

REED'S, INC.
Form 10-K
April 24, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2016

Commission File Number 000-32501

REED'S, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|--|
| Delaware | 35-2177773 |
| State or other jurisdiction of incorporation or organization | I.R.S. Employer Identification Number |

| | |
|--|--------------|
| 13000 South Spring Street | |
| Los Angeles, California | 90061 |
| Address of principal executive offices | Zip Code |

(310) 217-9400

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

| Title of Class | Name of each exchange where registered |
|---|---|
| Common Stock, \$.0001 par value per share | NYSE MKT |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer" and "small reporting company" in Rule 12b-2 of the Exchange Act.

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

Large Accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates (excluding voting shares held by officers and directors) as of June 30, 2016 was \$28,320,000.

13,982,230 common shares, \$.001 par value, were outstanding on December 31, 2016.

TABLE OF CONTENTS

| | Page |
|---|--------|
| <u>PART I</u> | 5 |
| Item 1. <u>Business</u> | 5 |
| Item 2. <u>Properties</u> | 12 |
| Item 3. <u>Legal Proceedings</u> | 12 |
| Item 4. <u>Mine Safety Disclosures.</u> | 12 |
| <u>PART II</u> | 13 |
| Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 13 |
| Item 6. <u>Selected Financial Data</u> | 15 |
| Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | 15 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 22 |
| Item 8. <u>Financial Statements</u> | 23 |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | 24 |
| Item 9A. <u>Controls and Procedures</u> | 24 |
| Item 9B. <u>Other Information</u> | 24 |
| <u>PART III</u> | 25 |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u> | 25 |
| Item 11. <u>Executive Compensation</u> | 30 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 32 |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u> | 32 |
| Item 14. <u>Principal Accountant Fees and Services</u> | 33 |
| <u>PART IV</u> | 35 |
| Item 15. <u>Exhibits, Financial Statement Schedules</u> | 35 |

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS AND INFORMATION

This Annual Report on Form 10-K (“Annual Report”), the other reports, statements, and information that we have previously filed or that we may subsequently file with the Securities and Exchange Commission (“SEC”) and public announcements that we have previously made or may subsequently make include, may include, incorporate by reference or may incorporate by reference certain statements that may be deemed to be forward-looking statements. The forward-looking statements included or incorporated by reference in this Annual Report and those reports, statements, information and announcements address activities, events or developments that Reed’s, Inc. (hereinafter referred to as “we,” “us,” “our” or “Reed’s”) expects or anticipates will or may occur in the future. Any statements in this document about expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and are forward-looking statements. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “will continue,” “a,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would” and “outlook” and similar expressions. Accordingly, these statements involve estimates, assumptions and uncertainties, which could cause actual results to differ materially from those expressed in them. Any forward-looking statements are qualified in their entirety by reference to the factors discussed throughout this document. All forward-looking statements concerning economic conditions, rates of growth, rates of income or values as may be included in this document are based on information available to us on the dates noted, and we assume no obligation to update any such forward-looking statements.

The risk factors referred to in this Annual Report could cause actual results or outcomes to differ materially from those expressed in any forward-looking statements made by us, and you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made and we do not undertake any obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Management cautions that these statements are qualified by their terms and/or important factors, many of which are outside of our control, involve a number of risks, uncertainties and other factors that could cause actual results and events to differ materially from the statements made, including, but not limited to, the following risk factors.

Our ability to generate sufficient cash flow to support capital expansion plans and general operating activities,

Decreased demand for our products resulting from changes in consumer preferences,

Competitive products and pricing pressures and our ability to gain or maintain its share of sales in the marketplace,

The introduction of new products,

Our being subject to a broad range of evolving federal, state and local laws and regulations including those regarding the labeling and safety of food products, establishing ingredient designations and standards of identity for certain foods, environmental protections, as well as worker health and safety. Changes in these laws and regulations could have a material effect on the way in which we produce and market our products and could result in increased costs,

Changes in the cost and availability of raw materials and the ability to maintain our supply arrangements and relationships and procure timely and/or adequate production of all or any of our products,

Our ability to penetrate new markets and maintain or expand existing markets,

Maintaining existing relationships and expanding the distributor network of our products,

The marketing efforts of distributors of our products, most of whom also distribute products that are competitive with our products,

Decisions by distributors, grocery chains, specialty chain stores, club stores and other customers to discontinue carrying all or any of our products that they are carrying at any time,

The availability and cost of capital to finance our working capital needs and growth plans,

The effectiveness of our advertising, marketing and promotional programs,

Changes in product category consumption,

Economic and political changes,

Consumer acceptance of new products, including taste test comparisons,

Possible recalls of our products,

Our ability to make suitable arrangements for the co-packing of any of our products, and

Our ability to find alternative copacking and production facilities for our Kombucha and Private Label products if our Los Angeles production facility is damaged by a disaster.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements.

PART I

Item 1. Business

Background

We develop, manufacture, market and sell natural non-alcoholic carbonated soft drinks, Kombucha, candies and ice creams. We currently manufacture, license, market and sell several unique product lines:

Reed's Ginger Brews,

Virgil's Root Beer, Cream Sodas, Dr. Better and Real Cola, including ZERO diet sodas,

Culture Club Kombucha,

China Colas,

Reed's Ginger candy and other products,

Sonoma Sparkler and other juice based products.

We also have a private label business.

We sell our products throughout the US and in select international markets. We started in specialty gourmet and natural food stores and have moved more into mainstream over time. We estimate that our products are sold in well over 22,000 natural, conventional, drug, club and mass merchandise accounts in the US, with approximately 10,000 of those being mainstream supermarkets. We sell our products through a network of natural, gourmet and beer distributors and direct to certain large national retailers.

We produce and co-pack our beverage products in part at our facility in Los Angeles, California, known as the Brewery and at contracted co-packing facilities in Pennsylvania and Indiana. These co-pack facilities typically service the eastern half of the United States and nationally for certain products that we do not produce at The Brewery.

Key elements of our business strategy include:

increase our relationship with and sales to the approximately 15,000 supermarkets that carry our products in natural and mainstream and capture more of the 30,000 supermarkets nationwide,

expand our distribution network by adding regional direct store delivery (DSD's) and additional direct accounts,

stimulate consumer demand and awareness for our existing brands and products through promotions and advertising,

develop additional product flavors under our brands (brand extensions) and other new products, including specialty packaging and alternative uses for our products,

develop and produce private-label products for select customers,

lower our cost of sales for our products by gaining economies of scale in our purchasing, and

optimize the size and focus of our sales force to manage our relationships with distributors and retail outlets.

We create consumer demand for our products by:

supporting in-store sampling programs of our products, and

generating free press through public relations, and

advertising in store publications, and

maintaining a company website (www.reedsinc.com), and

active social media campaigns on facebook.com, twitter.com and youtube.com, and

participating in large public events as sponsors, and

in the recent past deployed a national television commercial on cable television networks.

Our principal executive offices are located at 13000 South Spring Street, Los Angeles, California 90061. Our telephone number is (310) 217-9400. Our Internet address is (www.reedsinc.com). Information contained on our website or that is accessible through our website should not be considered to be part of this Annual Report.

Historical Development

Reed's Original Ginger Brew created in 1987 by Christopher J. Reed, our founder, former Chief Executive Officer, and current Chief Innovation Officer was introduced to the market in Southern California stores in 1989. By 1990, we began marketing our products through United Natural Foods Inc. (UNFI) and other natural food distributors and moved our production to a larger facility in Boulder, Colorado.

In 1991, we incorporated our business operations in the state of Florida under the name of Original Beverage Corporation and moved all production to a co-pack facility in Pennsylvania. Throughout the 1990's, we continued to develop and launch new Ginger Brew varieties. Reed's Ginger Brews reached broad placement in natural and gourmet foods stores nationwide through UNFI and other major specialty, natural/gourmet and mainstream food and beverage distributors.

In 1997, we began licensing the products of China Cola and eventually acquired the rights to that product in 2000. In 1999, we purchased the Virgil's Root Beer brand from the Crowley Beverage Company. In 2000, we moved into an 18,000-square foot warehouse property, the Brewery, in Los Angeles, California, to house our west coast production and warehouse facility. The Brewery also serves as our principal executive offices. In 2001, pursuant to a reincorporation merger, we changed our state of incorporation to Delaware and also changed our name to "Reed's, Inc."

On December 12, 2006, we completed the sale of 2,000,000 shares of our common stock at an offering price of \$4.00 per share in our initial public offering. The public offering resulted in gross proceeds of \$8,000,000. Following the public offering, we expanded sales and operations dramatically, initially using a direct store delivery strategy in Southern California, along with other regional independent direct store distributors (DSD). The relationships with DSD's were supported by our sales staff. In 2007 we raised a net of \$7,600,000 in a private placement. We re-focused our sales strategy to eliminate company direct store delivery sales and to expand sales to DSD's and natural food distributors on a national level. We also started selling directly to supermarket grocery stores, which has become a significant portion of our business today.

We continually introduce new products and line extensions, such as our California Juice Company products in 2009, Virgil's diet line of ZERO beverages introduced in 2010 and Dr. Better and Light 55 Calories Extra Ginger Brew in 2011. We commenced offering private label products in 2010 and in 2012 we launched our Culture Club Kombucha line that has been expanded as sales have grown. In 2015 we launched Stronger Ginger Brew that contains 50% more fresh ginger than our best-selling Reed's Extra Ginger Brew.

Industry Overview

We offer natural premium carbonated soft drinks (CSD), which are a growing segment of the estimated \$10 billion CSD market nationwide. Within natural food store markets, we are among the top-selling natural soft drinks. This market is steady and growing. We also sell in major grocery chains nationally. The trend in grocery stores is to expand offerings of natural products and we have the scale and capability to develop these direct customer relationships.

Our Products

We primarily manufacture and sell beverages and candies or other ginger related products. We make all of our products using premium all-natural ingredients and our beverage line is GMO free. Our primary brands are our Reed's ginger brew line, our Virgil's line of root beer and our Culture Club Kombucha. Our candy products that include Reed's Crystallized Ginger Candy and Reed's Chews represent a lesser portion of revenues. We have sold ginger ice cream in prior years.

Reed's Ginger Brews

Ginger ale is the oldest known soft drink. Before modern soft drink technology existed, non-alcoholic beverages were brewed at home directly from herbs, roots, spices, and fruits. These handcrafted brews were highly prized for their taste and their tonic, health-giving properties. Reed's Ginger Brews are a revival of this lost art of home brewing sodas. We make them with care and attention to wholesomeness and quality, using the finest fresh herbs, roots, spices, and fruits.

We believe that Reed's Ginger Brews are unique in their kettle-brewed origin among all mass-marketed soft drinks. Reed's Ginger Brews contain between 8 and 39 grams of fresh ginger in every 12-ounce bottle. We use pure cane sugar as the sweetener. Our products differ from commercial soft drinks in three particular characteristics: sweetening, carbonation and coloring for greater adult appeal. Instead of using injected-based carbonation, we produce our carbonation naturally, through slower, beer-oriented techniques. This process produces smaller, longer lasting bubbles that do not dissipate rapidly when the bottle is opened. We do not add coloring. The color of our products comes naturally from herbs, fruits, spices, roots and juices and our beverages are GMO free.

In addition, since Reed's Ginger Brews are pasteurized, they do not require or contain any preservatives. In contrast, modern commercial soft drinks generally are produced using natural and artificial flavor concentrates prepared by flavor laboratories, tap water, and highly refined sweeteners. Typically, manufacturers make a centrally processed concentrate that will lend itself to a wide variety of situations, waters and filling systems. The final product is generally cold-filled and requires preservatives for stability. Colors are added that are either natural, although highly processed, or artificial.

Our Reed's line contains the following products:

Reed's Original Ginger Brew was our first creation and is a Jamaican recipe for homemade ginger ale using 17 grams of fresh ginger root, lemon, lime, honey, raw cane sugar, pineapple, herbs and spices. Reed's Original Ginger Brew is 20% fruit juice.

Reed's Premium Ginger Brew is sweetened only with honey and pineapple juice. Reed's Premium Ginger Brew is 20% fruit juice and contains 17 grams of fresh ginger root.

Reed's Raspberry Ginger Brew is brewed from 17 grams of fresh ginger root, raspberry juice and lime. Reed's Raspberry Ginger Brew is 20% raspberry juice.

Reed's Spiced Apple Brew uses 8 grams of fresh ginger root, the finest tart German apple juice and such apple pie spices as cinnamon, cloves and allspice. Reed's Spiced Apple Brew is 50% apple juice.

Reed's Cherry Ginger Brew is naturally brewed from 17 grams of fresh ginger root, cherry juice from concentrate and spices.

Reed's Light 55 Calories Extra Ginger Brew is a reduced calorie version of our top selling Reed's Extra Ginger Brew that was made possible by using Stevia. We use the same recipe of 26 grams of fresh ginger root, honey, pineapple, lemon and lime juices and exotic spices.

Reeds Extra Ginger Brew *is the same recipe as Original Ginger Brew, but has 26 grams of fresh ginger root for a stronger bite.*

Reeds Stronger Ginger Brew has 50% more ginger than the Extra Ginger Brew and has the highest ginger content of any of our beverage products.

Reed's Natural Energy Elixir is an energy drink infused with all natural ingredients designed to provide consumers with a healthy and natural boost to energy levels

Reed's Nausea Relief is based on our Ginger Brews with added B vitamins. Both ginger and B vitamins have been studied for their effectiveness in combating nausea.

Virgil's Root Beer

Virgil's is a premium craft root beer. We use all-natural ingredients, including filtered water, unbleached cane sugar, anise from Spain, licorice from France, bourbon vanilla from Madagascar, cinnamon from Sri Lanka, clove from Indonesia, wintergreen from China, sweet birch and molasses from the southern United States, nutmeg from Indonesia, pimento berry oil from Jamaica, balsam oil from Peru and cassia oil from China. We collect these ingredients worldwide and gather them together at the brewing and bottling facilities. We combine these ingredients under strict specifications and finally heat-pasteurize Virgil's Root Beer, to ensure quality. We sell Virgil's Root Beer in three packaging styles: 12-ounce bottles in a four-pack, a special swing-lid style pint bottle and a 5-liter self-tapping party keg. The Virgil's soda line is GMO free.

