

Nasdaq: REED

Update

November 19, 2009

Rating: **Speculative Buy**  
(Unchanged)

## Reed's, Inc.

Recent Price: **\$1.50**  
(11/18/09)

Consumer; Specialty Beverages

Price Target: **\$5.25**  
(Unchanged)

### MARKET DATA

52-Week High/Low	\$2.60 - \$0.75
Ave. Daily Volume (6-mos.)	20 K
Shares Outstanding	9.6 M
Inside Ownership	34%
Institutional Ownership	<1%
Float	6.3 M
Short Interest (% of float)	<1%

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

### FINANCIAL DATA

Market Capitalization	\$14.4 M
- Cash & Equivalents	\$ 0.1 M
+ Preferred Stock	\$ 0.5 M
+ Long-term Debt	\$ 4.5 M
Enterprise Value	\$19.3 M
Book Value	\$3.6 M
Working Capital	\$1.5 M
Dividend Yield	nil

Balance sheet figures pro forma as of 9/30/09

### HIGHLIGHTS

- **Lower Sales, Reduced Profits.** Reed's recorded \$4.0 million in sales in 3Q09, representing a decrease of 4.8% from sales in the year-ago quarter. Gross profits were 24.6% of sales, compared to 30.6% in the same period last year.
- **Cash Usage.** We estimate operations used \$600,000 in cash during the September 2009 quarter, bringing total cash usage for the first nine months of 2009 to \$1.3 million.
- **Financings.** In October 2009, Reed's completed a private placement of common stock and warrants receiving gross proceeds of \$563,000. Mid-November 2009, the Company entered into a new credit line, under which we estimate approximately \$500,000 is available after repayment of the outstanding balance on the old credit line.
- **Rights Offering.** Reed's commenced a rights offering of Series B Preferred Stock. Shareholders have until 12/14/09, to subscribe to a total of 225,000 shares of preferred stock for \$10.00 per share. If fully subscribed and converted the rights offering could result in the issuance of 1,125,000 shares of common stock for gross proceeds of \$2,250,000.
- **Rating and Price Target.** We reiterate our Speculative Buy recommendation on REED shares and leave our price target at \$5.35 per share.

	SALES	NET LOSS	CFO	LPS
2007A	\$13.1	(\$5.6)	(\$5.8)	(\$0.70)
2008A	\$15.3	(\$3.8)	(\$2.5)	(\$0.43)
1Q09A	\$ 3.4	(\$0.5)	(\$0.0)	(\$0.06)
2Q09A	\$ 4.2	(\$0.9)	(\$0.7)	(\$0.10)
3Q09A	\$ 4.0	(\$0.4)	(\$0.6)	(\$0.04)
TTM	\$14.6	(\$2.9)	(\$1.2)	(\$0.33)

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

### VALUATION

Price/Sales	1.0 X
Price/CFO	Neg
Price/Trailing 12-mo. Earnings	Neg
Price/Book Value	4.0 X
Consensus EPS Estimate 2009	NA
Forward PE	NA
Consensus EPS Estimate 2010	NA
Forward PE	NA

**PLEASE READ THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGES 8 AND 9 OF THIS REPORT.**

Lead Analyst: Debra Fiakas, CFA  
212-400-7519  
dfiakas@crystalequityresearch.com

## OUTLOOK

Working and investment capital remain issues for Reed's despite the success the Company has had in penetrating the U.S. and international markets with its lines of natural beverages. The economic environment has been challenging for all beverage producers, but an expanding customer base, new distribution relationships and new product introductions have helped mitigate the impact of weak demand on Reed's top-line. A private label initiative could double the Company's revenue and drive profit margins next year.

In an effort to build capital resources to meet growth opportunities, Reed's has taken several steps to realign its balance sheet and leverage assets. A pending rights offering could raise an additional \$2.3 million if fully subscribed. Some investors may pause with concern for the potential dilution through the issuance of new shares or increased leverage. However, we note that the Company appears well positioned to build sales and improve margins in the coming quarters with existing distribution and private label relationships. A recent acquisition of sparkling beverages and strong pipeline of possible private label candidates hold the potential for double digit sales growth in 2010. We believe this base could produce the earnings needed to cover higher shares outstanding or increased interest burden.

We reiterate our Speculative Buy recommendation on REED shares and leave our price target at \$5.35 per share. We acknowledge a line of potential resistance may have developed at the \$2.30 price level. From the current depressed stock price, there would be considerable room for price appreciation before this price level is tested. In our view, a year-end 2009 report detailing the first results including sales and earnings from the Company's new private label initiative could provide investors with the confidence to drive the stock through possible lines of resistance. We continue to view REED shares as appropriate for investors with high tolerance for risk and sufficiently long investment horizons to withstand price volatility and wide spreads between bid and ask prices.

