REED'S, INC.
Form 10-Q
August 04, 2016

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 June 30, 2016

[ ] 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 [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 13,908,247 shares of Common Stock outstanding of which 833,834 were restricted as of July 29, 2016.

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	
Item 1. Condensed Financial Statements	F-1
Condensed Balance Sheets - June 30, 2016 (unaudited) and December 31, 2015	F-1
Condensed Statements of Operations for the three and six month periods ended June 30, 2016 and 2015 (unaudited)	F-2
Condensed Statement of Changes in Stockholders' Equity for the six month period ended June 30, 2016 (unaudited)	F-3
Condensed Statements of Cash Flows for the six month periods ended June 30, 2016 and 2015 (unaudited)	F-4
Notes to Condensed Financial Statements (unaudited)	F-5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	4
Item 3. Quantitative and Qualitative Disclosures About Market Risk	14
Item 4. Controls and Procedures	14
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	15
Item 1A. Risk Factors	15
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	15
Item 3. Defaults Upon Senior Securities	15
Item 4. Mine Safety Disclosures	15
Item 5. Other Information	15
Item 6. Exhibits	15

Part I – FINANCIAL INFORMATION

Item 1. Financial Statements

REED’S, INC.

CONDENSED BALANCE SHEETS

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash	$969,000	$1,816,000
Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of $306,000 and $356,000, respectively	3,544,000	2,894,000
Inventory, net of reserve for obsolescence of $150,000 and $290,000, respectively	7,723,000	7,927,000
Prepaid inventory	576,000	47,000
Prepaid and other current assets	573,000	769,000
Total Current Assets	13,385,000	13,453,000
Property and equipment, net of accumulated depreciation of $4,574,000 and $4,216,000, respectively	6,479,000	5,369,000
Brand names	1,029,000	1,029,000
Total assets	$20,893,000	$19,851,000
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Accounts payable	$5,673,000	$7,458,000
Accrued expenses	192,000	168,000
Line of Credit, net of discount of $11,000 and $0, respectively	5,646,000	4,443,000
Current portion of long term financing obligations	175,000	160,000
Current portion of capital leases payable	142,000	153,000
Current portion of capital expansion loan	341,000	341,000
Total current liabilities	12,169,000	12,723,000
Long term financing obligation, less current portion, net of discount of $880,000 and $953,000, respectively	1,408,000	1,443,000
Capital leases payable, less current portion	499,000	490,000
Capital expansion loan, less current portion	2,849,000	1,542,000
Term loan, net of discount $114,000 and $132,000	2,886,000	2,868,000
Total Liabilities	19,811,000	19,066,000
Stockholders’ equity:		
	94,000	94,000

Series A Convertible Preferred stock, $10 par value, 500,000 shares authorized, 9,411 shares issued and outstanding		
Common stock, $.0001 par value, 19,500,000 shares authorized, 13,908,247 and 13,160,860 shares issued and outstanding, respectively	1,000	1,000
Additional paid in capital	30,044,000	27,399,000
Accumulated deficit	(29,057,000)	(26,709,000)
Total stockholders' equity	1,082,000	785,000
Total liabilities and stockholders' equity	$20,893,000	$19,851,000

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

REED'S, INC.

CONDENSED STATEMENTS OF OPERATIONS

For the Three Months and Six Months Ended June 30, 2016 and 2015
(Unaudited)

	Three months ended		Six months ended	
	2016	2015	2016	2015
Net Sales	$10,992,000	$12,178,000	$20,996,000	$22,850,000
Cost of goods sold	8,390,000	8,538,000	16,501,000	15,950,000
Gross profit	2,602,000	3,640,000	4,495,000	6,900,000
Operating expenses:				
Delivery and handling expenses	1,064,000	1,429,000	1,913,000	2,597,000
Selling and marketing expense	954,000	1,335,000	1,995,000	2,528,000
General and administrative expense	931,000	1,369,000	2,136,000	2,338,000
Total operating expenses	2,949,000	4,133,000	6,044,000	7,463,000
Loss from operations	(347,000)	(493,000)	(1,549,000)	(563,000)
Interest expense	(416,000)	(193,000)	(794,000)	(394,000)
Net loss	(763,000)	(686,000)	(2,343,000)	(957,000)
Preferred Stock Dividends	(5,000)	(5,000)	(5,000)	(5,000)
Net loss attributable to common stockholders, basic and diluted	$(768,000)	$(691,000)	$(2,348,000)	$(962,000)
Weighted average number of shares outstanding – basic	13,424,796	13,104,227	13,305,821	13,086,560
Loss per share – basic and diluted	$(0.06)	$(0.05)	$(0.18)	$(0.07)

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

REED’S, INC.

