Bay Business for \$150,000.

Our trade accounts receivable, net, was \$797,614 at December 31, 2004, an increase of \$231,557 (40.9%) over our accounts receivable, net, of \$566,057 at December 31, 2003. The increase in accounts receivable was due primarily to an increase in sales and not to any change in our credit policy.

Of the aggregate principal amount of \$420,000 that we borrowed from various investors in 2001 with an interest rate of 8% and which loans had an extended maturity date of October 2004, we repaid \$116,000 on or before December 31, 2004. \$224,000 (\$255,002 including interest) was converted into shares of Series A preferred stock in October 2004 and \$80,000 remains outstanding. The remaining debt holders have signed extensions of their notes with a new maturity of June 21, 2006. In consideration for this extension, these note holders have been granted an interest rate increase to 10% from 8% effective retroactively to June 30, 2004.

We do not have any current material commitments for capital expenditures.

On June 25, 2004, we renewed our credit facility with Bay Business Credit. The credit facility consists of a one-year revolving line of credit of up to \$1,100,000, which expires on June 25, 2005. The amount available for borrowing from time to time under the revolving line of credit is dependent upon the levels of certain eligible accounts receivable and inventory. As of December 31, 2004, we had an outstanding balance of \$759,387 under the line of credit, based on eligible accounts receivable and inventory at that time. Borrowings under the credit facility bear interest at the prime rate plus 9% per annum (14.25% for the accounts receivable line and 15.25% for the inventory line as of December 31, 2004).

This revolving line of credit is secured by all of our assets, including accounts receivable, inventory, trademarks and other intellectual property, and equipment. The credit facility does not impose any financial covenants on us.

On December 11, 2000, we borrowed \$748,000 from U.S. Bank National Association, guaranteed by the U.S. Small Business Administration, which we used to finance the purchase of the Brewery. At the same time, we borrowed \$168,000 from U.S. Bank National Association, guaranteed by the U.S. Small Business Administration, which we used to make improvements at the Brewery. The interest for these loans is prime plus 1% per annum (6% as of December 31, 2004), and the loans mature in 25 years. Our founder and CEO, Christopher J. Reed, has personally guaranteed these loans. Payments under the loans are current.

In the second quarter of 2004, we began a private placement of Series A convertible preferred stock. We raised \$334,400 from the sale of 33,440 shares of Series A convertible preferred stock and a number of our debt holders converted an aggregate of \$255,002 of debt to 25,500 shares of Series A preferred stock.

On September 24, 2004, we obtained a line of credit from Merrill Lynch. The loan was co-signed by Robert T. Reed, Jr., our Vice President and National Sales Manager — Mainstream and a brother of our founder and CEO, Christopher J. Reed. Robert Reed also pledged his stock account at Merrill Lynch as collateral. The line of credit bears interest at a rate of rate of 3.785% plus LIBOR (6.3% as of December 31, 2004). The balance as of December 31, 2004 is \$287,934. In consideration for Mr. Reed's pledging his stock account at Merrill Lynch as collateral, we pay Mr. Reed 5% per annum of the amount we borrow from Merrill Lynch. See "Certain Relationships and Related Transactions."

On September 28, 2004, we obtained a loan for \$150,000 from Bay Business Credit secured by certain plant equipment. This loan bears interest at prime plus 10% (15.25% as of December 31, 2004) and matures in November 2007.

On January 14, 2004, we obtained a loan for \$41,000 from Bay Business Credit secured by certain plant equipment. This loan bears interest at prime plus 12% (17.25% as of December 31, 2004) and matures in January 2007.

During the next six months, we expect to reduce our raw materials inventory by approximately \$150,000. We built up this inventory by purchasing beverage bottles in a foreclosure proceeding of an unrelated party.

As a result of our cash reserves and the combination of the recent private stock offering and new borrowings, we believe that we have adequate resources to fund our operations, without implementing most of our business expansion plan, for at least the next 12 months.

### **Inflation**

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



## BUSINESS

### Background

We are a growing developer, manufacturer, marketer, and seller of New Age beverages, as well as 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 offer 14 beverages, including six varieties of Reed's Ginger Brews, Virgil's Root Beer and Cream Soda, China Cola and Cherry China Cola, and four varieties of a new line of non-carbonated ginger brews called Reed's Ginger Juice Brews. Our recent products include Reed's Crystallized Ginger Candy, Reed's Crystallized Ginger Baking Bits, Reed's Ginger Candy Chews, Reed's Original Ginger Ice Cream, Reed's Chocolate Ginger Ice Cream, and Reed's Green Tea Ginger Ice Cream.

We sell the majority of our products primarily in upscale gourmet and natural food stores and supermarket chains in the United States and, to a lesser degree, in Canada. Historically, most of our beverages were sold in the natural food industry.

Our current business strategy is to maintain a firm marketing focus in the natural food marketplace while building a national direct sales and distribution force to take our proven products into mainstream market and distribution channels. Key elements of our business strategy include:

Key elements of our business strategy include:

- increased direct sales and distribution;
- increased store placement in mass market;
- strong national distributor relationships;
- stimulating strong consumer demand for our existing brands and products;
- developing additional unique alternative beverage brands and other products; and
- specialty packaging like our 5-liter party kegs, our ceramic swing-lid bottle and our 750 ml. champagne bottle.

Our current sales efforts are focused in three areas. Our first area of focus is sales to natural and specialty food stores in the United States and, to a lesser degree, Canada, through our regional sales people in conjunction with regional food brokerage organizations. The second area of focus is our local direct store distribution program, using Company-owned trucks and drivers to service a majority of our retail accounts in southern California. The third area of focus is our sales effort selling directly to large retailers and to mainstream beverage distributors. We believe that all three sales efforts are contributing to our growth. We intend to continue to expand our sales personnel in each of these three sales efforts.

We are developing new packaging options of our most successful products. These new packaging options are 750 ml. champagne bottle versions, European swing lid-style bottles, and 5-liter party kegs. These new packaging options are being utilized in all three sales efforts.

We create consumer demand for our products in the following ways: we support sampling programs of our products that sample approximately 30,000 people a week, we generate free press through our in house public relations, we advertise in national magazines targeting our customers, we maintain a company website and we participate in large public events as sponsors.

In addition, our Brewery recently started contracting, or co-packing, production for other companies' products, although this is a small part of our business. We do not maintain product recall insurance at the Brewery. Generally,

we believe that we maintain adequate insurance coverage for our business as it is currently conducted.

Our business expansion plans are contingent to a great extent by the success of this offering. If all or most of the shares being offered hereby are sold, we will be able to increase substantially our marketing, advertising and distribution, as well as the number of products we offer. If only a smaller number of shares are sold, we will need to expand at a much slower rate.

Our principal executive offices are located at 13000 South Spring Street, Los Angeles, California 90061. Our telephone number is (310) 217-9400. Our Internet address is [www.reedsgingerbrew.com](http://www.reedsgingerbrew.com). Information contained on our website or that is accessible through our website should not be considered to be part of this prospectus.

