REEDS INC
Form SB-2/A
May 12, 2005
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Registration Statement No. 333-120451

As filed with the Securities and Exchange Commission on May 12, 2005

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

Amendment 5 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	**2086**	**95-4348325**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(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.

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum	Proposed Maximum	Amount of Registration

			Offering Price Per Share		Aggregate Offering Price(1)		Fee
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(2)	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 May 12, 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	---	$ 44,985	$ 3,303,985	$ 6,853,985

(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

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]

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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*. 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.

	Years Ended December 31,	
Statements of Operations Data:	2004 (Restated)	2003 (Restated)
Sales	$ 8,978,365	$ 6,781,776
Gross profit	1,875,328	1,319,571
Selling, general and administrative expenses	1,946,667	1,414,148
Loss from operations	(71,339)	(94,577)
Net Loss	(479,371)	(771,997)
Net Loss per share, basic and diluted	(0.10)	(0.16)
Weighted average shares used to compute net loss per share	4,726,091	4,724,488

	December 31, 2004
Balance Sheet Data:	
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.

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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.

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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	271,015		296,015		346,015	
Net Proceeds	448,985	(100)%	3,375,017	(100)%	6,853,985	(100)%
Additional Sales Representatives	250,000	(56)%	900,000	(27)%	2,100,000	(31)%
New product launches	100,000	(22)%	250,000	(8)%	375,000	(6)%
Retail Slotting	0	(0)%	750,000	(23)%	1,500,000	(22)%
Brand Advertising	0	(0)%	750,000	(23)%	1,500,000	(22)%
Cooler and in-store displays	31,985	(7)%	248,985	(8)%	640,017	(8)%
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	(15)%	155,000	(4)%	560,000	(8)%
Total Estimated Net Proceeds	$ 448,985	(100)%	$ 3,303,985	(100)%	$ 6,853,985	(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 Kegerators, 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:	Actual	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
Total current liabilities	1,255,335	1,255,335	1,255,335	1,255,335
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
Total Long-term liabilities	1,294,114	1,294,114	1,294,114	1,294,114
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	3,232,429	6,087,349	9,637,249
Preferred stock	589,402	589,402	589,402	589,402
Accumulated deficit	(2,403,638)	(2,403,638)	(2,403,638)	(2,403,638)
Total stockholders' equity	969,700	1,418,685	4,273,685	7,823,685

Total Capitalization	$	3,519,149	$	3,968,134	$	6,823,134	$	10,373,134

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 $6,787,894 or $1.0201 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 $2.9899 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	0.13	0.61	1.06
Net tangible book value per share of common stock after the offering	0.12	0.60	1.05
Dilution per share of common stock to new investors	$ 3.88	$ 3.40	$ 2.95

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)	Shares Purchased	Percentage	Total Consideration ($)	Percentage	Average Price per Share Paid ($)
Existing Shareholders(1)	4,726,091	95.9%	2,783,936	77.7%	0.59
New Investors	200,000	4.1%	800,000	22.3%	4.00
Total	4,926,091	100%	3,583,936	100%	

If 50% of Offering sold (1,000,000 shares)	Shares Purchased	Percentage	Total Consideration ($)	Percentage	Average Price per Share Paid ($)
Existing Shareholders(1)	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
Total	5,726,091	100%	6,783,936	100%	

If 100% of Offering sold (2,000,000 shares)	Shares Purchased	Percentage	Total Consideration ($)	Percentage	Average Price per Share Paid ($)
Existing Shareholders(1)	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
Total	6,726,091	100%	10,783,936	100%	

(1) 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 theses 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.

In 2004, we incurred $400,000 of promotional expenses due to deals offered by our sales force in the sale of our products. This represented about 4.3% of gross sales. In 2003, they were $240,000 and about 3.4% of gross sales. These deals are accounted for as a direct reduction of sales. These percentage rates are in line with our historical rates and we do not anticipate them changing significantly. These promotional expenses are monitored and kept in a certain range.

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 $1,074,536 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.