

Nasdaq: REED

Update

April 5, 2010

Rating: **Speculative Buy**
(Unchanged)

Reed's, Inc.

Recent Price: **\$1.66**
(4/1/10)

Consumer; Specialty Beverages

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

MARKET DATA

52-Week High/Low	\$2.60 - \$0.90
Ave. Daily Volume (6-mos.)	50 K
Shares Outstanding	10.1 M
Inside Ownership	31.7%
Institutional Ownership	<1%
Float	6.9 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	\$16.8 M
- Cash & Equivalents	\$ 1.3 M
+ Preferred Stock	\$ 1.7 M
+ Long-term Debt	\$ 3.8 M
Enterprise Value	\$21.0 M
Book Value	\$4.4 M
Working Capital	\$2.1 M
Dividend Yield	nil

Balance sheet figures pro forma as of 12/31/09

HIGHLIGHTS

- **Fourth Quarter Sales.** Sales totaled \$3.5 million and represented a year-over-year increase of 21.0%. Sales were driven by new supermarket relationships, new private label sales and continued market penetration of Reed's Ginger Brews.
- **Year 2009 Sales.** Fourth quarter results brought revenue for the year 2009 to \$15.2 million compared to \$15.3 million in 2008. This represents a year-over-year decline of 0.6%. Although disappointing, 2009 top-line performance compares favorably against net shrinkage of 2.1% in 2009 for the soft-drink market.
- **Gross Margin.** Gross margin for the year 2009 increased to a record 23.8% compared to 22.2% in the previous year. The Company reduced promotional spending to \$2.4 million in 2009, from \$3.8 million the year before. This was largely accomplished by reducing personnel.
- **First Quarter 2010 Prognosis.** As sales ramp in the first quarter in anticipation of the 2010 season, we expect Reed's to reach breakeven. We estimate a net operating loss of \$180,000 and positive EBITDA of \$120,000 in 1Q10.
- **Outlook.** In the near-term, the possibility of an acquisition of Jones Soda could weigh on REED, at least until more clarity is available on how Reed's might bring that operation to profitability. Historic trading patterns indicate a line of price resistance has developed over the last two years near the \$2.20 level. While we have kept our price target at \$5.25, we view the \$2.20 price as an interim target for REED shares.

	SALES	NET LOSS	CFO	LPS
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)
4Q09A	\$ 3.5	(\$0.8)	(\$0.0)	(\$0.08)
2009A	\$15.2	(\$2.9)	(\$1.3)	(\$0.28)

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

VALUATION

Price/Sales	1.1 X
Price/CFO	Neg
Price/Trailing 12-mo. Earnings	Neg
Price/Book Value	3.8 X
Consensus EPS Estimate 2010	NA
Forward PE	NA
Consensus EPS Estimate 2011	NA
Forward PE	NA

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SUMMARY

Reed's appears to have made progress in right-sizing its production and operating structure, bringing back into view the potential for breakeven at the operating line. The Company appeared to have met the challenges of a difficult economy during 2009 with strong new product offerings and a timely strategy to engage in private label production. Although operations continue to burn up cash resources, balance sheet metrics have improved following sales of common and preferred stock in the last six months.

We reiterate our Speculative Buy rating on Reed's and our \$5.25 price target based on progress in achieving profitability. The potential for the strategic acquisition of a competitor, Jones Soda (JSDA: Nasdaq) presents a wild card for valuation. Jones is struggling against weak demand, high production costs, and a bloated operating structure. In our view, integration of Jones product line and market reach into Reed's could have strategic value in the long-term. However, Reed's goal of reporting an operating profit could be push backed in the near-term, a development that could keep a lid on the REED price.

