JONES SODA CO
Form 10QSB
November 14, 2003
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-QSB

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended September 30, 2003**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Transition Period From ______ to ______**

**Commission File Number 0-28820**

# Jones Soda Co.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Washington** | **91-1696175** |

| | |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification Number)** |
| **234 9th Avenue North** | |
| **Seattle, Washington 98109** | **(206) 624-3357** |
| **(Address of principal executive office)** | **(Registrant s telephone number, including area code)** |

Check whether the issuer: (1) 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 for such reports), and (2) has been subject to such filing requirements for the past 90 days.    Yes x    No ¨

As of September 30, 2003, the issuer had 19,966,596 shares of common stock outstanding.

Transitional Small Business Disclosure Format:    Yes ¨    No x

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**JONES SODA CO.**

**FORM 10-QSB**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**JONES SODA CO. AND SUBSIDIARIES**

Interim Consolidated Balance Sheets

(Expressed in U.S. dollars)

September 30, 2003 with comparative figures for December 31, 2002

| | September 30, 2003 (Unaudited) | December 31, 2002 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents (note 4) | $ 308,177 | $ 50,065 |
| Accounts receivable | 2,240,411 | 932,654 |
| Current portion of note receivable | 73,939 | 73,939 |
| Inventory (note 3) | 1,800,145 | 1,760,188 |
| Prepaid expenses | 248,186 | 457,582 |
| | 4,670,858 | 3,274,428 |
| Note receivable | 105,435 | 153,278 |
| Deposit | 29,464 | 29,464 |
| Fixed assets | 520,106 | 539,758 |
| Intangible assets | 84,168 | 106,434 |
| | $ 5,410,031 | $ 4,103,362 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Bank indebtedness (note 4) | $ | $ 114,833 |
| Accounts payable and accrued liabilities | 2,495,457 | 1,765,297 |
| Current portion of capital lease obligations | 56,706 | 56,706 |
| Current portion of deferred revenue | 50,000 | 50,000 |
| | 2,602,163 | 1,986,836 |
| Capital lease obligations, less current portion | 14,501 | 13,777 |

| | | |
|---|---|---|
| Deferred revenue | 272,953 | 301,979 |
| Stockholders equity | | |
| Common stock: | | |
| Authorized: 100,000,000 common stock, no par value Issued and outstanding: 19,966,596 common shares (2002 19,800,596) | 11,110,595 | 11,021,231 |
| Additional paid-in capital | 734,183 | 625,560 |
| Accumulated other comprehensive income | 107,752 | 107,752 |
| Deficit | (9,432,116) | (9,953,773) |
| | 2,520,414 | 1,800,770 |
| | $ 5,410,031 | $ 4,103,362 |

See accompanying notes to interim consolidated financial statements

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**JONES SODA CO. AND SUBSIDIARIES**

Interim Consolidated Statements of Operations

(Expressed in U.S. dollars)

(Unaudited)

Three months and nine months ended September 30, 2003 and 2002

| | Nine months ended September 30, 2003 | Three months ended September 30, 2003 | Nine months ended September 30, 2002 | Three months ended September 30, 2002 |
|---|---|---|---|---|
| Revenue | $ 16,000,631 | $ 5,917,195 | $ 15,386,025 | $ 5,571,531 |
| Cost of goods sold | 10,203,376 | 3,726,593 | 10,016,302 | 3,671,273 |
| Write down of inventory | | | 408,238 | (24,788) |
| | 10,203,376 | 3,726,593 | 10,424,540 | 3,646,485 |
| Gross profit | 5,797,255 | 2,190,602 | 4,961,485 | 1,925,046 |
| Operating expenses: | | | | |
| Promotion and selling | 3,675,448 | 1,357,930 | 3,837,801 | 1,307,243 |
| General and administrative | 1,480,148 | 486,787 | 1,925,036 | 612,361 |
| Non cash stock compensation | 108,623 | 45,539 | | |
| | 5,264,219 | 1,890,256 | 5,762,837 | 1,919,604 |
| Earnings (loss) from operations | 533,036 | 300,346 | (801,352) | 5,442 |
| Other income (expense): | | | | |
| Interest income (expense), net | 28,811 | (5,281) | (36,738) | (12,411) |
| Other income (expense) | (40,190) | (19,618) | (304) | 2,829 |
| | (11,379) | (24,899) | (37,042) | (9,582) |
| Earnings (loss) for the period | $ 521,657 | $ 275,447 | $ (838,394) | $ (4,140) |
| Earnings (loss) per share, basic | $ 0.03 | $ 0.01 | $ (0.04) | $ (0.00) |
| Earnings (loss) per share, diluted | 0.03 | 0.01 | (0.04) | (0.00) |
| Weighted average common stock, basic | 19,810,091 | 19,829,080 | 19,883,730 | 19,800,596 |
| Weighted average common stock, diluted | 20,226,493 | 20,883,595 | 19,883,730 | 19,800,596 |

See accompanying notes to interim consolidated financial statements.