We were incorporated in 1991 in Florida as Original Beverage Corporation. In October 2001, we changed our state of incorporation to Delaware and also changed our name to Reed's, Inc.

## Historical Development

In June 1987, Christopher J. Reed, our founder and CEO, began development of Reed's Original Ginger Brew, his first beverage creation. After two years of development, it was ready for market in June 1989. Initial sales were in 11 southern California stores.

By 1990, we brought on the next three natural food distributors. Production moved to a larger facility in Boulder, Colorado. In 1991, we moved all of our production to our co-pack facility in Pennsylvania. We began exhibiting at the national natural and specialty food trade shows, which brought national distribution in natural, gourmet and specialty foods and the signing of our first mainstream supermarket distributor. Sales topped \$500,000.

Also in 1991, the United States National Association of the Specialty Food Trade, or NASFT, and the Canadian Fancy Food Association, or CFFA, both gave us top honors as a new product that year. CFFA awarded us "Best Imported Food Product" at their annual show and Original Ginger Brew was a NASFT "Outstanding Beverage Finalist" in the United States.

Throughout the 1990's, we continued to develop and launch new ginger brew varieties. Reed's Ginger Brews reached broad placement in natural foods stores nationwide. The major natural food distributors and many specialty food and mainstream beverage distributors started carrying our beverages. In 1997, we began licensing the products of China Cola. In addition, we launched Reed's Crystallized Ginger Candy. We have the candy manufactured in Fiji under a proprietary, natural, non-sulfured process.

In 1999, we purchased the Virgil's Root Beer brand from Crowley Beverage Company. The brand has won numerous gourmet awards. Because the Virgil's brand is partially produced under our auspices in Europe, this purchase also secured our entry into the European Union for our entire line of products.

In connection with our acquisition of China Cola in 2000, we agreed to pay the seller royalties equal to \$0.75 per case sold. The minimum payments per agreement year were \$18,750 and the royalties expired on July 1, 2002.

Also in 2000, we launched Reed's Original Ginger Ice Cream and two more products: Reed's Cherry Ginger Brew and a beautiful designer 10-ounce gift tin of our Reed's Crystallized Ginger Candy. In December 2000, we acquired China Cola. Our sales broke through the \$5 million level, reaching \$5.7 million that year.

In December 2000, we also purchased an 18,000 square foot warehouse property, the Brewery, to house our West Coast production facility. The Brewery now also houses our executive offices and serves as our southern California warehouse facility.

In 2001, we saw the national launch of Reed's Chocolate Ginger Ice Cream and Reed's Green Tea Ginger Ice Cream. We also expanded our confectionary line with two new candy products: Reed's Crystallized Ginger Baking Bits and Reed's Ginger Candy Chews.

In 2002, we launched our Reed's Ginger Juice Brew line, with four flavors of organic juice blends. In November, we completed our first test runs of Reed's and Virgil's products at the new Brewery and in January 2003, our first commercially available products came off the Los Angeles line.

We filed a registration statement on Form SB-2 offering 3,000,000 shares at \$6.00 through Blue Bay Capital Corp., which was declared effective by the SEC on December 31, 2002. We withdrew that Registration Statement in March 2003 in response to our analysis of capital market conditions in the economic climate surrounding the 2003 Iraq War. We collected \$11,160; all moneys collected were returned.

We launched our own direct distribution in Los Angeles in April 2003. In its first year, it has successfully opened hundreds of new accounts in stores that represent a completely new phase of expansion for our sales and distribution of our products. These include successes in industrial foodservice, hospitals, motion picture studios, local “mom and pop” groceries and mainstream supermarket chains, both large and small. In November, we launched the 5-liter Virgil’s party keg and sales for that single SKU reached \$120,000 in the first month due to large, initial orders from Costco Club stores in San Diego, Arizona, New England, and Texas. Market expansion in this area continues to accelerate.

In 2004, we launched Virgil’s Cream Soda, draught Virgil’s Root Beer, and draught Cream Soda from the Brewery, with installations at the Getty Center in Los Angeles, Fox Studios and other locations around Los Angeles. In May, our local southern California direct sales effort landed direct distribution of our products into Ralph’s supermarkets. In October 2004, we launched our two newest products: Virgil’s Cream Soda in a 5-liter keg and Reed’s Spiced Apple Brew in a 750 ml. champagne bottle.

## Industry Overview

Our beverages are classified as New Age beverages, a category that includes natural soda, fruit juices and fruit drinks, ready-to-drink teas, sports drinks and water. In just four years, manufacturers' sales of New Age beverages ballooned from \$8 billion in 1998 to more than \$13 billion in 2002. This represents an average growth of more than 11% per year. In 2004, dollar sales are expected to reach \$15 billion, reflecting average growth of 7.4% from 2002. Estimates are that sales will reach more than \$18 billion by 2008. (Source: Business Trends Analysts) The Alternative Beverage category is a small portion of the non-alcoholic beverage market, which has annual sales in excess of \$80 billion.

The candy industry in the United States exceeds \$23 billion in sales annually in 2003, of which approximately 40% is non-chocolate candy. The average American consumes over 25 pounds of candy per year. (Source: National Confectioners Association)

The ice cream industry in the United States generates more than \$20 billion in annual sales in 2003. (Source: International Dairy Foods Association and the United States Dairy Association) The packaged ice cream industry includes economy, regular, premium, and super-premium products.

Super-premium ice cream such as Reed's Ginger Ice Creams is generally characterized by a greater richness and density than other kinds of ice cream. This higher quality ice cream generally costs more than other kinds and is usually marketed by emphasizing quality, flavor selection, texture and brand image. Based on supermarket sales, super-premium sales in the United States were \$700 million in 2003, or approximately 3.5% of all ice cream sales. (Source: AC Nielsen Scan Trak) The highest supermarket sales increases in 2003 were seen by the premium and super-premium higher fat varieties. Sales of super-premium ice cream grew by more than 12% in 2003 over 2002. (Source: International Dairy Foods Association)

## Our Products

We currently manufacture and sell 14 beverages, two candies, and three ice creams. We make all of our products using premium all-natural ingredients. According to Spence Information Services (SPINS), which is the only sales information service catering to the natural food trade; Reed's Brews and Virgil's Root Beer currently hold three of the top ten positions based on dollar sales among all beverages in the natural foods industry with Reed's Extra Ginger Brew holding the number 1 position. Our products include:

### *Beverages*

#### *Reed's Ginger Brews*

Why ginger? We have found friends and advocates among alternative, holistic, naturopathic, and homeopathic medical practitioners, dieticians and medical doctors. This is because our beverages contain a high volume of ginger. A number of practitioners have contacted us of their own accord, telling us of their habit of recommending Reed's Extra Ginger Brew for their patients as a simple way to ingest a known level of ginger. Reed's Ginger Brews contain between eight and 26 grams of fresh ginger in every 12-ounce bottle.