In addition to our Virgil's Root Beer, we also offer the following products under our Virgil's brand:

Virgil's Cream Soda,

Virgil's Orange Cream Soda,

Virgil's Black Cherry Cream Soda,

Virgil's Real Cola,

Virgil's Dr. Better,

Virgil's ZERO line, including Root Beer, Cream Soda, Real Cola, Dr. Better and Black Cherry Cream Soda. (Our ZERO line is naturally sweetened with Stevia), and

Reed's Culture Club Kombucha

We introduced our Culture Club Kombucha in 2012. Kombucha is a fermented tea that dates its origin back thousands of years. Among consumers, Kombucha is believed to have healing and cleansing characteristics. Sweetened tea is introduced to a "starter" culture and lightly fermented to produce an acetic drink. We make the finest Kombucha possible, using a combination of Oolong and Yerba Mate teas, spring water and a combination of ginger, organic juices and flavors. Initially, we produced four flavors, Goji Ginger, Hibiscus Ginger Grapefruit, Lemon Ginger Raspberry and Cranberry Ginger. We introduced four additional flavors in 2013, Pomegranate Ginger, Coconut Water Lime, Cabernet Grape, and Passion Mango Ginger.

Other Beverage Brands

We have other popular brands that currently have limited distribution, including China Cola, California Juice, Sonoma Sparkler and Flying Cauldron Butterscotch Beer. We are continually developing new brands and products.

Private Label Products

We design and manufacture drinks for private label customers in multiple facilities. We are experts in flavor development and in matching existing products in the market. We develop the recipe and may design the label and/or the bottle style. We do not private label any of our own branded product recipes.

Our private label products have been variations of any of our offerings. We develop the sources for glass and ingredients. We have a variety of packaging options, including swing-lid bottles, foil capsules and various label types. Our Los Angeles facility is certified as SQF level 2 compliant.

New Product Development

We are always working on ideas and products to continue expanding our Reed's Ginger Brews, Virgil's product line, Reed's Ginger Candy product lines and packaging styles. Current focus in our research is for reduced sugar offerings. Among the advantages of our self-operated Brewery are the flexibility to try innovative packaging and the capability to experiment with new product flavors at less cost to our operations or capital.

We have developed and are currently field testing an all-natural fountain offering. We expect the testing to be completed in 2017 and to begin distribution later in the year.

Our private label products require continual product development. We are able to be nimble and innovative, producing new products in a short amount of time.

Manufacture of Our Products

We produce our carbonated beverages in multiple facilities:

a facility in Los Angeles, California, known as The Brewery, at which we currently produce Kombucha, certain soda products and our private label products, and

two packing, or co-pack facilities in Pennsylvania and an additional co-packer in Indiana which supplies us with product we do not produce at The Brewery. The co-packer assembles our products and charges us a fee, generally by the case, for the products they produce.

We follow a “fill as needed” manufacturing model to the best of our ability and we have no significant backlog of orders. Substantially all of the raw materials used in the preparation, bottling and packaging of our products are purchased by us or by our contract packers in accordance with our specifications. Reed’s Crystallized Ginger is made to our specifications in Fiji. Reed’s Ginger Candy Chews are made and packed to our specifications in Indonesia.

Generally, we obtain the ingredients used in our products from domestic suppliers and each ingredient has several reliable suppliers. We have no major supply contracts with any of our suppliers. As a general policy, we pick ingredients in the development of our products that have multiple suppliers and are common ingredients. This provides a level of protection against a major supply constriction or calamity.

We believe that as we continue to grow, we will be able to keep up with increased production demands. The LA Brewery is nearing the completion of a major renovation that we believe will allow the Brewery to handle the entire West Coast business and to absorb significant increases in general sales. To the extent that any significant increase in business requires us to supplement or substitute our current co-packers, we are developing a pre-qualification for all prospective co-packers, so that there would not be a significant delay or interruption in fulfilling orders and delivery of our products. In addition, we do not believe that growth will result in any significant difficulty or delay in obtaining raw materials, ingredients or finished product that is repackaged at the Brewery.

Our Primary Markets

We target a niche in the estimated \$100 billion carbonated and non-carbonated soft drink markets in the US, Canada and International markets. Our brands are generally regarded as premium and natural, with upscale packaging and are loosely defined as the artisanal (craft), premium bottled carbonated soft drink category.

The soft drink industry is highly fragmented and the craft soft drink category consists of such competitors as, Henry Weinhardts, Thomas Kemper, Hansen's, Izze, Boylan and Jones Soda, to name a few. These brands have the advantage of being seen widely in the national market and being commonly known for years through well-funded ad campaigns. Despite our products having a relatively high price for an artisanal premium beverage product, minimal mass media advertising and a relatively small but growing presence in the mainstream market compared to many of our competitors, we believe that results to date demonstrate that Reed's Ginger Brews and Virgil's sodas are making strong inroads and market share gains against some of the larger brands in the market.

Kombucha is the largest growth segment of the functional beverage category of drinks and foods, including coconut water, yogurt and fresh juices. Among this broader category, the refrigerated juices and functional beverages segment grew by approximately \$200 million in 2012 to an estimated market of approximately \$600 million (50% growth), according to SPINS data. We are preparing an exciting relaunch of these brands in 2017 and expect to gain back a significant amount of lost space. Kombucha comprises the overwhelming majority share of this explosive growth and comprises most of the segment. It is generally believed that the segment will continue to expand at a strong rate over the next few years. Other functional drinks in this category are also expanding sales at healthy rates, primarily coconut water and fresh pressed juices. Consumer awareness and demand for functional drinks is increasing and we feel that Kombucha and other cultured drinks will be in the forefront of this expanding market category.

We sell the majority of our products in the natural food store, mainstream supermarket chains and foodservice locations, primarily in the United States and, to a lesser degree, in Canada and Europe.

Natural Food Stores

Our primary and historical marketing and distribution source of our products has been natural food and gourmet stores throughout the US. These stores include Whole Foods Market, Trader Joe's, Sprouts, The Fresh Market, Earth Fare, and New Seasons, just to name a few. Our brands are also sold in gourmet restaurants and deli's nationwide. With the advent of large natural food store chains and specialty merchants, the natural foods segment continues to grow each year, helping fuel the continued growth of our brands.

Mainstream Supermarkets and Retailers

We also sell our products to direct store delivery distributors (DSD) who specialize in distributing and selling our products directly to mainstream retail channels, natural foods, and specialty retail stores. Our brands are further sold directly to some retailers who require that we sell directly to their distribution centers since they have developed their own logistics capabilities. Examples of chains that fall into the “direct” category are retailers such as, Costco, Trader Joe’s, some Whole Foods Market Regions and Kroger.

Supermarkets, particularly supermarket chains and prominent local/regional chains, often impose slotting fees in order to gain shelf presence within their stores. These fees can be structured to be paid one-time only or in installments. We utilize selective slotting in supermarket chains throughout the US and to a lesser degree, in Canada. However, our local and national sales team has been able to place our products without having to pay significant slotting fees. Slotting fees for new item placements on average have cost anywhere between \$10 to \$150 per store, per new item.

Food Service Placement

We also market our beverages to industrial cafeterias (corporate feeders), and to on premise bars and restaurants. As our business continues to mature, we intend to place our beverages in stadiums, sport arenas, concert halls, theatres, and other cultural centers as long-term marketing and pouring relationships are developed within this business segment.

International Sales

We have developed a limited market for our products in Canada, Europe and Asia. Sales outside of North America currently represent 3% of our total gross sales. Sales in Canada represent about 1.3% of our total sales. We believe that there are good opportunities for expansion of sales in Canada, Middle East, England and Australia and we are increasing our marketing focus on those markets. Other international sales become cost prohibitive, except in specialty sales circumstances, since our premium sodas are packed in glass, which involves substantial freight to move overseas. We are open to opportunities to export and to co-pack internationally and expand our brands into foreign markets, and we are holding preliminary discussions with trading companies and import/export companies for the distribution of our products throughout Asia, Europe, Australia and South America. We believe that these areas are a natural fit for Reed's ginger products, because of the importance of ginger in international markets, especially the Asian market where ginger is a significant part of diet and nutrition.

Distribution, Sales and Marketing

We currently have a national network of mainstream, natural and specialty food distributors in the United States and Canada. We sell directly to our distributors, who in turn sell to retail stores. We also use our own internal sales force and independent sales representatives to promote our products for our distributors and direct sales to our retail customers. One of the main goals of our sales and marketing efforts is to increase sales and grow our brands. Our sales force consists of senior sales representatives in five geographic regions across the country who are supported in their region by local Reeds sales staff. Generally, our sales managers are responsible for all activities related to the sales, distribution and marketing of our brands to our entire distributor and retail partner network in North America. We distribute our products primarily through several national natural foods distributors and an increasing number of regional mainstream DSD distributors. We have entered into agreements with some of our distributors that commit us to "termination fees" if we terminate our agreements early or without cause. These agreements call for our customer to have the right to distribute our products to a defined type of retailer within a defined geographic region. As is customary in the beverage industry, if we should terminate the agreement or not automatically renew the agreement, we would be obligated to make certain payments to our customers. We are in constant review of our distribution agreement with our partners across North America. We also offer our products and promotional merchandise directly to consumers via the Internet through our website, www.reedsgingerbrew.com.

Marketing to Distributors

We market to distributors using a number of marketing strategies, including direct solicitation, telemarketing, trade advertising and trade show exhibition. These distributors include natural food, gourmet food and mainstream distributors. Our distributors sell our products directly to natural food, gourmet food and mainstream supermarkets for sale to the public. We maintain direct contact with our distributor partners through our in-house sales managers. From time to time and in very limited markets, when use of our own sales force is not cost effective, we will utilize

independent sales brokers and outside representatives.

Marketing to Retail Stores

The primary focus of our sales efforts is supermarket sales. We have a small highly trained sales force that is directly contacting supermarket chains and setting up promotional calendars. In addition, we market to retail stores by utilizing trade shows, trade advertising, telemarketing, direct mail pieces and direct contact with the store. Our sales managers and representatives visit these retail stores to sell directly in many regions. Sales to retail stores are coordinated through our distribution network and our regional warehouses.

Competition

The beverage industry is highly competitive. The principal areas of competition are pricing, packaging, development of new products and flavors and marketing campaigns. Our products compete with a wide range of drinks produced by a relatively large number of manufacturers. Most of these brands have enjoyed broad, well-established national recognition for years, through well-funded ad and other branding campaigns. In addition, the company's manufacturing these products generally have greater financial, marketing and distribution resources than we do. Important factors affecting our ability to compete successfully include taste and flavor of products, trade and consumer promotions, rapid and effective development of new, unique cutting edge products, attractive and different packaging, branded product advertising and pricing. We also compete for distributors who will concentrate on marketing our products over those of our competitors, provide stable and reliable distribution and secure adequate shelf space in retail outlets. Competitive pressures in the soft drink category could cause our products to be unable to gain or to lose market share or we could experience price erosion. We believe that our all natural innovative beverage recipes, packaging, use of premium ingredients and a trade secret brewing process provide us with a competitive advantage and that our commitments to the highest quality standards and brand innovation are keys to our success.

The Kombucha market is dominated by a few producers who sell their products nationally. The remainder of the producers is comprised of mostly fragmented regional or local companies. There are companies that gain market share in certain regions; however, most do not have the scale and capability to effectively sell and distribute on a national basis. We believe that Reed's Kombucha market share was achieved in a relatively short period of time, by leveraging our existing distribution channels and customer relationships to expand our sales volume quickly. We also have in-house production capabilities that can be scaled up as needed to make this a primary brand for Reed's. We believe that our existing infrastructure creates a competitive advantage, including product design, manufacturing & production and a network of sales & distribution.

Proprietary Rights

We own trademarks that we consider material to our business. Three of our material trademarks are registered trademarks in the U.S. Patent and Trademark Office: Reed's Original Ginger Brew All-Natural Jamaican Style Ginger Ale ®, Virgil's ®, and China Cola ®. Registrations for trademarks in the United States will last indefinitely as long as we continue to use and police the trademarks and renew filings with the applicable governmental offices. We have not been challenged in our right to use any of our material trademarks in the United States. We intend to obtain international registration of certain trademarks in foreign jurisdictions.

In addition, we consider our finished product and concentrate formulae, which are not the subject of any patents, to be trade secrets. Our brewing process is a trade secret. This process can be used to brew flavors of beverages other than ginger ale and ginger beer, such as root beer, cream soda, cola and other spice and fruit beverages. We have not sought any patents on our brewing processes because we would be required to disclose our brewing process in patent applications.

We generally use non-disclosure agreements with employees and distributors to protect our proprietary rights.

Government Regulation

The production, distribution and sale in the United States of many of our Company's products are subject to the Federal Food, Drug, and Cosmetic Act, the Federal Trade Commission Act, the Lanham Act, state consumer protection laws, federal, state and local workplace health and safety laws, various federal, state and local environmental protection laws and various other federal, state and local statutes and regulations applicable to the production, transportation, sale, safety, advertising, labeling and ingredients of such products. Outside the United States, the distribution and sale of our many products and related operations are also subject to numerous similar and other statutes and regulations.