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**JONES SODA CO. AND SUBSIDIARIES**

Interim Consolidated Statements of Stockholders Equity and Comprehensive Income (loss)

(Expressed in U.S. dollars)

Nine months ended September 30, 2003 (Unaudited )

Years ended December 31, 2002 and 2001

| | Common stock | | Reacquired Shares | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Number | Amount | Number | Amount | Additional paid-in capital | Accumulated other comprehensive income (loss) | Accumulated deficit | Comprehensive income (loss) | Total stockholders equity |
| Balance, December 31, 2000 | 19,303,378 | $ 10,708,519 | | $ | $ 407,455 | $ 107,752 | $ (7,067,317) | | $ 4,156,409 |
| Options exercised | 35,000 | 17,931 | | | | | | | 17,931 |
| Warrants exercised | 913,468 | 542,969 | | | | | | | 542,969 |
| Stock-based compensation | | | | | 118,500 | | | | 118,500 |
| Repurchase escrow shares | | | (200,000) | (13,333) | | | | | (13,333) |
| Comprehensive loss: | | | | | | | | | |
| Loss for the year | | | | | | | (1,702,228) | $ (1,702,228) | (1,702,228) |
| Total comprehensive income | | | | | | | | | |
| Balance, December 31, 2001 | 20,251,846 | $ 11,269,419 | (200,000) | $ (13,333) | $ 525,955 | $ 107,752 | $ (8,769,545) | | $ 3,120,248 |
| Stock-based compensation (recovery) | | | | | (118,500) | | | | (118,500) |
| Repurchase escrow shares | | | (251,250) | (16,750) | | | | | (16,750) |
| Cancelled escrow shares | (451,250) | (248,188) | 451,250 | 30,083 | 218,105 | | | | |
| Comprehensive loss: | | | | | | | | | |
| Loss for the year | | | | | | | (1,184,228) | $ (1,184,228) | (1,184,228) |
| Balance, December 31, 2002 | 19,800,596 | $ 11,021,231 | | $ | $ 625,560 | $ 107,752 | $ (9,953,773) | | $ 1,800,770 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Options exercised | 166,000 | 89,364 | | | | | | 89,364 |
| Stock-based compensation | | | | 108,623 | | | | 108,623 |
| Comprehensive Income: | | | | | | | | |
| Earnings for the period | | | | | | 521,657 | $ 521,657 | 521,657 |
| Balance, September 30, 2003 | 19,966,596 | $ 11,110,595 | $ | $ 734,183 | $ 107,752 | $ (9,432,116) | | $ 2,520,414 |

See accompanying notes to consolidated interim financial statements.

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**JONES SODA CO. AND SUBSIDIARIES**

Interim Consolidated Statements of Cash Flows

(Expressed in U.S. dollars)

( Unaudited )

Nine months ended September 30, 2003 and 2002

| | 2003 | 2002 |
|---|---|---|
| Cash flows from (used in) operating activities: | | |
| Earnings (loss) for the period | $ 521,657 | $ (838,394) |
| Items not involving cash: | | |
| Depreciation and amortization | 121,021 | 136,793 |
| Non cash stock compensation | 108,623 | |
| Bad debt recovery | (71,493) | |
| Changes in assets and liabilities: | | |
| Accounts receivable | (1,236,264) | 139,206 |
| Inventory | (39,957) | (85,865) |
| Prepaid expenses | 209,396 | 25,226 |
| Accounts payable and accrued liabilities | 730,160 | 865,749 |
| Net cash from operating activities | 343,143 | 242,715 |
| Cash flows used in investing activities: | | |
| Purchase of fixed assets | (70,260) | (27,705) |
| Purchase of intangible assets | (8,843) | (25,537) |
| Net cash used in investing activities | (79,103) | (53,242) |
| Cash flows from (used in) financing activities: | | |
| Net borrowing (repayment) under line of credit | (114,833) | (254,963) |
| Bank indebtedness | | 159,229 |
| Net borrowing (repayment) of capital lease obligations | 724 | (39,489) |
| Note receivable | 47,843 | |
| Deferred revenue | (29,026) | (37,500) |
| Proceeds from exercise of options | 89,364 | |
| Repurchase of escrow shares | | (16,750) |
| Net cash used in financing activities | (5,928) | (189,473) |
| Net increase in cash and cash equivalents | 258,112 | |
| Cash and cash equivalents, beginning of year | 50,065 | |
| Cash and cash equivalents, end of period | $ 308,177 | $ |
| Supplemental disclosure of non-cash financing and investing activities: | | |
| Licensing and inventory sold for note receivable | $ | $ 226,586 |
| Stock-based compensation | 108,623 | $ |

| | | |
|---|---|---|
| Bad debt recovery | 71,493 | |
| Increase in capital lease obligation | 40,740 | |
| Cash paid (received) during year for: | | |
| Interest received | $ (45,295) | $ |
| Interest payment | 41,373 | 36,722 |

See accompanying notes to interim consolidated financial statements.

**JONES SODA CO. AND SUBSIDIARIES**

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Unaudited    Prepared by Management

Nine months ended September 30, 2003

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**1. Nature and continuance of operations:**

Jones Soda Co. (the Company or Jones Soda ) develops, produces, markets, and distributes alternative or new age beverages. The Company s main product lines include the brands: Jones Soda Co.®, Jones Naturals, a non-carbonated juice & tea drink, Jones Energy, a high energy drink, WhoopAss, a high energy drink, and Whoopass Shots. Urban Juice and Soda Company Limited, the Company s predecessor, was incorporated in 1986 under the Company Act (British Columbia). Effective December 31, 1999, Urban Juice continued its incorporation in Wyoming. On August 3, 2000, Urban Juice reincorporated as a Washington corporation under the name Jones Soda Co. The Company has three operating subsidiaries, Jones Soda Co. (USA) Inc., Jones Soda (Canada) Inc., and myJones.com Inc., as well as one non-operating subsidiary, Whoopass USA Inc.