While we make no claim as to any medical or therapeutic benefits of our products, among the applications frequently cited in third-party medical studies on ginger are:

- Recommended use for prevention and relief of motion sickness,
  - A preferred alternative to aspirin in heart attack prevention,
- A safe and effective alternative to pharmaceutical anti-ulcer drugs,
  - Anti-inflammatory treatment for arthritis,

- Treatment for a variety of digestive disorders, including both constipation and diarrhea,
  - Natural therapy for menstrual discomfort, nausea, colds and influenza, and
    - Anti-cancer properties
      - References:
        - o University of Minnesota Press and ePress (October, 2003),
          - o Vegetarian Times (Jan. 2004),
          - o Hormel Institute of Phoenix, AZ (Jan. 2004),
        - o Common Spice Or Wonder Drug (Herbal Free Press, 1993)

The United States Food and Drugs Administration (FDA) include Ginger on their GRAS (generally recognized as safe) list, however, neither the FDA nor any other government agency officially endorses or recommends the use of ginger as a dietary supplement.

Ginger ale is the oldest known soft drink. Before modern soft drink technology existed, non-alcoholic beverages were brewed at home directly from herbs, roots, spices, and fruits. These handcrafted brews were then aged like wine and highly prized for their taste and their tonic, health-giving properties. Reed's Brews are a revival of this home brewing art and we make them with care and attention to wholesomeness and quality, using the finest fresh herbs, roots, spices, and fruits. Our expert brew masters brew each batch and age it with great pride.

We believe that Reed's Ginger Brews are unique in their kettle brewed origin among all mass-marketed soft drinks. We use no refined sugars as sweeteners. Our products differ from commercial soft drinks in three particular characteristics: sweetening, carbonation, and coloring. Reed's Ginger Brews present 20% less sweetness, for greater adult appeal. Instead of using injected-based carbonation, we produce our carbonation naturally, through slower, beer-oriented techniques. This process produces smaller, longer lasting bubbles that do not dissipate rapidly when the bottle is opened. We do not add coloring. The color of our products comes naturally from herbs, fruits, spices, roots and juices.

In addition, since Reed's Brews are pasteurized, they do not require or contain any preservatives. In contrast, modern commercial soft drinks generally are produced using natural and artificial flavor concentrates prepared by flavor laboratories, tap water, and highly refined sweeteners. Typically, manufacturers make a centrally processed concentrate that will lend itself to a wide variety of situations, waters, and filling systems. The final product is generally cold-filled and requires preservatives for stability. Colors are added that are either natural, although highly processed, or artificial.

We currently manufacture and sell six varieties of Reed's Ginger Brews:

*Reed's Original Ginger Brew* was our first creation, and is a Jamaican recipe for homemade ginger ale using 17 grams of fresh ginger root, lemon, lime, honey, fructose, pineapple, herbs, and spices. Reed's Original Ginger Brew is 20% fruit juice.

*Reed's Extra Ginger Brew* is the same approximate recipe, with 26 grams of fresh ginger root for a stronger bite. Reed's Extra Ginger Brew is 20% fruit juice.

*Reed's Premium Ginger Brew* is the no-fructose version of Reed's Original Ginger Brew, and is sweetened only with honey and pineapple juice. Reed's Premium Ginger Brew is 20% fruit juice.

*Reed's Raspberry Ginger Brew* is brewed from 17 grams of fresh ginger root, raspberry juice, and lime. It is 20% raspberry juice and is sweetened with fruit juice and fructose.

*Reed's Spiced Apple Brew* uses 8 grams of fresh ginger root, the finest tart German apple juice, and such apple pie spices as cinnamon, cloves, and allspice. Spiced Apple Brew is 50% apple juice and sweetened with fruit juice and fructose.

*Reed's Cherry Ginger Brew* is the newest addition to our Ginger Brew family, and is naturally brewed from: filtered water, fructose, fresh ginger root, cherry juice from concentrate, and spices. Reed's Cherry Ginger Brew is 22% cherry juice.

All six of Reed's Ginger Brews are offered in 12-ounce bottles and are sold in stores as singles, in four-packs and in 24-bottle cases. Reed's Original Ginger Brew is sold in select Costco stores in a special 12-pack. Reed's Spiced Apple Brew is now available in a 750 ml. champagne bottle.





### *Virgil's Root Beer*

Over the years, Virgil's has won numerous awards and has a reputation among many as one of the best root beers made anywhere. Virgil's Root Beer won the "Outstanding Beverage" award at NASFT's International Fancy Food and Confection Show three times, in 1994, 1996 and 1997. *Bon Apétit* magazine has also named Virgil's Root Beer "Best Beverage." Originally brewed in the north of England, Virgil's is now produced in the United States and Germany.

Virgil's is a premium root beer. We use these all-natural ingredients:

- Filtered water
- Unbleached cane sugar
- Anise from Spain
- Licorice from France
- Bourbon vanilla from Madagascar
- Cinnamon from Sri Lanka
- Clove from Indonesia
- Wintergreen from China
- Sweet birch and molasses from the southern United States
- Nutmeg from Indonesia
- Pimento berry oil from Jamaica
- Balsam oil from Peru, and
- Cassia oil from China

We collect these ingredients worldwide and gather them together at the brewing and bottling facilities we use in the United States and Germany. At the breweries, we combine and brew these ingredients under strict specifications and finally heat-pasteurize Virgil's Root Beer, to ensure quality.

We sell Virgil's Root Beer in three packaging styles: 12-ounce bottles in a four-pack, a special ceramic-swing-lid Grolsch Beer-style pint bottle, and a 5-liter self-tapping party keg. We now make Virgil's available in draught "pony kegs" as well.

### *Virgil's Cream Soda*

We launched Virgil's Cream Soda in January 2004 and initial sales have been strong. We make this product with the same attention to quality that makes Virgil's Root Beer so popular.

Virgil's Cream Soda is a gourmet cream soda. We use these all-natural ingredients:

- Filtered water
- Unbleached cane sugar
- Bourbon vanilla from Madagascar

We brew Virgil's Cream Soda the same way we brew Virgil's Root Beer.

Virgil's Cream Soda is currently being sold in 12-ounce long neck bottles in colorful 4-packs and a 5-liter party keg version. We offer Virgil's Cream Soda in our draught format as well.

*China Cola*

We consider China Cola to be the best tasting and most natural cola in the world. Now sweetened with raw cane, we restored China Cola to its original delicious blend of imported Chinese herbs, essential oils, and natural spices. China Cola contains no caffeine. It comes in two varieties, Original China Cola and Cherry China Cola.

Original China Cola is made from:

- filtered water,
- raw cane sugar,
- Szechwan peony root,
  - cassia bark,
- Malaysian vanilla,
  - oils of lemon,
  - oil of lime,
  - oil of orange,
    - nutmeg,
    - clove,
    - licorice,
  - cardamom,
- caramel color,
- citric acid and
- phosphoric acid

Cherry China Cola is made from the same ingredients as Original China Cola, with the addition of natural cherry flavor.

China Cola and Cherry China Cola sell as singles, in four-packs and in 24-bottle cases.