CONDENSED STATEMENT OF CHANGES IN STOCKHOLDERS’ EQUITY

For the Six Months Ended June 30, 2016
(Unaudited)

	Common Stock		Preferred Stock		Additional Paid	Accumulated	Total Stockholder’s
	Shares	Amount	Shares	Amount	In Capital	Deficit	Equity
Balance, January 1, 2016	13,160,860	$ 1,000	9,411	$94,000	27,399,000	(26,709,000)	785,000
Common shares issued upon exercise of warrants	16,260				45,000		45,000
Common shares issued upon cashless exercise of options	7,211				-		-
Fair value vesting of options issued to employees & consultant					302,000		302,000
Common shares issued upon sale of securities	722,412				2,239,000		2,239,000
Fair value of warrants issued as debt discount					54,000		54,000
Series A Preferred Stock Dividend	1,504				5,000	(5,000)	-
Net loss						(2,343,000)	(2,343,000)
Balance June 30, 2016	13,908,247	$ 1,000	9,411	$94,000	$30,044,000	$(29,057,000)	$ 1,082,000

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

F-3

REED’S, INC.

CONDENSED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2016 and 2015
(Unaudited)

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(2,343,000)	$(957,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	477,000	453,000
Fair value of stock options issued to employees & consultant	302,000	560,000
(Decrease) increase in allowance for doubtful accounts	(50,000)	(81,000)
Changes in assets and liabilities:		
Accounts receivable	(600,000)	(1,005,000)
Inventory	204,000	(2,631,000)
Prepaid Inventory	(529,000)	(14,000)
Prepaid expenses and other current assets	196,000	167,000
Accounts payable	(1,785,000)	1,644,000
Accrued expenses	24,000	20,000
Net cash used in operating activities	(4,104,000)	(1,844,000)
Cash flows from investing activities:		
Purchase of property and equipment	(78,000)	(430,000)
Net cash used in investing activities	(78,000)	(430,000)
Cash flows from financing activities:		
Proceeds from sale of common stock	2,239,000	-
Proceeds from stock option and warrant exercises	45,000	31,000
Principal repayments on long term financial obligation	(76,000)	(64,000)
Principal repayments on capital lease obligation	(87,000)	(63,000)
Net draw down (repayment) on line of credit	1,214,000	1,626,000
Net cash provided by financing activities	3,335,000	1,530,000
Net decrease in cash	(847,000)	(744,000)
Cash at beginning of period	1,816,000	959,000
Cash at end of period	$969,000	$215,000
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	843,000	395,000
Non Cash Investing and Financing Activities		
Property and equipment acquired through capital expansion loan	1,307,000	486,000
Property and equipment acquired through capital lease obligations	86,000	-
Other current assets acquired through capital expansion loan	-	250,000
Fair value of warrants granted as debt discount	54,000	-
Dividends payable in common stock	5,000	5,000

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

REED’S, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

Six Months Ended June 30, 2016 and 2015 (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 June 30, 2016 and the results of operations and cash flows for the six months ended June 30, 2016 and 2015. The balance sheet as of December 31, 2015 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 23, 2016.

The results of operations for the six months ended June 30, 2016 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2016.

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.

Liquidity

As of June 30, 2016, we had stockholders equity of $1,082,000 and working capital of $1,216,000 compared to stockholders equity of $785,000 and working capital of $730,000 at December 31, 2015.

We believe that the Company currently has the necessary working capital to support existing operations until our line of credit and all of the long term loans become due on October 1, 2017. Consistent with past refinancing practices regarding the Line of Credit, the Company believes that it will be successful in renewing the Line of Credit for another time frame similar to what it has done in the past. There are no assurances that this refinancing will be completed. We believe 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 cash generated from operations and a line of credit from a financial institution. Additionally, we have done private sales of common stock to fund 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, 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 stockholders 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:

	June 30, 2016	June 30, 2015
Warrants	803,909	216,261
Series A Preferred Stock	37,644	37,644
Options	967,500	1,065,000
Total	1,809,053	1,318,905

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 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. On August 12, 2015, FASB delayed the required implementation to fiscal years ending after December 15, 2017 but now permitted organizations such a Reeds to adopt earlier. 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. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. The Company is in the process of evaluating the impact of ASU 2014-09 on the Company's financial statements and disclosures.