The Company s future operations are dependent upon the market s acceptance of its products. There can be no assurance the Company will be able to secure sufficient market acceptance for its products to generate income from operations. Operations to date have primarily been financed through the issuance of common stock and short-term debt. These consolidated financial statements have been prepared on a basis that assumes the realization of assets and settlement of liabilities in the normal course of business. During the nine month period ended September 30, 2003, the Company had net earnings of $521,657 and generated positive cash flows from operating activities. However, the Company s ability to continue as a going concern may be dependent upon its ability to raise additional financing and its ability to generate future profitable operations.

**2. Significant accounting policies:**

(a) Basis of presentation:

These interim consolidated financial statements have been prepared using generally accepted accounting principles in the United States of America.

The financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

The accompanying unaudited interim consolidated financial statements are prepared in accordance with United States generally accepted accounting principles but do not include all information and footnotes required by United States generally accepted accounting principles for annual statements. However, in the opinion of management, all adjustments (which consist only of normal recurring adjustments) necessary for a fair presentation of the results of operations for the relevant periods have been made. Results for the interim period are not necessarily indicative of the results to be expected for the year or for any other period. These financial statements should be read in conjunction with the summary of accounting policies and the notes to the consolidated financial statements for the year ended December 31, 2002 included in the Company s annual report on Form 10-KSB.

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**JONES SODA CO. AND SUBSIDIARIES**

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Unaudited    Prepared by Management

Nine months ended September 30, 2003

(b) Use of estimates:

The preparation of financial statements in accordance with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Areas of significant estimates include the assessment of collectibility of accounts receivable, net realizable value of inventory, and valuation allowance against deferred income tax assets. Accordingly, actual results may differ from these estimates.

(c) Foreign currency translation:

At December 31, 1999, the Company migrated its primary operations to Seattle, Washington, and subsequently the majority of the Company s transactions are originally denominated in US dollars. Accordingly, for the years ended December 31, 2002, 2001 and 2000, the functional currency of all companies within the group is the US dollar. As such, all foreign exchange gains or losses, including those arising from translating the net monetary assets of the Company s Canadian operations to US dollars, have been included in income. For the period ended September 30, 2003, the Company incurred a foreign exchange loss of $40,190 (2002 - $340 gain).

(d) Cash and cash equivalents:

The Company considers all short-term investments with a term to maturity at purchase of three months or less to be cash equivalents.

(e) Inventory:

Inventory has been stated at the lower of cost and estimated net realizable value and includes adjustments for estimated obsolescence. Cost includes laid-down cost and is determined principally using actual cost on a first-in first-out basis.

(f) Fixed assets:

Fixed assets are recorded at cost and are depreciated on the declining balance basis over the estimated useful lives of the assets as follows:

| **Asset** | **Rate** |
|---|---|
| Equipment | 20% to 50% |
| Automobile and computers | 30% |
| Equipment under capital lease | Lease term |

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**JONES SODA CO. AND SUBSIDIARIES**

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Unaudited Prepared by Management

Nine months ended September 30, 2003

(g) Intangible assets:

The Company s intangible assets include costs associated with attaining trademarks and patents for the Company s products and are amortized on a straight-line basis over 5 years.

(h) Impairment of long-lived assets and long-lived assets to be disposed of:

Long-lived assets, which include fixed assets and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(i) Revenue recognition:

Sales are recorded when title passes, which is when goods are received by the customer, and represent amounts realized net of provisions for sales returns, discounts and allowances which are recognized at the time of sale. Cash received in advance of delivery is recorded as deferred revenue in the consolidated balance sheet. Consideration paid to the customer is accounted for as a reduction in revenue.

For sales returns, the Company issues a credit note to the customer once it has obtained the returned goods. Discounts are offered to customers via promotional events. Discounts are recorded at the time of sale by issuing a credit note for the discount relating to the shipment.

In November 2002, the Financial Accounting Standards Board in the United States issued Emerging Issue Task Force 00-21 ( EITF 00-21 ). EITF 00-21, which, addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. In some arrangements, the different revenue-generating activities are sufficiently separable, and there may be sufficient evidence of their fair value to separate account for some or all of the deliverables. In other arrangements, some or all of the deliverables are not independently functional, or there is not sufficient evidence if their fair values to account for them separately. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The company believes that the adoption of ETIF 00-21 will have no material impact on its financial condition or result of operations.

(j) Research and development:

Research and development costs, which consist primarily of product development costs, are expensed in the period incurred and are included in general and administrative expenses. During the period ended September 30, 2003, the Company incurred research and development costs of $ nil (2002- $232).

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**JONES SODA CO. AND SUBSIDIARIES**

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Unaudited Prepared by Management

Nine months ended September 30, 2003

(k) Stock-based compensation:

The Company accounts for its stock-based compensation arrangements with employees in accordance with the provisions of Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees , and related interpretations. As such, compensation expense under fixed plans is recorded on the date of grant only if the market value of the underlying stock at that date exceeds the exercise price.

SFAS No. 123, Accounting for Stock Based Compensation , requires entities that continue to apply the provisions of APB Opinion No. 25 for transactions with employees to provide pro forma earnings (loss) and pro forma earnings (loss) per share disclosures for employee stock option grants as if the fair-value-based method in SFAS No. 123 had been applied to these transactions.

The Company recognizes compensation expense for stock options, common stock and other equity instruments issued to non-employees for services received based upon the fair value of the equity instruments issued at the date of performance completion.