*Reed's Ginger Juice Brews*

In May 2002, we launched a new line of ginger brews called Reed's Ginger Juice Brews. They are 100% juice products that are non-carbonated and brewed from organic fresh ginger root and sweetened with organic juices. We did this in part in response to a strong trend we have seen toward organic ingredients and non-carbonated beverages in the marketplace. We wanted to extend our ginger brew line and believe that these new flavors will cater to the growing market for organic non-carbonated beverages.

All four of our Reed's Ginger Juice Brews start with:  
filtered water,

- organic fresh ginger root, and
- organic white grape juice from concentrate.

*Reed's Lemon Guava Ginger Juice Brew* adds:

- guava juice from concentrate, and
- lemon juice from concentrate.

*Reed's Strawberry Kiwi Ginger Juice Brew* adds:

- organic strawberry juice from concentrate, and
- organic kiwi juice from concentrate.

*Pineapple Orange Ginger Juice Brew* adds:

- organic pineapple juice from concentrate,
- organic orange juice from concentrate, and
- organic lime juice from concentrate.

*Reed's Cranberry Raspberry Ginger Juice Brew* adds:

- cranberry juice from concentrate, and
- organic raspberry juice from concentrate

Reed's Ginger Juice Brews drinks come in a 16-ounce juice bottle as singles or in cases of 12 and 24 bottles.

*Malibu Teaz*

Under a license agreement, we previously sold six different types of Malibu Teaz, a line of organic ready-to-drink teas and sweeteners. Under the license agreement, profits were split equally between Malibu Teaz and us. In 2002, we entered into discussions to purchase Malibu Teaz but no agreement was reached. At the end of 2002, we decided not to renew the license and we stopped selling Malibu Teaz products.

***Reed's Ginger Candies***

*Reed's Crystallized Ginger Candy*

Reed's Crystallized Ginger was the first crystallized ginger on the market in the United States to be sweetened with raw cane instead of refined white sugar. Reed's Crystallized Ginger is custom-made for us in Fiji.

The process is an ancient one that has not changed much over time. After harvesting baby ginger (the most tender kind), the root is diced and then steeped in large vats filled with simmering raw cane syrup. Steeping for several days, the ginger is then removed and allowed to crystallize into soft, delicious nuggets. Many peoples of the islands have long enjoyed these treats for health and pleasure.

We sell this product in 3.5-ounce bags, 10-ounce enameled, rolled steel gift tins, 16-ounce re-sealable Mylar bags, and in bulk. We also sell Reed's Crystallized Ginger Baking Bits in bulk.

*Reed's Ginger Candy Chews*

For more than 100 years, residents of Southeast Asia from Indonesia to Thailand have enjoyed soft, gummy ginger candy chews. Individually wrapped, ten to a 'Lucky Strike' style soft-pack, Reed's has taken them a step further, adding more ginger, using no gelatin (vegan-friendly) and making them slightly easier to unwrap than their Asian counterparts.

Reed's Ginger Candy Chews are made for us in Indonesia from sugar, maltose (malt sugar), ginger, and tapioca starch.

We sell Reed's Ginger Candy Chews individually wrapped in soft-packs of ten candies and as individually wrapped loose pieces in bulk.



### ***Reed's Ginger Ice Creams***

We make Reed's Ginger Ice Creams with 100% natural ingredients, using the finest hormone-free cream and milk. We combine fresh milk and cream with the finest natural ginger puree, Reed's Crystallized Ginger Candy and natural raw cane sugar to make a delicious ginger ice cream with a super premium, ultra-creamy texture and Reed's signature spicy-sweet bite. Our ice creams are made for us, according to our own recipes, at a dairy in upstate New York. The three Reed's Ginger Ice Creams are:

*Reed's Original Ginger Ice Cream* made from milk, cream, raw cane sugar, Reed's Crystallized Ginger Candy (finest ginger root, raw cane sugar), ginger puree, and guar gum (a natural vegetable gum)

*Chocolate Ginger Ice Cream* made from milk, cream, raw cane sugar, finest Belgian Cocoa (used to make Belgian Chocolate), Reed's Crystallized Ginger Candy (fresh baby ginger root, raw cane sugar), chocolate shavings (sugar, unsweetened chocolate, Belgian Cocoa, soy lecithin and real vanilla), ginger puree, and guar gum (a natural vegetable gum) creating the ultimate chocolate ginger ice cream.

*Reed's Green Tea Ginger Ice Cream* made from milk, cream, the finest Green Tea, raw cane sugar, ginger puree, Reed's Crystallized Ginger Candy (fresh baby ginger root, raw cane sugar), and guar gum (a natural vegetable gum) creating the ultimate green tea ginger ice cream.

We sell Reed's Ginger Ice Creams in pint containers and cases of eight pints. We plan to supply Reed's Ginger Ice Creams in foodservice volume-packaging as well.

### ***New Product Development***

We plan to continue expanding the Reed's Ginger Brew, Reed's Ginger Juice Brew, Reed's Ginger Ice Cream, and Reed's Ginger Candy product lines. Other Reed's Ginger Product concepts and lines are under consideration. We also plan to expand the Virgil's product line into additional new flavors and packaging styles.

Among the advantages of our owned and self-operated Brewery are the flexibility to try innovative packaging and the capability to experiment inexpensively with new product flavors with little risk to our operations or capital. For example, to the best of our knowledge, our Brewery is the first plant mass-producing swing-lid bottled soft drinks in North America; we will soon produce several of our beverages in one-liter swing-lid bottles. Our Spiced Apple Brew is now available in a 750 ml. champagne bottle and other products are planned to be available with this packaging in the near future.

Currently, we sell a half-liter Virgil's Root Beer swing-lid bottle that is made for us in Europe. The new one-liter bottles will be filled at the Brewery, allowing us to provide a greater amount of product at a substantially lower price. We have received preliminary interest from several large national supermarket chains for this product.

Although we are always working on new products and designs, research and development expenses in the last two years have been nominal. We do not expect any significant increases in research and development expenses.

### **Manufacture of Our Products**

At this time, we produce our carbonated beverages at two facilities. Our Brewery in Los Angeles handles the western half of the United States and we have a contract with The Lion Brewery, Inc., a packing, or co-pack, facility in Pennsylvania for the eastern United States. The current two-year term of the agreement expires on May 31, 2005 and renews automatically for successive two-year terms unless terminated by either party. The co-pack facility assembles our products and charges us a fee, generally by the case, for the products they produce.

Our Ginger Juice Brews are co-packed at H.A. Ryder for us in Northern California. We supply all the ingredients and packaging. The co-pack facility assembles our products and charges us a fee, by the case. Our ice creams are co-packed for us at Ronnybrooke dairy in upstate New York. We supply all the flavor additions and packaging and the dairy supplies the ice cream base. The co-pack facility assembles our products and charges us a fee, by the unit produced for us. We have half-liter swing-lid bottles of our Virgil's Root Beer line co-packed for us at the Hofmark brewery in southern Germany. The co-pack facility assembles our products and charges us a fee by the unit they produce for us. We do not have written contracts with H.A Ryder, Ronnybrooke Dairy or the German co-pack facility.

We follow a ‘fill as needed’ manufacturing model to the best of our ability and we have no significant backlog of orders.