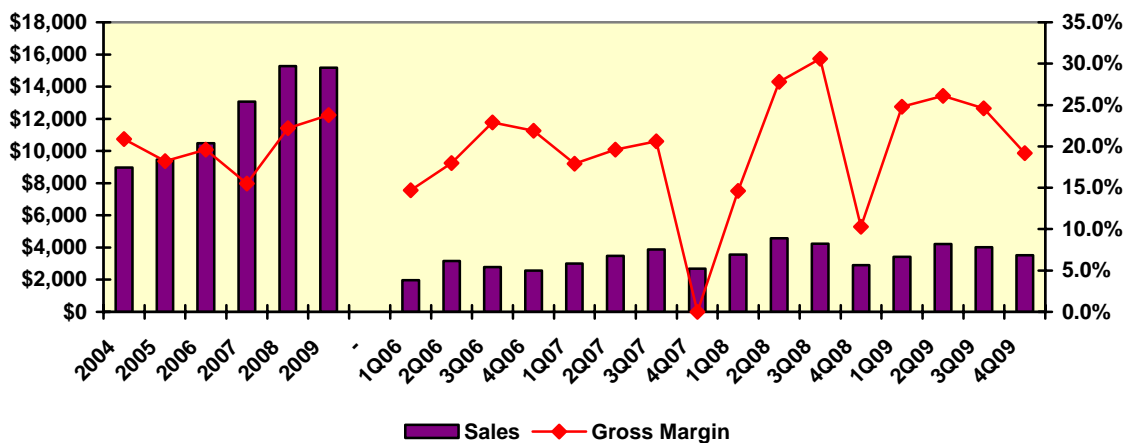
FOURTH QUARTER AND YEAR-END 2009 RESULTS

Fourth Quarter 2009

As pre-announced, sales totaled \$3.5 million and represented a year-over-year increase of 21.0%. Sales in the quarter were driven by new supermarket relationships that afforded increased shelf space, new products such as *Reed's Energy Elixir*, and continued market penetration of the Company's flagship *Reed's Ginger Brews*. We believe the recently acquired *Sonoma Sparkler Sparkling Juices* made a nominal contribution to the quarter. A more significant contribution to the fourth quarter came from Reed's launch of private label production in the last half of the year. Orders increased for two private label customers during the quarter.

Reed's profit margin slipped sequentially to 19.2% in the fourth quarter 2009, in the typical season low period for the Company's beverage products. This compares to a gross margin of 10.3% in the same quarter last year. We believe the improved performance was due primarily to better coverage of fixed costs by the higher sales volumes. The Company indicated capacity utilization was near 60% at year-end, suggesting that margins have considerable room for growth as volumes increase for both branded and private label products.

Chart I: Historic Sales and Gross Margin



Source: Company Reports

Operating expenses totaled \$1.3 million or 36.8% of total sales. This compares to the same quarter in the previous year when the spending rate was 48.6% of sales. Operating expenses also declined nominally to \$1.3 million from \$1.4 million a year ago and flat from the September 2009 quarter.

After interest expenses of \$167,000, the net loss in the fourth quarter 2009 was \$786,000 or \$0.08 per share.

Year 2009

Fourth quarter results brought revenue for the year 2009 to \$15.2 million compared to \$15.3 million in the previous year. This represents a year-over-year decline of 0.6%. Although disappointing, 2009 top-line performance compares favorably against net shrinkage of 2.1% in 2009 for the greater soft-drink market. According to *Beverage Digest* soft-drink volumes declined at a slower rate in 2009, compared to 3.0% in 2008 and 2.3% in 2007. Although lower-priced soft-drinks appeared to retake some volume during the tough economic situation during 2009, we believe Reed's has been a beneficiary of the long-term switch from soft-drinks to juices and teas.

Gross margin for the year 2009 increased to a record 23.8% compared to 22.2% in the previous year. The Company reduced spending on sales and marketing to \$2.4 million in 2009, from \$3.8 million the year before. This was largely accomplished by reducing personnel in this department. The Company also scaled back its participation in trade shows and advertising promotions. A shift in focus on building relationships with key stores and chains across the country from a regional focus was an enabling factor in reducing expenses without impinging on sales volumes.

In 2009, operating expenses totaled \$5.1 million or 33.6% of sales compared to \$7.0 million and 45.7% in 2008. The 27.1% decrease in total operating expenses and the reduction in the spending rate were due primarily to a reduction in compensation and professional services. Operating loss was \$2.1 million in 2009 compared to \$3.6 million in the previous year. The 2009 net loss includes a charge of \$641,000 in the second quarter 2009, related to asset impairment that was record subsequent to the sale and leaseback of the Company's west coast brewery facility. Excluding this non-cash charge the operating loss would have been \$1.4 million.

Interest expense totaled \$486,000 for the year 2009, bringing the net loss to \$2.6 million or \$0.28 per share.

Cash Usage and Balances

Reed's used \$1.3 million in cash during the year 2009. This compares to net cash usage of \$2.5 million in the previous year. Free cash flow after an investment of \$356,000 in capex was negative \$1.7 million. We estimate cash flow from operations was neutral in the fourth quarter 2009, as volumes and revenue provided better coverage of fixed costs. At the end of December 2009, the Company held \$1.3 million in cash. Working capital increased to \$2.1 million from \$1.5 three months earlier. Shareholder equity increased to \$4.4 million.