Under APB 25, compensation expense is measured as the excess, if any, of the market price of the underlying stock over the exercise price on the measurement date of the grant. Had stock compensation expense for grants to employees under the Company s stock option plan been determined based on the fair value methodology under SFAS 123, the Company s net earnings (loss) for each of the three and Nine periods ended September 30, 2003 are presented as follows:

| | Nine Months Ended September | | Three Months ended September | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| Earnings (loss) as reported | $ 521,657 | $ (838,394) | $ 275,447 | $ (4,140) |
| Add: Stock-based employee compensation expenses included in reported earnings (loss) | 108,623 | | 45,539 | |
| Deduct: Total stock-based employee compensation expenses determined under fair value method for all awards | (102,462) | (39,138) | (23,551) | (2,621) |

| | | | | |
|---|---|---|---|---|
| Pro forma earnings (loss) | $ 527,818 | $ (877,532) | $ 297,435 | $ (6,761) |
| Earnings (loss) per share | | | | |
| Basic - as reported | 0.03 | (0.04) | 0.01 | (0.00) |
| Basic - pro forma | 0.03 | (0.04) | 0.01 | (0.00) |
| Diluted -as reported | 0.03 | (0.04) | 0.01 | (0.00) |
| Diluted -pro forma | 0.03 | (0.04) | 0.01 | (0.00) |

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**JONES SODA CO. AND SUBSIDIARIES**

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Unaudited  Prepared by Management

Nine months ended September 30, 2003

The fair value of these options was estimated at the date of grant using the Black-Scholes option pricing model, which takes into account (1) the market price of the underlying stock at the grant date, (2) the exercise price, (3) an expected life ranging from one to five years, (4) 0% dividend yield, (5) a risk-free interest rate of 1.61% (2002  3.75%), and (6) an estimated volatility of 77% (2002  75%)

The weighted average fair value of options granted in the third quarter 2003 was $1.10 (2002 no options granted).

The Company accounts for stock based compensation associated with employee awards with variable terms in accordance with the provisions of FASB Interpretation No. 28,  Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans  ( FIN 28 ). Under FIN 28, awards under stock compensation plans with variable exercise prices require variable accounting from the date of grant to the date the award is forfeited, exercised or expires unexercised. Variable accounting requires that the intrinsic value, being the excess of the current market price at the end of each reporting period over the exercise price of the options, be expensed as non-cash stock based compensation expense. Any increase in the intrinsic earnings will decrease reported earnings, and any subsequent decreases in value will increase reported earnings.

As at September 30, 2003, 285,000 options awards were outstanding with variable exercise prices. Incremental stock based compensation recognized during the nine month period ended September 30, 2003 for employee awards subject to variable accounting totaled $108,623.

(l) Advertising:

The Company expenses advertising costs as incurred. During the nine-month period ended September 30, 2003, the Company incurred advertising costs of $2,329,652 (2002 - $2,384,729).

(m) Income taxes:

The Company follows the asset and liability method of accounting for income taxes. Under this method, current taxes are recognized for the estimated income taxes payable for the current period. Deferred income taxes are provided based on the estimated future tax effects of temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases as well as the benefits of losses available to be carried forward to future years for tax purposes.

Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets when it is not more likely than not that such deferred tax assets will be realized.

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**JONES SODA CO. AND SUBSIDIARIES**

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Unaudited Prepared by Management

Nine months ended September 30, 2003

(n) Earnings (loss) per share:

Basic earnings (loss) per share is computed using the weighted average number of common shares outstanding during the periods, excluding treasury stock and common stock held in escrow that is subject to cancellation if certain criteria are not achieved. Diluted earnings (loss) per share is computed by adjusting the weighted average number of common shares by the effective net exercise or conversion of all dilutive securities.

(o) Comprehensive income (loss):

SFAS No. 130, Reporting Comprehensive Income , establishes standards for reporting and disclosure of comprehensive income and its components in a full set of general-purpose financial statements. The Company discloses the comprehensive income (loss) in the Consolidated Statement of Stockholders Equity. Comprehensive income (loss) includes earnings (loss) and foreign currency translation adjustments.

(p) Comparative figures:

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

**3. Inventory:**

| | **September 30 2003** | **December 31 2002** |
|---|---|---|
| Finished goods | $ 1,158,746 | $ 1,200,236 |
| Raw materials | 641,399 | 559,952 |
| | $ 1,800,145 | $ 1,760,188 |

**4. Bank indebtedness:**

On May 14, 2003, a credit facility was granted to the Company by Capco Financial Company, a division of Cupertino Bank, consisting of one-year revolving line of credit of up to $3,000,000. The amount available for borrowing from time to time under the revolving line of credit is dependent upon the levels of certain accounts receivable and inventory. This revolving line of credit is secured by all of the Company s assets, including accounts receivable, inventory, trademarks and other intellectual property, and certain equipment. Borrowings under the credit facility bear interest at prime plus 4% (8% at September 30, 2003). The credit facility does not impose any financial covenants. As of September 30, 2003, the Company had $Nil outstanding under the line of credit, out of total of $1,749,605 available for borrowing based on eligible accounts receivable and inventory at that time. In addition, part of the agreement all payments received on account receivable are submitted to Capco as collateral on the line of credit, if no amounts are outstanding on the line of credit the payment received by Capco are subject to a 3 day hold to allow for the application of funds. As of September 30, 2003, $303,381 included in cash and cash equivalents are subject to this 3 day hold.

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**JONES SODA CO. AND SUBSIDIARIES**

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Unaudited Prepared by Management

Nine months ended September 30, 2003

**5. Segmented information and export sales:**

The Company operates in one industry segment, with operations in the United States, Canada, Guam and Bermuda. During the nine-month periods ended September 30, 2003 sales in the United States were approximately $13,828,755 (2002 - $13,318,895); sales in Canada were approximately $2,086,857 (2002 - $2,067,131), and sales in Guam and Bermuda were approximately $85,019 (2002 Nil).

