

REED'S, INC.  
Form 10-Q  
May 15, 2017

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended March 31, 2017

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE 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  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  No

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

Large Accelerated Filer       Accelerated Filer       Non-Accelerated Filer  
(do not check if Smaller Reporting Company)   
Smaller Reporting Company  Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Edgar Filing: REED'S, INC. - Form 10-Q

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 13,982,230 shares of Common Stock outstanding as of May 10, 2017.

*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.*

**TABLE OF CONTENTS**

**PART I - FINANCIAL INFORMATION**

<u>Item 1. Condensed Financial Statements</u>	F-1
<u>Condensed Balance Sheets - March 31, 2017 (unaudited) and December 31, 2016</u>	F-1
<u>Condensed Statements of Operations for the three month periods ended March 31, 2017 and 2016 (unaudited)</u>	F-2
<u>Condensed Statement of Changes in Stockholders' Deficiency for the three month period ended March 31, 2017 (unaudited)</u>	F-3
<u>Condensed Statements of Cash Flows for the three month periods ended March 31, 2017 and 2016 (unaudited)</u>	F-4
<u>Notes to Condensed Financial Statements (unaudited)</u>	F-5
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	4
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	10
<u>Item 4. Controls and Procedures</u>	10
<b><u>PART II - OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings</u>	11
<u>Item 1A. Risk Factors</u>	11
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	11
<u>Item 3. Defaults Upon Senior Securities</u>	11
<u>Item 4. Mine Safety Disclosures</u>	11
<u>Item 5. Other Information</u>	11
<u>Item 6. Exhibits</u>	11

**Part I – FINANCIAL INFORMATION****Item 1. Financial Statements****REED'S INC. CONDENSED BALANCE SHEETS**

	March 31, 2017 (Unaudited)	December 31, 2016
<b>ASSETS</b>		
Current assets:		
Cash	\$ 197,000	\$ 451,000
Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of \$282,000 and \$256,000, respectively	2,414,000	2,485,000
Inventory, net of reserve for obsolescence of \$165,000 and \$115,000, respectively	5,516,000	6,885,000
Prepaid and other current assets	377,000	500,000
Total Current Assets	8,504,000	10,321,000
Property and equipment, net of accumulated depreciation of \$4,984,000 and \$4,719,000, respectively	7,934,000	7,726,000
Brand names	805,000	805,000
Total assets	\$ 17,243,000	\$ 18,852,000
<b>LIABILITIES AND STOCKHOLDER'S DEFICIENCY</b>		
Current liabilities:		
Accounts payable	\$ 6,617,000	\$ 5,959,000
Accrued expenses	191,000	215,000
Advances from officers	380,000	-
Line of credit	3,530,000	4,384,000
Current portion of long term financing obligations	197,000	190,000
Current portion of capital leases payable	187,000	183,000
Current portion of bank notes	953,000	953,000
Total current liabilities	12,055,000	11,884,000
Other long term liabilities		
Other liabilities	129,000	130,000
Long term financing obligation, less current portion, net of discount of \$797,000 and \$825,000, respectively	1,337,000	1,363,000
Capital leases payable, less current portion	389,000	438,000
Bank notes, net of discount \$32,000 and \$78,000, respectively	6,077,000	5,919,000
Warrant liability	766,000	775,000
Total Liabilities	20,753,000	20,509,000
Stockholders' Deficiency		

Edgar Filing: REED'S, INC. - Form 10-Q

Series A Convertible Preferred stock, \$10 par value, 500,000 shares authorized, 9,411 shares issued and outstanding	94,000	94,000
Common stock, \$.0001 par value, 19,500,000 shares authorized, 13,982,230 outstanding	1,000	1,000
Additional paid in capital	30,111,000	29,971,000
Accumulated deficit	(33,716,000)	(31,723,000)
Total stockholders' deficiency	(3,510,000 )	(1,657,000 )
Total liabilities and stockholders' deficiency	\$17,243,000	\$18,852,000

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

F-1

**REED'S, INC.****CONDENSED STATEMENTS OF OPERATIONS****For the Three Months Ended March 31, 2017 and 2016****(Unaudited)**

	2017	2016
Net sales	\$8,295,000	\$10,004,000
Cost of goods sold	7,239,000	8,111,000
Gross profit	1,056,000	1,893,000
Operating expenses:		
Delivery and handling expenses	743,000	849,000
Selling and marketing expense	788,000	1,041,000
General and administrative expense	1,111,000	1,205,000
Total operating expenses	2,642,000	3,095,000
Loss from operations	(1,586,000 )	(1,202,000 )
Interest expense	(416,000 )	(378,000 )
Change in fair value of warrant liability	9,000	
Net loss attributable to common stockholders	\$(1,993,000 )	\$(1,580,000 )
Loss per share – basic and diluted	\$(0.14 )	\$(0.12 )
Weighted average number of shares outstanding – basic and diluted	13,982,230	13,184,000

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



**REED'S, INC.****CONDENSED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIENCY****For the Three Months Ended March 31, 2017****(Unaudited)**

	Common Stock		Preferred Stock		Additional Paid In Capital	Accumulated Deficit	Total Shareholder Deficiency
	Shares	Amount	Shares	Amount			
Balance, December 31, 2016	13,982,230	\$ 1,000	9,411	\$94,000	\$29,971,000	\$(31,723,000)	\$(1,657,000)
Fair value of vesting of options to employees and directors					140,000		140,000
Net Loss						(1,993,000)	(1,993,000)
Balance, March 31, 2017	13,982,230	\$ 1,000	9,411	\$94,000	\$30,111,000	\$(33,716,000)	\$(3,510,000)