A California law requires that a specific warning appear on any product that contains a component listed by the state as having been found to cause cancer or birth defects. The law exposes all food and beverage producers to the possibility of having to provide warnings on their products. This is because the law recognizes no generally applicable quantitative thresholds below which a warning is not required. Consequently, even trace amounts of listed components can expose affected products to the prospect of warning labels. Products containing listed substances that occur naturally or that are contributed to such products solely by a municipal water supply are generally exempt from the warning requirement. No Company beverages produced for sale in California are currently required to display warnings under this law. We are unable to predict whether a component found in a Company product might be added to the California list in the future, although the state has initiated a regulatory process in which caffeine will be evaluated for listing. Furthermore, we are also unable to predict when or whether the increasing sensitivity of detection methodology that may become applicable under this law and related regulations as they currently exist, or as they may be amended, might result in the detection of an infinitesimal quantity of a listed substance in a beverage of ours produced for sale in California.

Bottlers of our beverage products presently offer and use non-refillable, recyclable containers in the United States and various other markets around the world. Some of these bottlers also offer and use refillable containers, which are also recyclable. Legal requirements apply in various jurisdictions in the United States and overseas requiring that deposits or certain taxes or fees be charged for the sale, marketing and use of certain non-refillable beverage containers. The precise requirements imposed by these measures vary. Other types of beverage container-related deposit, recycling, tax and/or product stewardship statutes and regulations also apply in various jurisdictions in the United States and overseas. We anticipate that additional, similar legal requirements may be proposed or enacted in the future at local, state and federal levels, both in the United States and elsewhere.

All of our facilities and other operations in the United States are subject to various environmental protection statutes and regulations, including those relating to the use of water resources and the discharge of wastewater. Our policy is to comply with all such legal requirements. Compliance with these provisions has not had, and we do not expect such compliance to have, any material adverse effect on our capital expenditures, net income or competitive position.

Environmental Matters

Our primary cost environmental compliance activity is in recycling fees and redemption values. We are required to collect redemption values from our customers and remit those redemption values to the state, based upon the number of bottles of certain products sold in that state.

Employees

We have 62 full-time equivalent employees on our corporate staff down from 69 in the year ending December 31, 2015. The table below lists the departments. We employ additional people on a part-time basis as needed. We have never participated in a collective bargaining agreement. We believe that the relationship with our employees is good.

| Department | Number of FTE's | | |
|------------------------|-----------------|------|--------|
| | 2016 | 2015 | Change |
| General Management | 4.0 | 4.0 | - |
| Administrative Support | 9.2 | 11.1 | (1.9) |
| Research & Development | 5.5 | 4.0 | 1.5 |
| Sales | 16.0 | 17.4 | (1.4) |
| Production & Warehouse | 27.7 | 32.9 | (5.2) |
| Total | 62.4 | 69.4 | (7.0) |

Item 2. Property

We lease a facility of approximately 76,000 square feet, which serves as our principal executive offices, our West Coast Brewery and bottling plant and our Southern California warehouse facility. Approximately 30,000 square feet of the total space is leased under a long-term lease expiring in 2024. We also lease a warehouse of approximately 18,000 square feet under a lease expiring in October 2017, a warehouse of approximately 13,000 square feet under a lease expiring in November 2017, and a warehouse of 15,000 square feet on a month-to-month basis.

Item 3. Legal Proceedings

From time to time, we are a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates our exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

Item 4. Mine Safety Disclosures

Not applicable.

PART II**Item 5. Market for Common Equity and Related Stockholder Matters**

Our common stock is listed for trading on the NYSE MKT trading under the symbol “REED”. The following is a summary of the high and low bid prices of our common stock on the NYSE MKT Capital Markets for the periods presented:

| | Sales Price | |
|-------------------------------|-------------|--------|
| | High | Low |
| Year Ending December 31, 2015 | | |
| First Quarter | \$7.00 | \$5.32 |
| Second Quarter | 6.64 | 5.08 |
| Third Quarter | 6.39 | 4.44 |
| Fourth Quarter | 5.90 | 4.50 |
| Year Ending December 31, 2016 | | |
| First Quarter | \$5.46 | \$4.62 |
| Second Quarter | 4.85 | 2.37 |
| Third Quarter | 3.74 | 2.51 |
| Fourth Quarter | 4.25 | 3.86 |

As of December 31, 2016, there were approximately 4,500 stockholders of record of the common stock (including only non-objecting beneficial owners of record) and 13,982,230 outstanding shares of common stock.

Unregistered Sales of Equity Securities

During the fiscal year ended December 31, 2016, we issued the following equity securities that were unregistered under the Securities Act:

We issued 214 shares of common stock in exchange for Reeds Board of Director services. The value of the stock was based on the closing price of the stock on the issuance or agreed upon date. The total value of shares issued for services was \$900 the shares were issued pursuant to exemption from registration under Section 4(2) of the Securities Act.

Also during the fiscal year ended December 31, 2016, we issued the following equity securities that were registered under the Securities Act:

On June 2, 2016, pursuant to a Securities Purchase Agreement dated May 26, 2016 (“Purchase Agreement”) with institutional and accredited investors, Reed’s Inc., a Delaware corporation (“Reed’s” or the “Company”) closed a private financing transaction for the issuance and sale by Reed’s of 692,412 shares of common stock (“Shares”) and warrants to purchase 346,206 shares of common stock (“Warrants”), for gross proceeds to Reed’s of \$2,354,200. The Offering was made solely to accredited investors (as defined in Rule 501(a) under the Securities Act of 1933, as amended (the “Securities Act”)) in reliance upon the exemption from registration in Section 4(a)(2) of the Securities Act and Rule 506 of Regulation D.

The Company used the net proceeds from the offering for working capital and general corporate purposes.

The Warrants have an exercise price of \$4.25 per share and a term of 5 years. The exercise price of the Warrants is subject to customary adjustments in the event of stock dividends and splits, and the Warrants contain protective provisions in the event of fundamental transactions. In addition, holders of the Warrants shall be entitled to participate in distributions, dividends and subsequent rights offerings to the same extent that the holders would have participated therein if the holders had held the number of shares of common stock acquirable upon complete exercise of the Warrants. Except upon at least 61 days’ prior notice from a holder of a Warrant to the Company, the holder will not have the right to exercise any portion of the Warrant if the holder, together with its affiliates, would beneficially own in excess of 4.99% of the number of shares of the Company’s common stock (including securities convertible into common stock) outstanding immediately after the exercise.

The Company entered in to a registration rights agreement with the investors pursuant to which it filed a resale registration statement for the Shares and the common stock underlying the Warrants within 30 days of effective date.

Maxim Group LLC (“Maxim”) acted as the placement agent for the offering under a Placement Agent Agreement, dated May 26, 2016, between Maxim and Reed’s (the “Placement Agent Agreement”). Upon the closing of the offering, pursuant to the Placement Agent Agreement, Maxim received warrants to purchase up to 72,703 shares of common stock (“Placement Agent Warrants”). The Placement Agent Warrants have an exercise price of \$3.74 and are exercisable for a term of 5 years. The exercise price of the Placement Agent Warrants is subject to customary adjustments in the event of stock dividends and splits, and the Placement Agent Warrants contain protective provisions in the event of fundamental transactions.

Each of the Purchase Agreement and the Placement Agent Agreement contains customary representations, warranties and covenants of the parties thereto. The Company also agreed not to issue any shares of its common stock or rights to acquire shares of its common stock for a period of 90 days from the closing of the offering, subject to certain customary exemptions for issuances pursuant to the Company’s equity plans. In addition, the Company agreed not to enter into any variable rate transactions for a period of one year.

Dividend Policy

We have never declared or paid dividends on our common stock. We currently intend to retain future earnings, if any, for use in our business, and, therefore, we do not anticipate declaring or paying any dividends in the foreseeable future. Payments of future dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including the terms of our credit facility and our financial condition, operating results, current and anticipated cash needs and plans for expansion.

We are obligated to pay a non-cumulative 5% dividend from lawfully available assets to the holders of our Series A preferred stock in additional shares of common stock at our discretion. In 2016 and 2015, we paid dividends on our Series A preferred stock in an aggregate of 1,504 and 751 shares of common stock in each such year, respectively and anticipate that we will be obligated to issue at least this many shares annually to the holders of the Series A preferred stock so long as such shares are issued and outstanding.

Securities Authorized for Issuance Under Equity Compensation Plans

2007 Stock Option Plan and 2015 Incentive and Non-statutory stock option plan

On October 8, 2007, our board of directors adopted the 2007 Stock Option Plan for 1,500,000 shares and the plan was approved by our stockholders on November 19, 2007. All of the shares granted under our 2007 Stock Option Plan have been issued. Forfeited options issued under the 2007 plan can be reissued prior to expiration of the plan. On April 6, 2015, our board of directors adopted the 2015 Incentive and Non-statutory Stock Option Plan for 500,000 shares and the plan was approved by our stockholders on December 30, 2015. Forfeited options issued under the 2015 plan cannot be reissued.

The plans permit the grant of options to our employees, directors and consultants. The options may constitute either “incentive stock options” within the meaning of Section 422 of the Internal Revenue Code or “non-qualified stock options”. The primary difference between “incentive stock options” and “non-qualified stock options” is that once an option is exercised, the stock received under an “incentive stock option” has the potential of being taxed at the more favorable long-term capital gains rate, while stock received by exercising a “non-qualified stock option” is taxed according to the ordinary income tax rate schedule.

The plans are currently administered by the board of directors. The plan administrator has full and final authority to select the individuals to receive options and to grant such options as well as a wide degree of flexibility in determining the terms and conditions of options, including vesting provisions.

The exercise price of an option granted under the plan cannot be less than 100% of the fair market value per share of common stock on the date of the grant of the option. The exercise price of an incentive stock option granted to a person owning more than 10% of the total combined voting power of the common stock must be at least 110% of the fair market value per share of common stock on the date of the grant. Options may not be granted under the plan on or after the tenth anniversary of the adoption of the plan. Incentive stock options granted to a person owning more than 10% of the combined voting power of the common stock cannot be exercisable for more than five years.

When an option is exercised, the purchase price of the underlying stock will be paid in cash, except that the plan administrator may permit the exercise price to be paid in any combination of cash, shares of stock having a fair market value equal to the exercise price, or as otherwise determined by the plan administrator.

If an optionee ceases to be an employee, director, or consultant with us, other than by reason of death, disability or retirement, all vested options must be exercised within three months following such event. However, if an optionee’s employment or consulting relationship with us terminates for cause, or if a director of ours is removed for cause, all unexercised options will terminate immediately. If an optionee ceases to be an employee or director of, or a consultant to us, by reason of death, disability, or retirement, all vested options may be exercised within one year following such event or such shorter period as is otherwise provided in the related agreement.

For the 2007 plan, when a stock award expires or is terminated before it is exercised, the shares set aside for that award are returned to the pool of shares available for future awards. For the 2015 plan, when a stock award expires or is terminated before it is exercised, the shares are canceled and cannot be reissued.

No option can be granted under the plan after ten years following the earlier of the date the plan was adopted by the board of directors or the date the plan was approved by our stockholders.

Equity Compensation Plan Information

The following table provides information, as of December 31, 2016, with respect to equity securities authorized for issuance under compensation plans:

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in Column (a)) |
|--|--|--|---|
| Equity compensation plans approved by security holders | 1,048,500 | \$ 4.68 | 87,500 |
| Equity compensation plans not approved by security holders | 803,909 | \$ 4.50 | - |
| TOTAL | 1,852,409 | \$ 4.60 | 87,500 |

Item 6. Selected Financial Data

As a smaller reporting company, Reed's is not required to provide the information required by this Item 6.

Item 7. 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 Annual Report. This discussion and analysis may contain forward-looking statements based on assumptions about our future business. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including but not limited to those set forth under "Risk Factors" and elsewhere in this Annual Report.

Results of Operations

The following table sets forth key statistics for the years ended December 31, 2016 and 2015, respectively.

| | Year Ended | | Pct. | |
|--|----------------------|--------------|--------|---|
| | December 31, 2016 | 2015 | Change | |
| Gross sales, net of discounts & returns (a) | \$46,198,000 | \$49,713,000 | -7 | % |
| Less: Promotional and other allowances (b) | 3,726,000 | 3,765,000 | -1 | % |
| Net sales | \$42,472,000 | \$45,948,000 | -8 | % |
| Cost of tangible goods sold (c) | 31,626,000 | 32,295,000 | -2 | % |
| As a percentage of: | | | | |
| Gross sales | 68 | % 65 | | % |
| Net sales | 74 | % 70 | | % |
| Cost of goods sold – idle capacity (d) | 1,864,000 | 2,048,000 | -9 | % |
| As a percentage of net sales | 4 | % 4 | | % |
| Gross profit | \$8,982,000 | \$11,605,000 | -23 | % |
| Gross profit margin as a percentage of net sales | 21 | % 25 | | % |

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

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

(c) Cost of tangible goods sold consists of the costs of raw materials and packaging utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, inventory adjustments, as well as certain internal transfer costs. Cost of tangible goods sold is used internally by management to measure the direct costs of goods sold, aside from unallocated plant costs. Cost of tangible goods sold is not a measure that is recognized under GAAP and should not be considered as an alternative to cost of goods sold, which is determined in accordance with GAAP, and should not be used alone as an indicator of operating performance in place of cost of goods sold.

(d) Cost of goods sold – idle capacity consists of direct production costs in excess of charges allocated to our finished goods in production. Plant costs include labor costs, production supplies, repairs and maintenance, and inventory write-off. Our charges for labor and overhead allocated to our finished goods are determined on a market cost basis, which is lower than our actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced. Cost goods sold – idle capacity is not a measure that is recognized under GAAP and should not be considered as an alternative to cost of goods sold, which is determined in accordance with GAAP, and should not be used alone as an indicator of operating performance in place of cost of goods sold.

Year ended December 31, 2016 Compared to Year ended December 31, 2015

Gross Sales

Gross sales for all of Reeds products decreased 7% to \$46,198,000 for the year ended December 31, 2016 from \$49,713,000 in the prior year.

