

Nasdaq: REED

Update

May 14, 2009

Rating: **Speculative Buy**
(Unchanged)

Reed's, Inc.

Recent Price: **\$2.12**
(5/13/09)

Consumer; Specialty Beverages

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

MARKET DATA

52-Week High/Low	\$3.30 - \$0.75
Ave. Daily Volume (6-mos.)	12 K
Shares Outstanding	9.1 M
Inside Ownership	35%
Institutional Ownership	<1%
Float	5.9 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	\$19.3 M
- Cash & Equivalents	\$ 0.1 M
+ Preferred Stock	\$ 0.5 M
+ Long-term Debt	\$ 3.0 M
Enterprise Value	\$21.8 M
Book Value	\$3.8 M
Working Capital	\$0.5 M
Dividend Yield	nil

Balance sheet figures pro forma as of 3/31/09

HIGHLIGHTS

- **Resilient Top-line.** Despite a difficult consumer environment, Reed's reported \$3.4 million in total sales in the first quarter 2009, down by a lower-than-expected 4.1% compared to the year-ago quarter.
- **Market Penetration.** Since the beginning of the year Reed's has announced a string of expanded relationships with key retailers such as Ingles Markets, Kroger's Ralph's Markets, the Fresh Market and most recently Cost Plus World Market. The Company has also added new distribution relationships such as with Maletis Beverage and Odom Corporation in the Northwest.
- **Product Introduction.** We expect the Company's new *Natural Energy Elixir* to play a key role in sales growth in the rest of 2009.
- **Guidance.** Management issued limited guidance for the balance of 2009, but did suggest that further improvement in gross margins is possible through a combination of higher sales levels and further cost reductions. Management apparently expects positive cash flow from operations yet in 2009.
- **Rating and Price Target.** We believe the stock has broken through a critical level of price resistance at \$2.00 to \$2.15 per share. At the current price target, the trailing sales multiple is 1.3 times. This is well below the average 2.7 times sales multiple commanded by a group of thirty-nine beverage producers. Our price target implies a price to sales multiple nearer that of REED's peers.

	SALES	NET LOSS	CFO	EPS
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)
TTM	\$15.1	(\$2.3)	(\$1.0)	(\$0.26)

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

VALUATION

Price/Sales	1.3 X
Price/CFO	Neg
Price/Trailing 12-mo. Earnings	Neg
Price/Book Value	5.1 X
Consensus EPS Estimate 2009	NA
Forward PE	NA
Consensus EPS Estimate 2010	NA
Forward PE	NA

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SUMMARY

The sun is shining brighter as Reed's bucks the trend in the natural beverage market with better than expected sales and higher profits. For example, competitor Jones Soda Co. (JSDA: Nasdaq) experienced a 25% year-over-year decline in sales. The next few quarters could be even more interesting for Reed's as it's most recent and perhaps most exciting product introduction, the *Natural Energy Elixir*, hits store shelves.

