REED'S, INC.
Form 10-Q
November 13, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2014

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to ___________

Commission file number: 001-32501

REED'S INC.

(Exact name of registrant as specified in its charter)

Delaware	35-2177773

(State of incorporation) (I.R.S. Employer Identification No.)

13000 South Spring St. Los Angeles, Ca. 90061

(Address of principal executive offices) (Zip Code)

(310) 217-9400

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer	[ ]	Accelerated filer	[ ]
Non-accelerated filer	[ ]	Smaller reporting company	[X]

Indicate by check mark whether the issuer is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: There were a total of 13,061,480 shares of Common Stock outstanding as of November 13, 2014.

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 of Part I of this report include forward-looking statements. These 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 achievements expressed or implied by forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as "may," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "proposed," "intended," or "continue" or the negative of these terms or other comparable terminology. You should read statements that contain these words carefully, because they discuss our expectations about our future operating results or our future financial condition or state other "forward-looking" information. There may be events in the future that we are not able to accurately predict or control. Before you invest in our securities, you should be aware that the occurrence of any of the events described in this Quarterly Report could substantially harm our business, results of operations and financial condition, and that upon the occurrence of any of these events, the trading price of our securities could decline and you could lose all or part of your investment. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, growth rates, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report to conform these statements to actual results.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

REED'S, INC.

CONDENSED BALANCE SHEETS

	September 30, 2014 (unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash	$1,705,000	$1,104,000
Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of $414,000 and $324,000, respectively	3,759,000	2,143,000
Inventory	5,983,000	6,293,000
Prepaid inventory	787,000	256,000
Prepaid and other current assets	290,000	178,000
Total Current Assets	12,524,000	9,974,000
Property and equipment, net of accumulated depreciation of $3,243,000 and $2,796,000, respectively	4,069,000	3,686,000
Brand names	1,029,000	1,029,000
Deferred financing fees, net of amortization of $90,000 and $40,000, respectively	17,000	60,000
Total assets	$17,639,000	$14,749,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$5,788,000	$3,612,000
Accrued expenses	147,000	136,000
Line of credit	4,159,000	4,524,000
Current portion of long term financing obligation	128,000	111,000
Current portion of capital leases payable	119,000	79,000
Current portion of term loan	184,000	165,000
Total current liabilities	10,525,000	8,627,000
Long term financing obligation, less current portion, net of discount of $488,000 and $526,000, respectively	2,087,000	2,147,000
Capital leases payable, less current portion	489,000	106,000
Term loan, less current portion	341,000	482,000
Total Liabilities	13,442,000	11,362,000

Commitments and contingencies		
Stockholders' equity:		
Series A Convertible Preferred stock, $10 par value, 500,000 shares authorized, 9,411 and 9,411 shares issued and outstanding, respectively	94,000	94,000
Common stock, $.0001 par value, 19,500,000 shares authorized, 13,060,971 and 12,922,832 shares issued and outstanding, respectively	1,000	1,000
Additional paid in capital	25,625,000	25,276,000
Accumulated deficit	(21,523,000)	(21,984,000)
Total stockholders' equity	4,197,000	3,387,000
Total liabilities and stockholders' equity	$17,639,000	$14,749,000

The accompanying notes are an integral part of these condensed financial statements

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REED'S, INC.

CONDENSED STATEMENTS OF OPERATIONS

For the Three and Nine months Ended September 30, 2014 and 2013

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Sales	$12,319,000	$10,076,000	$32,456,000	$27,721,000
Cost of goods sold	8,434,000	6,900,000	21,962,000	19,553,000
Gross profit	3,885,000	3,176,000	10,494,000	8,168,000
Operating expenses:				
Delivery and handling expenses	1,310,000	1,040,000	3,131,000	2,900,000
Selling and marketing expense	1,480,000	1,159,000	3,604,000	2,999,000
General and administrative expense	849,000	763,000	2,730,000	2,663,000
Total operating expenses	3,639,000	2,962,000	9,465,000	8,562,000
Income (loss) from operations	246,000	214,000	1,029,000	(394,000)
Interest expense	(195,000)	(180,000)	(560,000)	(469,000)
Income (loss) before provision for income taxes	51,000	34,000	469,000	(863,000)
Income taxes	(3,000)	-	(3,000)	0
Net income (loss)	48,000	34,000	466,000	(863,000)
Preferred stock dividends	-	-	(5,000)	(5,000)
Net income (loss) attributable to common stockholders	$48,000	$34,000	$461,000	$(868,000)
Income (loss) per share available to common stockholders, basic	$0.00	$0.00	$0.04	$(0.07)
Weighted average number of shares outstanding - basic	13,053,627	12,627,864	13,034,707	12,498,935
Income (loss) per share available to common stockholders, diluted	$0.00	$0.00	$0.03	$(0.07)
Weighted average number of shares outstanding - diluted	13,135,317	13,496,714	13,291,536	12,498,935

The accompanying notes are an integral part of these condensed financial statements

REED'S, INC.

CONDENSED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

For the Nine months Ended September 30, 2014

(unaudited)

	Common Stock		Series A Preferred Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount			
Balance, December 31, 2013	12,922,832	$ 1,000	9,411	$ 94,000	$ 25,276,000	$ (21,984,000)	$ 3,387,000
Fair Value of common stock issued for services	2,299		-	-	10,000	-	10,000
Common shares issued upon exercise of stock options	134,783	-	-	-	26,000	-	26,000
Fair value vesting of options issued to employees	-	-	-	-	308,000	-	308,000
Common stock paid for Series A preferred stock dividend	1,057	-	-	-	5,000	(5,000)	-
Net income	-	-	-	-	-	466,000	466,000
Balance, September 30, 2014	13,060,971	$ 1,000	9,411	$ 94,000	$ 25,625,000	$ (21,523,000)	$ 4,197,000

The accompanying notes are an integral part of these condensed financial statements

REED'S, INC.