Sales Volume Eight Ounce Equivalents - Our total sales volume for all beverages decreased 5.0%. Reed's Ginger based beverages increased 0.5%, Reed's variety beverages led by Flying Cauldron was up 4.4% and net private label beverages were up 0.5%. Virgils decreased 10.4% and Reed's Kombucha decreased 54.3%.

Gross Sales Dollars Eight Ounce Equivalents - Our gross sales dollars for all beverages decreased 5.9%. Reed's Ginger based beverages increased 1.9%, Reed's variety beverages led by Flying Cauldron were up 4.1% and net private label beverages was up 3.6%. Virgils decreased 9.8% and Reed's Kombucha decreased 53.8%. On an eight-ounce serving size, gross sales were unchanged at \$12.16 per eight-ounce case.

Sales are down an average of 9% in all selling channels. All customers representing at least one percent of sales in 2015 were still customers in 2016. We believe that the decline in all channels was due to consumer preferences away from all sugar sodas including our natural based sugars. In response to the general consumer trend, the Company's research and development efforts have focused on all natural alternatives that have 12 calories per 12 ounce serving. We are in tests in the market place and expect to have these offerings available in the marketplace in the second half of this year.

Gross sales of items such as candy, ingredients, packaging and mail order are not included in the discussion above. These items as a group totaled \$1,684,000 in gross sales, a decrease of \$743,000 or 31% over 2015. The decrease in candy was \$597,000 and was the direct result of a California lawsuit that has required the Company to find reliable alternative suppliers.

Promotional and other allowances

Promotions and allowances for beverage products decreased in dollars 1% to \$3,726,000 (8.1% of gross sales) for the year ended December 31, 2016 from \$3,765,000 (7.6% of gross sales) in the prior year.

The promotional discounts on eight-ounce equivalent increased 4.1% or \$0.04/case to \$1.02/case from \$0.98/case in 2015. This increase is primarily attributable to an increase in the promotional programs and discounts offered in the fourth quarter of 2016 over a lower sales volume.

Net Sales

Net sales of all items decreased 7.6% or \$3,476,000 to \$42,472,000 for the year ended December 31, 2016 from \$45,948,000 in the prior year.

For beverage products, net sales by 8oz case equivalents decreased in 2016 by 2.7% to \$11.60/case from \$11.92/case from the prior year.

Cost of Goods Sold

Cost of goods sold consists of the costs of raw materials and packaging utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, inventory adjustments, as well as certain internal transfer costs. Cost of goods sold also consists of direct production costs in excess of charges allocated to our finished goods in production. Plant costs include labor costs, production supplies, and repairs and maintenance. Our charges for labor and overhead allocated to our finished goods are determined on a market cost basis, which is lower than our actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced.

Total cost of goods sold decreased to \$33,490,000 in the year ended December 31, 2016, a decrease of \$853,000 or 2.5% from 2015. The decrease was due to net volume decrease of 7.6% and increases in cost of production. Had total cost of goods decreased at a rate equal to the volume decrease of 7.6%, total cost of goods would have decreased a total of \$3,228,000. The company incurred an additional \$2,376,000 in the rate of cost of goods sold.

Specific production costs that comprised the additional \$2,376,000 or \$0.65 eight-ounce case was comprised of direct write off of inventories of \$705,000 or \$0.19/eight-ounce case, packaging cost increases of \$1,208,000 or \$0.33/eight-ounce case and ingredient cost increases of 842,000 or \$0.23/eight-ounce case. These increases were partially offset by labor productivity decreases of \$183,000 or \$0.05/eight-ounce case and a decrease in the reserve for obsolescence by \$175,000 over 2015 or \$0.05/eight-ounce case.¹⁷

Gross Profit

Our gross profit of \$8,982,000 in the year ended December 31, 2016 represents a decrease of \$2,623,000, or 22.6% from 2015. As a percentage of sales, our gross profit decreased to 21.1% in 2016 as compared to 25.3% in 2015. As noted above, the gross profit is the result of a decrease in net selling price of 4.1% and an increase cost of goods sold of 7.1%.

The Company has in place for the first quarter of 2017 cost cutting initiatives related to ingredient usage and package pricing that are on track to drive over 200 basis point improvement for the full year. In addition, the Company LA plant is scheduled for production in May that will enable the Company to realize an overdue savings of an additional 350 basis points on an annualized basis from that initiative. We believe that since these initiatives are under our control, the savings will be realized in 2017.

Delivery and Handling Expenses

Delivery and handling expenses consist of delivery costs to customers and warehouse costs incurred for handling our finished goods after production. Delivery and handling costs decreased to \$3,902,000 in the year ended December 31, 2016 compared to \$5,100,000 in 2015. The \$1,198,000 (23%) decrease is due to lower volume but higher full truck quantities. Current rates of 9% are comparable to historic rates. The Company expects costs to decrease further when the L.A. Brewery upgrade is finalized.

Selling and marketing expenses

Selling and marketing expenses consist primarily of three categories; direct charges for staff compensation costs in sales labor, sales operations consisting of travel and entertainment, office rent and communications and sales support consisting primarily of brokers fees, advertising and consultants. Selling and marketing costs for 2016 were \$3,701,000 or a decrease of 24% when compared to \$4,867,000 in 2015.

The decrease of \$1,166,000 is the result of decreases in sales labor costs of \$461,000, sales operations of \$188,000 and sales support of \$517,000.

Our sales staff decreased to 16 full time equivalents (FTE's) employees at December 31, 2016, from 17 FTE's at December 31, 2015.

General and Administrative Expenses

General and administrative expenses consist primarily of three categories; direct charges for staff compensation costs in office and general management, General and administrative operations consisting of office rent, facility depreciation, utilities, General and administrative support in information, SEC filings, shareholder meetings, legal and audit and finally; miscellaneous expenses such as amortization of intangibles and bad debt expense. General and administrative costs for 2016 were \$4,208,000 or a decrease of 4% when compared to \$4,368,000 in 2015.

The total decrease of \$160,000 is due to a decrease in administrative wage related expenses of \$257,000, a decrease of administrative operations of \$154,000, an increase administrative support expenses of \$251,000. Impairment loss of \$224,000 driven by the China Cola brand impairment.

The General management and administrative staff decreased to 13 FTE's at December 31, 2016, from 15 at December 31, 2015.

Loss from Operations

Loss from operations was \$3,053,000 in the year ended December 31, 2016, as compared to loss from operations of \$2,730,000 in 2015 or an increase of \$323,000. The increase in the operating loss is due to the decline in sales that were not offset by similar reduction in cost of goods sold that resulted in a lower gross profit of \$2,623,000. The lower gross profit was mirrored by a similar decrease in expenses of \$2,300,000.

Interest Expense

Interest expense increased to \$1,724,000 in the year ended December 31, 2016, compared to interest expense of \$1,231,000 in the same period of 2015. During 2016 and 2015 the Company's losses incurred liquidity shortages that required a an infusion of capital. A total of \$3,000,000 was obtained that also changed the terms of the existing line of credit and CAPEX loan. As the plant approached completion, further borrowing was obtained to complete the plant. As a direct consequence of the term change and the additional borrowing, the Company's net interest charge increased.

Modified EBITDA

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

MODIFIED EBITDA SCHEDULE

| | Year ended December 31, | |
|---|-------------------------|---------------|
| | 2016 | 2015 |
| | (unaudited) | (unaudited) |
| Net loss | \$(5,009,000) | \$(3,961,000) |
| Modified EBITDA adjustments: | | |
| Depreciation and amortization | 642,000 | 933,000 |
| Interest expense | 1,724,000 | 1,231,000 |
| Reserve for replacement on fixed assets | 260,000 | - |
| Stock option and warrant compensation | 658,000 | 877,000 |
| Stock compensation for services | 15,000 | 1,000 |
| Impairment loss on brand names | 224,000 | - |
| Change in fair value of warrant liability | 232,000 | - |
| Total EBITDA adjustments | \$3,755,000 | \$1,811,000 |
| Modified EBITDA | \$(1,254,000) | \$(2,150,000) |

Liquidity and Capital Resources

As of December 31, 2016, we had stockholder's deficit of \$1,657,000 and working capital deficit of \$1,563,000, compared to stockholder's equity of \$785,000 and working capital of \$730,000 at December 31, 2015. The decrease in our working capital of \$2,293,000 was primarily a result of cash flow from operations.

Our decrease in cash and cash equivalents to \$451,000 at December 31, 2016 compared to \$1,816,000 at December 31, 2015, a decrease of \$1,365,000 was primarily a result of cash generated by financing activities of \$1,578,000 less cash used for costs of plant improvements of \$410,000 and use of cash for operations of \$2,533,000.

On September 1, 2015 Reed's Inc. (the "Company") entered into an additional Term Loan (Term Loan B) with a principal balance of \$1,500,000 at prime plus 11.60% (currently 14.85%) with PMC Financial Services Group, LLC.

Concurrently, the conditions for a rate change involving Term Loan A of \$1,500,000 from December 5, 2014 have been modified. The payment terms have not been modified. 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 was at the time of financing, the rate would rise to 12% from the current rate of 9%. If EBITDA rises to \$1,500,000 then the rate will remain at 9%.

Notwithstanding the other borrowing terms above, if Excess Borrowing Availability under the \$6 million Revolving working capital loan 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 are to remain the same at 14.85%.

For the year ended December 31, 2016, the Company recorded a net loss of \$5,009,000 and utilized cash in operations of \$2,533,000. During 2015, the company experienced a major disruption in our east coast production facilities. By October of 2015, the Company had qualified another two co-packers for a total of three co-packers enabling the Company to avoid supply chain interruptions in 2016. We believe that if this disruption had not occurred, the Company would have been able to fill purchase orders and avoid the additional costs related to delivery and raw materials in 2015. The Company's ability to reclaim the lost shelf space continued in 2016. This remains the Company's main focus.

As of March 31, 2017, the Company had a cash balance of \$197,000 and had available borrowing on our existing line of credit of \$191,000. On April 24, 2017, the Company issued a convertible note resulting in net proceeds of \$3,240,000. Furthermore, during the year ended December 31, 2016, we were able to extend the maturity date of our operating line of credit and our other bank loans through October 21, 2018.

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

We may not generate sufficient revenues from product sales in the future to achieve profitable operations. If we are not able to achieve profitable operations at some point in the future, we eventually may have insufficient working capital to maintain our operations as we presently intend to conduct them or to fund our expansion and marketing and product development plans. In addition, 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.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. GAAP requires us to make estimates and assumptions that affect the reported amounts in our financial statements including various allowances and reserves for accounts receivable and inventories, the estimated lives of long-lived assets and trademarks and trademark licenses, as well as claims and contingencies arising out of litigation or other transactions that occur in the normal course of business. The following summarize our most significant accounting and reporting policies and practices:

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

Long-Lived Assets. Management assesses the carrying value of property and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If there is indication of impairment, management prepares an estimate of future cash flows expected to result from the use of the asset and its eventual disposition. If these cash flows are less than the carrying amount of the asset, an impairment loss is recognized to write down the asset to its estimated fair value. For the years ended December 31, 2016 the Company recognized a charge of \$268,000 for impairments for its property and equipment in anticipation of early retirement of equipment with the Los Angeles plant. There were no charges for equipment impairment prior to that in the prior years.

Intangible assets are comprised of indefinite-lived brand names acquired and have been assigned an indefinite life as we currently anticipate that these brand names will contribute cash flows to the Company perpetually. These indefinite-lived intangible assets are not amortized, but are assessed for impairment annually and evaluated annually to determine whether the indefinite useful life is appropriate. As part of our impairment test, we first assess qualitative factors to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. If further testing is necessary, we compare the estimated fair value of our indefinite-lived intangible asset with its book value. If the carrying amount of the indefinite-lived intangible asset exceeds its fair value, as determined by its discounted cash flows, an impairment loss is recognized in an amount equal to that excess. For the year ended December 31, 2016 the Company recognized a \$224,000 impairment charge related to its China Cola brand. For the year ended December 31, 2015, the Company did not recognize any impairment charges for its indefinite-lived intangible assets.

Management believes that the accounting estimate related to impairment of our long lived assets, including our trademark license and trademarks, is a “critical accounting estimate” because: (1) it is highly susceptible to change from period to period because it requires management to estimate fair value, which is based on assumptions about cash flows and discount rates; and (2) the impact that recognizing an impairment would have on the assets reported on our balance sheet, as well as net income, could be material. Management’s assumptions about cash flows and discount rates require significant judgment because actual revenues and expenses have fluctuated in the past and we expect they will continue to do so.

In estimating future revenues, we use internal budgets. Internal budgets are developed based on recent revenue data for existing product lines and planned timing of future introductions of new products and their impact on our future cash flows.

Accounts Receivable. We evaluate the collectability of our trade accounts receivable based on a number of factors. In circumstances where we become aware of a specific customer’s inability to meet its financial obligations to us, a specific reserve for bad debts is estimated and recorded which reduces the recognized receivable to the estimated amount our management believes will ultimately be collected. In addition to specific customer identification of potential bad debts, bad debt charges are recorded based on our historical losses and an overall assessment of past due trade accounts receivable outstanding.

Inventories. Inventories are stated at the lower of cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review our inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and/or our ability to sell the product(s) concerned and production requirements. Demand for our products can fluctuate significantly. Factors that could affect demand for our products include unanticipated changes in consumer preferences, general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by customers. Additionally, our management's estimates of future product demand may be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory.

Stock-Based Compensation. The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board (FASB) whereas the value of the award is measured on the date of grant and recognized as compensation on the straight-line basis over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the FASB whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete. Options granted to non-employees are revalued each reporting period to determine the amount to be recorded as an expense in the respective period. As the options vest, they are valued on each vesting date and an adjustment is recorded for the difference between the value already recorded and the then current value on the date of vesting. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company's stock option and warrant grants are estimated using the Black-Scholes-Merton Option Pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the stock options or warrants, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes Option Pricing model, and based on actual experience. The assumptions used in the Black-Scholes-Merton Option Pricing model could materially affect compensation expense recorded in future periods.