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 will adopt ASU 2014-15 on the Company's financial statement presentation and disclosures after the effective date.

In February 2016, the FASB issued Accounting Standards Update (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 comparative period presented in the financial statements, with certain practical expedients available. The Company is in the process of evaluating the impact of ASU 2016-02 on the Company's financial statements and 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.

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 $250,000 during the six months ended June 30, 2016.

During the six months ended June 30, 2016, the Company had one customer that accounted for 26% of sales. During the six months ended June 30, 2015, the Company had two customers that accounted for 32% and 14% of sales respectively. No other customer accounted for more than 10% of sales in either period. During the three months ended June 30, 2016 and 2015, the Company had one customer that accounted for 26% of sales in 2016, and two customers that accounted for 29% and 15% of sales in 2015, respectively. No other customers accounted for more than 10% of sales in either period.

As of June 30, 2016, the Company had accounts receivable due from one customer who comprised 23% of its total accounts receivable and as of December 31, 2015 the Company had accounts receivable due from two customers who comprised 24% and 12% of its total accounts receivable. No other customer accounted for more than 10% of accounts receivable in the periods.

During the six months ended June 30, 2016, the Company had one vendor who accounted for 27% of all purchases and in the six months ended June 30, 2015. three vendors, which accounted for 14.0%, 12.6% and 10.0% of all purchases. No other vendor accounted for more than 10% of all purchases in either period. As of June 30, 2016, the Company had one vendor, which accounted for 20% of total accounts payable and as of December 31, 2015, the Company had two vendors, which accounted for 31% and 11% 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 Company had no such assets or liabilities recorded to be valued on the basis above at June 30, 2016 or December 31, 2015.

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.

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:

	June 30, 2016	December 31, 2015
Raw Materials and packaging	$4,172,000	$4,364,000
Finished Goods	3,551,000	3,563,000
	$7,723,000	$7,927,000

4. Property and Equipment

Property and equipment are comprised of the following as of:

	June 30, 2016	December 31, 2015
Land	$1,107,000	$1,107,000
Building	1,875,000	1,875,000
Vehicles	600,000	500,000
Machinery and equipment	3,695,000	3,800,000
Equipment under capital leases	228,000	857,000
Office equipment	474,000	469,000

Construction in Progress	3,074,000	977,000
	11,053,000	9,585,000
Accumulated depreciation	(4,574,000)	(4,216,000)
	$6,479,000	$5,369,000

Depreciation expense for the six months ended June 30, 2016 and 2015 was $357,000 and $412,000 respectively.

5. Notes Payable

Line of Credit

	June 30, 2016	December 31, 2015
Line of credit	$5,657,000	$4,443,000
Valuation discount	(11,000)	-
Net	$5,646,000	$4,443,000

On November 9, 2011, the Company entered into a Loan and Security Agreement with PMC Financial Services Group, LLC (PMC), which was amended and extended for two years on December 5, 2014, that provides a $6,000,000 revolving line of credit. The Amended Agreement extends and amends the Revolving Loan and Term Loan (see discussion below) and adds a new Capital Expansion Loan (the “Capex Loan”) (see discussion below). At June 30, 2016 and December 31, 2015, the aggregate amount outstanding under the line of credit was $5,657,000 and $4,443,000 respectively.

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. The interest rate on the Revolving Loan was the prime rate plus .35% (9% at June 30, 2016). However, the interest rate has been adjusted as described below in term loans. The monthly management fee is .45% of the average monthly loan balance. As of June 30, 2016, the Company had a maximum borrowing availability of $250,000 under the line of credit agreement.

On April 25, 2016, the Company agreed with PMC to amend the definition of eligible inventory to include certain glass containers in exchange for 10,000 warrants. The total value of the line did not increase and the inclusion of the glass as defined under the amendment will expire December 31, 2016. In connection with the agreement, the Company granted PMC 10,000 warrants at an exercise price of $3.90 per share with a term of five years and six months. The 10,000 warrants were valued at $15,000 using the Black Scholes Merton option pricing model and were recorded as a valuation discount. The following assumptions were made in valuing the 10,000 warrants; term of 5.5 years, volatility of 56.35%, expected dividends of 0% and discount rate of 1.50%. The warrants value of $15,000 is being amortized over the 8 months of the length of the time for the change to the eligible inventory definition. During the six months ending June 30, 2016, $4,000 of valuation discount was amortized resulting in an unamortized balance of $11,000 at June 30, 2016.