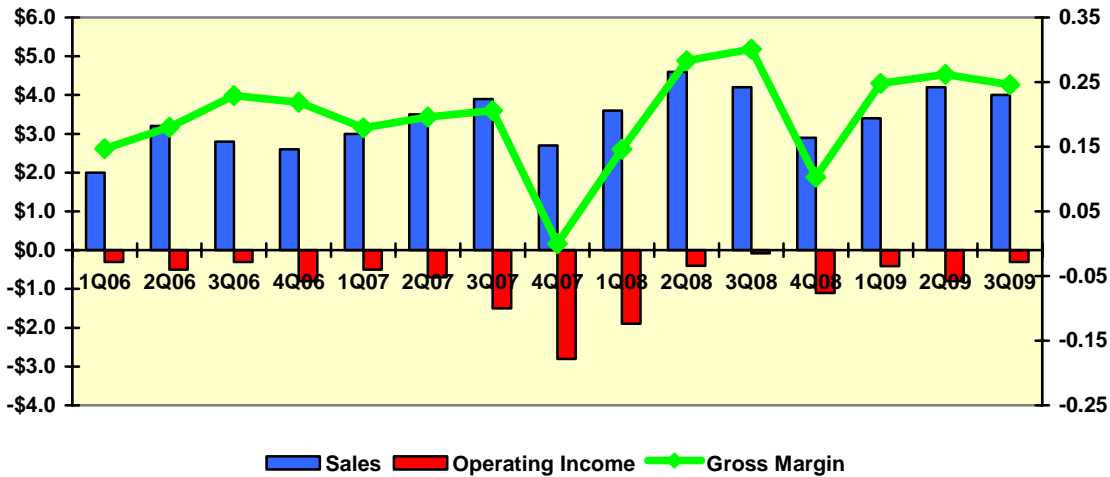
## HIGHLIGHTS OF THIRD QUARTER 2009 RESULTS

Reed's recorded \$4.0 million in sales in the third quarter 2009, representing a decrease of 4.8% from sales in the year-ago quarter. Gross profits were 24.6% of sales, compared to 30.6% in the same period last year. Increased fixed costs and higher transportation expenses contributed to the decline in profit margin. After interest expenses, the net loss was \$402,000 or \$0.04 per share. Operating expenses totaled \$1.3 million or 32.5% compared to \$1.4 million or 32.5% in the year-ago period. Operating expenses included \$247,000 in stock-compensation as payment for professional services, \$360,000 in stock options issued to employees, and \$324,000 in depreciation and amortization. We estimate the net cash income was \$529,000 excluding these non-cash expenses.

### Exhibit I: Stock Price Chart



Source: [Stockcharts.com](http://Stockcharts.com)

**Chart I: Quarter Results Comparison**

Source: Company Reports

### **Cash Usage and Balances**

We estimate operations used \$600,000 in cash during the September 2009 quarter, bringing total cash usage for the first nine months of 2009 to \$1.3 million. The cash balance at the end of the quarter was \$76,000 and working capital was \$1.5 million. Accounts receivable represented 31 days sales outstanding. Inventory turned 3.9 times in the first nine months of 2009.

Directly following the close of the quarter, the Company completed a private placement of common stock and warrants receiving gross proceeds of \$563,000. A total of 364,189 shares of common stock and a total of 242,899 warrants in three series were issued aggregated in 364,189 units at \$1.80 per unit. The Company now has 9.6 million shares of common stock outstanding and 2.5 million warrants with an average exercise price of \$4.61. In addition to warrants Reed's has 720,000 outstanding options, of which 291,666 can be exercised.

Mid-November 2009, the Company entered into a new credit line with Gem Cap Lending. The credit line is secured by accounts receivable and inventory. Based on outstanding balances in those two accounts at the end of September and the leverage terms of the credit line and after payoff of the old credit line, we estimate that that is approximately \$500,000 available at the date of this report under the new credit line.

### **Rights Offering**

We believe this recent equity private placement and new credit line could be sufficient to support operations through the first quarter 2010. However, it appears the Company requires additional capital to execute on its plans to ramp private label production and introduce additional new products in 2010. The Company has commenced a rights offering of Series B Preferred Stock. Shareholders have until December 14, 2009, to subscribe to a total of 225,000 shares of preferred stock for \$10.00 per share. Each preferred share will pay a 5% dividend for up to three years and can be converted to five shares of common stock at \$2.00 per share.