CONDENSED STATEMENTS OF CASH FLOWS

For the Nine months Ended September 30, 2014 and 2013

(Unaudited)

	Nine Months Ended September 30, 2014	2013
Cash flows from operating activities:		
Net income (loss)	$466,000	$(863,000)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	536,000	387,000
Fair value of stock options issued to employees	308,000	257,000
Fair value of common stock issued for services and bonus	10,000	5,000
(Decrease) increase in allowance for doubtful accounts	90,000	(24,000)
Changes in assets and liabilities:		
Accounts receivable	(1,706,000)	(1,200,000)
Inventory	309,000	(911,000)
Prepaid expenses and inventory and other current assets	(644,000)	(434,000)
Accounts payable	2,177,000	1,847,000
Accrued expenses	11,000	(99,000)
Net cash provided by (used in) operating activities	1,557,000	(1,035,000)
Cash flows from investing activities:		
Purchase of property and equipment	(355,000)	(447,000)
Net cash used in investing activities	(355,000)	(447,000)
Cash flows from financing activities:		
Proceeds from stock option and warrant exercises	26,000	105,000
Principal repayments on long term financing obligation	(81,000)	(66,000)
Principal repayments on capital lease obligation	52,000	(52,000)
Payment of deferred finance fees	(7,000)	(21,000)
Increased borrowing on note payable	-	217,000
Principal repayments on term loan	(122,000)	(108,000)
Net (repayment) borrowing on line of credit	(365,000)	1,290,000
Net cash (used in) provided by financing activities	(601,000)	1,365,000
Net increase (decrease) in cash	601,000	(117,000)
Cash at beginning of period	1,104,000	1,163,000
Cash at end of period	$1,705,000	$1,046,000
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$560,000	$518,000
Non cash investing and financing activities:		

Series A Preferred stock converted to common stock	$0	$10,000
Series B Preferred stock converted to common stock	$0	$456,000
Dividends paid in common stock	$0	$74,000
Common stock issued in settlement of Series A preferred stock dividend	$5,000	$5,000
Property and equipment acquired through capital lease	$475,000	$13,000

The accompanying notes are an integral part of these condensed financial statements

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REED'S, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

Three and Nine months Ended September 30, 2014 and 2013 (UNAUDITED)

1. Basis of Presentation

The accompanying interim condensed financial statements are unaudited, but in the opinion of management of Reeds, Inc. (the "Company"), contain all adjustments, which include normal recurring adjustments necessary to present fairly the financial position at September 30, 2014 and the results of operations and cash flows for the three and nine months ended September 30, 2014 and 2013. The balance sheet as of December 31, 2013 is derived from the Company's audited financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although management of the Company believes that the disclosures contained in these condensed financial statements are adequate to make the information presented herein not misleading. For further information, refer to the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on March 25, 2014.

The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2014.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expense during the reporting period. Actual results could differ from those estimates. Those estimates and assumptions include estimates for reserves of uncollectible accounts, inventory obsolescence, analysis of impairments of recorded intangibles, accruals for potential liabilities and assumptions made in valuing stock instruments issued for services.

Income (Loss) per Common Share

Basic earnings (loss) per share is computed by dividing the net income (loss) applicable to common stock holders by the weighted average number of shares of common stock outstanding during the year. Diluted earnings per share is computed by dividing the net income applicable to common stock holders by the weighted average number of common shares outstanding plus the number of additional common shares that would have been outstanding if all dilutive potential common shares had been issued, using the treasury stock method. Potential common shares are excluded from the computation when their effect is antidilutive.

For the three and nine months ended September 30, 2014 and the three months ended September 30, 2013 the calculations of diluted earnings per share included stock options and warrants, calculated under the treasury method, and excluded preferred stock since the effect was antidilutive. For the nine months ended September 30, 2013 the calculations of basic and diluted loss per share are the same as the effect of stock options, warrants, and preferred stock are antidilutive. The calculation of weighted average shares outstanding – diluted is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net income (loss) attributable to common stockholders	$48,000	$34,000	$461,000	$(868,000)
Denominator:				
Weighted average shares outstanding - basic	13,053,627	12,627,864	13,034,707	12,498,935
Effect of dilutive instruments:				
Warrants and options	81,690	868,850	256,829	-
Weighted average shares outstanding-diluted	13,135,317	13,496,714	13,291,536	12,498,935

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The Company had potentially dilutive securities that consisted of:

	September 30, 2014	September 30, 2013
Warrants	101,963	211,182
Options	716,833	657,668
Series A Preferred Stock	9,411	41,644
Total	828,207	910,494

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09 (ASU 2014-09), *Revenue from Contracts with Customers.* ASU 2014-09 will eliminate transaction- and industry-specific revenue recognition guidance under current U.S. GAAP and replace it with a principle based approach for determining revenue recognition. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. The ASU also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for reporting periods beginning after December 15, 2016, and early adoption is not permitted. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. Management is currently assessing the impact the adoption of ASU 2014-09 and has not determined the effect of the standard on our ongoing financial reporting.

In April 2014, the FASB issued Accounting Standards Update No. 2014-08 (ASU 2014-08), *Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360).* ASU 2014-08 amends the requirements for reporting discontinued operations and requires additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations or that have a major effect on the Company's operations and financial results should be presented as discontinued operations. This new accounting guidance is effective for annual periods beginning after December 15, 2014. The Company is currently evaluating the impact of adopting ASU 2014-08 on the Company's results of operations or financial condition.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15 (ASU 2014-15), Presentation of Financial Statements - Going Concern (Subtopic 205-10). ASU 2014-15 provides guidance as to management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued when applicable). Substantial doubt about an entity's ability to continue as a going concern exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued). ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company is currently evaluating the impact the adoption of ASU 2014-15 on the Company's financial statement presentation and disclosures.

Other recent accounting pronouncements were issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the Securities Exchange Commission (the "SEC"), however such pronouncements are not believed by management to have a material impact on the Company's present or future financial statements.

Concentrations

The Company's cash balances on deposit with banks are guaranteed by the Federal Deposit Insurance Corporation up to $250,000. The Company may be exposed to risk for the amounts of funds held in one bank in excess of the insurance limit. In assessing the risk, the Company's policy is to maintain cash balances with high quality financial institutions. The Company had cash balances in excess of the guarantee during the three and nine months ended September 30, 2014.