On May 13, 2016, PMC agreed to an extension of the maturity date until October 1, 2017 for the line of credit that was to mature on December 5, 2016 as part of the restructuring of all debt at PMC. See discussion of the consideration

given PMC below under term loans. All other terms for the line of credit remain the same.

Term Loans

The Company has the following term loans outstanding with PMC Financial Services Corporation;

	June 30, 2016	December 31, 2015
Term Loans	$3,000,000	$3,000,000
Valuation discount	(114,000)	(132,000)
Net	$2,886,000	$2,868,000

In connection with the Loan and Security Agreement with PMC, the Company entered into a Term Loan. The Term Loan was $750,000, and was secured by all of the unencumbered assets of the Company. Effective December 5, 2014 the Term Loan's outstanding principal balance was increased to $1,500,000 and the annual interest rate was revised to prime plus 5.75% (currently 9%) subject to adjustment as described below.

Effective September 1, 2015 the Company entered into an additional Term Loan with a principal balance of $1,500,000 at prime plus 11.60% (currently 14.85%) with PMC. As of June 30, 2016 and December 31, 2015, the aggregate amount under the Term Loans outstanding was $3,000,000.

The interest rate on the line of credit and Term Loans described above were modified on September 1, 2015 and are subject to adjustment as follows:

Under the new conditions, the rate charge will be calculated on a sliding scale 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%.

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 Interest Rate shall remain unchanged for the asset based lending that includes the Revolving working capital loan, CAPEX capital improvement loan and Term Loan A. The six month Term Loan B rates will remain the same at 14.85%.

On November 9, 2015, the Company completed a restructuring of the Term Loans with PMC. The aggregated amount of the principal for affected term loans is $3,000,000. Under the new agreement, the maturity of both loans was to be due in lump sum on April 1, 2017 under the same rates and conditions as before. In connection with the agreement, the Company granted PMC 125,000 warrants at an exercise price of $4.50 per share with a term of 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 of 0% and discount rate of 0.68%. The warrants value of $141,000 is being amortized over the remaining 16 months of the term loans..

On May 13, 2016, the Company agreed with PMC to extend the loan maturity date to October 1, 2017 for all loans outstanding at PMC under the same rates and conditions as before. In connection with the agreement, 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 warrants value of $38,000 is being amortized over the 16 months until the maturity date of all loans. During the six months ended June 30, 2016, $57,000 of valuation discount was amortized resulting in an unamortized balance of $114,000 at June 30, 2016

Capital Expansion ("CAPEX") Loan

In connection with the loan and security agreement with PMC, the Company entered into a CAPEX loan in the aggregate outstanding amount not to exceed $3,000,000. The CAPEX loan will finance new asset purchases for modernization and improvement of the beverage bottling equipment in the Los Angeles plant. Interest only on the CAPEX loan shall be paid from time to time until the end of each fiscal quarter, at which time the principal amounts of each outstanding CAPEX loan will be aggregated and repaid in 48 equal monthly installments of principal plus accrued but unpaid interest beginning July 31, 2016, or if earlier, the revolver maturity of October 1, 2017. The maximum amount that can be borrowed under the CAPEX loan was increased to $3,210,000 on May 13, 2016. The interest rate on the CAPEX loan is the prime rate plus 5.75% 7at June 30, 2016. At June 30, 2016 and December 31, 2015, the balance on the CAPEX loan balance was $3,190,000 and $1,883,000 respectively. On June 30, 2016, the loan funding closed and the Company will begin repayments in July, 2016.

In conjunction with this loan the Company has placed equipment with a cost of $341,000 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

6. 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. Most of the leases are personally guaranteed by the Company's chief executive officer. 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 June 30, 2016, monthly payments under these leases aggregated to $16,000. The leases expire at various dates through 2020.

Future minimum lease payments under capital leases are as follows:

Years Ending December 31,	
2016	$109,000
2017	213,000
2018	217,000
2019	169,000
2020	65,000
Total payments	773,000
Less: Amount representing interest	(132,000)

Present value of net minimum lease payments	641,000
Less: Current portion	(142,000)
Non-current portion	$499,000

7. Long-term Financing Obligation

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 of 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 of 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 $55,000 and $41,000 during the six months ended June 30, 2016 and 2015.