The Company's improved current accounts were due largely to a series of capital raises in the second half of 2009.

- June 2009 - Sale and leaseback of the Company's west coast brewery facility and equipment
- Oct. 2009 - Sale of 364,189 units (one share common stock, four warrants) at \$1.80 per unit, for net proceeds of \$563,000
- Nov. 2009 - Execution of new, replacement credit line for \$3.0 million secured by receivables and inventory
- Dec. 2009 - Sale of 120,820 shares of Series B Preferred stock for net proceeds of \$829,000

During 2009, the Company issued a total of 626,786 shares of common stock, 500 share of Series A preferred stock, 120,820 shares of Series B preferred shares, representing a total of \$1.8 million in incremental paid in capital.

Since close of the December 2009 quarter, the Company has raised additional capital.

- Feb. 2010 - Sale of 12,780 shares of Series B preferred stock for net proceeds of \$116,800
- Feb. 2010 - Sale of 277,359 share of common stock and 83,208 warrants for net proceeds of \$434,000

We estimate these transactions brought total cash to \$1.8 million by the end of March 2010. Our estimate assumes that operations remained cash neutral in the first quarter 2010. We estimate shareholders' equity is now \$5.1 million. This brings the debt-to-equity ratio to 0.75, including current portions of long-term notes and the outstanding balance on the Company's revolving line of credit.

In addition to the shares issued in the private placement of common stock in February 2010, the Company also issued shares for professional services. The Company also issued 156,642 shares of common stock in the conversion of 22,806 shares of Series B preferred stock. Total shares outstanding at the end of March 2010, were 10.1 million.

Sonoma Cider Mill Acquisition

Reed's acquired the *Sonoma Sparkler* brand in October 2009, from Sonoma Cider Mill, Inc. (private). The deal created new debt totaling \$239,000 on the balance sheet, which is payable over two years and bears interest at the rate of 5%. At the end of December 2009, the note had been paid down to \$173,000.

Sources of Dilution

The Company now has 2.1 million warrants outstanding, of which 1.6 million are exercisable at an average \$5.38 per share. Additionally, the Company has 690,000 options outstanding, of which 334,999 are exercisable at \$2.23 per share. Since the warrants are far out-of-the-money, we do not believe they represent a serious overhang in the near term. However, the options may be a greater concern from a dilution standpoint. A mitigating factor in options exercises would be the receipt of additional capital. We estimate that if all exercisable options were converted to common stock, the Company could receive an \$747,000 in incremental capital. The catalytic effect of such an infusion of cash to working capital could help mitigate in the long-term the dilutive effects of the share issuance.

Furthermore, the recently issued Series B preferred stock is convertible at \$1.43 per share. We estimate that after the early 2010 conversions, a total of 835,714 shares of Series B preferred are outstanding. Series B holders earn dividends at the rate of 5%, which can be paid in cash or common stock. The first payment was due March 3, 2010.

FUTURE PROFITABILITY

As we noted in our recent reported on Reed's dated March 23, 2010, Reed's has made considerable progress in developing its product line and refining its growth strategy. Reed's is now in full production for two private label customers and has been successful in tripling volume for one of them. The Company is in serious discussions with three additional potential private label parties and management expects to have as many as seven private label relationships by the end of 2010. Private label production contributes a lower profit margin, but with no sales or marketing expenses makes a strong contribution to operating income. Reed's announced record sales in the December 2009 quarter and the month of January 2010. All indications are that the rest of the first quarter 2010 has been at a similar pace. We believe Reed's is positioned to report a record year in terms of sales, possibly reaching quarterly profitability before the end of the current year.

As sales ramp in the first quarter in anticipation of the spring and summer 2010 seasons, we expect Reed's to reach breakeven. January 2010 sales were preannounced as up over 30% from last year. If the Company is able to keep this pace through the March 2010 quarter, we estimate first quarter 2010 sales could reach \$4.4 million. Using similar cost and spending rates as in 4Q09, we estimate a net operating loss of \$180,000 and positive EBITDA of \$120,000.