During the three months ended September 30, 2014, the Company had two customers which accounted for approximately 28% and 16% of sales, and in the three months ended September 30, 2013 one customer who accounted for approximately 33% of sales. During the nine months ended September 30, 2014, the Company had two customers which accounted for approximately 34% and 13% of sales respectively, and during the nine months ended September 30, 2013 the Company had one customer who accounted for approximately 34% of sales. No other customers accounted for more than 10% of sales in either year. As of September 30, 2014, the Company had accounts receivable due from two customers who comprised $1,100,000 (26%) and $628,000 (15%) of its total accounts receivable and as of December 31, 2013 the Company had accounts receivable due from one customer who comprised $734,000 (21%), of its total accounts receivable.

During the three months ended September 30, 2014, the Company had one vendor which accounted for approximately 26% of all purchases, and in the three months ended September 30, 2013 one vendor who accounted for approximately 31% of all purchases. During the nine months ended September 30, 2014, the Company had one vendor, which accounted for approximately 26% of all purchases, and during the nine months ended September 30, 2013 the Company had one vendor who accounted for approximately 29% of all purchases. No other vendor accounted for more than 10% of all purchases in either year. As of September 30, 2014, the Company had accounts payable due to a vendor who comprised 30% of its total accounts payable and as of December 31, 2013 the Company had accounts payable due to one vendor who comprised 35% of its total accounts payable. No other vendor exceeded 10% of the balance of accounts payable as of September 30, 2014 and December 31, 2013.

Advertising

Advertising costs are expensed as incurred. For the three months ended September 30, 2014 and 2013, advertising costs were $460,000 and $38,000, respectively, and for the nine months ended September 30, 2014 and 2013, advertising costs were $571,000 and $90,000, respectively. The Company paid $407,000 for its inaugural cable television advertising commercials during the three months ended September 30, 2014

Comprehensive Income

For the three and nine months ended September 30, 2014 and 2013, the Company had no items of comprehensive income.

Fair Value of Financial Instruments

The Company uses various inputs in determining the fair value of its investments and measures these assets on a recurring basis. Financial assets recorded at fair value in the balance sheets are categorized by the level of objectivity associated with the inputs used to measure their fair value. Authoritative guidance provided by the FASB defines the following levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these financial assets:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.

Level 3—Unobservable inputs based on the Company’s assumptions.

The Company had no such assets or liabilities recorded to be valued on the basis above at September 30, 2014 or December 31, 2013.

2. Inventory

Inventory consists of the following as of:

	September 30, 2014	December 31, 2013
Raw Materials and packaging	$3,602,000	$3,118,000
Finished Goods	2,381,000	3,175,000
	$5,983,000	$6,293,000

3. Property and Equipment

Property and equipment are comprised of the following as of:

	September 30, 2014	December 31, 2013
Land	$1,108,000	$1,108,000
Building	1,858,000	1,829,000
Vehicles	338,000	338,000
Machinery and equipment	3,560,000	2,763,000
Office equipment	448,000	444,000
	7,312,000	6,482,000
Accumulated depreciation	(3,243,000)	(2,796,000)
	$4,069,000	$3,686,000

Machinery and equipment at September 30, 2014 and December 31, 2013 includes equipment held under capital leases of $890,000 and $322,000, respectively. Accumulated depreciation on equipment held under capital leases was $290,000 and $208,000 at September 30, 2014 and December 31, 2013, respectively.

4. Line of Credit

On November 9, 2011, the Company entered into a Loan and Security Agreement with PMC Financial Services Group, LLC (PMC) which provides a $4,500,000 revolving line of credit and a $750,000 term loan (see Note 5). On September 20, 2013, the line of credit was increased to $4,800,000 effective September 1, 2013 to September 30, 2014. The $4.8 million line of credit was extended to December 31, 2014.

At September 30, 2014 and December 31, 2013, the aggregate amount outstanding under the line of credit was $4,159,000 and $4,524,000, respectively. The line of credit is based on 85% of eligible accounts receivable and 50% of eligible inventory and is secured by substantially all of the Company’s assets. The interest rate is at the prime rate plus 3.75% (7% at September 30, 2014). There is an early termination fee of 1% of the maximum revolver amount during 2014. Also on September 20, 2013, the Company was granted an over-advance on its revolving line of credit calculation of $500,000 effective September 1, 2013 to September 30, 2014, The original expiration date of November 7, 2014 and $500,000 over-advance were extended to December 31, 2014.

The revolving line of credit agreement includes a financial covenant debt service coverage ratio that is effective only if the credit availability under the revolving line of credit falls below $100,000 and a financial covenant that the Company will not make capital expenditures in excess of $500,000 in any fiscal year. At September 30, 2014, the credit availability under the revolving line of credit was above $100,000. This revolving line of credit matures December 31, 2014.

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5. Term Loan

On May 1, 2013 the term loan was increased to $750,000. Other terms of the term loan remain the same. The term loan bears interest at the prime rate plus 11.6%, which shall not be below 14.85%, is secured by all of the unencumbered assets of the Company, and is to be repaid in 48 equal installments of principal and interest of $21,000.

	September 30, 2014	December 31, 2013
Term loan	$525,000	$647,000
Less current portion	(184,000)	(165,000)
Long term debt	$341,000	$482,000

6. Long-term Financing Obligation

In 2009 the Company sold two buildings and its brewery equipment and concurrently entered into a long-term lease agreement for the same property and equipment. In connection with the lease the Company has the option to repurchase the buildings and brewery equipment from 12 months after the commencement date to the end of the lease term at the greater of the fair market value or an agreed upon amount. Since the lease contains a buyback provision and other related terms, the Company determined it had continuing involvement that did not warrant the recognition of a sale; therefore, the transaction has been accounted for as a long-term financing. The proceeds from the sale, net of transaction costs, have been recorded as a financing obligation in the amount of $3,056,000. Monthly payments under the financing agreement are recorded as interest expense and a reduction in the financing obligation at an implicit rate of 9.9%. The financing obligation is personally guaranteed up to a limit of $150,000 by the principal shareholder and Chief Executive Officer. (see note 10)

In connection with the financing obligation, the Company issued an aggregate of 400,000 warrants to purchase its common stock at $1.20 per share for five years. The 400,000 warrants were valued at $752,000 and reflected as a debt discount, using the Black Scholes option pricing model. The following assumptions were utilized in valuing the 400,000 warrants: strike price of $2.10 to $2.25; term of 5 years; volatility of 91.36% to 110.9%; expected dividends 0%; and discount rate of 2.15% to 2.20%. The 400,000 warrants were recorded as valuation discount and are being amortized over 15 years, the term of the purchase option. Amortization of valuation discount during the nine months ended September 30, 2014 and 2013 was $38,000 and $38,000, respectively.