If fully subscribed and converted the rights offering could result in the issuance of 1,125,000 shares of common stock for gross proceeds of \$2,250,000. The preferred dividend obligation would be \$112,500 per year if fully subscribed. The terms of the rights offering allow the Company to extend the offer to non-shareholders if the offering is not fully subscribed by existing shareholders.

The option of issuing preferred stock with a 5% preferred dividend allows the Company to raise capital that is comparatively lower cost than prevailing interest rates on debt. It also minimizes dilution during the initial period of deploying the capital for growth. We expect the Company's private label strategy to contribute materially to sales in the year 2010, which could ultimately support the share issuance with higher earnings. Management is predicting that the Company will be profitable in 2010, a prediction that was also made a year-ago in advance of 2009 product introductions. We note that private label orders are typically in higher volumes than Reed's specialty beverages and will not require an investment by Reed's for marketing and distribution. In our view, the private label production business model is strong in terms of its potential to provide a material contribution to operating profits.

### ***Sonoma Cider Mill Acquisition***

Capital will also be need to fulfill payment commitments made in the acquisition of Sonoma Cider Mill. In October 2009, the Company completed the acquisition of Sonoma Cider Mill, Inc., a specialty beverage producer located in southern California. Reed's had been producing six Sonoma Sparkler branded products since June 2009. Reed's paid \$252,000 for the Sonoma Sparkler brand name, formulas for six flavors, customer lists and vendor contact information. Reed's is obligated to pay a total of \$207,000 in increments of \$9,000 over the next two years after having made an initial payment of \$45,000.

### ***Guidance***

Management remains optimistic about the Company's growth prospects, particularly with regard to a private label initiative. Reed's has won two private label relationships, which we expect to contribute to results in the December 2009 quarter. Reed's appeared at a recent private label trade show and management claims as many as thirty potential relationships are now at various stages of development. CEO Chris Reed estimates that total sales could grow by as much as 20% in 2010 through the contribution of private label relationships. Revenue from private label production should dramatically increase the top-line. While profit margins on private label sales will likely be lower than average profits on the Company's branded products, the contribution margin should be significant as fixed cost coverage will be higher. Reed's invested \$300,000 in capital improvements in the California brewery facility in order to prepare for private label production.

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

	2005	2006	2007	2008	1Q09	2Q09	3Q09	TTM
Sales	9,470	10,484	13,059	15,277	3,417	4,214	4,027	14,567
Cost of sales	7,745	8,427	11,040	11,891	2,570	3,114	3,038	11,330
Gross profit	1,725	2,057	2,019	3,386	847	1,100	989	3,237
Selling expense	1,125	1,352	4,587	3,817	659	548	646	2,676
General & admin. expense	956	2,187	2,621	3,140	603	670	623	2,488
Other expense	160	325	300	-	-	641	-	641
Income from operations	(516)	(1,807)	(5,489)	(3,571)	(415)	(759)	(280)	(2,568)
Net interest income (expense)	(310)	(407)	(62)	(243)	(83)	(114)	(122)	(364)
Net income	(826)	(2,214)	(5,551)	(3,814)	(498)	(873)	(402)	(2,932)
Preferred dividend	(29)	(29)	(28)	(24)	-	(23)	-	(23)
Net income for shareholders	(855)	(2,243)	(5,579)	(3,838)	(498)	(896)	(402)	(2,955)
Diluted earnings per share	(\$0.18)	(\$0.41)	(\$0.70)	\$0.43	(\$0.06)	(\$0.10)	(\$0.04)	\$ (0.32)
Wtd shares outstanding	4,885	5,523	8,009	8,884	9,041	9,119	9,215	9,045
Sales growth, yr/yr	5.5%	10.7%	24.6%	17.0%				
Net income growth, yr/yr	72.4%	168.0%	150.7%	-31.3%				
EPS growth, yr/yr	80.0%	127.8%	70.7%	-161.4%				
Gross margin	18.2%	19.6%	15.5%	22.2%	24.8%	26.1%	24.6%	22.2%
Operating margin	-5.4%	-17.2%	-42.0%	-23.4%	-12.1%	-18.0%	-7.0%	-17.6%
Net margin	-8.7%	-21.1%	-42.5%	-25.0%	-14.6%	-20.7%	-10.0%	-20.1%
Direct costs as a % of sales	81.8%	80.4%	84.5%	77.8%	75.2%	73.9%	75.4%	77.8%
SG&A as a % of sales	22.0%	33.8%	55.2%	45.5%	36.9%	28.9%	31.5%	35.4%