**6. Earnings (loss) per share:**

The computation for basic and diluted earnings per share are as follows:

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|---|---|---|---|
| | **2003** | **2002** | **2003** | **2002** |
| Earnings (loss) for the period | $ 275,447 | $ (4,140) | $ 521,657 | $ (838,394) |
| Weighted average number of common stock outstanding: | | | | |
| Outstanding September 30, 2003 | 19,966,596 | 19,800,596 | 19,966,596 | 19,800,596 |
| Basic | 19,829,080 | 19,800,596 | 19,810,091 | 19,883,730 |
| Dilutive stock option | 1,054,515 | | 416,402 | |
| Diluted | 20,883,595 | 19,800,596 | 20,226,493 | 19,883,730 |
| Earnings (loss) per share: | | | | |
| Basic | $ 0.01 | $ (0.00) | $ 0.03 | $ (0.04) |
| Diluted | $ 0.01 | $ (0.00) | $ 0.03 | $ (0.04) |

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

**Forward Looking Statements**

The matters discussed in this Report contain forward-looking statements that involve known and unknown risks and uncertainties, such as statements of the Company s plans, objectives, expectations and intentions. Generally, words such as anticipate, believe, estimate, intend, ma could, will, expect, project, plan and variations of such words and similar expressions are intended to identify such forward-looking stateme All statements that address operating performance, events or developments that management expects or anticipates will or may occur in the future, including statements related to distributor channels, volume growth, revenues, profitability, new products, adequacy of funds from operations, statements expressing general optimism about future operating results and non-historical information, are forward looking statements within the meaning of Section 27.A of the Securities Act of 1933, as amended, and Section 21.E of the Securities Exchange Act of 1934, as amended.

Readers should not place undue reliance on these forward-looking statements, which are based on management s current expectations and projections about future events, are not guarantees of future performance, are subject to risks, uncertainties and assumptions (including those described below) and apply only as of the date of this Report. The Company s actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below in Other Factors that May Affect Operating Results as well as those discussed elsewhere in this Report, and the risks discussed in the Company s most recently filed Annual Report on Form 10-KSB and in the press releases and other communications to shareholders issued by the Company from time to time which attempt to advise interested parties of the risks and factors that may affect the Company s business. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**Critical Accounting Estimates and Policies**

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates including, among others, those affecting revenues, the allowance for doubtful accounts, the saleability of inventory and the useful lives of tangible and intangible assets. The discussion below is intended as a brief discussion of some of the judgments and uncertainties that can impact the application of these policies and the specific dollar amounts reported on our financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, or if management made different judgments or utilized different estimates. Many of our estimates or judgments are based on anticipated future events or performance, and as such are forward-looking in nature, and are subject to many risks and uncertainties, including those discussed below and elsewhere in this Report. We do not undertake any obligation to update or revise this discussion to reflect any future events or circumstances.

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We have identified below some of our accounting policies and management s estimates used in applying such polices that we consider critical to our business operations and the understanding of our results of operations. This is not a complete list of all of our accounting policies, and there may be other accounting policies that are significant to the Company. For a detailed discussion on the application of these and our other accounting policies, see Note 2 to the Consolidated Financial Statements included in this Report.

**Revenue Recognition**. Our products are sold to distributors and various customers and retailers for cash or on credit terms. Our credit terms, which are established in accordance with local and industry practices, typically require payment within 30 days of delivery. We recognize revenue upon receipt by our distributors and customers of our products, in accordance with written sales terms, net of provisions for discounts and allowances. All sales to distributors and customers are final sales.

We also pay lump sum slotting fees to certain of our retailers for shelf space in their stores. Effective January 1, 2002, these slotting fees have been recorded as a reduction to revenue (which resulted in a reduction in revenue of approximately $402,000 for the first nine months of fiscal 2003 compared to a reduction in revenue of approximately $350,500 for the comparable period in fiscal 2002). We amortize the lump sum payment over a two-year period, which is based on historical data of product maintenance on retail shelves for that period of time. If we used a shorter amortization period (such as 18 months), we would have recognized a greater reduction in revenue for the applicable periods; and conversely, if we used a longer amortization period (such as three years), this would result in a relative increase in revenue being recognized for the period.

**Allowance for Doubtful Accounts; Bad Debt Reserve**. Management must estimate the collectibility of our accounts receivable. Management analyzes accounts receivable and historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. In general, we have historically and continue today to provide an allowance for doubtful accounts equal to 100% of any balance greater than 60 days since invoice. In addition, we accrue a bad debt reserve, which is estimated as a percentage of total sales. We believe that in general bad debt reserves for others in the beverage industry represent approximately 2% of total sales. Historically, our bad debt reserve has represented approximately 0.7% of total sales. However, due to the bad debt recorded in 2001 as a result of several of our distributors filing for bankruptcy or going out of business, for 2002 we increased our bad debt reserve. For 2002, we accrued an average bad debt reserve of approximately 0.9% of our total sales for the 2002 year. Our actual bad debt for 2002 was ultimately less than our accrued reserve and we adjusted the accrued reserve to our bad debt experience. Currently for 2003 we are accruing a bad debt reserve of 0.8% of our total sales for 2003. This current accrual is management s estimation based on historical bad debt expense and is in line with industry standards. If however there was bad debt expense in excess of that which was accrued, the bad debt expense would be adjusted accordingly. Bad debt expense is classified within general and administrative expenses in our Consolidated Statements of Operations.