Long term financing obligation is comprised of the following as of:

	September 30, 2014	December 31, 2013
Financing obligation	$2,703,000	$2,784,000
Valuation discount	(488,000)	(526,000)
	2,215,000	2,258,000
Less current portion	(128,000)	(111,000)
Long term financing obligation	$2,087,000	$2,147,000

7. Stockholders' Equity

Preferred Stock

On July 25, 2014, dividends were paid on the Series A Preferred stock in the amount of $5,000, by issuing 1,057 shares of common stock.

During the nine months ended September 30, 2013, the remaining 45,602 shares of Series B Convertible Preferred Stock were converted to 319,214 shares of common stock. Accrued dividends of $74,000 were paid by issuing 47,890 shares of common stock.

Common Stock

During the nine months ended September 30, 2014, the Company issued 2,299 shares of common stock for consulting services valued at $4.35 per share with an aggregate value of $10,000 for services rendered. During the nine months ended September 30, 2013, the Company issued 1,250 shares of common stock for services at $4.00 per share with a value of $5,000 for services rendered.

8. Stock Based Compensation

Stock Options

During the nine months ended September 30, 2014, the Company granted 477,500 stock options to various employees at the market price of $4.74 to $5.70 per share. The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. Assumptions used in valuing stock options granted during the nine months ended September 30, 2014 are as follows: (i) volatility rate of between 59.43% and 66.3%, (ii) discount rate of 0.73%, (iii) zero expected dividend yield, and (iv) expected term of 3.5 to 4.5 years based upon the average of the term of the option and the vesting period. The aggregate grant date fair value of the options granted during the nine months ended September 30, 2014, was approximately $765,000.

On June 5, 2014, the Company repriced 323,000 employee options to an exercise price of $4.60 per share, which were previously $4.74-$6.70 per share. The total increase in stock compensation expense, as a result of the repricing was approximately $4,000.

Total stock-based compensation recognized on the Company’s statement of operations for the nine months ended September 30, 2014 and 2013 was $307,000 and $257,000, respectively. Stock based compensation expense for the three months ended September 30, 2014 and 2013 was $90,000 and $69,000 respectively. As of September 30, 2014, the aggregate value of unvested options was $1,108,000 which will vest over an average period of three to four years. There were 204,634 stock options exercised in the nine months ended September 30, 2014 at exercise prices between $1.14 and $5.70 per share. The Company received $25,700 for 10,000 of such exercises and allowed cash-less exercise of 194,634 of such options, issuing 124,783 shares of common stock for a total of 134,783 shares issued relative to stock options in the nine months ended September 30, 2014.

Stock options granted under our equity incentive plans generally vest over 3 – 4 years from the date of grant, at 33% or 25% per year respectively and expire 5 years from the date of grant. The following table summarizes stock option activity for the nine months ended September 30, 2014:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2013	639,334	$ 1.84		
Granted	477,500	$ 5.06		
Exercised	(204,634)	$ 2.39		
Forfeited or expired	(195,367)	-		
Outstanding at September 30, 2014	716,833	$ 3.96	3.82	$1,397,000
Exercisable at September 30, 2014	198,123	$ 2.55	3.12	$679,000

The aggregate intrinsic value was calculated as the difference between the market price, which was $5.90, and the exercise price of the Company’s common stock as of September 30, 2014.

The following table summarizes information about stock options at September 30, 2014:

	Options Outstanding at September 30, 2014			Options Exercisable at September 30, 2014	
Range of Exercise Price	Number of Shares Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number of Shares Exercisable	Weighted Average Exercise Price
$0.01 - $1.99	107,833	2.22	$ 1.24	87,483	$ 1.22
$2.00 - $4.99	489,000	3.92	$ 4.27	110,640	$ 3.60
$5.00 - $5.99	120,000	4.82	$ 5.13	0	NA
	716,833			198,123	

Stock Warrants

During the nine months ended September 30, 2014, no warrants were granted or exercised. The following table summarizes stock warrant activity for the nine months ended September 30, 2014:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2013	101,963	$ 2.30		
Granted	-	-		
Exercised	-	-		
Forfeited or expired	-	-		
Outstanding at September 30, 2014	101,963	$ 2.30	.62	$ 367,000
Exercisable at September 30, 2014	101,963	$ 2.30	.62	$ 367,000

The intrinsic value was calculated as the difference between the market price, which was $5.90, and the exercise price of the Company’s common stock, as of September 30, 2014.

9. Income Taxes

For the three months ended September 30, 2014, net income was $48,000, and for the nine months ended September 30, 2014 net income was $466,000 and no income tax provision was recorded. For the three months ended September 30, 2013, net income was $34,000 and for the nine months ended September 30, 2013 net loss was ($863,000), and our provision for income taxes was zero. We made no provision for income taxes during periods of net income due to our utilization of federal net operating loss carryforwards to offset both regular taxable income and alternative minimum taxable income.

In accordance with Accounting Standards Codification (“ASC”) 740-10, *Income Taxes*, the Company evaluates its deferred tax assets to determine if a valuation allowance is required based on the consideration of all available evidence using a “more likely than not” standard, with significant weight being given to evidence that can be objectively verified. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability; the length of statutory carryover periods for operating losses and tax credit carryovers; and available tax planning alternatives. Our deferred tax assets are composed primarily of U.S. federal net operating loss carryforwards. Based on available objective evidence, management believes it is more likely than not that these deferred tax assets are not recognizable and will not be recognizable until its determined that we have sufficient taxable income. Under ASC 740-10, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. ASC 740-10 also provides guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods, and disclosures. As of September 30, 2014, the Company does not have a liability for unrecognized tax uncertainties.