Substantially all of the raw materials used in the preparation, bottling and packaging of our products are purchased by us or by our contract packers in accordance with our specifications. Reed’s Crystallized Ginger is made to our specifications in Fiji. Reed’s Ginger Candy Chews are made to our specifications in Indonesia, and we repackage them at the Brewery in Los Angeles.

Generally, we obtain the ingredients used in our products from domestic suppliers and each ingredient has several reliable suppliers. We have no major supply contracts with any of our suppliers. As a general policy, we pick ingredients in the development of our products that have multiple suppliers and are common ingredients. This provides a level of insurance against a major supply constriction or calamity.

We believe that as we continue to grow, we will be able to keep up with increased production demands. We believe that the Brewery has ample capacity to handle increased West Coast business. To the extent that any significant increase in business requires us to supplement or substitute our current co-packers, we believe that there are readily available alternatives, so that there would not be a significant delay or interruption in fulfilling orders and delivery of our products. In addition, we do not believe that growth will result in any significant difficulty or delay in obtaining raw materials, ingredients or finished product that is repackaged at the Brewery.

### **Our Primary Markets**

We target a niche in the soft drink industry known as New Age beverages. The soft drink industry generally characterizes New Age Beverages as being made more naturally, with upscale packaging, and often creating and utilizing new and unique flavors and flavor combinations. The New Age Beverage segment of our industry has grown from \$620 million in annual sales in 1989 to over \$15 billion in estimated annual revenues in 2004 (Source: Business Trend Analysts).

The New Age beverage segment is highly fragmented and includes such players as SoBe (acquired by PepsiCo), Snapple (acquired by Cadbury Schweppes in 2000), Arizona (2003 revenues over \$200 million), Hansen’s (2003 revenues over \$110 million) and Jones Sodas (2003 revenues over \$23 million), among others. (Sources: BevNet, Beverage World, Yahoo Finance, and company filings made with the SEC.) These brands have the advantage of being seen widely in the national market and being commonly well known for years through well-funded ad campaigns. Despite our products’ having a higher price, no mass media advertising and a relatively small presence in the mainstream market compared to many of our competitors, we believe that results to date demonstrate that Reed’s Ginger Brews and Virgil’s sodas are holding up well among these significantly larger brands. See “Business — Competition.”

We sell the majority of our products in natural food stores, gourmet shops, and supermarket chains, primarily in the United States and, to a lesser degree, in Canada. In addition, we increasingly sell our products in restaurants, delicatessens, neighborhood grocery markets, movie studios, hospitals and industrial foodservice locations.

### ***Natural Foods***

We believe that our products have achieved a leading position in their niche in the fast-growing natural food industry. According to May 2001 data from the Spence Information Service, a Nielson Company, or SPINS, our top-selling items are in over 90% of natural food stores in the United States. The last time we purchased natural foods sales ratings surveys by SPINS, in 2001, we also found three of our SKUs leading the top five and five of our SKUs in the top ten based on sales.



With the advent of large chains like Whole Foods and Wild Oats and specialty merchants like Trader Joe's, the natural foods segment continues to grow each year in direct competition with the mainstream grocery trade.

***Mainstream Supermarkets***

Our products are currently placed in approximately 110 Safeway stores in Oregon and all 130 Raley's stores in Northern California. Safeway and Raley's data show Reed's Ginger Brews, with minimal advertising and promotions, performs in the "middle of the pack" of highly advertised national brands in the New Age Beverage segment of the market.

We intend to build on this success by placing Reed's, Virgil's and the rest of our lines in the New Age section of as many of the nation's 35,000 supermarkets as possible.

Our products are currently in supermarkets throughout the United States and Western Canada, including the following:

30

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Supermarket Chain	Location
Acme	Pennsylvania
AJ's	Arizona
Albertson's	Texas, Florida & California
A&P	Northeast
Bashas	Arizona
Bi-Lo	South Carolina
Big Save	Hawaii
Bristol Farms	Southern California
Bruno's	Alabama
Byerly's	Minnesota
Clemens Family Markets	Pennsylvania
Dierbergs Markets	Missouri
Dominick's Finer Foods	Illinois
Foodarama	New England
Food Emporium	New York
Food Lion	North Carolina and Virginia
Fred Meyers	Northwestern U.S.
The Fresh Market	North Carolina
Gelson's	Southern California
Giant Eagle	Pennsylvania
Giant Food	Maryland
Hannaford Bros.	Maine
Harris Teeter	North Carolina
HEB	Texas
Henry's	San Diego
Hy-Vee	Iowa
Ingles Markets	Southeast
Jewel-Osco	Illinois
Kash n Karry (Sweetbay)	Florida
King Kullen	New York
Kroger	Various
Larry's Markets	Seattle
Lowe's Food Stores	North and South Carolina
Meijers	Michigan
Overwaitea/Save-On-Foods	Western Canada
Patrini's	San Francisco
Pavilion's	Southern California
Publix	Florida

Quality Food Centers	Northwestern U.S.
Raley's/Nob Hill	Northern California
Ralph's	Southern California
Rameys/Price Cutter	Missouri
Randall's	Houston
Rice's	Houston
Safeway	National and Western Canada
Schnuck's Markets	Missouri
Sentry Foods	Milwaukee
Shaw's Supermarkets	Massachusetts
Smith's	Utah
Stater Brothers	California
Stop and Shop	Massachusetts
Super Fresh	Philadelphia
Thriftway	Northwest
Tops Markets	New York
Trader Joe's	National
Treasure Island	Chicago
Vons	Southern California
Wegman's	New York
Whole Foods Markets	National
Winn-Dixie	New Orleans

Supermarkets, particularly supermarket chains and prominent local supermarkets, often impose slotting fees before permitting new product placements in their store or chain. These fees can be structured to be paid one-time only or in installments. We pursue broad-based slotting in supermarket chains throughout the United States and, to a lesser degree, in Canada. However, our direct sales team in southern California and our national sales management team have been able to place our products without having to pay slotting fees much of the time. However, when we have to pay slotting fees for new placement, the slotting fee normally costs between \$10 and \$100 per store per new item placed. We intend to use a portion of the net proceeds of this offering to pay slotting fees. See “Use of Proceeds.”

### ***Foodservice***

On-premise (restaurant) activity in commercial and non-commercial locations is an increasing component of total beverage sales. In recognition of this trend, we market aggressively to industrial cafeterias, bars, and restaurants. Placement of our products in stadiums, sports arenas, concert halls, theatres, and other cultural centers is another long-term marketing priority. In addition, we plan to seek placement of our ice creams in restaurants nationwide.

### ***International Sales***

A limited market has developed for our products in Europe and Asia, with increasing activity from our distributor in the Netherlands and increasing purchases by a Japanese marketer. Sales outside of North America currently represent less than 1% of our total sales. Sales in Canada represent about 1.3% of our total sales.