Additionally, if we receive notice of a disputed receivable balance, we accrue such additional amount as management determines is reflective of the risk of non-collection. To date, other than as a result of the bankruptcies in 2001, we have not incurred material write-offs of accounts receivable. In considering the amount of bad debt allowance we rely heavily on our history of no material write-offs and that our revenue is not dependent on one or several customers, but is spread among a number of customers. However, other factors which could cause management to change its estimates would be a downturn in the economy that management determines has the potential to affect collectibles or if we see a greater concentration of our receivables from fewer customers. In such events, we may be required to record additional charges to cover this exposure. Material differences may result in the amount and timing of our bad debt expenses for any period if management made different judgments or utilized different estimates.

**Inventory**. We hold raw materials and finished goods inventories, which are manufactured and procured based on our sales forecasts. We value inventory at the lower of cost and estimated net realizable value, and includes adjustments for estimated obsolescence, on a first in-first out basis. These valuations are subject to customer acceptance and demand for the particular products, and our estimates of future realizable values based on these forecasted demands. We regularly review inventory detail to determine whether a write-down is necessary. We consider various factors in making this determination, including recent sales history and predicted trends, industry market conditions and general economic conditions. Differences could result in the amount and timing of write-downs for any period if we make different judgments or use different estimates. We also determine an allowance for obsolescence based on products that are over nine months from production date.

## MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

### Results of Operations for the Three and Nine Months Ended September 30, 2003

**(Expressed in U.S. Dollars)**

### Revenues

For the three months ended September 30, 2003, revenues were approximately $5,917,000, an increase of $345,000, or 6.2% over the $5,572,000 in revenues for the three months ended September 30, 2002. Consolidated case sales for the third quarter of 2003 were 448,000, a slight decrease of 1.3% over case sales of 454,000 for the third quarter of 2002. The increase in revenues during the three months ended September 30, 2003 from the comparable period in 2002 was primarily attributable to higher case sales of Jones Energy (up 67% from the comparable period in 2002) and Jones Naturals (up 21.2% from the comparable period in 2002), higher overall per case selling prices, and the sale of a one time limited edition promotional package which includes a limited edition Hot Wheels Jones Soda R.V. as well as four Hot Wheels themed Jones Soda. The Company implemented a price increase on Jones Naturals in March 2003, and previously implemented a price increase on its Jones Soda product line in June 2002. For the nine-month period ended September 30, 2003, revenues were approximately $16,001,000, an increase of $611,000, or 4.0% over the $15,390,000 in revenues for the nine-month period ended September 30, 2002. Consolidated case sales for the nine months of 2003 were 1,237,000, a slight decrease of 1.1% from case sales of 1,251,000 for the nine months of 2002. The increase in revenues during the nine months ended September 30, 2003 from the comparable period in 2002 was primarily attributable to higher case sales of Jones Energy (up 79.5% from the comparable period in 2002) and Jones Naturals (up 17.5% from the comparable period in 2002), higher overall per case selling prices, and the sale of a one-time limited edition Hot Wheels promotional package.

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Management believes that the overall increase in revenues was primarily attributable to its strategy of adding certain national accounts, including Barnes & Noble (Jones Naturals) and Panera Bread Company (Jones Soda and Jones Naturals), in conjunction with continuing to focus on selling its products into four distinct regions consisting of the Northwest, the Southwest, the Midwest and Western Canada. Revenues for Jones Energy increased primarily due to the launch of a 16 ounce Jones Energy format in the second quarter of 2003. We anticipate sales of Whoopass for the remainder of fiscal 2003 will continue to be less than in the comparable period of fiscal 2002, as we are focusing our efforts more on the Jones Soda, Jones Naturals and Jones Energy brands.

**Gross Profit**

For the three and nine-month periods ended September 30, 2003, gross profit was approximately $2,191,000 and $5,797,000 respectively. Gross profit increased by approximately $266,000 or 13.8% over the $1,925,000 in gross profit for the three months ended September 30, 2002, and $836,000 or 16.9% over the $4,961,000 in gross profit for the nine months ended September 30, 2002. For the three-month period ended September 30, 2003, gross profit as a percentage of revenue increased from 34.6% to 37.0%, and gross profit as a percentage of revenue increased from 32.2% to 36.2% for the nine-month period ended September 30, 2003. Gross profit for 2002 was negatively affected by write downs in inventory of approximately $408,000 taken in the second and third quarters of 2002, whereas there have been no inventory write downs in 2003. The increase in gross profit and gross profit as a percentage of revenue between comparable periods was also attributable to higher per case selling prices on Jones Soda and Jones Naturals, the sale of one time limited promotional package of Hot Wheels, in conjunction with a lower cost of product on Jones Soda and Jones Naturals, and a higher gross margin on Whoopass. These increases were partially offset by a lower gross margin on Jones Energy due to the new 16 ounce format of Jones Energy.

**Total Operating Expenses**

Total operating expenses for the three and nine-month periods ended September 30, 2003 were approximately $1,890,000 and $5,264,000 respectively. Total operating expenses decreased by $30,000, or 1.64%, over operating expenses of $1,920,000 for the three months ended September 30, 2002, and decreased by $499,000, or 8.7%, over operating expenses of $5,763,000 for the nine months ended September 30, 2002. For the quarter ended September 30, 2003, operating expenses as a percentage of revenue decreased to 32% from 34.8% over the comparable period in 2002. For the nine-month period ended September 30, 2003, total operating expenses as a percentage of revenue decreased to 33% from 37.4% over the comparable period in 2002. The decrease in total operating expenses in absolute dollars was primarily attributable to a reduction in general and administrative expenses, and to a lesser extent, for the nine month period only, a reduction in promotion and selling expenses. These decreases in expenses were partially offset by an increase in non-cash stock based compensation expense.