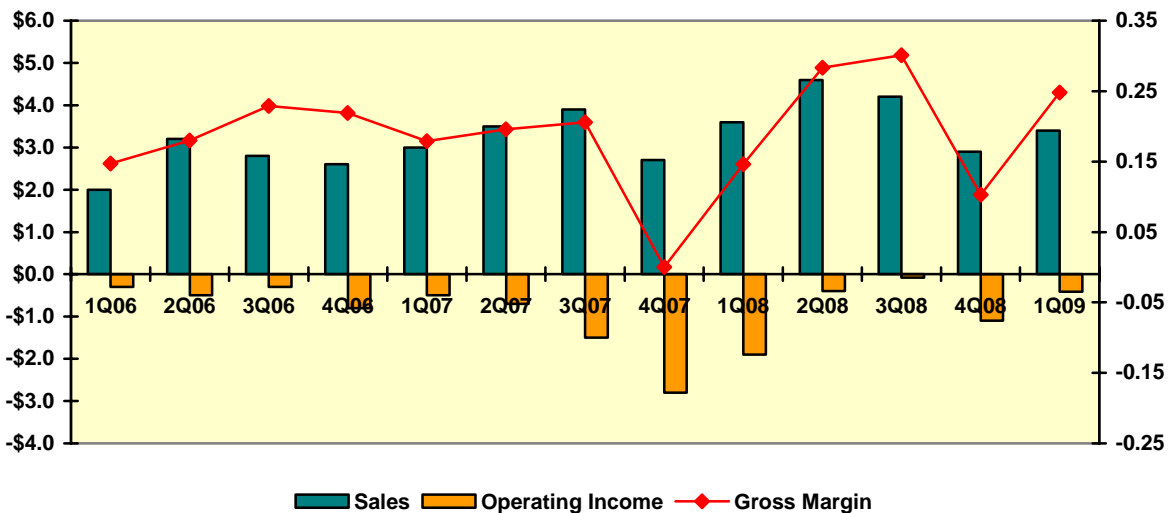
We continue to rate REED a Speculative Buy and remain bullish on the Company's long-term prospects. We acknowledge that working capital is constrained and could limit growth in the near-term. However, we note that the Company has made considerable progress in the last year in improving profit margins by right sizing operations. We believe more savings could accrue in the balance of 2009, driving profit margins to even higher levels. These efforts should take more of the pressure off working capital so that the Company can meet demand for its products.

HIGHLIGHTS OF FIRST QUARTER 2009 RESULTS

Despite a difficult consumer environment, Reed's reported \$3.4 million in total sales in the first quarter 2009, down by a lower-than-expected 4.1% compared to the year-ago quarter. The quarter was also remarkable given that the March quarter is typically the Company's seasonally weakest quarter of the year. Since the beginning of the year Reed's has announced a string of expanded relationships with key retailers such as Ingles Markets, Kroger's Ralph's Markets, the Fresh Market and most recently Cost Plus World Market. The Company has also added new distribution relationships such as with Maletis Beverage and Odom Corporation in the Northwest.

A year ago the Company dramatically reduced its sales staff and realigned marketing priorities. Keen focus on building sales with existing beverage distributors and capturing more supermarket shelf space appears to be paying off. Those personnel and budget changes have also made a difference at the operating line as operating expenses declined to 38.2% of total sales in the recent quarter compared to 69.4% in the year-ago quarter. The Company was also successful in renegotiating a better co-packing arrangement, thereby lowering production and packaging costs. Gross margin in the quarter was 23.5% compared to 14.6% in the year-ago quarter.

Chart I: Quarter Results Comparison



Source: Company Reports

Cash Flow and Balances

Operations neared breakeven and cash usage by operations was a nominal \$18,000 in the March 2009 quarter. Cash rose slightly to \$108,000 and working capital was \$515,000. Long-term debt was largely unchanged in the quarter, ending at \$1.7 million at the end of March 2009. The Company has \$1.3 million outstanding on a revolving line of credit.

GUIDANCE AND EARNINGS OUTLOOK

Management issued limited guidance for the balance of 2009, but did suggest that further improvement in gross margins is possible through a combination of higher sales levels and further cost reductions. Management apparently expects positive cash flow from operations yet in 2009.

We expect the Company's new *Natural Energy Elixir* to play a key role in sales growth in the rest of 2009. The drink is expected to stand out in the natural food aisle. Unlike most energy drinks that are heavy on fruit flavors and caffeine, Reed's drink is laced with ginger, green tea, and ginseng among a variety of lesser known fruits such as camu camu, goji and acai. The drink is also fortified with Vitamin B for stress. The first production is packaged in 10.5 ounce cans. The product was well received at trade events in the fall of 2008 and early 2009. Existing grocery store customers have expressed interest in the energy drink, which is highly differentiated from other energy drinks by its unique ingredients.



We expect the *Natural Energy Elixir* to contribute to second quarter 2009 results, but the first meaningful impact on contribution to sales probably will not be recorded until in the third quarter. We also expect initial margins to fall short of goals for product since initial product runs are expected to be smaller, and therefore not as efficient as when larger follow-on orders have been received. Ultimately, we expect the *Natural Energy Elixir* to be among Reed's most profitable products. Another new product, *Virgil's Orange Crème Soda* is also expected to contribute to 2009 sales growth.