The European Union is an open market for Reed’s with access to that market due in part to the ongoing production of Virgil’s Special Extra Nutmeg Root Beer in Germany. Reaction to the Reed’s brands at Natural Products Exposition Europe in June 2000 was very positive. In October 2003, in Cologne, Germany at ANUGA, one of the world’s largest food shows, our products experienced a broad, positive reception. We have already had some success in selling our products in Europe through a master distributor in Amsterdam and sub-distributors in the Netherlands, Denmark, the United Kingdom, and Spain. We are currently negotiating with a Dutch company in Amsterdam for wider European distribution.

American Trading Corp. in Japan orders our products on a regular basis for distribution in Japan. We are holding preliminary discussions with other trading companies and import/ export companies for the distribution of our products throughout Japan, China and the rest of Asia. We believe that these areas are a natural fit for Reed’s ginger products, because of the importance of ginger in Asian diet and nutrition.

### **Distribution, Sales and Marketing**

We currently have a national network of natural and specialty food distributors in the United States and Canada. We also have mainstream beverage distributors in select markets. In southern California, we have our own direct distribution in addition to other local distributors.

We plan to expand our direct distribution into other markets. In addition, where a market does not support or lend itself to direct distribution, we intend to enlist local mainstream beverage distributors to carry our products.

We plan to use a significant portion of the proceeds of this offering toward hiring the additional sales people needed to support both the expansion of our existing direct distribution and to grow sales through mainstream distributors. See “Use of Proceeds.”



Other New Age beverages employed this model for growth in their early years before being acquired by large beverage concerns. Snapple, SoBe, Arizona Teas, and Energy Brands had or have large dedicated sales forces supporting extensive networks of beverage distributors. A few New Age beverage companies have put in place their own direct distribution, such as Odwala and Fresh Samantha. Which model we ultimately favor will depend on results in the marketplace. We anticipate using a hybrid of both distribution strategies.

We currently maintain two separate sales organizations, one of which handles natural food sales and the other of which handles mainstream sales. Both sales forces consist of sales managers and sales representatives. The natural food sales force works mainly in the natural and gourmet food stores serviced by natural and gourmet distributors. Representatives are responsible for the accounts in their territory and they stay on a focused schedule of visits to maintain store and distributor relationships. In the future, we intend to integrate both our distribution and sales forces.

The job of the in-house representative is to merchandize existing products, run promotions and introduce new items. The sales manager is responsible for the distributor relationships and larger chain accounts that require headquarter sales visits in addition to managing the sales representatives. We sell directly to our distributors, who in turn sell to retail stores. Our representatives maintain the pipeline flow of our products from our distributors (our direct customers), to the retailer (our distributors' customers) to the end customer (the individual consumer).

We currently have two sales representatives working alongside our mainstream distributors. Based upon their results, we anticipate expanding the number of direct hired sales representatives to work along side our mainstream distributors. In addition, we have three sales representatives working with our southern California direct distribution services. Based on their results, we plan rapidly to hire more of these representatives.

We are placing vending machines, in-store draught displays, which we call Kegeators, and fully branded coolers in our retail establishments.

We also offer our products and promotional merchandise directly to consumers via the Internet through our website, [www.reedsgingerbrew.com](http://www.reedsgingerbrew.com).

One of the main goals of our sales and marketing efforts is to increase the number of sales people and distributors focused on growing our brands. Our increased efforts in marketing also will require us to hire additional sales representatives, and lease additional equipment for Kegeators and coolers. See "Use of Proceeds." We anticipate that as our sales force grows that additional office support in accounting, production and purchasing will be required.

### ***Marketing to Distributors***

We market to distributors using a number of marketing strategies, including direct solicitation, telemarketing, trade advertising, and trade show exhibition. These distributors, who may also have relationships with our competitors, include natural food, gourmet food, and mainstream distributors. Direct contact with the distributors is by in-house sales representatives. In limited markets, where direct representation is too costly, we utilize food brokers and outside representatives.

### ***Marketing to Retail Stores***

We market to stores by utilizing trade shows, trade advertising, telemarketing, direct mail pieces, and direct contact with the store. For our direct contact, we have sales representatives and brokers who visit stores to sell directly in many regions. Sales to retail stores are coordinated through our distribution network and our regional warehouses. We intend to use a portion of the net proceeds of this offering to expand our direct sales force. See "Use of Proceeds."

### ***Direct Sales and Distribution***

In June 2003, we started Direct Sales and Distribution (DSD) to stores in southern California, using a direct hired sales team and Company owned delivery trucks. Our sales representatives work closely with our new route drivers and with distributors in areas farther away from our West Coast Brewery in Los Angeles. This effort has increased our product distribution. Early efforts are producing very encouraging results including placement in most of the supermarkets in southern California and other mainstream accounts.

While we do not break out sales figures on a regional basis, we can reasonably estimate that Southern California sales traditionally represent about \$1 million per annum. The initial indication from our Southern California DSD team suggests that this amount will increase. The local effort is currently selling at about \$50,000 per month at the end of year 2004 and at the end of year 2003 the sales were averaging around \$15,000 per month. This is mostly new business and outside our existing markets.

These new direct-distribution accounts also include retail locations up and down the street, including many new independent supermarkets, mom and pop markets, Japanese, Korean, Chinese and Thai markets, foodservice and delis, among others. In addition, direct distribution facilitates our new placements at hospitals, the Getty Center in Los Angeles, Fox Studios and other cultural and institutional accounts.

### ***In-Store Draught Displays***

As part of our new direct distribution, we have started to offer in-store draught displays, or Kegerators. While we believe that packaging is an important part of making successful products, we also believe that our products themselves need to be exceptional to survive in today's marketplace. Our Kegerator is an unattended, in-store draught display that allows a consumer to sample our products at an extremely low cost per demonstration. Stores offer premium locations for these new, and we believe unique, draught displays. Our product sales in most of these stores have increased significantly from the exposure of the premium locations and product taste trials. We intend to use a portion of the net proceeds of this offering to increase the number of Kegerators we place in stores. See "Use of Proceeds."

### ***Marketing to Consumers***

We utilize several marketing strategies to market directly to consumers. Advertising in targeted consumer magazines such as “Vegetarian Times” and “New Age” magazine, in-store discounts on the products, in-store product demonstration, street corner sampling, coupon advertising, consumer trade shows, event sponsoring and our website [www.reedsgingerbrew.com](http://www.reedsgingerbrew.com) are all among current consumer-direct marketing devices.

### ***New On-Draught Business***

Our West Coast Brewery has initiated an on-draught program. The first draught location we have installed is at Fox Studios commissaries and restaurants. Sales have exceeded our expectations and Fox has asked for more installations. Currently, we are serving Virgil’s Root Beer, Virgil’s Cream Soda, and Reed’s Extra Ginger Brew on draught. In addition, all of our other carbonated drinks are available in draught format. We have informal commitments from 50 or more locations in southern California, without having made a large marketing effort in this direction.

### ***Vending Machines***

To our knowledge, no other independent soft drink manufacturers, other than Coca-Cola and PepsiCo, have placed fully-branded, back-lit vending machines nationwide. We believe we are the first natural soft drink manufacturer to create its own fully branded, backlit vending machine. We lease the vending machines and then modify them to our specifications. Over the next few years, we intend to expand direct consumer distribution through placement of these branded vending machines in additional locations in the United States and, to a lesser degree, in Canada. The cost to lease the vending machines is relatively low. We will use a portion of the proceeds of this offering to lease, brand and install more vending machines. See “Use of Proceeds.”