We believe there have been no significant changes, during the year ended December 31, 2016, to the items disclosed as critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

As a smaller reporting company, Reed's is not required to provide the information required by this Item 7A.

Item 8. Financial Statements

| | |
|---|-----|
| <u>Report of Independent Registered Public Accounting Firm</u> | F-1 |
| Financial Statements: | |
| <u>Balance Sheets as of December 31, 2016 and December 31, 2015</u> | F-2 |
| <u>Statements of Operations for the years ended December 31, 2016 and 2015</u> | F-3 |
| <u>Statements of Changes in Stockholders' Equity (Deficit) for the years ended December 31, 2016 and 2015</u> | F-4 |
| <u>Statements of Cash Flows for the years ended December 31, 2016 and 2015</u> | F-5 |
| <u>Notes to Financial Statements for the years ended December 31, 2016 and 2015</u> | F-6 |

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

Reed's, Inc.

We have audited the accompanying balance sheets of Reed's, Inc. as of December 31, 2016 and 2015, and the related statements of operations, changes in stockholders' equity (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of Reed's, Inc. as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Weinberg & Company, P.A.

Los Angeles, California
April 24, 2017

F-1

REED'S INC.**BALANCE SHEETS**

| | December 31, 2016 | December 31 2015 |
|--|----------------------|---------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$451,000 | \$1,816,000 |
| Trade accounts receivable, net of allowance for doubtful accounts and returns and discounts of \$256,000 and \$356,000, respectively | 2,485,000 | 2,894,000 |
| Inventory, net of reserve for obsolescence of \$115,000 and \$290,000, respectively | 6,885,000 | 7,974,000 |
| Prepaid and other current assets | 500,000 | 769,000 |
| Total Current Assets | 10,321,000 | 13,453,000 |
| Property and equipment, net of accumulated depreciation of \$4,719,000 and \$4,216,000, respectively | 7,726,000 | 5,369,000 |
| Brand names | 805,000 | 1,029,000 |
| Total assets | \$18,852,000 | \$19,851,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Current Liabilities: | | |
| Accounts payable | \$5,959,000 | \$7,458,000 |
| Accrued expenses | 215,000 | 168,000 |
| Line of credit | 4,384,000 | 4,443,000 |
| Current portion of long term financing obligations | 190,000 | 160,000 |
| Current portion of capital leases payable | 183,000 | 153,000 |
| Current portion of bank notes | 953,000 | 341,000 |
| Total current liabilities | 11,884,000 | 12,723,000 |
| Other Long Term Liabilities | 130,000 | - |
| Long term financing obligation, less current portion, net of discount of \$825,000 and \$935,000, respectively | 1,363,000 | 1,443,000 |
| Capital leases payable, less current portion | 438,000 | 490,000 |
| Bank notes, net of discount \$78,000 and \$132,000, respectively | 5,919,000 | 4,410,000 |
| Warrant liability | 775,000 | - |
| Total Liabilities | 20,509,000 | 19,066,000 |
| Stockholders' equity (deficit): | | |
| Series A Convertible Preferred stock, \$10 par value, 500,000 shares authorized, 9,411 shares issued and outstanding | 94,000 | 94,000 |
| Common stock, \$.0001 par value, 19,500,000 shares authorized, 13,982,230 and 13,160,860 shares issued and outstanding, respectively | 1,000 | 1,000 |
| Additional paid in capital | 29,971,000 | 27,399,000 |
| Accumulated deficit | (31,723,000) | (26,709,000) |
| Total stockholders' equity (deficit) | (1,657,000) | 785,000 |

| | | |
|--|--------------|--------------|
| Total liabilities and stockholders' equity (deficit) | \$18,852,000 | \$19,851,000 |
|--|--------------|--------------|

The accompanying notes are an integral part of these financial statements

F-2

REED'S, INC.**STATEMENTS OF OPERATIONS****For the Years Ended December 31, 2016 and 2015**

| | 2016 | 2015 |
|---|----------------|----------------|
| Net Sales | \$42,472,000 | \$45,948,000 |
| Cost of goods sold | 33,490,000 | 34,343,000 |
| Gross profit | 8,982,000 | 11,605,000 |
| Operating expenses: | | |
| Delivery and handling expenses | 3,902,000 | 5,100,000 |
| Selling and marketing expense | 3,701,000 | 4,867,000 |
| General and administrative expense | 4,208,000 | 4,368,000 |
| Impairment of assets | 224,000 | - |
| Total operating expenses | 12,035,000 | 14,335,000 |
| Loss from operations | (3,053,000) | (2,730,000) |
| Interest expense | (1,724,000) | (1,231,000) |
| Change in fair value of warrant liability | (232,000) | - |
| Net loss | (5,009,000) | (3,961,000) |
| Preferred Stock Dividends | (5,000) | (5,000) |
| Net loss attributable to common stockholders | \$(5,014,000) | \$(3,966,000) |
| Loss per share – basic and diluted | \$(0.37) | \$(0.30) |
| Weighted average number of shares outstanding – basic and diluted | 13,619,930 | 13,147,815 |

The accompanying notes are an integral part of these financial statements

REED'S, INC.**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)****For the Years Ended December 31, 2016 and 2015**

| | Common Stock | | Preferred Stock | | Additional Paid In Capital | Accumulated Deficit | Total Shareholder Equity (Deficit) |
|--|--------------|----------|-----------------|----------|----------------------------------|------------------------|---|
| | Shares | Amount | Shares | Amount | | | |
| Balance, January 1, 2014 | 13,068,058 | \$ 1,000 | 9,411 | \$94,000 | \$26,300,000 | \$(22,743,000) | \$3,652,000 |
| Fair Value of common stock issued for services | 247 | | | | 1,000 | | 1,000 |
| Common shares issued upon exercise of warrants | 57,112 | | | | | | - |
| Common shares issued upon exercise of options | 34,692 | | | | 75,000 | | 75,000 |
| Fair value of warrants granted as valuation discount | | | | | 141,000 | | 141,000 |
| Fair value vesting of options issued to employees | | | | | 877,000 | | 877,000 |
| Series A preferred stock dividend | 751 | | | | 5,000 | (5,000) | - |
| Net Loss | | | | | | (3,961,000) | (3,961,000) |
| Balance, December 31, 2015 | 13,160,860 | 1,000 | 9,411 | 94,000 | 27,399,000 | (26,709,000) | 785,000 |
| Fair value of common stock issued for services | 4,228 | | | | 15,000 | | 15,000 |
| Common shares issued upon exercise of warrants | 16,260 | | | | 45,000 | | 45,000 |
| Common shares issued upon exercise of options | 76,966 | | | | 71,000 | | 71,000 |
| Fair value of vested options | | | | | 658,000 | | 658,000 |
| Common shares issued upon sale of securities | 722,412 | | | | 1,687,000 | | 1,687,000 |
| Fair value vesting of warrants issued as debt discount | | | | | 91,000 | | 91,000 |
| Series A preferred stock dividend | 1,504 | | | | 5,000 | (5,000) | - |
| Net Loss | | | | | | (5,009,000) | (5,009,000) |
| Balance, December 31, 2016 | 13,982,230 | \$ 1,000 | 9,411 | \$94,000 | \$29,971,000 | \$(31,723,000) | \$(1,657,000) |

The accompanying notes are an integral part of these financial statements

F-4

REED'S, INC.**STATEMENTS OF CASH FLOWS****For the Years Ended December 31, 2016 and 2015**

| | 2016 | 2015 |
|---|---------------|---------------|
| Cash flows from operating activities: | | |
| Net loss | \$(5,009,000) | \$(3,961,000) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 642,000 | 933,000 |
| Fair value of vested stock options issued to employees | 658,000 | 877,000 |
| Fair value of common stock issued for services | 15,000 | 1,000 |
| (Decrease) increase in allowance for doubtful accounts | (100,000) | 103,000 |
| (Decrease) increase in reserve for impairment of assets | 484,000 | - |
| Change in fair value of warrant liability | 232,000 | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 509,000 | (497,000) |
| Inventory | 1,089,000 | (381,000) |
| Prepaid expenses and other assets | 269,000 | (25,000) |
| Accounts payable | (1,499,000) | 1,564,000 |
| Accrued expenses | 17,000 | 38,000 |
| Increase in other long term obligations | 160,000 | - |
| Net cash used in operating activities | (2,533,000) | (1,348,000) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (410,000) | (532,000) |
| Net cash used in investing activities | (410,000) | (532,000) |
| Cash flows from financing activities: | | |
| Proceeds from stock option and warrant exercises | 116,000 | 75,000 |
| Principal payments on capital expansion loan | (375,000) | - |
| Proceeds from sale of common stock | 2,230,000 | - |
| Proceeds from borrowing on Term Loan B | - | 1,500,000 |
| Principal repayments on long term financial obligation | (160,000) | (134,000) |
| Principal repayments on capital lease obligation | (174,000) | (138,000) |
| Net borrowings (repayments) on existing line of credit | (59,000) | 1,434,000 |
| Net cash provided by financing activities | 1,578,000 | 2,737,000 |
| Net increase (decrease) in cash | (1,365,000) | 857,000 |
| Cash at beginning of period | 1,816,000 | 959,000 |
| Cash at end of period | \$451,000 | \$ 1,816,000 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest | \$1,746,000 | \$1,187,000 |
| Non Cash Investing and Financing Activities | | |
| Property and equipment acquired through capital expansion loan | \$2,442,000 | \$915,000 |
| Property and equipment acquired through capital lease obligations | 152,000 | 179,000 |

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

| | | |
|--|---------|---------|
| Other current assets acquired through capital expansion loan | - | 297,000 |
| Fair value of warrants granted as debt discount | 91,000 | 141,000 |
| Dividends payable in common stock | 5,000 | 5,000 |
| Warrant liability from private financing | 543,000 | - |

The accompanying notes are an integral part of these financial statements

F-5

REED'S, INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

(1) Operations and Liquidity

A) Nature of Operations

Reed's, Inc. (the "Company") was organized under the laws of the state of Florida in January 1991. In 2001, the Company changed its name from Original Beverage Corporation to Reed's, Inc. and changed its state of incorporation from Florida to Delaware. The Company is engaged primarily in the business of developing, manufacturing and marketing natural non-alcoholic beverages, as well as candies and ice creams. We currently manufacture, market and sell seven unique product lines:

Reed's Ginger Brews,

Virgil's Root Beer, Cream Sodas, Dr. Better and Real Cola, including ZERO diet sodas,

Culture Club Kombucha,

China Colas,

Reed's Ginger candy and ice creams,

Sonoma Sparkler and other juice based products.

The Company sells its products primarily in natural food stores, supermarket chains, and upscale gourmet stores in the United States and Canada.

B) Cash and Liquidity

The accompanying financial statements have been prepared under the assumption that the Company will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. For the year ended December 31, 2016 the Company recorded a net loss of \$ 5,009,000 and utilized cash in operations of \$2,533,000. As of December 31, 2016, we had a working capital deficiency of \$1,563,000 and a stockholders' deficit of \$1,657,000.

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

Historically, we have financed our operations primarily through private sales of common stock, preferred stock, a line of credit from a financial institution and cash generated from operations. We anticipate that our primary capital source will be positive cash flow from operations. If our sales goals do not materialize as planned, we believe that the Company can reduce its operating costs and achieve positive cash flow from operations. However, we may not generate sufficient revenues from product sales in the future to achieve profitable operations. If we are not able to achieve profitable operations at some point in the future, we may have insufficient working capital to maintain our operations as we presently intend to conduct them or to fund our expansion, marketing, and product development plans. There can be no assurance that we will be able to obtain such financing on acceptable terms, or at all.

(2) Significant Accounting Policies

A) 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 long term assets and intangibles, accruals for potential liabilities and assumptions made in valuing stock instruments issued for services.

B) Accounts Receivable

The Company evaluates the collectability of its trade accounts receivable based on a number of factors. In circumstances where the Company becomes aware of a specific customer's inability to meet its financial obligations to the Company, a specific reserve for bad debts is estimated and recorded, which reduces the recognized receivable to the estimated amount the Company believes will ultimately be collected. In addition to specific customer identification of potential bad debts, bad debt charges are recorded based on the Company's historical losses and an overall assessment of past due trade accounts receivable outstanding.

The allowance for doubtful accounts and returns and discounts is established through a provision reducing the carrying value of receivables. At December 31, 2016 and 2015, the allowance for doubtful accounts and returns and discounts was approximately \$256,000 and \$356,000, respectively.

C) Inventories

Inventories are stated at the lower of cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review our inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and/or our ability to sell the product(s) concerned and production requirements. Demand for our products can fluctuate significantly. Factors that could affect demand for our products include unanticipated changes in consumer preferences, general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by customers. Additionally, our management's estimates of future product demand may be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory.

D) Property and Equipment and Related Depreciation

Property and equipment is stated at cost. Expenditures for major renewals and improvements that extend the useful lives of property and equipment or increase production capacity are capitalized, and expenditures for repairs and maintenance are charged to expense as incurred. Depreciation is calculated using accelerated and straight-line methods over the estimated useful lives of the assets as follows:

| Property and Equipment Type | Years of Depreciation |
|-----------------------------|-----------------------|
| Building | 39 years |
| Machinery and equipment | 5-12 years |
| Vehicles | 5 years |
| Office equipment | 5-7 years |

Management assesses the carrying value of property and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If there is indication of impairment, management prepares an estimate of future cash flows expected to result from the use of the asset and its eventual disposition. If these cash flows are less than the carrying amount of the asset, an impairment loss is recognized to write down the asset to its estimated fair value. For the years ended December 31, 2016 the Company recognized a charge of \$260,000 for impairments for its property and equipment in anticipation of early retirement of equipment with the Los Angeles plant. There were no charges for equipment impairment prior to that in the prior years.