**Promotion and Selling Expenses**

Promotion and selling expenses for the three and nine-month periods ended September 30, 2003 were approximately $1,358,000 and $3,675,000, respectively. Promotion and selling expenses increased by $51,000, or 3.9%, over promotion and selling expenses of $1,307,000 for the three months ended September 30, 2002, and decreased by $163,000, or 4.2%, over promotion and selling expenses of $3,838,000 for the nine months ended September 30, 2002. Promotion and selling expenses as a percentage of revenue decreased to 22.9% for the three months ended September 30, 2003 from 23.5% over the comparable period in 2002. Promotion and selling expenses as a percentage of revenue decreased to 22.9% for the nine months ended September 30, 2003 from 24.9% over the comparable period in 2002. The increase in promotion and selling expenses for the three months ending September 30, 2003 was primarily attributable to a slight increase in distributor programs, including a promotional program with Albertsons in our Western region, partially offset by a decrease in other marketing programs as well as decreased salaries and wages associated with a new incentive-based compensation program for the Company s sales force implemented in the first quarter of 2003. During the remainder of fiscal 2003, we anticipate continuing to invest in our promotional and selling efforts, and increase sales staff, to help build and grow our brands, which may result in increased promotion and selling expenses.

**General and Administrative Expenses**

General and administrative expenses for the three- and nine-month periods ended September 30, 2003 were approximately $487,000 and $1,480,000, respectively, compared to $612,000 and $1,925,000 for comparable periods in 2002. General and administrative expenses decreased by $125,000 or 20.4% for the three months ended September 30, 2003, and $445,000 or 23.1% for the nine months ended September 30, 2003. General and administrative expenses as a percentage of revenue decreased to 8.2% for the three months ended September 30, 2003 from 11.0% over the comparable period in 2002. General and administrative expenses as a percentage of revenue decreased to 9.3% for the nine months ended September 30, 2003 from 12.5% over the comparable period in 2002. The decrease in general and administrative expenses in absolute dollars is primarily due to decreases in executive salaries (due in part to having only two current executives, compared to three executives at September 30, 2002) and rent, as well as a net reversal of $70,260 in bad debt expenses, partially offset by an increase in legal fees and insurance expenses.

**Other expenses**

Other expenses for the three and nine-month periods ended September 30, 2003 was approximately $25,000 and $11,000, respectively, compared to other expense of approximately $9,600 and $37,000 over the comparable periods in 2002. Other income in 2003 primarily includes a reversal of interest expense in each of the first and second quarters of 2003, which was over accrued in previous periods based on an assumption of an estimated minimum interest expense associated with our prior line of credit. Other expenses in 2003 included foreign exchange losses.

**Net Income (loss)**

Net income for the three and nine-month periods ended September 30, 2003 was approximately $275,000 and $522,000, respectively, compared to a net loss of $4,000 and $838,000 for the respective comparable periods in 2002. The increase in net income for the comparable three and nine-month periods was due primarily to an improvement in earnings from operations, the result of an increase in gross profit and a reduction in general and administrative expenses.

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**Liquidity and Capital Resources**

The operations of the Company historically have primarily been funded through the issuance of common stock and external borrowings.

As of September 30, 2003, the Company had working capital of approximately $2,068,000 compared to working capital of $1,288,000 as at December 31, 2002. The increase in working capital was primarily attributable to increased cash, accounts receivable and inventory as a result of increases in sales and cash flows from operations, more than offsetting increases in accounts payable.

On May 14, 2003, the Company entered into a new credit facility with Capco Financial Company, a division of Cupertino National Bank, consisting of a one-year revolving line of credit of up to $3,000,000. This credit facility with Capco Financial replaces the prior credit facility with Wells Fargo Business Credit, which expired by its terms in June 2003. The amount available for borrowing from time to time under the new revolving line of credit is dependent upon the levels of certain eligible accounts receivable and inventory. This revolving line of credit is secured by all of the Company s assets, including accounts receivable, inventory, trademarks and other intellectual property, and certain equipment. Borrowings under the credit facility bear interest at the prime rate plus 4% (8% as of September 30, 2003). The credit facility does not impose any financial covenants. As of September 30, 2003, the Company had no amounts outstanding under the line of credit, out of a total of $1,749,605 available for borrowing based on eligible accounts receivable and inventory at that time.

Cash and cash equivalents were $308,177 as of September 30, 2003 compared to $50,065 as of December 31, 2002 and compared to nil at September 30, 2002. Net cash from operating activities was $343,000 for the nine months ended September 30, 2003. The Company used $79,000 in investing activities for the nine months ended September 30, 2003, primarily for the purchase of coolers and registration of miscellaneous trademarks. Cash flow used in financing activities was $5,900 for the nine months ended September 30, 2003 and consisted primarily of a repayment of the prior line of credit with Wells Fargo and partially offset by proceeds from capital lease financing and proceeds from the exercise of stock options.

The increase in the Company s accounts receivable from December 31, 2002 to September 30, 2003 from $932,654 to $2,240,411 was due principally from seasonal fluctuations. The company s outstanding accounts receivable as of September 30, 2003 were substantially the same as the $2,180,263 outstanding at September 30, 2002. Similarly, the increase in accounts payable from December 31, 2002 to September 30, 2003 from $1,765,298 to $2,495,457 was due principally from seasonal fluctuations, and the Company s accounts payable as of September 30, 2003 were substantially the same as the $2,541,440 outstanding at September 30, 2002.

**Seasonality**

The Company has experienced significant fluctuations in quarterly results that have been the result of many factors, including the following:

- the shift in business focus from being solely a regional distributor of licensed and unlicensed brands and products to being a developer, producer, marketer and distributor of internally developed brands and products;
- the seasonal demand for beverages; and

competition and general economic conditions.