Vending machines present several advantages. As an outdoor source of product, a vending machine acts as a 24 hours a day, 7 days a week point of purchase. Using modern cellular technology, we will be able to track performance of each machine and the individual products within the machine. For example, this means that if Reed’s Extra Ginger Brew were outselling other products, we would see this in real time and be able to respond by restocking the vending machine promptly. Such data will also be invaluable as a tracking demographic, allowing us to place more of what sells best in a particular neighborhood in a responsive fashion or, in the case of a low performance location, to relocate the machine.

Our vending machine program is currently in development; to date we have placed one vending machine in Malibu as a test.

### ***Proprietary Coolers***

In-store placements of branded refrigerated coolers by Snapple, SoBe, and Jones Soda, among others, have proven to have a significant positive effect on their sales. For example, SoBe created its pervasive presence in the mass-marketplace almost entirely on a backbone of cooler placements and Jones saw a doubling of its business in just 18 months based upon this concept. We are currently testing our own Reed’s branded coolers in a number of locations.

### **Competition**



Our premium beverage products compete generally with all liquid refreshments and in particular with numerous other New Age beverages, including:

- SoBe (owned by Pepsi)
- Snapple, Mystic, IBC and Stewart's (owned by Cadbury Schweppes)
  - Henry Weinhard (owned by Phillip Morris)
    - Arizona
    - Hansen's
  - Knudsen & Sons
  - Jones Sodas

The Virgil's and China Cola lines compete with a number of other natural soda companies, including Stewarts, IBC, Henry Weinhard, Blue Sky, A&W and Natural Brews.

Many of these brands have enjoyed broad, well-established national recognition for years, through well-funded ad and other branding campaigns. In addition, the companies manufacturing these products generally have greater financial resources than we do and have greater access to additional financing.

We believe that our success to date is due in great part to our innovative beverage recipes and packaging and use of premium ingredients and a trade secret brewing process. We believe that our commitments to the highest quality standards and brand innovation are key to our success.

Reed's Crystallized Ginger Candy competes primarily with other candies and snacks in general and, in particular, with other ginger candies. The main competitors in ginger candies are Royal Pacific, Australia's Buderim Ginger Company, and Frontier Herbs. We believe that Reed's Crystallized Ginger Candy is the only one among these brands that is sulfur-free.

Reed's Ginger Ice Creams compete primarily with other premium and super-premium ice cream brands. Our principal competitors in the ice cream business are Haagen-Dazs, Ben & Jerry's, Godiva, Starbucks, Dreyer's and a number of smaller natural food ice cream companies. Most of these companies have greater brand recognition, market share, and access to financing than we do.

We compete with other companies not only for consumer acceptance but also for shelf space in retail outlets and for marketing focus by distributors, most of whom also distribute other brands with which our products compete. The principal methods of competition include product quality and taste, brand advertising, trade and consumer promotions, pricing, packaging and the development of new products.

Our sales are less than 1% of the over-all marketplace in the New Age Beverage Set

### **Proprietary Rights**

We own several trademarks that we consider material to our business, including Reed's, Virgil's and China Cola. In addition, we consider our finished product and concentrate formulae, which are not the subject of any patents, to be trade secrets.

Our brewing process is a trade secret. This process can be used to brew flavors of beverages other than ginger ale and ginger beer, such as root beer, cream soda, cola, and other spice and fruit beverages. We have not sought any patents on our brewing processes because we would be required to disclose our brewing process in patent applications.

Three of our material trademarks are registered trademarks in the U.S. Patent and Trademark Office: Reed's®, Virgil's®, and China Cola®. 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 under the Berne Convention.

We sometimes use non-disclosure agreements with employees and distributors to protect our proprietary rights.

### **Government Regulation**

The production and marketing of our products are governed by the rules and regulations of various federal, state, and local agencies, including the United States Food and Drug Administration. The Food and Drug Administration also

regulates the labeling of our products. We have not encountered any regulatory action as a result of our operations.

## **Environmental Matters**

Our primary cost of environmental compliance is in recycling fees, which are estimated to be \$30,000 in 2004. This is a standard cost of doing business in the soft drink industry.

In California, and in certain other states where we sell our products, we are required to collect redemption values from our customers and remit those redemption values to the state, based upon the number of bottles of certain products sold in that state.

## **Employees**

We currently have 30 full-time employees, as follows: one in general management, nine in sales and marketing support, five in operations and 15 in production. We employ additional people on a part-time basis as needed.

We have never participated in a collective bargaining agreement. We believe that the relationship with our employees is good.

## **Properties**

In December 2000, we purchased an 18,000 square foot warehouse, the Brewery, at 13000 South Spring Street in an unincorporated area of Los Angeles County, near downtown Los Angeles. The purchase price of the facility was \$850,000, including a down payment of \$102,000. We financed the balance of the purchase price with a loan from U.S. Bank National Association, guaranteed by the United States Small Business Administration. We also obtained a building improvement loan in the amount of \$168,000 from U.S. Bank National Association, guaranteed by the United States Small Business Administration. Christopher J. Reed, our founder and CEO, personally guaranteed both loans. Both loans have 25-year terms, with interest at the New York prime rate plus 1%, adjusted monthly, with no cap or floor. As of December 2004, the principal and interest payments on the two loans combined were \$5,926 per month. This facility serves as our principal executive offices, our West Coast Brewery, and bottling plant and our southern California warehouse facility.

The property is located in the Los Angeles County Mid-Alameda Corridor Enterprise Zone. Businesses located in the enterprise zone are eligible for economic incentives designed to stimulate business investment, encourage growth and development, and promote job creation. The incentives include a tax credit for wages paid to a qualified employee, up to \$26,895 over a five-year period; a credit for the sales or use tax paid or incurred on the purchase of certain qualified machinery or equipment; a business expense deduction for the cost of qualified property up to \$20,000 purchased for exclusive use in the enterprise zone; the ability to carry up to 100% of net operating losses over a maximum of 15 years to reduce the amount of taxable enterprise zone income for those years; and certain other financial incentives.

## **LEGAL PROCEEDINGS**

We currently and from time to time are involved in litigation incidental to the conduct of our business. We are not currently a party to any lawsuit or proceeding which, in the opinion of our management, is likely to have a material adverse effect on us.

**MANAGEMENT****General**

The following table sets forth certain information with respect to our directors and executive officers:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Christopher J. Reed	46	President, Chief Executive Officer, Chief Financial Officer and Chairman of the Board
Eric Scheffer	37	Vice President and National Sales Manager - Natural Foods
Robert T. Reed, Jr.	49	Vice President and National Sales Manager - Mainstream
Robert Lyon	55	Vice President Sales - Special Projects
Judy Holloway Reed	45	Secretary and Director
Peter Sharma III	45	Director
Mark Harris	48	Independent Director
Dr. D.S.J. Muffoletto, N.D.	50	Independent Director
Michael Fischman	49	Independent Director

*Christopher J. Reed* founded our company in 1987. Mr. Reed has served as our Chairman, President, Chief Executive Officer, and Chief Financial Officer since our incorporation in 1991. Mr. Reed has been responsible for our design and products including the original product recipes, the proprietary brewing process, and the packaging and marketing strategies. Mr. Reed received a B.S. in Chemical Engineering in 1980 from Rennselaer Polytechnic Institute in Troy, New York.