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

**REED'S, INC.****CONDENSED STATEMENTS OF CASH FLOWS****For the Three Months Ended March 31, 2017 and 2016****(Unaudited)**

	3/31/2017	3/31/2016
Cash flows from operating activities:		
Net loss	\$(1,993,000)	\$(1,580,000)
Adjustments to reconcile net loss to net cash provided (used) in operating activities:		
Depreciation and amortization	194,000	261,000
Fair value of vested stock options issued to employees and directors	140,000	169,000
Increase (decrease) in allowance for doubtful accounts	26,000	(93,000 )
Increase in reserve for inventory	50,000	
Change in fair value of warrant liability	(9,000 )	
Changes in operating assets and liabilities:		
Accounts receivable	45,000	313,000
Inventory	1,319,000	(415,000 )
Prepaid expenses and other assets	124,000	312,000
Accounts payable	656,000	263,000
Accrued expenses	6,000	15,000
Payment of other long term obligations	(31,000 )	0
Net cash provided (used) by operating activities	527,000	(755,000 )
Cash flows from investing activities:		
Purchase of property and equipment	(41,000 )	(186,000 )
Net cash used in investing activities	(41,000 )	(186,000 )
Cash flows from financing activities:		
Advances from officers	380,000	0
Proceeds from stock option and warrant exercises	-	45,000
Principal payments on capital expansion loan	(177,000 )	
Principal repayments on long term financial obligation	(44,000 )	(37,000 )
Principal repayments on capital lease obligation	(45,000 )	(42,000 )
Net repayments on existing line of credit	(854,000 )	(193,000 )
Net cash used in financing activities	(740,000 )	(227,000 )
Net decrease in cash	(254,000 )	(1,168,000)
Cash at beginning of period	451,000	1,816,000
Cash at end of period	\$197,000	\$648,000
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$400,000	\$364,000
Non Cash Investing and Financing Activities		
Property and equipment acquired through capital expansion loan	\$288,000	\$354,000
Property and equipment acquired through capital lease obligations	-	86,000

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

F-4

**REED'S, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**Three Months Ended March 31, 2017 and 2016 (Unaudited)**

**1. Basis of Presentation and Liquidity**

The accompanying interim condensed financial statements are unaudited, but in the opinion of management of Reed's, Inc. (the "Company"), contain all adjustments, which include normal recurring adjustments necessary to present fairly the financial position at March 31, 2017 and the results of operations and cash flows for the three months ended March 31, 2017 and 2016. The balance sheet as of December 31, 2016 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 April 24, 2017.

The results of operations for the three months ended March 31, 2017 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2017.

**Liquidity**

The accompanying financial statements have been prepared under the assumption that the Company will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. For the three months ended March 31, 2017 the Company recorded a net loss of \$1,993,000 and provided cash from operations of \$527,000. As of March 31, 2017, we had a stockholder's deficit of \$3,510,000 and working capital deficit of \$3,551,000 compared to stockholder's deficit of \$1,657,000 and working capital deficit of \$1,565,000 at December 31, 2016.

As of March 31, 2017, the Company had a cash balance of \$197,000 and had available borrowing on our existing line of credit of \$191,000. On April 21, 2017, the Company issued a convertible note resulting in net proceeds of \$3,240,000. Furthermore, during the year ended December 31, 2016, we were able to extend the maturity date of our operating line of credit and our other bank loans through October 2018.

We believe that the Company currently has the necessary working capital to support existing operations until the PMC loans mature on October 1, 2018. Consistent with past refinancing practices regarding the Line of Credit, the Company believes that we will be successful in renewing the debt for another time frame similar to the past. There are no assurances that this refinancing will be completed. We anticipate that our primary capital source will be positive cash flow from operations. If our sales goals do not materialize as planned, or we do not accomplish cost reductions in cost of goods sold 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 will continue to 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, our losses may increase 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.

## 2. Significant Accounting Policies

### 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.

The Company had potentially dilutive securities that consisted of:

	March 31,	
	2017	2016
Warrants	803,909	325,000
Series A Preferred Stock	37,644	37,644
Options	1,026,834	965,000
Total	1,868,387	1,327,644

## Use of estimates

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 and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Those estimates and assumptions include estimates for reserves of uncollectible accounts, inventory obsolescence, depreciable lives of property and equipment, analysis of impairments of recorded intangibles, accruals for potential liabilities and assumptions made in valuing stock instruments issued for services.

## Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. ASU 2014-09 is a comprehensive revenue recognition standard that will supersede nearly all existing revenue recognition guidance under current U.S. GAAP and replace it with a principle based approach for determining revenue recognition. Under ASU 2014-09, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The FASB has recently issued ASU 2016-08, ASU 2016-10, ASU 2016-11, ASU 2016-12, and ASU 2016-20 all of which clarify certain implementation guidance within ASU 2014-09. ASU 2014-09 is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted only in annual reporting periods beginning after December 15, 2016, including interim periods therein. The standard can be adopted either retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the cumulative catch-up transition method). The Company is currently in the process of analyzing the information necessary to determine the impact of adopting this new guidance on its financial position, results of operations, and cash flows. The Company will adopt the provisions of this statement in the first quarter of fiscal 2018.