E) Intangible Assets and Impairment Policy

Intangible assets are comprised of indefinite-lived brand names acquired and have been assigned an indefinite life as we currently anticipate that these brand names will contribute cash flows to the Company perpetually. These indefinite-lived intangible assets are not amortized, but are assessed for impairment annually and evaluated annually to determine whether the indefinite useful life is appropriate. As part of our impairment test, we first assess qualitative factors to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. If further testing is necessary, we compare the estimated fair value of our indefinite-lived intangible asset with its book value. If the carrying amount of the indefinite-lived intangible asset exceeds its fair value, as determined by its discounted cash flows, an impairment loss is recognized in an amount equal to that excess. For the years ended December 31, 2016 the Company recognized an impairment charge of \$224,000 for the China Cola brand. For 2015, the Company did not recognize any impairment charges for its indefinite-lived intangible assets.

F) Concentrations

The Company's cash balances on deposit with banks are guaranteed by the Federal Deposit Insurance Corporation up to \$250,000 at December 31, 2016. The Company may be exposed to risk for the amounts of funds held in bank accounts more than 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 more than the guarantee during the years ended December 31, 2016 and 2015.

During the year ended December 31, 2016, the Company had two customers who accounted for approximately 22% and 12% of its sales, respectively; and during the year ended December 31, 2015, the Company had two customers who accounted for approximately 28% and 14% of its sales, respectively. No other customer accounted for more than 10% of sales in either year. As of December 31, 2016, the Company had accounts receivable due from one customer who comprised \$719,000 (25%) of its total accounts receivable; and as of December 31, 2015, the Company had accounts receivable due from two customers who comprised \$782,000 (24%) and \$373,000 (12%), respectively, of its total accounts receivable. No other customer accounted for more than 10% of accounts receivable in either year.

During the year ended December 31, 2016, the Company had utilized three separate co-pack packers for most its production and bottling of beverage products in the Eastern United States. Although there are other packers and the Company has outfitted our own brewery and bottling plant, a change in packers may cause a delay in the production process, which could ultimately affect operating results.

During the years ended December 31, 2016 and 2015, the Company had one vendor which accounted for approximately 26% and 25%, respectively of purchases. At December 31, 2016 and 2015, the Company had accounts payable due to two vendors who comprised 13% and 10% for the year ended December 31, 2016, and 14% and 12% of its total accounts payable, for the year ended December 31, 2015. No other account was more than 10% of the

balance of accounts payable as of December 31, 2016, and December 31, 2015.

G) Fair Value of Financial Instruments

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

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

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

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

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

The fair value of the warrant liability of \$775,000 at December 31, 2016 was valued using Level 2 inputs.

H) Cost of sales

Cost of goods sold is comprised of the costs of raw materials and packaging utilized in the manufacture of products, co-packing fees, repacking fees, in-bound freight charges, as well as certain internal transfer costs. Additionally, cost of goods sold consists of direct production costs in excess of charges allocated to finished goods in production. Plant costs include labor costs, production supplies, repairs and maintenance, direct inventory write-off charges and adjustments to the inventory reserve. Charges for labor and overhead allocated to finished goods are determined on a market cost basis, which may be lower than the actual costs incurred. Plant costs in excess of production allocations are expensed in the period incurred rather than added to the cost of finished goods produced. Expenses not related to the production of our products are classified as operating expenses.

I) Delivery and Handling Expenses

Shipping and handling costs are comprised of purchasing and receiving costs, inspection costs, warehousing costs, transfer freight costs, and other costs associated with product distribution after manufacture and are included as part of operating expenses.

J) Income Taxes

The Company uses an asset and liability approach for financial accounting and reporting for income taxes that allows recognition and measurement of deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain. The Company's policy is to recognize interest and/or penalties related to income tax matters in income tax expense.

K) Revenue Recognition

Revenue is recognized on the sale of a product when the risk of loss transfers to our customers, and collection of the receivable is reasonably assured, which generally occurs when the product is shipped. A product is not shipped without an order from the customer and credit acceptance procedures performed. The allowance for returns is regularly reviewed and adjusted by management based on historical trends of returned items. Amounts paid by customers for shipping and handling costs are included in sales.

The Company accounts for certain sales incentives for customers, including slotting fees, as a reduction of gross sales. These sales incentives for the years ended December 31, 2016 and 2015 were approximately \$3,726,000 and \$3,765,000, respectively.

L) Net Loss Per 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 (loss) per share is computed by dividing the net income (loss) applicable to Common Stockholders 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 if their effect is antidilutive.

For the years ended December 31, 2016 and 2015, the calculations of basic and diluted loss per share are the same because potential dilutive securities would have an anti-dilutive effect. The potentially dilutive securities consisted of the following as of:

| | December 31, | |
|--------------------------|--------------|-----------|
| | 2016 | 2015 |
| Warrants | 803,909 | 341,261 |
| Series A Preferred Stock | 37,644 | 37,644 |
| Options | 1,048,500 | 980,000 |
| Total | 1,890,053 | 1,358,905 |

M) Advertising Costs

Advertising costs are expensed as incurred and are included in selling expense in the amount of \$254,000 and \$105,000, for the years ended December 31, 2016 and 2015, respectively.

N) Stock Compensation Expense

The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board (FASB) whereas the value of the award is measured on the date of grant and recognized as compensation expense on the straight-line basis over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the FASB whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete. Options granted to non-employees are revalued each reporting period to determine the amount to be recorded as an expense in the respective period. As the options vest, they are valued on each vesting date and an adjustment is recorded for the difference between the value already recorded and the then current value on the date of vesting. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company's stock option and warrant grants are estimated using the Black-Scholes-Merton Option Pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the stock options or warrants, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes-Merton Option Pricing model, and based on actual experience. The assumptions used in the Black-Scholes-Merton Option Pricing model could materially affect compensation expense recorded in future periods.

O) Reclassification

In presenting the Company's statement of operations for the year ended December 31, 2015, the Company previously included \$235,000 of banking fees as general and administrative expenses. In presenting the Company's statement of operations for the years ended December 31, 2016 and 2015, the Company has reclassified these expenses to interest expense.

P) Recent Accounting Pronouncements

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

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

In March 2016, the FASB issued the ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendments in this ASU require, among other things, that all income tax effects of awards be recognized in the income statement when the awards vest or are settled. The ASU also allows for an employer to repurchase more of an employee's shares than it can today for tax withholding purposes without triggering liability accounting and allows for a policy election to account for forfeitures as they occur. The amendments in this ASU are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted for any entity in any interim or annual period. The Company is currently evaluating the expected impact that the standard could have on its financial statements and related disclosures.

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

(3) Inventory

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

| | December 31, 2016 | December 31, 2015 |
|-----------------------------|----------------------|----------------------|
| Raw Materials and Packaging | \$3,874,000 | \$4,411,000 |
| Finished Goods | 3,011,000 | 3,563,000 |
| | \$6,885,000 | \$7,974,000 |

Consistent with prior years the Company prepaid for glass raw materials that was used in the following year. As of December 31, 2016, there was a balance of \$294,000 as compared to a balance of \$47,000 for prepaid inventory of as of December 31, 2015. The Company also decreased its reserve for obsolescence for the year ended December 31, 2016 by \$175,000 to \$115,000 from \$290,000, respectively as obsolete inventory was disposed.

(4) Property and Equipment

Property and equipment is comprised of the following as of:

| | December 31, 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 | 3,696,000 | 3,800,000 |
| Equipment under capital leases | 226,000 | 857,000 |
| Office equipment | 475,000 | 469,000 |
| Construction In Progress | 4,610,000 | 977,000 |
| | 12,589,000 | 9,585,000 |
| Accumulated depreciation | (4,863,000) | (4,216,000) |
| | \$7,726,000 | \$5,369,000 |

Depreciation expense for the years ended December 31, 2016 and 2015 was \$647,000 and \$828,000, respectively. In addition, during the year ended December 31, 2016, the Company established a reserve of \$260,000 for obsolete equipment in anticipation of the Los Angeles plant completion which is included as part of the cost of goods sold.

Accumulated depreciation on equipment held under capital leases was \$226,000 and \$461,000 as of December 31, 2016, and 2015, respectively. (See note 8).

F-11

(5) Intangible Assets***Brand Names***

Brand names consist of the following three trademarks for natural beverage as of December 31, 2016, and 2015. Virgil's, China Cola, and Sonoma Sparkler brand names are deemed to have indefinite lives and are not amortized, but are tested for impairment annually. For the year ended December 31, 2016 the Company recognized an impairment charge of \$224,000 for its China Cola Brand. The Company did not recognize any impairment for the year ended December 31, 2015.

| | December 31, 2016 | December 31, 2015 |
|-----------------------------|----------------------|----------------------|
| Virgil's | \$576,000 | \$576,000 |
| China Cola | 224,000 | 224,000 |
| Sonoma Sparkler | 229,000 | 229,000 |
| Purchased Brands | 1,029,000 | 1,029,000 |
| Less reserve for impairment | (224,000) | - |
| Brand names | \$805,000 | \$1,029,000 |

(6) Notes Payable

The Company has a Loan and Security Agreement with PMC Financial Services Group, LLC (PMC) that provides a \$6,000,000 revolving line of credit, a \$3,000,000 term loan, and a Capital Expansion loan up to \$4,700,000. The loans are secured by substantially all the assets of the Company and become due on January 1, 2019. The notes are as follows:

Revolving Line of Credit

The agreement provides a \$6,000,000 revolving line of credit. At December 31, 2016 and 2015, the aggregate amount outstanding under the line of credit was \$4,384,000 and \$4,443,000, respectively.

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

December 31, 2016, our effective rate under the revolving line was 9.5%. The monthly management fee is .45% of the average monthly loan balance.

The revolving line of credit is based on 85% of accounts receivable and 60% of eligible inventory and is secured by substantially all of the Company's assets. As of December 31, 2016, the Company had no borrowing availability 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 expired 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 value of the warrants was recorded as a valuation discount at issuance and was fully amortized to interest expense during the year ended December 31, 2016.

The line of credit matures on January 1, 2019 and is subject to a 1% prepayment penalty for prepayment prior to the first anniversary of the effective date.

Bank Notes

Bank notes consist of the following as of December 31, 2016 and 2015:

| | December 31, 2016 | December 31, 2015 |
|------------------------|----------------------|----------------------|
| (A) Term Loans | \$3,000,000 | \$3,000,000 |
| (B) Capex loan | 3,950,000 | 1,883,000 |
| (C) Valuation discount | (78,000) | (132,000) |
| Net | 6,872,000 | 4,751,000 |
| Current portion | (953,000) | (341,000) |
| Long term portion | \$5,919,000 | \$4,410,000 |

(A) Term Loans

In connection with the Loan and Security Agreement with PMC, the Company entered into two Term Loans of \$1,500,000 each, for an aggregate borrowing of \$3,000,000. The term loans are secured by all of the unencumbered assets of the Company and are due on January 1, 2019. The annual interest rate on the first loan was prime plus 5.75% (currently 9.5%), and the rate on the second loan was prime plus 11.60% (currently 14.85%) but was modified on December 7, 2016 such that the new rate will be based on the trailing 6 month EBITDA. If the EBITDA measuring point stays below \$1,000,000 where it is now, the rate will rise to 12% from the current rate of 9%. If EBITDA rises to \$1,500,000 then the rate will be reduced to 9%. As of December 31, 2016, and 2015, the amount outstanding was \$3,000,000 and \$3,000,000 respectively.

(B) Capital Expansion ("CAPEX") Loan

In connection with the Loan and Security Agreement with PMC, the Company entered into a Capital expansion loan which, after amendment allows a total borrowing of \$4,700,000. The loans are secured by all of the property and equipment purchased under the loan. The interest rate on the CAPEX loan is the prime rate plus 5.75% (9.5% at December 31, 2016). Interest only is payable on CAPEX Loans through January 31, 2017, at which time principal and interest will be aggregated and repaid in equal monthly payments of principal and interest based on 48 month amortization. Currently, the estimated amount that will become due in a year is \$953,000. At December 31, 2016 and 2015, the balance on the CAPEX loan balance was \$3,950,000 and \$1,883,000 respectively, and as of December 31, 2016, the Company had future borrowing availability of \$750,000.

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

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

F-13

(C) Issuance of Warrants upon Amendments

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

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

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

During the years ended December 31, 2016 and 2015 amortization of the discount was \$130,000 and \$9,000 respectively, and the unamortized discount was \$78,000 and \$132,000 as of December 31, 2016 and 2015, respectively.

(D) Interest Rates

Notwithstanding the other borrowing terms above, if Excess Borrowing Availability under the \$6 million Revolving line of credit remains more than \$1,500,000 at all times during the preceding month (currently Reed's Borrowing Availability is zero) the additional interest rate for all loans will be eliminated. The following chart summarizes the loans as of December 31, 2016,

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

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

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

F-14

(7) Long Term Financing Obligation

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

| | December 31, | |
|------------------------------------|--------------|-------------|
| | 2016 | 2015 |
| Financing obligation | \$2,378,000 | \$2,538,000 |
| Valuation discount | (825,000) | (935,000) |
| Net long term financing obligation | \$1,553,000 | \$1,603,000 |
| Less current portion | (190,000) | (160,000) |
| Long term financing obligation | \$1,363,000 | \$1,443,000 |

On June 15, 2009, the Company closed escrow on the sale of its two buildings and its brewery equipment and concurrently entered 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, former Chief Executive Officer and current Chief Innovation Officer, Christopher J. Reed.

In connection with the financing obligation, the Company issued an aggregate of 400,000 warrants to purchase its common stock at \$1.20 per share for five years. The 400,000 warrants were valued at \$752,000 and reflected as a debt discount, using the Black Scholes Merton option pricing model. The following assumptions were utilized in valuing the 400,000 warrants: strike price of \$2.10 to \$2.25; term of 5 years; volatility of 91.36% to 110.9%; expected dividends 0%; and discount rate of 2.15% to 2.20%. The 400,000 warrants were recorded as valuation discount and are being amortized over 15 years, the term of the purchase option. Amortization of valuation discount was \$50,000 during both of the years ended December 31, 2016 and 2015.