Our optimism is also fueled by the progress the Company had made in building the Reed's brand and increasing visibility for its products. It appears the Company's sales and marketing team is becoming more adept at promoting Reed's products. The pitch is that Reed's products earn higher profit margin and can generate better returns on shelf space even if sales volumes are lower than some popular soda drinks. The message resonates with both natural food and mainstream grocers who are pressed to keep profits up as consumers cut back on purchases, even groceries.

Reed's is also benefiting from exposure both mainstream print media and new electronic media. For example, a recent article in *The Wall Street Journal* featured comments on *Virgil's Root Beer*. The timing of the high profile mention could not have been better just following the introduction of the Company's new natural energy drink. Reed's has also started using trendy social networking platforms such as Facebook.com, Twitter.com and Delicious.com to cultivate a wider consumer audience.

VALUATION AND OUTLOOK

We believe the stock has broken through a critical level of price resistance at \$2.00 to \$2.15 per share. Accordingly, we have greater confidence that REED shares can reach fair valuation near our target price of \$5.25. At the current price target, the trailing sales multiple is 1.3 times. This is well below the average 2.7 times sales multiple commanded by a group of thirty-nine beverage producers. Our price target implies a price to sales multiple nearer that of REED's peers.

The Company appears to be well positioned heading into the June quarter, which is the seasonally strongest quarter for sales. We expect strong year-over-year comparisons through the rest of 2009 and into the year 2010, which should serve as a catalyst for revaluation of the stock. News of market penetration by the Company's newest product introductions should also help create interest in the stock.

Exhibit I: Stock Price Chart



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

	2004	2005	2006	2007	2008	1Q08	1Q09	TTM
Sales	8,978	9,470	10,484	13,059	15,277	3,564	3,417	15,130
Cost of sales	7,103	7,745	8,427	11,040	11,891	3,044	2,570	11,417
Gross profit	1,875	1,725	2,057	2,019	3,386	520	847	3,713
Selling expense	792	1,125	1,352	4,587	3,817	1,124	659	3,352
General & admin. Expense	1,074	956	2,187	2,621	3,140	1,330	603	2,413
Other expense	80	160	325	300	-	-	-	-
Income from operations	(71)	(516)	(1,807)	(5,489)	(3,571)	(1,934)	(415)	(2,052)
Other income, net	(153)	-	-	-	-	-	-	-
Net interest income (expense)	(255)	(310)	(407)	(62)	(243)	(56)	(83)	(270)
Income before taxes	(479)	(826)	(2,214)	(5,551)	(3,814)	(1,990)	(498)	(2,322)
Provision for taxes	-	-	-	-	-	-	-	-
Net income	(479)	(826)	(2,214)	(5,551)	(3,814)	(1,990)	(498)	(2,322)
Preferred dividend	-	(29)	(29)	(28)	(24)	-	-	(24)
Net income for shareholders	(479)	(855)	(2,243)	(5,579)	(3,838)	(1,990)	(498)	(2,346)
Diluted earnings per share	(\$0.10)	(\$0.18)	(\$0.41)	(\$0.70)	\$0.43	(\$0.23)	(\$0.06)	(\$0.26)
Wtd shares outstanding	4,726	4,885	5,523	8,009	8,884	8,765	9,041	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	20.9%	18.2%	19.6%	15.5%	22.2%	14.6%	24.8%	24.5%
Operating margin	-0.8%	-5.4%	-17.2%	-42.0%	-23.4%	-54.3%	-12.1%	-13.6%
Net margin	-5.3%	-8.7%	-21.1%	-42.5%	-25.0%	-55.8%	-14.6%	-15.3%
Direct costs as a % of sales	79.1%	81.8%	80.4%	84.5%	77.8%	85.4%	75.2%	75.5%
SG&A as a % of sales	20.8%	22.0%	33.8%	55.2%	45.5%	68.9%	36.9%	38.1%