In February 2016, the FASB issued ASU No. 2016-02, Leases. ASU 2016-02 requires a lessee to record a right of use asset and a corresponding lease liability on the balance sheet for all leases with terms longer than 12 months. ASU 2016-02 is effective for all interim and annual reporting periods beginning after December 15, 2018. Early adoption is permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest period presented in the financial statements. The Company is currently evaluating the expected impact that the standard could have on its financial statements and related disclosures.

Other recent accounting pronouncements issued by the FASB, including its Emerging Issues Task Force, the American Institute of Certified Public Accountants, and the Securities and Exchange Commission did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

F-7



## Concentrations

During the three months ended March 31, 2017, the Company had one customer that accounted for 21% of gross sales. During the months ended March 31, 2016, the company had two customers that accounted for 25% and 10% of sales respectively. As of March 31, 2017, the Company had accounts receivable due from one customer who comprised 23% of its total accounts receivable and as of December 31, 2016 the Company had accounts receivable due from two customers who comprised 23% and 11% of its total accounts receivable. No other customer exceeded 10% of either sales or accounts receivable for the months ended March 31, 2017.

During the three months ended March 31, 2017, the Company had one vendor which accounted for approximately 18% of all purchases, and in the three months ended March 31, 2016 one vendor who accounted for approximately 17% of all purchases. No other vendor accounted for more than 10% of all purchases in either period. As of March 31, 2017, the Company had two vendors which accounted for approximately 10% each of the total accounts payable and as of December 31, 2016, the Company had two vendors which accounted for approximately 20% and 10% of total accounts payable.

## 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 carrying amounts of financial assets and liabilities, such as cash and cash equivalents, accounts receivable, short-term bank loans, accounts payable, notes payable and other payables, approximate their fair values because of the short maturity of these instruments. The carrying values of capital lease obligations and long-term financing obligations approximate their fair values due to the fact that the interest rates on these obligations are based on prevailing market interest rates.

As of March 31, 2017 and December 31, 2016, the Company's balance sheets included the fair value of derivative liabilities of \$766,000 and \$775,000 respectively, which were based on Level 2 measurements.

### 3. Inventory

Inventory is valued at the lower of cost (first-in, first-out or market) and, net of reserves, is comprised of the following as of:

	March 31, 2017	December 31, 2016
Raw Materials and Packaging	\$3,660,000	\$3,874,000
Finished Goods	1,856,000	3,011,000
	\$5,516,000	\$6,885,000

### 4. Property and Equipment

Property and equipment are comprised of the following as of:

	March 31, 2017	December 31, 2016
Land	\$1,107,000	\$1,107,000
Building	1,875,000	1,875,000
Vehicles	651,000	666,000
Machinery and equipment	3,686,000	3,686,000
Equipment under capital leases	226,000	226,000
Office equipment	480,000	475,000
Construction In Progress	4,893,000	4,554,000
	12,918,000	12,589,000
Accumulated depreciation	(4,984,000 )	(4,863,000 )
	\$7,934,000	\$7,726,000

Depreciation expense for the three months ended March 31, 2017 and 2016 was \$121,000 and \$200,000, respectively.

## 5. Intangible Assets and Impairment Policy

Intangible assets are comprised of indefinite-lived brand names acquired and have been assigned an indefinite life as we currently anticipate that these brand names will contribute cash flows to the Company perpetually. These indefinite-lived intangible assets are not amortized, but are assessed for impairment annually and evaluated annually to determine whether the indefinite useful life is appropriate. As part of our impairment test, we first assess qualitative factors to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. If further testing is necessary, we compare the estimated fair value of our indefinite-lived intangible asset with its book value. If the carrying amount of the indefinite-lived intangible asset exceeds its fair value, as determined by its discounted cash flows, an impairment loss is recognized in an amount equal to that excess. Based on management's measurement, there were no indications of impairment at March 31, 2017.

	March 31, 2017	December 31, 2016
Virgil's	\$576,000	\$576,000
Sonoma Sparkler	229,000	229,000
Brand names	\$805,000	\$805,000

## 6. Advances from Officers

During the period ended March 31, 2017, Chris Reed (the former CEO) and Daniel Miles (CFO) advanced working capital funds of \$260,000 and \$120,000 respectively to the Company for working capital uses. As of March 31, 2017, the aggregate amount advanced totaled \$380,000. Chris Reed was repaid \$141,000 in April 2017 and the remainder for both Chris Reed and Daniel Miles will be repaid by the end of this year.

## 7. Notes Payable

The Company has a Loan and Security Agreement with PMC Financial Services Group, LLC (PMC) that provides a \$6,000,000 revolving line of credit, a \$3,000,000 term loan, and a Capital Expansion loan up to \$4,700,000. The loans are secured by substantially all the assets of the Company and become due on October 1, 2018. The notes are as follows:

### Revolving Line of Credit

The agreement provides a \$6,000,000 revolving line of credit. At March 31, 2017 and December 31, 2016, the aggregate amount outstanding under the line of credit was \$3,530,000 and \$4,384,000, respectively.