VALUATION AND OUTLOOK

As shown in Chart I on the previous page, Reed's top-line growth stalled in 2009. Coupled with the net loss, many investors may dismiss Reed's. Yet given economic conditions and negative trends in consumer and beverage markets the Company is counting the year among its successes. In our view, the addition of new products, acquisition of the *Sonoma Sparkler* product line and launch of private label production all illustrate Reed's scrappy response to the challenges of the current market for natural beverages. Investors could also be impressed by the increasing gross margin, which came largely increasing production volumes and reductions in direct costs following negotiation of better terms by co-packers.

In the near-term, the possibility of an acquisition of Jones Soda could weigh on REED, at least until more clarity is available on how Reed's might bring that operation to profitability. Jones is non-committal about any deal, refraining from identifying a second suitor or detailing the terms of an offer that precipitated Reed's releasing Jones from an exclusivity provision. Jones is facing a delisting action by Nasdaq, the resignation of its current CEO and possible class action lawsuits by shareholders who question the Jones director's execution of their fiduciary duty in putting the Jones brands up for sale. Jones fourth quarter 2009 results, which revealed weak sales volumes, pricing pressures and escalating operating losses, suggest the onus to complete a sale is hard on Jones leadership.

A review of historic trading patterns indicates a line of price resistance has developed over the last two years near the \$2.20 price level. While we have kept our price target at \$5.25, we view the \$2.20 price as an interim target for REED shares. The next line of resistance is likely at the \$5.25 price level where we have set our price target. As shown in Exhibit I below, shareholders may get support at the \$1.40 price level. That said, we do not expect REED shares to move beyond a tight trading range between \$1.60 and \$1.80 as investors await news on whether Reed's \$0.37 per share bid for Jones Soda will withstand a competing offer.

Exhibit I: REED Price Chart



Source: Stockcharts.com

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

Dollars in Thousands Except EPS

	2005	2006	2007	2008	2009	1Q09	2Q09	3Q09	4Q09
Sales	9,470	10,484	13,059	15,277	15,178	3,417	4,214	4,027	3,520
Cost of sales	7,745	8,427	11,040	11,891	11,566	2,570	3,114	3,038	2,844
Gross profit	1,725	2,057	2,019	3,386	3,612	847	1,100	989	676
Selling expense	1,125	1,352	4,587	3,817	2,412	659	548	646	559
General & admin. Expense	956	2,187	2,621	3,140	2,632	603	670	623	736
Other expense	160	325	300	-	641	-	641	-	-
Income from operations	(516)	(1,807)	(5,489)	(3,571)	(2,073)	(415)	(759)	(280)	(619)
Other income, net	-	-	-	-	-	-	-	-	-
Net interest income (expense)	(310)	(407)	(62)	(243)	(486)	(83)	(114)	(122)	(167)
Income before taxes	(826)	(2,214)	(5,551)	(3,814)	(2,559)	(498)	(873)	(402)	(786)
Provision for taxes	-	-	-	-	-	-	-	-	-
Net income	(826)	(2,214)	(5,551)	(3,814)	(2,559)	(498)	(873)	(402)	(786)
Preferred dividend	(29)	(29)	(28)	(24)	(23)	-	(23)	-	-
Net income for shareholders	(855)	(2,243)	(5,579)	(3,838)	(2,582)	(498)	(896)	(402)	(786)
Diluted earnings per share	(\$0.18)	(\$0.41)	(\$0.70)	\$0.43	(\$0.28)	(\$0.06)	(\$0.10)	(\$0.04)	(\$0.08)
Wtd shares outstanding	4,885	5,523	8,009	8,884	9,238	9,041	9,119	9,215	9,200
Sales growth, yr/yr	5.5%	10.7%	24.6%	17.0%	-0.6%				
Net income growth, yr/yr	72.4%	168.0%	150.7%	-31.3%	-32.9%				
EPS growth, yr/yr	80.0%	127.8%	70.7%	-161.4%	-165.1%				
Gross margin	18.2%	19.6%	15.5%	22.2%	23.8%	24.8%	26.1%	24.6%	19.2%
Operating margin	-5.4%	-17.2%	-42.0%	-23.4%	-13.7%	-12.1%	-18.0%	-7.0%	-17.6%
Net margin	-8.7%	-21.1%	-42.5%	-25.0%	-16.9%	-14.6%	-20.7%	-10.0%	-22.3%
Direct costs as a % of sales	81.8%	80.4%	84.5%	77.8%	76.2%	75.2%	73.9%	75.4%	80.8%
SG&A as a % of sales	22.0%	33.8%	55.2%	45.5%	33.2%	36.9%	28.9%	31.5%	36.8%