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

	June 30, 2016	December 31, 2015
Financing obligation	$2,463,000	2,538,000
Valuation discount	(880,000)	(935,000)

	1,583,000	1,603,000
Less current portion	(175,000)	(160,000)
Long term financing obligation	$1,408,000	1,443,000

8. Stockholders' Equity

Common Stock

On June 2, 2016, the Company entered into a securities purchase agreement with institutional investors in a private financing transaction for the issuance and sale of 692,412 shares of the Company's common stock and warrants to purchase 346,206 shares of common stock. The net proceeds to the Company from the offering were $2,122,000 after deducting underwriting discounts, commissions and offering expenses. The Warrants have an exercise price of $4.25 per share and a term of 5 years.

During the six months ended June 30, 2016, the Company sold 30,000 shares of its common stock to certain officers of the Company at $3.90 per share with total proceeds of $117,000.

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 six months ended June 30, 2016:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2016	980,000	4.54	3.10	
Granted	2,500	2.50	5.00	
Exercised	(15,000)	2.43		
Forfeited or expired	0			
Outstanding at June 30, 2016	967,500	4.54	2.93	92,000
Exercisable at June 30, 2016	547,501	4.37	2.32	92,000

During the six months ended June 30, 2016, the Company granted options to purchase 2,500 shares at $2.50 for consulting services.

The aggregate intrinsic value was calculated as the difference between the closing market price, which was $2.47, and the exercise price of the Company's stock options as of June 30, 2016. Stock-based compensation recognized on the Company's statement of operations for the six months ended June 30, 2016 and 2015 was $302,000 and $446,000, respectively and is included in the selling and marketing and general and administrative expenses in the accompanying statements of operations. During the six months ended June 30, 2016, the Company issued 7,211 shares of the Company's common stock upon exercise of 15,000 stock options on a cashless basis.

Stock Warrants

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2015	341,261	3.74	3.87	
Granted	478,909	4.19	4.98	
Exercised	(16,260)	2.77		
Forfeited or expired	(1)			
Outstanding at June 30, 2016	803,909	5.18	4.53	0
Exercisable at June 30, 2016	743,909	5.60	3.25	0

The intrinsic value was calculated as the difference between the closing market price, which was $2.47 and the exercise price of the Company's warrants common stock, as of June 30, 2016. There was no intrinsic value for warrants outstanding as of June 30, 2016, based on the fair value of the Company's common stock on June 30, 2016.

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 second quarter of 2016 reflect our operations continuing to meet demand, margins improving and significant cost containment. Our Reed’s Ginger Brew and Virgils’ craft soda products gross sales grew sequentially in the second quarter over the first quarter by 3.6% and 17.1% respectively. Our other Reed’s brands grew 61.3% in gross sales during the quarter driven by our Butterscotch Beer craft soda that sequentially more than doubled versus first quarter gross sales.

Private label sales volume grew 33.0% percent sequentially or year over year driven in part by the liquidation of discontinued SKU’s. These discounts negatively impacted total gross margins by 1.9% during the second quarter.

We have included below detailed information on our products from a sales perspective that is based on year over year results with the associated cost of goods sold and production. The year over year comparison reflects the impact of the supply chain disruption last year. The information is presented in an industry standard of eight ounce serving equivalents for ease of comparison.

We continue to work on upgrading our Los Angeles plant facility with the goal of increasing its capacity. We believe that this will result in savings on transportation as well as other benefits that include quicker delivery of our products, particularly to our west coast customers. Our capital equipment outlay in the second quarter was $1,444,000 as additional line equipment was procured for installation. The Idle Plant cost increased by $10,000 over the same quarter last year while we begin installation of the new equipment.

Driven by cost containment initiatives overall expenses decreased 28.6% or $1,184,000 during the second quarter and resulted in savings in each individual category. Delivery expenses decreased 25.5%, Selling expenses decreased 28.5% and General and Administrative expenses decreased 32.0% versus the prior year second quarter. Interest expense grew 116% or $223,000 during the quarter versus the prior year second quarter and reflects the additional borrowing incurred as a direct result of the supply chain disruption.

Primarily due to gross margin improvement and expense management the operating loss realized in the second quarter decreased $146,000 versus the same quarter in the prior year. Total operating loss for the second quarter 2016 was $347,000.

4

Results of Operations

The following table sets forth-key statistics for the three months ended June 30, 2016 and 2015, respectively.

Three Months Ended June 30,		Pct.
2016	2015	Change