The interest rate on the Revolving Loan was the prime rate plus .35% but was modified on December 7, 2016, such that the rate charge will be calculated on a sliding scale based on the trailing 6 month Earnings Before Interest Taxes and Depreciation ("EBITDA"). If the EBITDA measuring point stays below \$1,000,000 where it is now, the rate will rise to 12% from the current rate of 9%. If EBITDA rises to \$1,500,000 then the rate will be reduced to 9%. As of March 31, 2017, our effective rate under the revolving line was 9.5%. The monthly management fee is .45% of the average monthly loan balance.

The revolving line of credit is based on 85% of accounts receivable and 60% of eligible inventory and is secured by substantially all of the Company's assets. As of March 31, 2017, the Company had \$192,000 borrowing availability under the line of credit agreement.

The line of credit matures on October 21, 2018 and is subject to a 1% prepayment penalty for prepayment prior to the first anniversary of the effective date.

Bank Notes

Bank notes consist of the following as of March 31, 2017 and December 31, 2016:

	March 31, 2017	December 31, 2016
(A) Term Loans	\$3,000,000	\$3,000,000
(B) Capex loan	4,062,000	3,950,000
(C) Valuation discount	(32,000 )	(78,000 )
Net	7,030,000	6,872,000
Current portion	(953,000 )	(953,000 )
Long term portion	\$6,077,000	\$5,919,000

(A) Term Loans

In connection with the Loan and Security Agreement with PMC, the Company entered into two Term Loans of \$1,500,000 each, for an aggregate borrowing of \$3,000,000. The term loans are secured by all of the unencumbered assets of the Company and are due on October 1, 2018. The annual interest rate on the first loan was prime plus 5.75% (currently 9.5%), and the rate on the second loan was prime plus 11.60% (currently 14.85%) but was modified on December 7, 2016 such that the new rate will be based on the trailing 6 month EBITDA. If the EBITDA measuring point stays below \$1,000,000 where it is now, the rate will rise to 12% from the current rate of 9%. If EBITDA rises to \$1,500,000 then the rate will be reduced to 9%. As of March 31, 2017, and December 31, 2016, the amount outstanding was \$3,000,000 and \$3,000,000 respectively.

(B) Capital Expansion ("CAPEX") Loan

In connection with the Loan and Security Agreement with PMC, the Company entered into a Capital expansion loan which, after amendment allows a total borrowing of \$4,700,000. The loans are secured by all of the property and equipment purchased under the loan. The interest rate on the CAPEX loan is the prime rate plus 5.75% (9.5% at March 31, 2017). Interest only is payable on CAPEX Loans through January 31, 2017, at which time principal and interest will be aggregated and repaid in equal monthly payments of principal and interest based on 48 month amortization. Currently and until the second tranche has been closed, the estimated amount that will become due in a the next twelve months is \$953,000. At March 31, 2017 and December 31, 2016, the balance on the CAPEX loan balance was \$4,062,000 and \$3,950,000 respectively, and as of March 31, 2017 and December 31, 2016, the Company

had future borrowing availability of \$638,000 and \$750,000, respectively.

In addition, Reed's agreed to pre-pay the CAPEX Loan by at least \$300,000 from the proceeds of the sale of idle equipment, if such sale were to occur.

In conjunction with this loan the Company placed equipment with a cost of \$250,000 at a co-packing facility to enable the co-packer to manufacture our products. Should the Company be unable to secure access to the equipment in the event of failure of the co-packer, the amount will become due and payable by the Company immediately.

F-10

(C) Issuance of Warrants upon Amendments

On November 9, 2015, as part of restructuring of the Term Loans with PMC, the Company granted PMC 125,000 warrants at an exercise price of \$4.50 per share for five years and six months. The 125,000 warrants were valued at \$141,000 using the Black Scholes Merton option pricing model and were recorded as a valuation discount. The following assumptions were made in valuing the 125,000 warrants; term of 5.5 years, volatility of 56.04%, expected dividends 0% and discount rate of 0.68%. The value of the warrants of \$141,000 was recorded as a valuation discount and is being amortized over the remaining 16 months of the term loans.

On May 13, 2016, as part of a further restructuring of the loans with PMC, the Company granted PMC 50,000 warrants at an exercise price of \$4.50 per share with a term of five years and six months. The 50,000 warrants were valued at \$38,000 using the Black Scholes Merton option pricing model and were recorded as a valuation discount. The following assumptions were made in valuing the 50,000 warrants; term of 5.5 years, volatility of 54.17%, expected dividends of 0% and discount rate of 1.49%. The value of the warrants of \$38,000 was recorded as a valuation discount and is being amortized over the remaining term of the loans.

On December 7, 2016, the Company agreed to reprice the exercise price of 50,000 common stock purchase warrants granted under Amendment Twelve from \$4.50 to \$4.10 and to reprice the exercise price of 125,000 common stock purchase warrants granted under Amendment Ten from \$5.01 to \$4.10. The following assumptions were made in repricing the warrants; term of 3.5 years, volatility of 49.52%, expected dividends 0% and discount rate of 0.74%. The incremental value of the warrants before and after the modification of \$38,000 will be amortized over the remaining 24 months of the term loans. Reed's also agreed to pay a one-time fee of \$35,000.

During the quarter ended March 31, 2017 and the year ended December 31, 2016 the amortization of the discount was \$46,000 and \$130,000 respectively, and the unamortized discount was \$32,000 and \$78,000 as of March 31, 2017 and December 31, 2016 respectively.