10. Subsequent Events

Effective October 1, 2014, the Company executed Amendment #1 to the Long-term Financing Obligation (see Note 6). In exchange for a release from the $150,000 personal guarantee by the principal shareholder and Chief Executive Office, and a release of the brewery equipment which was collateral for the lease agreement, the Company issued 200,000 warrants to purchase it’s common stock for $5.60 per share for five years. The 200,000 warrants were valued at $584,000 using the Black Scholes option pricing model. The following assumptions were made in valuing the 200,000 warrants; term of 5 years, volatility of 59.53%, expected dividends 0% and discount rate of 2.19%. The warrants will be amortized over 5 years.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes appearing elsewhere in this report. This discussion and analysis may contain forward-looking statements based on assumptions about our future business.

Overview

The results for our third quarter of 2014 reflect continuing strong growth in sales volume among all of our products. Our net sales (see below) increased by 22% in the 2014 third quarter, as compared to 2013, and 17% for the nine month period as compared to 2013. The sales increases are led by our Culture Club Kombucha which was introduced in 2012 and Reed's and Virgil's branded product sales. We have decreased promotional spending in favor of national advertising including our first national cable television commercials and national magazine advertising which produce a good return on investment, in the form of increased market penetration and a higher floor of recurring business.

We have maintained a solid #2 position in national Kombucha sales. We believe that there is a strong opportunity to gain additional market share and expand this product line with existing and new customers. As we expand, we are improving our production techniques and we will add a coffee flavor in the fourth quarter of 2014 and will sell 9 Kombucha flavors.

Promotional and other allowances are handled as a direct reduction of sales, so decreasing the promotional spending has the effect of increasing our sales and gross margin percentage, as reflected in the nine month 2014 period as compared to 2013. Our direct cost of tangible goods sold is also decreasing, as production efficiencies are realized, as a percentage of gross sales, and Gross Profit improved from 29% of year to date sales in 2013 to 32% of year to date in 2014 sales.

We have placed a high focus on upgrading our Los Angeles plant equipment in 2014 and on increasing its capacity. Our plant production has increased by approximately 25% in 2014, and we anticipate further improvements in future quarters. In the fourth quarter of 2014 and during the first two quarters of 2015, the Company plans to purchase equipment which will require fewer employees and triple the production line speed. This project will improve production capacity and reduce labor costs. As a result Idle Plant Capacity will be significantly reduced and may be eliminated. The increased West Coast production will also result in lower freight costs since there will be fewer cross country deliveries from the East Coast to West Coast customers. We also have plans to reduce costs at our East Coast production facility.

The Company is discussing its options with financial organizations and expects to reduce its total borrowing costs by over 50% in 2015.

The Company EBITDA increased from $255,000 for the nine months ended September 2013 to $1,880,000 for the nine months ended September 30, 2014 which is a $1,625,000 (637%) improvement.

Results of Operations

The following table sets forth key statistics for the three and nine months ended September 30, 2014 and 2013, respectively.

	Three Months Ended September 30, 2014	2013	Pct. Change	Nine Months Ended September 30, 2014	2013	Pct. Change
Gross sales, net of discounts & returns *	13,590,000	11,501,000	18 %	36,036,000	31,290,000	15 %
Less: Promotional and other allowances**	1,271,000	1,425,000	-11 %	3,580,000	3,569,000	0.3 %
Net sales	12,319,000	10,076,000	22 %	32,456,000	27,721,000	17 %
Cost of tangible goods sold	8,010,000	6,399,000	25 %	20,616,000	18,028,000	14 %
As a percentage of:						
Gross sales	*59 %*	*56 %*		*57 %*	*58 %*	
Net sales	*65 %*	*64 %*		*64 %*	*65 %*	
Cost of goods sold – idle capacity	424,000	501,000	-15 %	1,346,000	1,525,000	-12 %
As a percentage of net sales	*3 %*	*5 %*		*4 %*	*6 %*	
Gross profit	3,885,000	3,176,000	22 %	10,494,000	8,168,000	28 %
Gross profit margin as a percentage of net sales	32 %	32 %		32 %	29 %	

** Gross sales is used internally by management as an indicator of and to monitor operating performance, including sales performance of particular products, salesperson performance, product growth or declines and overall Company performance. The use of gross sales allows evaluation of sales performance before the effect of any promotional items, which can mask certain performance issues. We therefore believe that the presentation of gross sales provides a useful measure of our operating performance. Gross sales is not a measure that is recognized under GAAP and should not be considered as an alternative to net sales, which is determined in accordance with GAAP, and should not be used alone as an indicator of operating performance in place of net sales. Additionally, gross sales may not be comparable to similarly titled measures used by other companies, as gross sales has been defined by our internal reporting practices. In addition, gross sales may not be realized in the form of cash receipts as promotional payments and allowances may be deducted from payments received from certain customers.*

*** Although the expenditures described in this line item are determined in accordance with GAAP and meet GAAP requirements, the disclosure thereof does not conform with GAAP presentation requirements. Additionally, our definition of promotional and other allowances may not be comparable to similar items presented by other companies. Promotional and other allowances primarily include consideration given to the Company's distributors or retail customers including, but not limited to the following: (i) reimbursements given to the Company's distributors for agreed portions of their promotional spend with retailers, including slotting, shelf space allowances and other fees for both new and existing products; (ii) the Company's agreed share of fees given to distributors and/or directly to retailers for in-store marketing and promotional activities; (iii) the Company's agreed share of slotting, shelf space allowances and other fees given directly to retailers; (iv) incentives given to the Company's distributors and/or retailers for achieving or exceeding certain predetermined sales goals; and (v) discounted or free products. The presentation of promotional and other allowances facilitates an evaluation of their impact on the determination of net sales and the spending levels incurred or correlated with such sales. Promotional and other allowances constitute a material portion of our marketing activities. The Company's promotional allowance programs with its numerous distributors and/or retailers are executed through separate agreements in the ordinary course of business. These agreements generally provide for one or more of the arrangements described above and are of varying durations, ranging from one week to one year.*

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Three months ended September 30, 2014 Compared to Three months ended September 30, 2013

Sales

Sales of $12,319,000 for the three months ended September 30, 2014 represented an increase of 22% from $10,076,000 over the prior year same period due a 18% in gross sales and an 11% decrease in promotional spending. Sales growth was driven primarily by a 16% increase in sales of our branded products, including Kombucha, as well as a 49% increase in private label product revenues. Kombucha sales began in the 2012 third quarter and have increased to become approximately 11% of our total net revenues.