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 for five years. The 200,000 warrants were valued at \$584,000 using the Black Scholes Merton option pricing model and were recorded as a valuation discount. The following assumptions were made in valuing the 200,000 warrants; term of 5 years, volatility of 59.53%, expected dividends 0% and discount rate of 1.25%. The warrants value of \$584,000 is being amortized over the remaining term of the purchase option.

F-15

The aggregate amount due under the financing obligation at December 31, 2016 and 2015 was \$2,377,000 and \$2,538,000, respectively. Aggregate future obligations under the financing obligation are as follows:

| Year | Amount |
|------------|-------------|
| 2017 | \$ 190,000 |
| 2018 | 222,000 |
| 2019 | 259,000 |
| 2020 | 299,000 |
| 2021 | 344,000 |
| Thereafter | 1,064,000 |
| Total | \$2,378,000 |

(8) Obligations Under Capital Leases

The Company leases equipment for its brewery operations with an aggregate value of \$903,000 under 10 non-cancelable capital leases. In addition, the company leases vehicles and office equipment with rates and monthly payments range from \$189 to \$10,441 per month, including interest, at interest rates ranging from 3.50% to 17.31% per annum. The principal balance due under these leases was \$621,000 and \$643,000 at December 31, 2016 and 2015, respectively. At December 31, 2016, monthly payments under these leases aggregated \$19,000. The leases expire at various dates through 2021.

Future minimum lease payments under capital leases are as follows:

| | |
|---|-----------|
| Years Ending December 31, | |
| 2017 | \$223,000 |
| 2018 | 227,000 |
| 2019 | 190,000 |
| 2020 | 62,000 |
| 2021 | 6,000 |
| Total payments | \$708,000 |
| Less: Amount representing interest | (87,000) |
| Present value of net minimum lease payments | \$621,000 |
| Less: Current portion | (183,000) |
| Non-current portion | \$438,000 |

(9) Warrant Liability

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

The warrant liability was valued at the following dates using Black-Scholes-Merton option pricing model with the following average assumptions:

| | Issuance Date | | December 31, 2016 | |
|------------------------------|--------------------------|---|------------------------------|---|
| Stock Price | \$3.34 | | \$4.10 | |
| Risk free interest rate | 1.50 | % | 1.58 | % |
| Expected Volatility | 55.82 | % | 55.81 | % |
| Expected life in years | 5 | | 4.42 | |
| Expected dividend yield | 0 | % | 0 | % |
| Fair Value – Warrants | \$543,000 | | \$775,000 | |

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

(10) Stockholders’ Equity

Preferred Stock

Series A

Series A Preferred stock consists of 500,000 shares \$10.00 par value, 5% non-cumulative, participating, preferred stock. As of December 31, 2016, and 2015, there were 9,411 shares outstanding, with a liquidation preference of \$10.00 per share. Each share of Series A Preferred stock can be converted into four shares of Reed’s common stock.

The Series A Preferred shares have a 5% pro-rata annual non-cumulative dividend. The dividend can be paid in cash or, in the sole and absolute discretion of our board of directors, in shares of common stock based on its then fair market value. We cannot declare or pay any dividend on shares of our securities ranking junior to the preferred stock until the holders of our preferred stock have received the full non-cumulative dividend to which they are entitled. In addition, the holders of our preferred stock are entitled to receive pro rata distributions of dividends on an “as converted” basis with the holders of our common stock. During the year ended December 31, 2016 the Company accrued and paid a \$5,000 dividend payable to the preferred shareholders, which the board of directors elected to pay through the issuance of 1,504 shares of its common stock. During the year ended December 31, 2015 the Company paid a \$5,000 dividend payable to the preferred shareholders through the issuance of 751 shares of its common stock.

In the event of any liquidation, dissolution or winding up of the Company, or if there is a change of control event, then, subject to the rights of the holders of our more senior securities, if any, the holders of our Series A preferred stock are entitled to receive, prior to the holders of any of our junior securities, \$10.00 per share plus all accrued and unpaid dividends. Thereafter, all remaining assets shall be distributed pro rata among all of our security holders. Since June 30, 2008, we have the right, but not the obligation, to redeem all or any portion of the Series A preferred stock by paying the holders thereof the sum of the original purchase price per share, which was \$10.00, plus all accrued and unpaid dividends.

The Series A preferred stock may be converted, at the option of the holder, at any time after issuance and prior to the date such stock is redeemed, into four shares of common stock, subject to adjustment in the event of stock splits, reverse stock splits, stock dividends, recapitalization, reclassification and similar transactions. We are obligated to reserve out of our authorized but unissued shares of common stock enough such shares to affect the conversion of all outstanding shares of Series A preferred stock. During 2016, no shares of Series A preferred stock were converted into common stock.

Except as provided by law, the holders of our Series A preferred stock do not have the right to vote on any matters, including, without limitation, the election of directors. However, so long as any shares of Series A preferred stock are outstanding, we shall not, without first obtaining the approval of at least a majority of the holders of the Series A preferred stock, authorize or issue any equity security having a preference over the Series A preferred stock with respect to dividends, liquidation, redemption or voting, including any other security convertible into or exercisable for any equity security other than any senior preferred stock.

Common Stock

Common stock consists of \$.0001 par value, 19,500,000 shares authorized, 13,982,230 shares outstanding as of December 31, 2016, and 13,160,860 shares outstanding as of December 31, 2015.

During the year ended December 31, 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 \$2,113,000 after deducting underwriting discounts, commissions and offering expenses. The investor warrants have an exercise price of \$4.25 per share and a term of 5 years. As per the terms of the offering, the placement agent received 72,703 warrants and a term of 5 years at an exercise price of \$3.74.

In connection with the issuance of the warrants, the Company recorded a warrant liability on its balance sheet as a fundamental transaction could give rise to an obligation of the Company to pay cash to such warrant holders. Corresponding changes to the fair value of the warrants are recognized in earnings on the Company's statements of operations in each subsequent period. The Company determined the aggregate initial fair value of the warrants in the financing transaction to be \$543,000 valued using Black-Scholes-Merton option pricing model. For financial statement purposes, the amount of the warrant liability created from the issuance of the warrants of \$543,000 has been offset to the net cash proceeds received of \$2,113,000, resulting in a reduction of additional paid-in capital of \$543,000 from the sale of the shares of common stock and warrants.

During the year ended December 31, 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.

During the year ended December 31, 2016, the Company issued 4,228 shares of common stock for consulting services valued at an aggregate value of \$15,000 for services rendered.

(11) Stock Options and Warrants

A) Stock Options

In 2007, the Company adopted the Reed's Inc. 2007 Stock Option Plan and in 2015 the Company adopted the Reed's Inc. 2015 Incentive and Non-statutory Stock Option Plan (the "Plans"). The options under both plans shall be granted from time to time by the Board of Directors. Individuals eligible to receive options include employees of the Company, consultants to the Company and directors of the Company. The options shall have a fixed price, which will not be less than 100% of the fair market value per share on the grant date or 110% of the fair market value per share on the grant date for Chief Executive Officer of the Company. The total number of options authorized is 1,500,000 and 500,000, respectively for the Plans.

During the years ended December 31, 2016 and 2015, the Company granted 172,500 and 548,000 options, respectively, to purchase the Company's common stock at a weighted exercise price of \$4.01 and \$5.63, respectively, to employees under the Plans. The fair value of the options granted during the years ended December 31, 2016 and 2015 was \$714,000 and \$1,398,000, respectively.

The weighted-average grant date fair value of options granted during 2016 and 2015 was \$4.01 and \$2.54, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option pricing model that uses the assumptions noted in the following table. For purposes of determining the expected life of the option, an average of the estimated holding period is used. The risk-free rate for periods within the contractual life of the options is based on the U. S. Treasury yield in effect at the time of the grant.

| | Year ended December 31, | |
|----------------------------------|----------------------------|---------------|
| | 2016 | 2015 |
| Expected volatility | 57 | % 56 - 62% |
| Expected dividends | — | — |
| Expected average term (in years) | 1.77 | 3.5 - 4.5 |
| Risk free rate - average | 0.77%-1.81% | 0.69% - 1.64% |
| Forfeiture rate | 0 | 0 |

The aggregate fair value of the options vesting, net of forfeitures, during the years ended December 31, 2016 and 2015 was \$658,000 and \$877,000, respectively, and has been reflected as compensation cost. As of December 31, 2016, the aggregate value of unvested options was \$700,000 which will be amortized as compensation cost as the options vest, over 2 to 4 years.

During the year ended December 31, 2016 there were 84,000 options exercised into 76,966 shares of common stock at an average price of \$1.37. Most of such exercises were cash-less, however, the Company did receive proceeds from certain exercises aggregating \$71,000.

During the year ended December 31, 2015 there were 135,833 stock options exercised on a cashless basis at exercise prices between \$1.14 and \$4.60 per share, issuing 57,112 shares of common stock.

A summary of option activity as of December 31, 2016, and changes during the two years then ended is presented below:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Terms (Years) | Aggregate Intrinsic Value |
|----------------------------------|------------|------------------------------------|---|---------------------------------|
| Outstanding at January 1, 2015 | 705,333 | \$ 3.96 | | |
| Granted | 548,000 | 5.01 | | |
| Exercised | (135,833) | 3.36 | | |
| Forfeited or expired | (137,500) | 4.85 | | |
| Outstanding at December 31, 2015 | 980,000 | 3.96 | 3.41 | \$ 843,000 |
| Granted | 172,500 | 4.01 | | |
| Exercised | (84,000) | 1.36 | | |
| Forfeited or expired | (20,000) | 4.92 | | |
| Outstanding at December 31, 2016 | 1,048,500 | \$ 4.68 | 3.80 | \$ 61,000 |
| Exercisable at December 31, 2016 | 543,534 | \$ 4.61 | 3.04 | \$ 39,000 |

As of December 31, 2016, the aggregate intrinsic values of \$61,000 was calculated as the difference between the market price and the exercise price of the Company's stock, which was \$4.10 as of December 31, 2016.

A summary of the status of the Company's non-vested shares granted under the Company's stock option plan as of December 31, 2016 and changes during the year then ended is presented below:

Additional information regarding options outstanding as of December 31, 2016, is as follows:

| | Shares | Weighted- Average Grant Date Fair Value |
|--------------------------------|-----------|---|
| Nonvested at December 31, 2015 | 661,083 | \$ 2.41 |
| Granted | 172,500 | 4.01 |
| Vested | (316,117) | 4.61 |
| Forfeited | (12,500) | 4.92 |
| Nonvested at December 31, 2016 | 504,966 | \$ 4.68 |

B) Warrants

| Range of Exercise Price | Options Outstanding at December 31, 2016 | | | Options Exercisable at December 31, 2016 | |
|-------------------------|--|---|---------------------------------|--|---------------------------------|
| | Number of Shares Outstanding | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Number of Shares Exercisable | Weighted Average Exercise Price |
| \$2.00 - \$3.99 | 237,500 | 6.27 | \$3.83 | 143,700 | \$3.89 |
| \$4.00 - \$5.99 | 811,000 | 3.08 | \$4.93 | 399,834 | \$4.87 |
| | 1,048,500 | 3.80 | \$4.68 | 543,534 | \$4.61 |

On June 2, 2016, the Company granted warrants to purchase 346,206 shares of common stock in connection with the common stock offering. The warrants have an exercise price of \$4.25 per share and a term of 5 years. In addition, the Company granted Maxim Group LLC who acted as the placement agent for the offering warrants to purchase up to 72,703 shares of common stock at an exercise price of \$3.74 and are exercisable for a term of 5 years. The exercise prices of the warrants are subject to customary adjustments in the event of stock dividends and splits, and the warrants contain protective provisions in the event of fundamental transactions.

During the year ended December 31, 2016, 16,260 warrants were exercised into 16,260 shares of common stock for \$45,000.

The following table summarizes warrant activity for the two years ended December 31, 2016:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Terms (Years) | Aggregate Intrinsic Value |
|----------------------------------|-----------|------------------------------------|---|---------------------------------|
| Outstanding at December 31, 2014 | 301,963 | \$ 4.49 | | |
| Granted | 125,000 | \$ 4.50 | | |
| Exercised | (34,692) | | | |
| Forfeited or expired | (51,010) | - | | |
| Outstanding at December 31, 2015 | 341,261 | \$ 5.17 | 3.30 | \$ 152,000 |
| Granted | 478,909 | \$ 4.50 | | |
| Exercised | (16,260) | \$ 2.77 | | |
| Forfeited or expired | (1) | | | |
| Outstanding at December 31, 2016 | 803,909 | \$ 4.50 | 4.00 | \$ 26,000 |
| Exercisable at December 31, 2016 | 803,909 | \$ 4.54 | 4.20 | \$ 26,000 |

As of December 31, 2016, the aggregate intrinsic value of \$26,000 for both outstanding and exercisable was calculated as the difference between the market price of the company which was \$4.10 and the exercise price.

The following table summarizes the outstanding warrants to purchase Common Stock at December 31, 2016:

| Number | Price | Expiration Dates |
|---------|--------|------------------|
| 200,000 | \$5.60 | Sep-19 |
| 125,000 | \$4.10 | May-21 |
| 10,000 | \$3.90 | Oct-21 |
| 50,000 | \$4.10 | Nov-21 |
| 346,206 | \$4.25 | Jun-21 |
| 72,703 | \$3.74 | Jun-21 |
| 803,909 | | |

(12) Income Taxes

At December 31, 2016 and 2015, the Company had available Federal and state net operating loss carryforwards to reduce future taxable income. The amounts available were approximately \$21.3 million and \$18.6 million for Federal purposes, respectively, and \$14.5 million and \$13.3 million for state purposes respectively. The Federal carryforward expires in 2034 and the state carryforward expires in 2019. Given the Company's history of net operating losses, management has determined that it is more likely than not that the Company will not be able to realize the tax benefit of the carryforwards. Accordingly, the Company has not recognized a deferred tax asset for this benefit.