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Due to these and other factors, the Company s results of operations have fluctuated from period to period. As a result, management believes that period-to-period comparisons of results of operations are not necessarily meaningful and should not be relied upon as any indication of future performance. Like many other companies in the beverage industry, the Company generates a substantial percentage of its revenues during the warm weather months of April through September. Management believes that the demand for the Company s products will continue to reflect such seasonal consumption patterns. While the Company looks to expand its distribution network and increase market penetration, however, such seasonality may not be easily discernible from results of operations. Due to all of the foregoing factors, the Company s operating results in a particular quarter may fail to meet market expectations.

**Other Factors that May Affect Operating Results**

The Company s operating results may fluctuate due to a number of factors, including, but not limited to:

- the ability of the Company s third party distributors to successfully promote and sell the Company s products;
- the Company s ability to (i) develop and expand distribution channels, (ii) develop favorable arrangements with third party distributors of the Company s products and (iii) minimize or reduce issues associated with engaging new distributors, including, but not limited to, transition costs and expenses and down time resulting from the initial deployment of the Company s products in each new distributor s network;
- the Company s ability to develop and implement its direct-to-retail sales channels and national retail accounts, as well as its yourjones and myjones programs;
- the Company s ability to increase distribution in its four core regions consisting of the Northwest, the Southwest, the Midwest and Western Canada, and its ability to expand and manage distributor growth in areas outside of the core regions;
- unilateral decisions by distributors, grocery store chains, specialty chain stores, club stores, mass merchandisers and other customers to discontinue carrying all or any of the Company s products that they are carrying at any time;
- competitive products and pricing pressures and the Company s ability to gain or maintain share of sales in the marketplace as a result of actions by competitors;
- the Company s ability to generate sufficient cash flows to support general operating activities, promotion and sales activities, and capital expansion, and its ability to operate profitably;
- the availability of financing, whether on terms acceptable to the Company or at all, including the terms and/or availability of the Company s credit facility and the actions of its creditors;
- the Company s ability to develop and maintain favorable arrangements with third party packers and suppliers of the Company s products, including the outcome of the arbitration proceeding involving Pro-Liquitech (see Legal Proceedings below);
- the Company s ability to effectively manage changes in key personnel or management;

the Company s ability to develop and maintain brand awareness for its products;

the Company s success in introducing new products to the market and the market s acceptance of the new products;

the Company s ability to comply with federal, state and provincial laws and regulations and any changes or amendments thereon, and the cost and effect of such compliance;

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- changes in consumer tastes, preferences and demographic patterns;

- changes in the cost and availability of raw materials and the ability to maintain favorable supply arrangements and relationships and procure timely and/or adequate production of all or any of the Company s products;

- fluctuations in foreign currency rates, interest rates and other capital market conditions;

- the Company s ability to penetrate new markets;

- the effectiveness of the Company s advertising, marketing and promotional programs; and

- adverse weather conditions, which could reduce demand for the Company s products.

**Investor Relations**

During the period ending September 30, 2003, the Company completed all Investor Relations activities in-house. The Company sent out copies of news or press releases, the Company s corporate brochure, and communicated to shareholders with a monthly newsletter and a quarterly Investor Conference Call.

**ITEM 3 Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of the Company s management, including the Chief Executive Officer and Chief Financial Officer/Chief Operating Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer/Chief Operating Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

## PART II. OTHER INFORMATION

**ITEM 1. Legal Proceedings**

The Company is currently in dispute with Pro-Liquitech International, its primary flavor concentrate supplier, with respect to pricing, exclusivity, and other terms of and performance under the supply contract between the parties. In February 2003, Pro-Liquitech filed a request for arbitration with the American Arbitration Association claiming monetary damages, and the Company has counterclaims against Pro-Liquitech.

On October 17, 2003 the Company and Pro-Liquitech entered into a short-form settlement agreement resolving their disputes under the supply contract and agreeing to drop their respective claims and counterclaims in exchange for mutual waivers and releases. The short-form settlement agreement contemplates that the parties will enter into formal mutual waiver and release documentation, which documents have not yet been finalized. Management believes that settlement of this dispute on the terms set forth in the short-form settlement agreement will not have a material adverse effect on the Company  s ability to obtain supplies of flavor concentrate as and when needed, or on its financial condition or results of operations.

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Other than described above, the Company is not a party to any pending material legal proceedings. However, from time to time, we may pursue (and have pursued in the past) litigation against third parties to enforce or protect our rights under our trademarks, trade secrets and our intellectual property rights generally.

### ITEM 5. OTHER INFORMATION

### ITEM 6 Exhibits and Reports on Form 8-K

(a) Exhibits

10.1 Employment Agreement dated October 1, 2003 between the Company and Jennifer Cue

31.1 Certification of Peter van Stolk, President and Chief Executive Officer

31.2 Certification of Jennifer Cue, Chief Financial Officer and Chief Operating Officer

32.1 Certification Peter van Stolk, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Jennifer Cue, Chief Financial Officer and Chief Operating Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on 8-K.

The Company filed a Form 8-K on October 30, 2003, reporting that a news release was issued on October 30, 2003 announcing the Company s financial results for its third quarter ended September 30, 2003.

## SIGNATURE

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 hereunto duly authorized.

November 13, 2003

JONES SODA CO.

By: /s/ Peter van Stolk

Peter van Stolk
President and Chief Executive Officer

(principal executive officer)

By: /s/ Jennifer L. Cue

Jennifer L. Cue
Chief Financial Officer and Chief Operating Officer

(principal financial officer)

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