Source: Company reports and Crystal Equity Research measures

Table II: Historic Balances (dollars in thousands)

Dollars in Thousands	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009
Current assets					
Cash and equivalents	27	3,220	743	229	1,306
Accounts receivable	535	1,184	1,161	897	866
Inventory	1,208	1,511	3,028	2,837	2,884
Prepaid expenses	74	164	77	68	99
Other current assets	11	25	16	-	-
Total current assets	1,855	6,104	5,025	4,031	5,155
PP&E	1,886	1,795	4,249	4,133	3,655
Other long-term assets	1,171	814	814	939	1,160
Total assets	4,912	8,713	10,088	9,103	9,970
Current liabilities					
Accounts payable	1,645	1,695	1,997	1,929	954
Lines of credit	1,446	1,356	-	1,354	1,415
Current portion of long-term debt/financing	169	72	27	16	166
Accrued liabilities	190	146	58	96	583
Total current liabilities	3,450	3,269	2,082	3,395	3,118
Long-term debt, less current portion	1,313	821	766	1,747	2,345
Capital leases	-	-	-	-	130
Stockholders' equity					
Preferred stock	589	589	481	471	1,674
Common stock	1	1	1	1	1
Common stock in reserve	29	-	-	-	-
Paid-in-capital	2,789	9,535	17,838	18,408	20,203
Retained earnings (deficit)	(3,259)	(5,502)	(11,081)	(14,919)	(17,501)
Stockholders' equity	149	4,623	7,239	3,961	4,377
Total liabilities and equity	4,912	8,713	10,087	9,103	9,970
SELECTED MEASURES					
Working capital, \$\$	(1,595)	2,835	2,943	636	2,037
Debt to equity	9.9	0.2	0.1	0.4	0.6
Productivity measures					
Growth in sales	5.5%	10.7%	24.6%	17.0%	-0.6%
Growth in inventory		25.1%	100.4%	-6.3%	1.7%
Growth in accounts receivable		121.3%	-1.9%	-22.7%	-3.5%

Source: Company reports and Crystal Equity Research measures

Table III: Historic Cash Flows (dollars in thousands)

	2004	2005	2006	2007	2008	2009
Cash flows from operations						
Net income	(479)	(826)	(2,214)	(5,551)	(3,814)	(2,559)
Depreciation & amortization	97	119	156	205	355	469
Provision for amounts due from director	153	124	3	-	-	-
Stock compensation expense	-	-	6	425	536	657
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	(525)
Net cash provided by operations	(176)	(43)	(3,003)	(5,806)	(2,468)	(1,317)
Cash flows from investing activities						
Capital expenditures	(204)	(182)	(65)	(2,650)	(191)	(356)
Other investments	(44)	(33)	-	(300)	-	-
Net cash used by investing activities	(248)	(215)	(65)	(2,950)	(191)	(356)
Cash flows from financing activities						
Proceeds (payments) on debt, net	673	400	(403)	(100)	970	1,202
Proceeds (payments) on line of credit	-	-	1,081	(1,356)	1,354	61
Proceeds from issuance of equity	-	197	7,005	7,626	-	1,604
Proceeds from issuance of warrants	-	-	-	165	-	-
Decrease (increase) in restricted stock	-	-	(2,752)	1,580	-	-
Offering costs	(220)	(333)	(252)	(55)	(179)	(117)
Other	-	(21)	-	-	-	-
Net cash from financing activities	453	243	4,679	7,860	2,145	2,750
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	1,306
Selected Measures:						
Free cash flow	(380)	(225)	(3,068)	(8,456)	(2,659)	(1,673)
Conversion ratio (CFO to sales)	-2.0%	-0.5%	-28.6%	-44.5%	-16.2%	-8.7%

Source: Company reports and Crystal Equity Research measures

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ANALYST

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

ANALYST CERTIFICATION

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CER REPORT RESEARCH UNIVERSE*

Speculative Buy	3	60%	Unproved business model; catalysts exist to generate higher returns
Accumulate	2	40%	Long-term return potential above 10%; near-term catalysts may not exist
Hold	0	0%	Total return potential below 10%; an acceptable long-term holding
Sell	0	0%	Potential return greater than negative 10%; take profits or stem losses
Not Rated	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
Update	3/23/10	\$1.65	Speculative Buy	\$5.25
Update	4/5/10	\$1.66	Speculative Buy	\$5.25

DISCLOSURES

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

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