Cost of Tangible Goods Sold

Cost of tangible goods sold consists of the costs of raw materials utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, inventory adjustments, as well as certain internal transfer costs. Our costs of tangible goods sold of $8,010,000 for the three months ended September 30, 2014 represents an increase of 25% from the same period in 2013. The increase is primarily due to the 22% increase in sales. Additionally, the costs of sales for Private Label sales are higher than our branded products and Kombucha.

Cost of Goods Sold – Idle Capacity

Cost of goods sold – idle capacity consists of direct production costs of our Los Angeles plant in excess of charges allocated to our finished goods in production. Plant costs include labor costs, production supplies, repairs and maintenance, and depreciation. Our charges for labor and overhead allocated to our finished goods are determined on a market cost basis, which is lower than our actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced. Idle capacity expenses decreased to $424,000 in the three months ended September 30, 2014, from $501,000 in 2013. The decrease is primarily due to cost controls and better production efficiencies and production unit increases so costs are spread over more units of production. As a percentage of sales, the idle capacity costs decreased to 3% in the 2014 nine month period, from 5% in 2013.

Gross Profit

Our gross profit of $3,885,000 in the three months ended September 30, 2014 represents an increase of $709,000, or 22% from 2013. The increase is primarily due to increased sales. As a percentage of sales, our gross profit was 32% in 2014 and 2013.

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Delivery and Handling Expenses

Delivery and handling expenses consist of delivery costs to customers and warehouse costs incurred for handling our finished goods after production. Delivery and handling costs increased by 26% to $1,310,000 in the three months ended September 30, 2014 compared to 2013 due to the 22% increase in net sales and higher costs. The $270,000 cost increase is primarily due to freight cost increases of $245,000 caused by a higher portion of our branded products being manufactured at our copacker in Pennsylvania for west coast customers, requiring additional freight costs for delivery. Also, we have offered delivery terms to some new significant customers.

Selling and marketing expenses

Selling and marketing expenses consist primarily of direct charges for staff compensation costs, advertising, sales promotion, national advertising, marketing and trade shows. Selling and marketing costs increased to $1,480,000 in the three months ended September 30, 2014 from $1,159,000 in 2013. The $321,000 increase (28%) was primarily due to an increase in national advertising spending of $407,000 for the company’s for national cable television commercials. Our sales staff included 21 members at September 30, 2014 and 18 at September 30, 2013.

General and Administrative Expenses

General and administrative expenses consist primarily of the cost of executive, administrative, and finance personnel, as well as professional fees. General and administrative expenses increased to $849,000 during the three months ended September 30, 2014 from $763,000 in the same period of 2013, an increase of $86,000 (11%). Insurance costs increased by $41,000 and utility costs increased by $36,000.

Income/Loss from Operations

Our income from operations was $246,000 in the three months ended September 30, 2014, as compared to $214,000 in the same period of 2013 which is a 15% increase. The increase is primarily due to the increase in gross profit contribution of $709,000, or 22%, in the 2014 third quarter as compared to 2013.

Interest Expense

Interest expense increased to $195,000 in the three months ended September 30, 2014, compared to interest expense of $180,000 in the same period of 2013. The increase is primarily due to increased borrowing on our revolving line of credit.

Modified EBITDA

The Company defines modified EBITDA (a non-GAAP measurement) as net loss before interest, taxes, depreciation and amortization, and non-cash expense for securities. Other companies may calculate modified EBITDA differently. Management believes that the presentation of modified EBITDA provides a measure of performance that approximates cash flow before interest expense, and is meaningful to investors.

MODIFIED EBITDA SCHEDULE

	Three Months Ended September 30,	
	2014	**2013**
Net income (loss)	$48,000	$34,000
Modified EBITDA adjustments:		
Depreciation and amortization	144,000	89,000
Interest expense	195,000	180,000
Stock option compensation	90,000	69,000
Other stock compensation for services	-	-
Total EBITDA adjustments	429,000	338,000
Modified EBITDA income from operations	$477,000	$372,000

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Nine months ended September 30, 2014 Compared to Nine months ended September 30, 2013

Sales

Sales of $32,456,000 for the nine months ended September 30, 2014 represented an increase of 17% from $27,721,000 in the prior year same period. Sales growth was driven primarily by a 27% increase in sales of our branded products. Kombucha sales began in the 2012 third quarter, increased by 51% for the nine months ended September 30, 2014 over the nine months ended September 30, 2013 and have increased to become approximately 13% of our total net revenues.

Cost of Tangible Goods Sold

Cost of tangible goods sold consists of the costs of raw materials utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, inventory adjustments, as well as certain internal transfer costs. Our costs of tangible goods sold of $20,616,000 for the nine months ended September 30, 2014 represents an increase of 14% from the same period in 2013. The increase was primarily due to net revenue increases of 17%. During the 2013 second fiscal quarter, a one-time loss on a private label contract of $412,000 was recorded.

Cost of Goods Sold – Idle Capacity

Cost of goods sold – idle capacity consists of direct production costs of our Los Angeles plant in excess of charges allocated to our finished goods in production. Plant costs include labor costs, production supplies, and repairs and maintenance. Our charges for labor and overhead allocated to our finished goods are determined on a market cost basis, which is lower than our actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced. Idle capacity expenses decreased to $1,346,000 in the nine months ended September 30, 2014, from $1,525,000 in 2013. The 12% decrease was primarily due to production efficiencies in the third quarter. Our Kombucha production runs have become much more efficient during our third fiscal quarter and we anticipate additional reductions in our cost of goods sold – idle capacity in the future.