Source: Company reports and Crystal Equity Research measures

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

	12/31/2005	12/31/2006	12/31/2007	12/31/2008	9/30/2009
<b>Current assets</b>					
Cash and equivalents	27	3,220	743	229	76
Accounts receivable	535	1,184	1,161	897	1,375
Inventory	1,208	1,511	3,028	2,837	3,176
Prepaid expenses	74	164	77	68	226
Other current assets	11	25	16	-	-
<b>Total current assets</b>	<b>1,855</b>	<b>6,104</b>	<b>5,025</b>	<b>4,031</b>	<b>4,853</b>
PP&E	1,886	1,795	4,249	4,133	3,641
Other long-term assets	1,171	814	814	939	1,637
<b>Total assets</b>	<b>4,912</b>	<b>8,713</b>	<b>10,088</b>	<b>9,103</b>	<b>10,131</b>
<b>Current liabilities</b>					
Accounts payable	1,645	1,695	1,997	1,929	1,758
Lines of credit	1,446	1,356	-	1,354	1,447
Current portion of long-term debt/financing	169	72	27	16	-
Accrued liabilities	190	146	58	96	181
<b>Total current liabilities</b>	<b>3,450</b>	<b>3,269</b>	<b>2,082</b>	<b>3,395</b>	<b>3,386</b>
Long-term debt, less current portion	1,313	821	766	1,747	3,011
Capital leases	-	-	-	-	136
<b>Stockholders' equity</b>					
Preferred stock	589	589	481	471	466
Common stock	1	1	1	1	1
Common stock in reserve	29	-	-	-	-
Paid-in-capital	2,789	9,535	17,838	18,408	19,846
Retained earnings (deficit)	(3,259)	(5,502)	(11,081)	(14,919)	(16,715)
<b>Stockholders' equity</b>	<b>149</b>	<b>4,623</b>	<b>7,239</b>	<b>3,961</b>	<b>3,598</b>
<b>Total liabilities and equity</b>	<b>4,912</b>	<b>8,713</b>	<b>10,087</b>	<b>9,103</b>	<b>10,131</b>
<b>SELECTED MEASURES</b>					
Working capital	(1,595)	2,835	2,943	636	1,467
Debt to equity	9.9	0.2	0.1	0.4	0.8
<b>Productivity measures</b>					
Growth in sales	5.5%	10.7%	24.6%	0.0%	0.0%
Growth in inventory		25.1%	100.4%	-6.3%	11.9%
Growth in accounts receivable		121.3%	-1.9%	-22.7%	53.3%

Source: Company reports and Crystal Equity Research measures

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

	2004	2005	2006	2007	2008	9M 09
Cash flows from operations						
Net income	(479)	(826)	(2,214)	(5,551)	(3,814)	(1,773)
Depreciation & amortization	97	119	156	205	355	324
Provision for amounts due from director	153	124	3	-	-	-
Stock compensation expense	-	-	6	425	536	607
Write-off of note receivable	-	-	-	300	-	-
Loss on disposal of equipment	-	-	-	-	5	-
Impairment loss on assets	-	-	-	-	-	641
Working capital changes	53	540	(954)	(1,185)	450	(1,121)
<b>Net cash provided by operations</b>	<b>(176)</b>	<b>(43)</b>	<b>(3,003)</b>	<b>(5,806)</b>	<b>(2,468)</b>	<b>(1,322)</b>
Cash flows from investing activities						
Capital expenditures	(204)	(182)	(65)	(2,650)	(191)	(240)
Other investments	(44)	(33)	-	(300)	-	-
<b>Net cash used by investing activities</b>	<b>(248)</b>	<b>(215)</b>	<b>(65)</b>	<b>(2,950)</b>	<b>(191)</b>	<b>(240)</b>
Cash flows from financing activities						
Proceeds (payments) on debt, net	673	400	(403)	(100)	970	1,281
Proceeds (payments) on line of credit	-	-	1,081	(1,356)	1,354	93
Proceeds from issuance of equity	-	197	7,005	7,626	-	150
Proceeds from issuance of warrants	-	-	-	165	-	-
Decrease (increase) in restricted stock	-	-	(2,752)	1,580	-	-
Offering costs	(220)	(333)	(252)	(55)	(179)	(115)
Other	-	(21)	-	-	-	-
<b>Net cash from financing activities</b>	<b>453</b>	<b>243</b>	<b>4,679</b>	<b>7,860</b>	<b>2,145</b>	<b>1,409</b>
Cash and equivalents, beginning of the year	13	42	27	1,638	743	229
Cash and equivalents, end of the year	42	27	1,638	742	229	76
Selected Measures:						
Free cash flow	(380)	(225)	(3,068)	(8,456)	(2,659)	(1,562)
Conversion ratio (CFO to sales)	-2.0%	-0.5%	-28.6%	-44.5%	-16.2%	-9.1%