Source: Company reports and Crystal Equity Research measures

Table II: Historical Balances (dollars in thousands)

	12/31/2005	12/31/2006	12/31/2007	12/31/2008	3/31/2009
Current assets					
Cash and equivalents	27	3,220	743	229	108
Accounts receivable	535	1,184	1,161	897	1,050
Inventory	1,208	1,511	3,028	2,837	2,873
Prepaid expenses	74	164	77	68	187
Other current assets	11	25	16	-	-
Total current assets	1,855	6,104	5,025	4,031	4,218
PP&E	1,886	1,795	4,249	4,133	4,056
Other long-term assets	1,171	814	814	939	925
Total assets	4,912	8,713	10,088	9,103	9,199
Current liabilities					
Accounts payable	1,645	1,695	1,997	1,929	2,301
Lines of credit	1,446	1,356	-	1,354	1,274
Current portion of long-term debt	169	72	27	16	16
Accrued liabilities	190	146	58	96	112
Total current liabilities	3,450	3,269	2,082	3,395	3,703
Long-term debt, less current portion	1,313	821	766	1,747	1,743
Stockholders' equity					
Preferred stock	589	589	481	471	471
Common stock	1	1	1	1	1
Common stock in reserve	29	-	-	-	-
Paid-in-capital	2,789	9,535	17,838	18,408	18,698
Retained earnings (deficit)	(3,259)	(5,502)	(11,081)	(14,919)	(15,417)
Stockholders' equity	149	4,623	7,239	3,961	3,753
Total liabilities and equity	4,912	8,713	10,087	9,103	9,199

SELECTED MEASURES

Working capital	(1,595)	2,835	2,943	636	515
Debt to equity	9.9	0.2	0.1	0.4	0.5
Productivity measures					
Growth in sales	5.5%	10.7%	24.6%	0.0%	0.0%
Growth in inventory		25.1%	100.4%	-6.3%	1.3%
Growth in accounts receivable		121.3%	-1.9%	-22.7%	17.1%

Source: Company reports and Crystal Equity Research measures

Table III: Historical Cash Flows (dollars in thousands)

	2004	2005	2006	2007	2008	3/31/2009
Cash flows from operations						
Net income	(479)	(826)	(2,214)	(5,551)	(3,814)	(498)
Depreciation & amortization	97	119	156	205	355	109
Provision for amounts due from director	153	124	3	-	-	-
Stock compensation expense	-	-	6	425	536	290
Write-off of note receivable	-	-	-	300	-	-
Loss on disposal of equipment	-	-	-	-	5	-
Working capital changes	53	540	(954)	(1,185)	450	81
Net cash provided by operations	(176)	(43)	(3,003)	(5,806)	(2,468)	(18)
Cash flows from investing activities						
Capital expenditures	(204)	(182)	(65)	(2,650)	(191)	(1)
Other investments	(44)	(33)	-	(300)	-	-
Net cash used by investing activities	(248)	(215)	(65)	(2,950)	(191)	(1)
Cash flows from financing activities						
Proceeds (payments) on debt, net	673	400	(403)	(100)	970	(4)
Proceeds (payments) on line of credit	-	-	1,081	(1,356)	1,354	(80)
Proceeds from issuance of equity	-	197	7,005	7,626	-	-
Proceeds from issuance of warrants	-	-	-	165	-	-
Decrease (increase) in restricted stock	-	-	(2,752)	1,580	-	-
Offering costs	(220)	(333)	(252)	(55)	(179)	(18)
Other	-	(21)	-	-	-	-
Net cash from financing activities	453	243	4,679	7,860	2,145	(102)
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	108
Selected Measures:						
Free cash flow	(380)	(225)	(3,068)	(8,456)	(2,659)	(19)
Conversion ratio (CFO to sales)	-2.0%	-0.5%	-28.6%	-44.5%	-16.2%	-0.1%

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.

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Speculative Buy	3	60%	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	1	20%	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

DISCLOSURES

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

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