Gross Profit

Our gross profit of $10,494,000 in the nine months ended September 30, 2014 represents an increase of $2,326,000, or 28% over 2013. As a percentage of sales, our gross profit increased to 32% in 2014 as compared to 29% in 2013. As discussed above, our 2013 gross profit was negatively impacted by a loss of $412,000 on a private label contract. The gross profit percentage increase is also impacted by a decrease in promotional discount costs. Since such costs are a deduction from sales, the gross margin percentage is positively impacted by decreased promotional costs. We have reduced the initial substantial discounts on our Kombucha, as we expand this product line into new distribution channels and customers, and have also decreased promotional programs for other branded products. We believe that our promotional investments are an effective way to increase sales growth.

Delivery and Handling Expenses

Delivery and handling expenses consist of delivery costs to customers and warehouse costs incurred for handling our finished goods after production. Delivery and handling costs increased by 8% to $3,131,000 in the nine months ended September 30, 2014 compared to 2013. The $231,000 increase is primarily due to freight cost increases of $240,000. The freight cost increases are primarily due to a higher portion of our branded products being manufactured at our copacker in Pennsylvania for west coast customers, requiring additional freight costs for delivery. Also, we have offered delivery terms to several new significant customers.

Selling and marketing expenses

Selling and marketing expenses consist primarily of direct charges for staff compensation costs, advertising, sales promotion, marketing and trade shows. Selling and marketing costs increased overall to $3,604,000 in the nine months ended September 30, 2014 from $2,999,000 in 2013. The $605,000 increase is primarily due to increased advertising costs of $407,000 for the first national cable television commercials, increased compensation of $50,000, other advertising of $47,000 and increased stock option expense of $27,000. Our sales staff was 21 members at September 30, 2014 and 18 at September 30, 2013.

General and Administrative Expenses

General and administrative expenses consist primarily of the cost of executive, administrative, and finance personnel, as well as professional fees. General and administrative expenses increased to $2,730,000 during the nine months ended September 30, 2014 from $2,663,000 in the same period of 2013, in increase of $67,000 (3%). Compensation costs decreased by $96,000 due to management reductions, stock option expense increased by $54,000, and utilities increased $81,000.

Income/Loss from Operations

Our income from operations was $1,029,000 in the nine months ended September 30, 2014, as compared to a loss of $394,000 in the same 2013 period. The 2013 loss was primarily due to the $412,000 loss on a private label contract in the second quarter.

Interest Expense

Interest expense increased to $560,000 in the nine months ended September 30, 2014, compared to interest expense of $469,000 in the same period of 2013. The decrease is primarily due to a reversal of over-accrued interest on a long-term liability, as determined when the liability was paid in full.

Modified EBITDA

The Company defines modified EBITDA (a non-GAAP measurement) as net loss before interest, taxes, depreciation and amortization, and non-cash expense for securities. Other companies may calculate modified EBITDA differently. Management believes that the presentation of modified EBITDA provides a measure of performance that approximates cash flow before interest expense, and is meaningful to investors.

MODIFIED EBITDA SCHEDULE

	Nine Months Ended September 30,	
	2014	**2013**
Net (loss) income	$466,000	$(863,000)
Modified EBITDA adjustments:		
Depreciation and amortization	536,000	387,000
Interest expense	560,000	469,000
Stock option compensation	308,000	257,000
Other stock compensation for services	10,000	5,000
Total EBITDA adjustments	1,414,000	1,118,000
Modified EBITDA income from operations	$1,880,000	$255,000

Liquidity and Capital Resources

As of September 30, 2014, we had stockholders equity of $4,197,000 (24% increase) and working capital of $1,999,000 (48% increase), compared to stockholders equity of $3,387,000 and working capital of $1,347,000 at December 31, 2013. The increase in our working capital of $652,000 was primarily a result of net income for the nine month period.

Our increase in cash and cash equivalents to $1,705,000 at September 30, 2014 compared to $1,104,000 at December 31, 2013, an increase of $601,000, was primarily a result of cash generated by operating activities of $1,557,000, less purchases of property and equipment to improve plant production, less net debt and long term liability payments of $601,000. In addition to our cash position on September 30, 2014, the Company had availability under our line of credit of approximately $236,000.

Our Loan and Security Agreement with PMC Financial Services Group, LLC provides a $4.5 million revolving line of credit and a $750,000 term loan. The revolving line of credit is based on 85% of eligible accounts receivable and 50% of eligible inventory. The interest rate on the revolving line of credit is at the prime rate plus 3.75% (7% at September 30, 2014). The term loan is for $750,000 and bears interest at the prime rate plus 11.6%, which shall not be below 14.85%, is secured by all of the unencumbered assets of the Company, and is to be repaid in 48 equal installments of principal and interest of $21,000. On May 1, 2013 the term loan was increased back to the original balance of $750,000 under the same terms as the existing term loan. The Company was granted an over advance on its revolving line of credit of $500,000 and a temporary increase in the line amount to $4,800,000 through December 31, 2014. At September 30, 2013, our term loan balance was $684,000.

We believe that the Company currently has the necessary working capital to support existing operations for at least the next 12 months. Our primary capital source will be positive cash flow from operations. If our sales goals do not materialize as planned, we believe that the Company can reduce its operating costs and can be managed to maintain positive cash flow from operations. Historically, we have financed our operations primarily through private sales of common stock, preferred stock, convertible debt, a line of credit from a financial institution and cash generated from operations.

We may not generate sufficient revenues from product sales in the future to achieve profitable operations. If we are not able to achieve profitable operations at some point in the future, we eventually may have insufficient working capital to maintain our operations as we presently intend to conduct them or to fund our expansion and marketing and product development plans. In addition, the Company may have losses in the future as we expand our manufacturing capabilities and fund our marketing plans and product development. These losses, among other things, have had and may continue to have an adverse effect on our working capital, total assets and stockholders' equity. If we are unable to achieve profitability, the market value of our common stock would decline and there would be a material adverse effect on our financial condition.

If we suffer losses from operations, our working capital may be insufficient to support our ability to expand our business operations as rapidly as we would deem necessary at any time, unless we are able to obtain additional financing. There can be no assurance that we will be able to obtain such financing on acceptable terms, or at all. If adequate funds are not available or are not available on acceptable terms, we may not be able to pursue our business objectives and would be required to reduce our level of operations, including reducing infrastructure, promotions, personnel and other operating expenses. These events could adversely affect our business, results of operations and financial condition. 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.