(D) Interest Rates

Notwithstanding the other borrowing terms above, if Excess Borrowing Availability under the \$6 million Revolving line of credit remains more than \$1,500,000 at all times during the preceding month (currently Reed's Borrowing Availability is zero) the additional interest rate for all loans will be eliminated. The following chart summarizes the loans as of March 31, 2017,

Description	Base Interest	Increase in	Original rate	Additional Interest	Current rate
-------------	---------------	-------------	---------------	---------------------	--------------

	Rate		Prime						
Term A	9.00	%	0.50	%	9.50	%	3.00	%	12.50 %
Term B	11.60	%	0.50	%	12.10	%	3.00	%	15.10 %
Line of Credit (Prime Plus)	0.35	%	3.75	%	4.10	%	3.00	%	7.10 %
Capital Loans	9.00	%	0.50	%	9.50	%	3.00	%	12.50 %

## 8. Obligations under Capital Leases

The Company leases equipment for its brewery operations with an aggregate value of \$944,000 under six non-cancelable capital leases. Monthly payments range from \$341 to \$10,441 per month, including interest, at interest rates ranging from 6.51% to 17.31% per annum. At March 31, 2017, monthly payments under these leases aggregated \$19,000. The leases expire at various dates through 2020.

Future minimum lease payments under capital leases are as follows:

Years Ending March 31,	
2017	\$230,000
2018	228,000
2019	155,000
2020	48,000
2021	1,000
Total payments	\$662,000
Less: Amount representing interest	(86,000 )
Present value of net minimum lease payments	\$576,000
Less: Current portion	(187,000)
Non-current portion	\$389,000



**9. Long-term Financing Obligation**

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

	March 31, 2017	December 31, 2016
Financing obligation	\$2,331,000	\$2,378,000
Valuation discount	(797,000 )	(825,000 )
Net long term financing obligation	\$1,534,000	\$1,553,000
Less current portion	(197,000 )	(190,000 )
Long term financing obligation	\$1,337,000	\$1,363,000

On June 15, 2009, the Company closed escrow on the sale of its 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 was personally guaranteed up to a limit of \$150,000 by the principal shareholder and Chief Executive Officer, Christopher J. Reed.

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 Merton 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.

Effective October 1, 2014, the Company executed Amendment #1 to the Long-term Financing Obligation. 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 its common stock for \$5.60 per share with a term of five years. The 200,000 warrants were valued at \$584,000 using the Black Scholes Merton option pricing model and were recorded as a valuation discount. 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 1.25%. The warrants value of \$584,000 is being amortized over the remaining term of the purchase option. Amortization of valuation discount was \$27,000 and \$28,000 during the three months ended March 31, 2017 and 2016.

F-12

## 9. Warrant Liability

The Company issued warrants to investors and a placement agent as part of our June 2, 2016 financing transaction. In accordance with ASC 480, Distinguishing Liabilities from Equity (“ASC 480”), the fair value of these warrants are classified as a liability on the Company’s balance sheet as according to the warrant terms, a fundamental transaction could give rise to an obligation of the Company to pay cash to such warrant holders. Corresponding changes to the fair value of the warrants are recognized in earnings on the Company’s statements of operations in each subsequent period.

	March 31, 2016	December 31, 2016		
Stock Price	\$4.15	\$4.10		
Risk free interest rate	1.48	1.58	%	%
Expected Volatility	54.71	55.81	%	%
Expected life in years	4.17	4.42		
Expected dividend yield	0	0	%	%
Fair Value – Warrants	\$766,000	\$775,000		

The risk-free interest rate was based on rates established by the Federal Reserve Bank. The Company uses the historical volatility of its common stock to estimate the future volatility for its common stock. The expected life of the warrant was determined by the remaining contractual life of the warrant instrument. The expected dividend yield was based on the fact that the Company has not paid dividends to its common stockholders in the past and does not expect to pay dividends to its common stockholders in the future.

## 10. Stock Based Activity

### Stock Options

Stock options granted under our equity incentive plans generally vest over 3 years from the date of grant, at 33% per year or over 4 years at 25% per year and expire 5 years from the date of grant. The following table summarizes stock option activity for the three months ended March 31, 2017:

Shares	Weighted- Average Exercise	Weighted- Average Remaining	Aggregate Intrinsic Value
--------	----------------------------------	-----------------------------------	---------------------------------

Edgar Filing: REED'S, INC. - Form 10-Q

		Price	Contractual Terms (Years)	
Outstanding at December 31, 2016	1,048,500	4.68	3.8	\$ 61,000
Granted				
Exercised				
Forfeited or expired	(21,666 )	4.79	4.65	
Outstanding at March 31, 2017	1,026,834	4.68	3.50	\$ 72,000
Exercisable at March 31, 2017	601,368	4.65	3.04	\$ 47,000

During the three months ended March 31, 2017, the Company did not grant any stock options to any employee or other party.

The aggregate intrinsic value was calculated as the difference between the closing market price, which was \$4.15, and the exercise price of the Company's stock options as of March 31, 2017. Stock-based compensation recognized on the Company's statement of operations for the three months ended March 31, 2017 and 2016 was \$140,000 and \$169,000, respectively.