*Eric Scheffer* has been our Vice President and National Sales Manager - Natural Foods since May 2001. From September 2000 to May 2001, Mr. Scheffer worked as Vice President of Sales for Rachel Perry Natural Cosmetics. Mr. Scheffer was national sales manager at Earth Science, Inc. from January 1999 to September 2000, where he managed the United States and Canadian outside sales force. Mr. Scheffer was national sales manager at USA Nutritionals from June 1997 to January 1999, where he led a successful effort bridging their marketing from natural foods to mainstream stores. He worked for Vita Source as Western sales manager from May 1994 to June 1997 and was their first sales representative.

*Robert T. Reed Jr.* has been our Vice President and National Sales Manager - Mainstream since January 2004. From 1988 through December 2003, Mr. Reed was Vice President of Strategic Sales at SunGard Availability Services, during a period that company's revenues increased from \$30 million to over \$1.2 billion, earning the company a place in the Fortune 500. Mr. Reed became President of the SunGard eSourcing, the managed Internet services provider subsidiary of SunGard Availability Services, an entity with revenues in excess of \$70 million and over 300 employees. He earned a Bachelors of Science at Mount Saint Mary's University in 1977. Mr. Reed is the brother of Christopher J. Reed, our Chairman, President, Chief Executive Officer, and Chief Financial Officer.

*Robert Lyon* has been our Vice President Sales - Special Projects since June 2002. In that capacity, Mr. Lyon directs our southern California direct sales and distribution program, our launch in mainstream markets. Over the past five years, Mr. Lyon also ran an organic rosemary farm in Malibu, California, selling bulk to re-packagers. In the 1980s and 1990s, Mr. Lyon started a successful water taxi service with 20 employees and eight vessels of his own design. He also built the national sales team for a jewelry company, Iberia. Mr. Lyon holds several U.S. patents. He earned a Business Degree from Northwestern Michigan University in 1969.

*Judy Holloway Reed* has been with us since 1992 and, as we have grown, has run the accounting, purchasing, and shipping and receiving departments at various times in the 1990s. Ms. Reed has been one of our directors since June 2004, our Secretary since October 1996 and our Director of Office Operations and Staff Management since June 2004. In the 1980s, Ms. Reed managed media tracking for a Los Angeles Infomercial Media Buying Group and was an account manager with a Beverly Hills, California stock portfolio management company. She earned a Business Degree from MIU in 1981. Ms. Reed is the wife of Christopher J. Reed, our Chairman, President, Chief Executive Officer, and Financial Officer.

*Peter Sharma III* has been a member of our Board of Directors since June 2004, and is a registered representative of Brookstreet Securities Corporation, the underwriter of this offering, since June 2004. From March 2002 to April 2003, Mr. Sharma was a registered representative of Blue Bay Capital, the selling agent for the public offering from which we withdrew in March 2003. From time to time since January 2000, Mr. Sharma has acted as our management, information technology, sales, product development, and marketing consultant. He has worked as an independent management consultant since 1997 and continues to do so. From 1990 to 1997, Mr. Sharma worked as a sales trainer and regional manager for Time-Life and Encyclopædia Britannica North America. Mr. Sharma's consulting company, Sirius/Pureprophet, Ltd., is a sole proprietorship that requires only minimal clerical attention.

### Independent Board Members

*Mark Harris* has been a member of our board since April 2005. Mark is an independent venture capitalist and has been retired from the work force since 2002. In late 2003, Mr. Harris joined a group of Amgen colleagues in funding NeoStem, Inc., a company involved in stem-cell storage, archiving, and research to which he is founding angel investor. From 1991 to 2002 Mark worked at biotech giant Amgen managing much of the company's media production for internal use and public relations. Mr. Harris' spent the decade prior working in Aerospace with similar responsibilities. Mr. Harris holds a degree in Cinematography.

*Dr. Daniel S.J. Muffoletto, N.D.* has been a member of our Board of Directors since April 2005. Dr. Muffoletto has practiced as a Naturopathic Physician since 1986. He is CEO of Its Your Earth, a natural products marketing company. From 2003 to 2005, Daniel worked as sales and marketing director for Worthington, Moore & Jacobs, a Commercial Law League member firm serving FedEx, UPS, DHL & Kodak among others. From 2001 to 2003, he was owner-operator of the David St. Michel Art Gallery in Montreal, Québec. From 1991 to 2001 Dr. Muffoletto was the owner/operator of a Naturopathic Apothecary, Herbal Alter\*Natives of Seattle, WA and Ellicott City, MD; the apothecary housed Dr. Muffoletto's Naturopathic Practice. Daniel holds a B.A. in Government and Communications (U. of Baltimore, 1977), with postgraduate work in the schools of Public Administration and Publication Design (U. of Baltimore, 1978 - 1979). In 1986, he received his Doctorate of Naturopathic Medicine from the Santa Fe Academy of Healing, Santa Fe, NM.

*Michael Fischman* has been a member of our Board since April 2005. Since 1998, Michael has been President and CEO of the APEX course, the corporate training division of the International Association of Human Values. In addition, Mr. Fischman is a founding member and the director of training for USA at the Art of Living Foundation, a global non-profit educational and humanitarian organization at which he has coordinated over 200 personal development instructors since 1997. Among Mr. Fischman's personal development clients are the World Bank, Royal Dutch Shell, the United Nations, the US Department of Probation, the Washington, D.C. Police Department, and Rotary Clubs International.

Other than the relationship of Christopher J. Reed, Judy Holloway Reed, and Robert T. Reed, Jr., none of our directors or executive officers are related to one another.

*Key Employees.* Our key employees include the following people:

*Steven Hernandez*, age 48, became our controller in March 2004. From 1997 to March 2004, Mr. Hernandez was an independent consultant in the manufacturing field in systems, including cost accounting consultant for Gillead Sciences, Inc. (February 2002 to March 2004), cost accounting consultant for Flow Serve, Inc. (April 2001 to December 2002), cost accounting manager for Crown Bolt, Inc. (1999 to April 2001) and cost analyst at Health Valley Company (1997 to 1999). Mr. Hernandez also has experience in cost accounting in the snack food and confectionery industries. Mr. Hernandez earned his B.S. in Economics/Accounting from California State University, Bakersfield in 1978.

During the next 12 months, we intend to hire a Chief Operating Officer to handle day-to-day operations. This will provide operations support to Christopher J. Reed. In addition, we intend to hire a Distribution Manager with extensive experience in the beverage arena with specific experience in setting up a regional distributor network.

We have three independent directors and will maintain at least two independent directors on our board at all