Critical Accounting Policies and Estimates

Our 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 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:

Revenue Recognition. Revenue is recognized on the sale of a product when the product is shipped, which is when the risk of loss transfers to our customers, and collection of the receivable is reasonably assured. A product is not shipped without an order from the customer and credit acceptance procedures performed. The allowance for returns is regularly reviewed and adjusted by management based on historical trends of returned items. Amounts paid by customers for shipping and handling costs are included in sales. The Company reimburses its wholesalers and retailers for promotional discounts, samples and certain advertising and promotional activities used in the promotion of the Company’s products. The accounting treatment for the reimbursements for samples and discounts to wholesalers results in a reduction in the net revenue line item. Reimbursements to wholesalers and retailers for certain advertising activities are included in selling and marketing expenses.

Long-Lived Assets and Impairment. 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 three months ended September 30, 2014.

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 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 we expect they will 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.

Accounts Receivable. We evaluate the collectability 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.

Stock-Based Compensation. We periodically issue stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on FASB ASC Topic 718 "Compensation – Stock Compensation", whereas the award is measured at its fair value at the date of grant and is amortized ratably over the vesting period. We account for stock option and warrant grants issued and vesting to non-employees in accordance with FASB ASC Topic 505 "Equity" whereby the fair value of the stock compensation is based on the measurement date as determined at either (a) the date at which a performance commitment is reached, or (b) at the date at which the necessary performance to earn the equity instrument is complete.

We estimate the fair value of stock options using the Black-Scholes option-pricing model, which was developed for use in estimating the fair value of options that have no vesting restrictions and are fully transferable. This model requires the input of subjective assumptions, including the expected price volatility of the underlying stock and the expected life of stock options. Projected data related to the expected volatility of stock options is based on the historical volatility of the trading prices of the Company's common stock and the expected life of stock options is based upon the average term and vesting schedules of the options. Changes in these subjective assumptions can materially affect the fair value of the estimate, and therefore the existing valuation models do not provide a precise measure of the fair value of our employee stock options.

We believe there have been no significant changes, during the three month period ended September 30, 2014, to the items disclosed as critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09 (ASU 2014-09), *Revenue from Contracts with Customers.* ASU 2014-09 will eliminate transaction- and industry-specific revenue recognition guidance under current U.S. GAAP and replace it with a principle based approach for determining revenue recognition. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. The ASU also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for reporting periods beginning after December 15, 2016, and early adoption is not permitted. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. Management is currently assessing the impact the adoption of ASU 2014-09 and has not determined the effect of the standard on our ongoing financial reporting.

In April 2014, the FASB issued Accounting Standards Update No. 2014-08 (ASU 2014-08), *Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360).* ASU 2014-08 amends the requirements for reporting discontinued operations and requires additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations or that have a major effect on the Company’s operations and financial results should be presented as discontinued operations. This new accounting guidance is effective for annual periods beginning after December 15, 2014. The Company is currently evaluating the impact of adopting ASU 2014-08 on the Company’s results of operations or financial condition.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15 (ASU 2014-15), *Presentation of Financial Statements - Going Concern (Subtopic 205-10).* ASU 2014-15 provides guidance as to management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued when applicable). Substantial doubt about an entity's ability to continue as a going concern exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued). ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company is currently evaluating the impact the adoption of ASU 2014-15 on the Company's financial statement presentation and disclosures.

There were recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the Securities Exchange Commission (the “SEC”), however such pronouncements are not believed by management to have a material impact on the Company’s present or future financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

A smaller reporting company is not required to provide the information required by this Item.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Interim Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Securities and Exchange Act of 1934 Rules 13a-15(f). Based on this evaluation, our Chief Executive Officer and our Interim Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of September 30, 2014.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company’s internal control over financial reporting during the three months ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various legal proceedings from time to time in the ordinary course of business, none of which are required to be disclosed under this Item 1.

Item 1A. Risk Factors

A smaller reporting company is not required to provide the information required by this Item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

As consideration for Amendment #1 to the Company's lease with 525 South Douglas Street, LLC ("Lessor") dated May 7, 2009, which amendment was effective as of October 1, 2015, the Company issued 200,000 warrants to purchase shares of its common stock to the Lessor at an exercise price of $5.60 per share for five years, valued at $584,000. These warrants are exempt from registration under the Securities Act of 1933 pursuant to section 4(2) on the basis that the recipient has a pre-existing relationship with the Company and there was no public offering.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

On November 8, 2014, the Company entered into Amendment No. 8 to its Loan and Security Agreement with PMC Financial Services Group, LLC dated November 8,2011 pursuant to which the original maturity date of November 7, 2014 and $500,000 over-advance were extended to December 31, 2014.

On November 1, 2014, pursuant to its Master Lease Agreement with PMC Financial Services Group, LLC dated July 11, 2013, the Company financed $493,506 of brewery equipment through a 60 month lease with buyout option at fair market value.

Effective October 1, 2014, the Company entered into Amendment # 1 to its lease with 525 South Douglas Street, LLC ("Lessor"), which lease was originally dated May 7, 2009. The Company exercised its option to release the brewery equipment which was collateral for the lease. As payment, the Company issued 200,000 warrants to purchase shares of its common stock to the Lessor at an exercise price of $5.60 per share for five years. As part of the transaction, the Lessor released the principal shareholder and Chief Executive Officer from his $150,000 personal guarantee of the lease.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*

*filed herewith

In accordance with SEC Release 33-8238, Exhibits 32.1 and 32.2 are being furnished and not filed.

Furnished herewith, XBRL (Extensive Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Reed's, Inc. (Registrant)
Date: November 13, 2014	*/s/ Christopher J. Reed* Christopher J. Reed President and Chief Executive Officer (Principal Executive Officer)
Date: November 13, 2014	*/s/ Lawrence W. Tomsic* Lawrence W. Tomsic Interim Chief Financial Officer (Principal Financial Officer)

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