Source: Company reports and Crystal Equity Research measures

## CRYSTAL EQUITY RESEARCH, LLC

Crystal Equity Research, LLC is an impartial research resource, providing coverage of small capitalization companies in selected industries. The firm provides research reports by subscription to institutional investors, supplies research consulting services to financial professionals and offers an issuer or agent sponsored research program for qualifying companies. Crystal Equity Research is a Registered Investment Advisor with the State of New York.

## ANALYST

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

## ANALYST CERTIFICATION

The analyst who is primarily responsible for this research and whose name is listed first under Analysts above certifies that: 1) all of the views expressed in this research accurately reflect his or her professional views about any and all of the subject securities or issuers, and 2) no part of any of the analyst's compensation was, is or will be directly or indirectly related to the specific rating expressed by analyst in this research.

## CER REPORT RESEARCH UNIVERSE\*

Speculative Buy	4	80%	Unproved business model; catalysts exist to generate higher returns
Accumulate	1	20%	Long-term return potential above 10%; near-term catalysts may not exist
Hold	0	0%	Total return potential below 10%; an acceptable long-term holding
Sell	0	0%	Potential return greater than negative 10%; take profits or stem losses
Not Rated	0	0%	No rating
Total	5	100%	

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

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

<u>Report</u>	<u>Date</u>	<u>Price</u>	<u>Rating</u>	<u>Target Price</u>
Initial	4/24/08	\$2.85	Speculative Buy	\$5.25
Update	5/22/08	\$2.40	Speculative Buy	\$5.25
Update	8/21/08	\$2.95	Speculative Buy	\$5.25
Update	11/14/08	\$1.59	Speculative Buy	\$5.25
Update	4/1/09	\$0.99	Speculative Buy	\$5.25
Update	5/14/09	\$2.12	Speculative Buy	\$5.25
Update	8/19/09	\$2.16	Speculative Buy	\$5.25
Update	11/19/09	\$1.50	Speculative Buy	\$5.25

**DISCLOSURES**

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

**Disclosure Key**

- A A member or employee of Crystal Equity Research, LLC serves on the board of directors of the company.
- B A controlling member of Crystal Equity Research, LLC has a beneficial interest in the common stock of the company.
- C A person or persons preparing this report or an immediate family member of the preparer has a beneficial interest in the common stock of the company.
- D Crystal Equity Research, LLC received compensation for research coverage from the company or one of its agents. Subscription fees for CER Research Coverage are paid in advance in cash.
- E The company has a convertible issue outstanding.
- F The securities covered in this report can be optioned.
- G The securities covered in this report can be margined.

*\*An agent of Reed's, Inc. has sponsored research coverage of REED. The agent provided investment banking and advisory services to Reed's, Inc. in the past and may again provide such services to Reed's, Inc. in the future.*

**ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST.** Inquiries may be made by telephone at **212-400-7519**, by electronic message to **info@crystalequityresearch.com** or by mail to **1040 Avenue of the Americas, Floor 24, New York, NY 10018**. Additional information about Crystal Equity Research is available at the firm's web site at **www.crystalequityresearch.com**.

---

The information and opinions in this report were prepared by Crystal Equity Research, LLC. The information herein is believed to be reliable and has been obtained from public sources believed to be reliable. We make no representation as to the accuracy or completeness of such information. Opinions, estimates and projections in this report constitute the current judgment of the author as of the date of the report and are subject to change without notice. We have no obligation to update, modify or amend this report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate, or if research on the subject company is withdrawn.

This report is provided for informational purposes only. It is not to be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction. Opinions and recommendations in our reports do not take into account individual investor circumstances, objectives, or needs and are not intended as recommendations of particular securities or strategies to particular investors. The recipients of our reports must make their own independent decisions regarding any securities mentioned in our reports.

Crystal Equity Research, LLC may receive compensation from the company or companies mentioned in this report or agents acting on their behalf. Please review the important disclosures in this report.

This report may not be reproduced, distributed or published by any person for any purpose without the prior written consent of Crystal Equity Research. Please cite source when quoting.

Copyright © 2007-2009 Crystal Equity Research, LLC.