Stock Warrants

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2016	803,909	\$ 4.50	4.00	\$ 26,000
Granted				
Exercised				
Forfeited or expired				
Outstanding at March 31, 2017	803,909	\$ 4.50	3.75	\$ 41,058
Exercisable at March 31, 2017	803,909	\$ 4.54	3.95	\$ 41,058

The intrinsic value was calculated as the difference between the closing market price, which was \$4.15 and the exercise price of the Company's warrants common stock, as of March 31, 2017.

## 11. Subsequent Events

In April 2017, Robert Reed, brother of Chris Reed, Chief Innovation Officer advanced working capital funds of \$100,000 to the Company for working capital uses. This amount has been repaid from operational funds.

On April 21, 2017 (“Closing Date”), pursuant to a Securities Purchase the Company sold and issued a convertible subordinated note in the principal amount of \$3,400,000 (“Note”) and warrants to purchase 1,416,667 shares of common stock (“Warrant Shares”) to Raptor/ Harbor Reeds SPV, LLC. The Note bears interest at a rate of 12% per annum, compounded monthly on a 365-day year/ 30-day month basis. The Note is secured by a second priority security interest in the Company’s assets, which is subordinate to the first priority security interest of PMC Financial Services Group, LLC. The Note matures on the two-year anniversary of the Closing date and may not be prepaid. After 180 days, the Note may be converted, at any time and from time to time, into 1,133,333 shares of common stock of the Company (“Conversion Shares”). The Warrants will expire on the fifth (5th) anniversary of the Closing Date and have an exercise price equal to \$4.00. Warrants will not be exercisable until 180 days after the Closing date. The Note and Warrant contain customary anti-dilution provisions and the Conversion Shares and Warrant Shares are subject to a registration rights agreement. The fair value of the warrants and conversion feature was determined to be \$3,400,000 and will be recorded as a valuation discount and amortized as interest expense over the term of the note. In addition, the investor was granted a right to participate in future financing transactions of the Company for a term of two years.

To facilitate the close of the agreement between Reed’s Inc. and Raptor/ Harbor Reeds SPV LLC, Reed’s Inc. granted an acceleration of the maturity of existing indebtedness with PMC from January 1, 2019 to October 21, 2018.

On April 19, 2017, three accredited investors that are party to that certain Securities Purchase Agreement dated May 26, 2016 and hold participation rights in the Company’s financing transactions agreed to waive their participation rights with regard to the April 21, 2017 financing. In consideration, these investors’ participation rights, expiring in May 2017, were extended for a period of two years. In addition, the Company increased the terms of their outstanding warrants by one year and reduced the exercise price from \$4.25 to \$3.00 and also issued five-year warrants to purchase an aggregate of 210,111 shares of common stock at the exercise price of \$3.00 to these investors. The newly issued warrants contain customary anti-dilution provisions.

## 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

Upon receipt of the resignation of Christopher J. Reed from the position of Chief Executive Officer, the Company's new Board of Directors appointed Stefan Freeman as Interim Chief Executive Officer. The new leadership is committed to bringing to market more timely product offerings that consumers are seeking while continuing to lower costs throughout the supply chain.

The results for our first quarter of 2017 reflect consumer shifting away from sugar based beverages. Our first quarter results were disappointing and we are actively rebuilding the business to return to growth and profitability. We are in the process of a thorough evaluation of the business and are establishing both short and long term goals to return to higher levels of profitability. In short, we are simplifying the business without sacrificing our core brands or flavors. We have implemented a program to reduce the number of product packaging options by more than 100. We believe this stock keeping unit (SKU) rationalization will be a significant benefit to our co-packers, customers and our own production operations.

The effect of a lower margin and lower volume led an overall decrease in the top line results. Management continued to reduce operational expenses. However, with the added debt costs, the loss to shareholders increased

**Results of Operations**

The following table sets forth key statistics for the three months ended March 31, 2017 and 2016, respectively.

	March 31, 2017	2016	Pct. Change	
Gross sales	9,354,000	\$10,777,000	-13	%
Less: Promotional and other allowances	1,059,000	773,000	37	%
Net sales	\$8,295,000	\$10,004,000	-17	%
Cost of tangible goods sold	6,505,000	7,838,000	-17	%
As a percentage of:				
Gross sales	70	% 73		%
Net sales	78	% 78		%
Cost of goods sold – idle capacity	734,000	273,000	169	%
As a percentage of net sales	9	% 3		%
Gross profit	1,056,000	\$1,893,000	-44	%
Gross profit margin as a percentage of net sales	13	% 19		%
Expenses				
Delivery and handling	\$743,000	\$849,000	-12	%
Selling and marketing	788,000	1,041,000	-24	%
General and administrative	1,111,000	1,205,000	-8	%
Total Operating expenses	\$2,642,000	\$3,095,000	-15	%
Income from operations	\$(1,586,000 )	\$(1,202,000 )	32	%
Interest expense and other expense	(407,000 )	(378,000 )	8	%
Net loss to stockholders	\$(1,993,000 )	\$(1,580,000 )	26	%
Shares outstanding	13,982,230	13,184,000	6	%
Net income(loss) per share	\$(0.14 )	\$(0.12 )	19	%

**Metrics**

	Unaudited			Three months ended March 31		
	12 Ounce Volume			12 Ounce Gross Sales Revenue		
	2017	2016	Change	2017	2016	Change
Gross Sales						
Reeds Beverages	287,724	307,945	-6.6 %	4,980,000	5,257,000	-5.3 %
Virgils	169,276	188,641	-10.3 %	3,066,000	3,367,000	-8.9 %
Kombucha	5,402	15,231	-64.5 %	202,000	602,000	-66.4 %
All Other Reeds Beverages	26,116	20,619	26.7 %	487,000	385,000	26.5 %
Private Label	6,074	41,242	-85.3 %	97,000	729,000	-86.7 %
Reeds Candy				494,000	414,000	19.3 %
All Other Non-Beverages				28,000	23,000	21.7 %
Total Gross Sales	494,592	573,678	-13.8 %	9,354,000	10,777,000	-13.2 %
Sales Discounts Unallocated to Specific SKU's*				(1,059,000)	(773,000 )	37.0 %
Net Sales	494,592	573,678	-13.8 %	\$ 8,295,000	\$ 10,004,000	-17.1 %
Gross Sales per 12 ounce				\$ 18.91	\$ 18.79	0.7 %
Net Sales per 12 ounce				\$ 16.77	\$ 17.44	-3.8 %
Cost of Goods Sold						
Reeds Beverages	287,724	307,945	-6.6 %	3,414,000	3,463,000	-1.4 %
Virgils	169,276	188,641	-10.3 %	1,986,000	2,159,000	-8.0 %
Kombucha	5,402	15,231	-64.5 %	120,000	307,000	-60.9 %
All Other Reeds Beverages	26,116	20,619	26.7 %	318,000	272,000	16.9 %
Private Label	6,074	41,242	-85.3 %	53,000	382,000	-86.1 %
Costs Unallocated to Specific SKU's*				78,000	678,000	-88.5 %
Reeds Candy				355,000	317,000	12.0 %
All Other Non-Beverages				181,000	260,000	-30.4 %
Cost of Goods Sold	494,592	573,678	-13.8 %	\$ 6,505,000	\$ 7,838,000	-17.0 %
Additional Cost of Goods Produced						
Idle Plant				734,000	273,000	168.9 %
Cost of Goods produced and Sold	494,592	573,678	-13.8 %	\$ 7,239,000	\$ 8,111,000	-10.8 %
Cost of Goods Sold Per 12 ounce				\$ 13.15	\$ 13.66	-3.7 %
Cost of Goods Poduced Per 12 ounce				\$ 14.64	\$ 14.14	3.5 %
Gross Profit including Idle Plant				1,056,000	1,893,000	-44.2 %
Gross Profit on an 12 ounce basis including Idle Plant				2.14	3.30	-35.3 %
Gross Margin including Idle Plant				12.7 %	18.9 %	-6.2 %

\* Discounts and costs incurred that do not relate to specific SKU's



*\* 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.*

## **Sales**

Gross sales decreased in the first quarter of 2017 to \$9,354,000 from \$10,777,000 in the same period in 2016. On a 12-ounce serving basis, gross sales increased \$0.12 per 12-ounce serving or 0.7% year over year. The main driver of the increase was a targeted price increase for a specific delivery channel offset by losses in pricing mix.

Net sales decreased in the first quarter of 2017 to \$8,295,000 from \$10,004,000 in the same period in 2016. On a 12-ounce serving basis, net sales decreased \$0.67 per 12-ounce serving or 3.8% year over year. The main driver of the decrease was a 35% increase or \$0.77 per 12-ounce serving in promotional costs. It should be noted that with the candy supply secured, candy sales increased \$80,000 or 19% over the same period in 2016.



### **Cost of Goods Sold and Produced**

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 and internal transfer costs. 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.

Cost of goods *sold* decreased in the first quarter of 2017 to \$6,505,000 from \$7,838,000 in the same period in 2016. On a 12-ounce serving basis, cost of goods *sold* decreased \$0.51 per 12-ounce serving or 4% year over year. The main driver of decrease was in costs unallocated to specific SKUs in the prior year which was comprised primarily of inventory adjustments.

Cost of goods *produced* decreased in the first quarter of 2017 to \$7,239,000 from \$8,111,000 in the same period in 2016. On a 12-ounce serving basis, cost of goods *produced* increased \$0.50 per 12-ounce serving or 4% year over year. The main driver of the increase is LA Plant Idle Plant costs. Idle Plant costs increased \$1.04 per 12-ounce serving or 219% to \$734,000 from \$273,000 over the same period in 2016.

### **Gross Margin**

Gross margin declined in first quarter of 2017 to \$1,056,000 from \$1,893,000 in the same period in 2016. On a 12-ounce serving basis, gross margin declined \$0.99 or 30% year over year. The main drivers of the decrease were the \$0.64 increase in sales discounts and \$0.35 increase in idle plant costs.

### **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 expenses continued their decline in first quarter of 2017 to \$743,000 from \$849,000 or 13% in the same period in 2016. This decrease is in line with the 14% decline in volume. On a percentage of net sales, delivery costs were flat at 9%.

## **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 expenses continued their decline in first quarter of 2017 to \$788,000 from \$1,041,000 or 24% in the same period in 2016. On a percentage of net sales, Selling and marketing costs decreased 1% to 9% from 10%. The main driver of the decrease was a reduction in employee costs while full time equivalent employees remained flat.

## **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 continued their decline in first quarter of 2017 to \$1,111,000 from \$1,205,000 or 8% in the same period in 2016. On a percentage of net sales, General and administrative costs increased 1% to 13% from 12%. The main driver of the increase was due minor increases in administrative support.

## **Loss from Operations**

The loss from operations was (\$1,586,000) in the three months ended March 31, 2017, as compared to a loss of \$(1,202,000) in the same period of 2016 or an overall increase in the loss of \$384,000. The loss was comprised of decrease in sales volume of \$1,709,000, offset partially by a cost of goods sold decrease of \$872,000 that were partially offset by lower idle plant costs and decreases in every operating expense category that totaled \$455,000.

## **Interest Expense**

Interest expense and bank related charges increased \$38,000 to \$416,000 in the three months ended March 31, 2017, compared to expenses of \$378,000 in the same period of 2016. The increase is primarily due to increased borrowing on our revolving line of credit, an additional term loan and new capital expansion loan.

**Modified EBITDA**

In addition to our GAAP results, we present Adjusted EBITDA as a supplemental measure of our performance. However, Adjusted EBITDA is not a recognized measurement under GAAP and should not be considered as an alternative to net income, income from operations or any other performance measure derived in accordance with GAAP or as an alternative to cash flow from operating activities as a measure of liquidity. We define Adjusted EBITDA as net income (loss), plus interest expense, depreciation and amortization, stock-based compensation, and changes in fair value of warrant expense.

Management considers our core operating performance to be that which our managers can affect in any particular period through their management of the resources that affect our underlying revenue and profit generating operations that period. Non-GAAP adjustments to our results prepared in accordance with GAAP are itemized below. You are encouraged to evaluate these adjustments and the reasons we consider them appropriate for supplemental analysis. In evaluating Adjusted EBITDA, you should be aware that in the future we may incur expenses that are the same as or similar to some of the adjustments in this presentation. Our presentation of Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items.

Set forth below is a reconciliation of Adjusted EBITDA to net income (loss) for the three ended March 31, 2017 and 2016:

**MODIFIED EBITDA SCHEDULE**

	March 31,	
	2017	2016
	(unaudited)	(unaudited)
Net loss	\$(1,993,000)	\$(1,580,000)
Modified EBITDA adjustments:		
Depreciation and amortization	194,000	261,000
Interest expense	416,000	378,000
Stock option and warrant compensation	140,000	169,000
Change in fair value of warrant liability	(9,000 )	-
Total EBITDA adjustments	\$741,000	\$808,000
Modified EBITDA	\$(1,252,000)	\$(772,000 )

The \$1,252,000 modified EBITDA for the three months resulted from the decreases in the EBITDA adjustments totaling \$67,000 for the quarter ended March 31, 2017 plus the \$413,000 increase in the net loss. The \$67,000 decrease in depreciation and amortization was due to the aging of old equipment and the delay of installing new equipment. The increase in interest expense was due to the increased loan balances and stock option compensation decrease was due to no new options granted offset partially from additions in prior quarters, but after the first quarter of 2016.

We present Adjusted EBITDA because we believe it assists investors and analysts in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance. In addition, we use Adjusted EBITDA in developing our internal budgets, forecasts and strategic plan; in analyzing the effectiveness of our business strategies in evaluating potential acquisitions; and in making compensation decisions and in communications with our board of directors concerning our financial performance. Adjusted EBITDA has limitations as an analytical tool, which includes, among others, the following:

Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;

Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

Adjusted EBITDA does not reflect future interest expense, or the cash requirements necessary to service interest or principal payments, on our debts; and

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements.

## **Liquidity and Capital Resources**

The accompanying financial statements have been prepared under the assumption that the Company will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. For the quarter ended March 31, 2017 the Company recorded a net loss of \$1,993,000 and was provided cash from operations of \$527,000. As of March 31, 2017, we had a working capital deficiency of \$3,551,000 and a stockholders' deficit of \$3,510,000.

As of March 31, 2017, the Company had a cash balance of \$197,000 and had available borrowing on our existing line of credit of \$191,000. On April 21, 2017, the Company issued a convertible note resulting in net proceeds of \$3,240,000. Furthermore, during the year ended December 31, 2016, we were able to extend the maturity date of our operating line of credit and our other bank loans through October 21, 2018. We estimate the Company currently has sufficient cash and liquidity to meet its anticipated working capital for the next twelve months.

Historically, we have financed our operations primarily through private sales of common stock, preferred stock, a line of credit from a financial institution and cash generated from operations. We anticipate that 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 achieve positive cash flow from operations. However, 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 may have insufficient working capital to maintain our operations as we presently intend to conduct them or to fund our expansion, marketing, and product development plans. There can be no assurance that we will be able to obtain such financing on acceptable terms, or at all.

## 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.* 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 March 31, 2017.

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.



**Recent Accounting Pronouncements**

See Note 2 of the financial statements for a discussion of recent accounting pronouncements.

**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 Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2017.

*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 March 31, 2017 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**

None.

### **Item 3. Defaults Upon Senior Securities**

None.

### **Item 4. Mine Safety Disclosures**

Not applicable.

### **Item 5. Other Information**

**Item 6. Exhibits**

Exhibit No. Description

- |         |  |
|---------|--|
| 31.1    | Certification of Interim 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 Interim 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: May 15, 2017 /s/ *Stefan Freeman*  
Stefan Freeman  
Interim Chief Executive Officer  
(Principal Executive Officer)

Date: May 15, 2017 /s/ *Daniel V. Miles*  
Daniel V. Miles  
Chief Financial Officer  
(Principal Financial Officer)