Effective January 1, 2007, the Company adopted FASB guidelines that address the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. This guidance also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. At the date of adoption, and as of December 31, 2016 and 2015, the Company did not have a liability for unrecognized tax benefits, and no adjustment was required at adoption.

The Company's policy is to record interest and penalties on uncertain tax provisions as income tax expense. As of December 31, 2016, and 2015, the Company has not accrued interest or penalties related to uncertain tax positions. Additionally, tax years 2009 through 2016 remain open to examination by the major taxing jurisdictions to which the Company is subject.

Upon the attainment of taxable income by the Company, management will assess the likelihood of realizing the tax benefit associated with the use of the carryforwards and will recognize the appropriate deferred tax asset at that time.

Significant components of the Company's deferred income tax assets are as follows as of:

| | December 31, 2016 | December 31 2015 |
|---------------------------------|----------------------|---------------------|
| Deferred income tax asset: | | |
| Net operating loss carryforward | \$ 10,325,000 | \$ 9,034,000 |
| Valuation allowance | (10,325,000) | (9,034,000) |
| Net deferred income tax asset | \$ 0 | \$ 0 |

Reconciliation of the effective income tax rate to the U.S. statutory rate is as follows:

| | December 31, 2016 | December 31 2015 |
|-----------------------------------|----------------------|---------------------|
| Federal Statutory tax rate | (34 %) | (34 %) |
| State tax, net of federal benefit | (5 %) | (5 %) |
| | (39 %) | (39 %) |
| Valuation allowance | 39 % | 39 % |
| Effective tax rate | -% | -% |

(13) Commitments and Contingencies

Lease Commitments

The Company leases warehouse space under non-cancelable operating leases. Rental expense under these and other operating leases for the years ended December 31, 2016 and 2015 was \$137,000 and \$209,000, respectively. These leases expire in November 2017.

Future payments under these leases as of December 31, 2016, are as follows:

Year ending December 31, Amount

| | |
|-------|------------|
| 2017 | \$ 137,000 |
| 2018 | - |
| Total | \$ 137,000 |

Other Commitments

The Company has entered into contracts with customers with clauses that commit the Company to pay fees if the Company terminates the agreement early or without cause. The contracts call for the customer to have the right to distribute the Company's products to a defined type of retailer within a defined geographic region. If the Company should terminate the contract or not automatically renew the agreements without cause, amounts would be due to the customer. As of December 31, 2016 and 2015, the Company has no plans to terminate or not renew any agreement with any of their customers; therefore, no such fees have been accrued in the accompanying financial statements.

(14) Legal Proceedings

From time to time, we are a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates our exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

We believe that there are no material litigation matters at the current time. Although the results of such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of such claims and proceedings will not have a material adverse impact on our financial position, liquidity, or results of operations.

(15) Related Party Activity

During the year, Judy Reed, wife of Christopher J. Reed, served as Corporate Secretary along with being a member of the Board of Directors. Her replacement to the board was elected November 29, 2017 and she has agreed to remain as Corporate Secretary until a replacement can be found. Complete compensation information follows below in Part III.

(16) Subsequent Events

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

After December 31, 2016 Chris Reed (CEO) and Daniel Miles (CFO) advanced working capital funds of \$381,000 and \$120,000 respectively to the Company for working capital uses. Chris Reed will be repaid \$240,000 in April 2017 and the remainder for both Chris Reed and Daniel Miles will be repaid by the end of this year.

On April 19, 2017, Chris Reed resigned from his position as Chief Executive Officer of Reed's, effective immediately. Concurrently, Mr. Reed was appointed as Chief Innovation Officer. Mr. Reed will continue to serve as non-independent director of Reed's Board of Directors.

On April 19, 2017, Stefan Freeman, one of the Company's independent directors, was appointed as interim Chief Executive Officer of Reed's.

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

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

The fair value of the warrants and conversion feature was determined to be \$3,400,000 and will be recorded as a valuation discount and amortized as interest expense over the term of the note.

The Company intends to use the net proceeds from the offering of approximately \$3,240,000 for working capital and general corporate purposes. Wunderlich Securities, the Company's placement agent, will receive a fee of approximately \$160,000 of the gross proceeds.

F-22

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Management's Annual Report on Internal Control over Financial Reporting

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Securities and Exchange Act of 1934 Rules 13a-15(f). Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2016.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the last quarter of 2016, ending December 31, 2016, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are

recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2016. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework. Based on our assessment we concluded that, as of December 31, 2016, the Company's internal control over financial reporting was effective.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm, pursuant to provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act that permit us to provide only management's report in this Annual Report on Form 10-K.

This report shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liabilities of that section, and is not incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Item 9B. Other Information

None.

PART III**Item 10. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act****General**

Reed's current directors current have terms which will end at the next annual meeting of the stockholders or until their successors are elected and qualify, subject to their death, resignation or removal. Officers serve at the discretion of the board of directors. Our board members are encouraged to attend meetings of the board of directors and the annual meeting of stockholders. The board of directors held eighteen meetings in 2016. The following table sets forth certain information with respect to our current directors and executive officers as of December 31, 2016:

| Name | Position | Age |
|---------------------|--|------------|
| Christopher J. Reed | Director, Chief Innovation Officer | 58 |
| Daniel V. Miles | Chief Financial Officer | 61 |
| Mark B. Beaton | Chief Operating Officer | 53 |
| Neal Cohane | Senior Vice President of Sales | 57 |
| John Bello | Chairman of the Board and member of Compensation Committee | 70 |
| Stefan Freeman | Interim Chief Executive Officer, Director and Chairman of the Compensation Committee | 55 |
| Lewis Jaffe | Director and Chairman of the Governance Committee | 58 |
| Charles Cargile | Director and Chairman of the Audit Committee | 52 |

Business Experience of Directors and Executive Officers

Christopher J. Reed founded our company in 1987. Since inception, Mr. Reed has served in the roles of Chairman, President, Chief Executive Officer and is currently our Chief Innovation Officer and non-independent Director since our incorporation in 1991. Mr. Reed also served as Chief Financial Officer during fiscal year 2007 until October 1, 2007 and again from April 17, 2008 to January 19, 2010. Mr. Reed remains a Director of the Company with the election of John Bello as Chairman of the Board by fellow Board members. Mr. Reed has been responsible for our design and products, including the original product recipes, the proprietary brewing process and the packaging and marketing strategies. Mr. Reed received a B.S. in Chemical Engineering in 1980 from Rennselaer Polytechnic Institute in Troy, New York.

Mark Beaton, Chief Operating Officer Mr. Beaton joined Reed's Inc. in March of 2015 and brings over 17 years of experience directing high-volume, multi-site operations for major Fortune 500 CPG companies including Dr. Pepper/Snapple Group, Pepsi Bottling Group and United Parcel Service. Prior to joining Reed's, Mr. Beaton was Vice President of Operations at the Dr. Pepper/Snapple Group where he drove operational efficiencies and was responsible for leading and directing functions that focused on warehouse and distribution operations, inventory management, environmental health and safety and a corporate real estate portfolio. While at Dr. Pepper, Mr. Beaton was responsible for leadership across the packaged beverage network of 160 distribution facilities that delivered 290 million cases and more than \$5 billion of annual sales. Additional positions throughout Mr. Beaton's career include the Director of Supply Chain Technology and Warehousing at Cadbury Schweppes Bottling Group where he was responsible for developing and managing strategies for delivering productivity and process improvement across 166 distribution centers in North America. Mr. Beaton also served in Production, Maintenance and Product Availability Manager Roles with the Pepsi Bottling Group. Mr. Beaton began his career as a Hub Operations Supervisor at UPS and is a Certified Lean Six Sigma Green Belt who also served in the United States Army.

Dan Miles, Chief Financial Officer Dan Miles is a licensed CPA in the State of California who started with Ernst & Young and progressed through financial managerial roles within the beverage industry and other local business enterprises. Dan managed the financial sector for Coors' largest distributor that grew 250% in 8 years via acquisitions of companies, brands and organic growth. Dan worked at the Pepsi Bottling Group in corporate finance and field operations in various capacities. Recently Dan held the position of interim Chief Financial Officer for the Port of Long Beach and the Central Basin Municipal Water District where he led the production of both the annual budget and the reporting of the results of those enterprises. Dan earned his Bachelor of Science degrees at the University of San Francisco in Biology, California State University Long Beach in Accounting and a Master's Degree from University of Southern California in taxation.

Neal Cohane, Senior Vice President of Sales and Marketing has served as Reed's Senior Vice President of Sales and Marketing since March of 2008 and previously Vice President of Sales since August 2007. From March 2001 until August 2007, Mr. Cohane served in various senior-level sales and executive positions for PepsiCo, most recently as Senior National Accounts Manager, Eastern Division. In this capacity, Mr. Cohane was responsible for all business development and sales activities within the Eastern Division. From March 2001 until November 2002, Mr. Cohane served as Business Development Manager, Non-Carbonated Division within PepsiCo where he was responsible for leading the non-carbonated category build-out across the Northeast Territory. From 1998 to March 2001, Mr. Cohane spent three years at South Beach Beverage Company, most recently as Vice President of Sales, Eastern Region. From 1986 to 1998, Mr. Cohane spent approximately twelve years at Coca-Cola of New York where he held various senior-level sales and managerial positions, most recently as General Manager New York. Mr. Cohane holds a B.S. degree in Business Administration from Merrimack College in North Andover, Massachusetts.

John Bello is Reed's Board Chairman and sales and marketing expert. Since 2001, Mr. Bello has been the Managing Director of JoNa Ventures, a family venture fund. From 2004 to 2012 Mr. Bello also served as Principal and General Partner at Sherbrooke Capital, a venture capital group dedicated to investing in leading, early stage health and wellness companies. Mr. Bello is the founder and former CEO of South Beach Beverage Company, the maker of nutritionally enhanced teas and juices marketed under the brand name SoBe. The company was sold to PepsiCo in 2001 for \$370 million and in the same year Ernst and Young named Mr. Bello National Entrepreneur of the Year in the consumer products category for his work with SoBe. Before founding SoBe, Bello spent 14 years at National Football League Properties, the marketing arm of the NFL and served as its President from 1986 to 1993. As the President, Mr. Bello has been credited for building NFL Properties into a sports marketing leader and creating the model by which every major sports league now operates.

Prior to working for the NFL, Mr. Bello served in marketing and strategic planning capacities at the Pepsi Cola Division of PepsiCo Inc. and in product management roles for General Foods Corporation in the Sanka and Maxwell House brands. Mr. Bello has also worked with IZZE and Firefighter brands in brand building, marketing and strategic planning capacities.

Mr. Bello earned his BA from Tufts University, cum laude, and received his MBA from the Tuck School of business at Dartmouth College as an Edward Tuck Scholar. Mr. Bello is extensively involved in non-profit work and currently serves as a Tufts University Trustee and advisory board member (athletics). Additionally, he serves on the boards of: the Gordon Entrepreneurial Center at Tufts, the Tuck Center for Private Equity, the YMCA in Rye, New York and the New York Council Boy Scouts of America. Mr. Bello also serves on the board of Boathouse Sports and is executive director of Luminesce Eye Therapies.

Lewis Jaffe is a Director and Chairman of the Governance Committee. Since August 2014, Mr. Jaffe has been teaching as an Executive-in-Residence and Clinical Faculty at the Fred Kiesner Center for Entrepreneurship, Loyola Marymount University. Since January 2010 Mr. Jaffe has served as Chairman of the Board for FitLife Brands Inc (FTLF:OTCBB) and serves on its audit, compensation and governance committees. Since 2006 he has served on the board of Director of York Telecom, a private equity owned company, and serves on its compensation and governance committees. From 2006 to 2008 Mr. Jaffe was Interim Chief Executive Officer and President of Oxford Media, Inc. Mr. Jaffe has also served in executive management positions with Verso Technologies, Inc., Wireone Technologies, Inc., Picturitel Corporation, and he was also previously a Managing Director of Arthur Andersen. Mr. Jaffe was the co-founder of MovieMe Network. Mr. Jaffe also served on the Board of Directors of Benihana, Inc. as its lead independent director from 2004 to 2012.

Mr. Jaffe is a graduate of the Stanford Business School Executive Program, holds a Bachelor of Science from LaSalle University and holds a Masters Professional Director Certification from the American College of Corporate Directors, a public company director education and credentialing program.

Stefan Freeman, was appointed Interim Chief Executive Officer on April 19, 2016 and is Chairman of the Compensation Committee. Mr. Freeman is a strategic and performance focused executive with more than 25 years in sales operations, manufacturing and supply chain operations in beverages and consumer products. Mr. Freeman has worked for the three largest soda companies in the world and was promoted within each company. From 2011 through 2014, Mr. Freeman was the Regional Vice President of Manufacturing for Coca-Cola Refreshments, managing eight manufacturing plants located throughout Southern California, Arizona and Hawaii. These plants produced 231 million cases with revenues in excess of \$500 million annually. In 2014 Mr. Freeman was promoted from within Coca-Cola Refreshments to Vice President of Fleet Operations in Atlanta, Georgia where he managed one of the five largest fleet operations in North America through April 2016. Prior to working for Coca-Cola, Mr. Freeman was Director of Supply Chain for Dean Foods' Pacific Coast Group, managing nine production facilities with responsibility for a \$155 million annual operating budget. Other prior positions include Director of Sales Operations for Dr. Pepper Snapple Group and Supply Chain Manager and Plant Manager for Pepsi-Cola Bottling Group.

Mr. Freeman hold a Bachelors of Science in mechanical engineering from Tuskegee University and is an active member of the Cisco Systems Global Manufacturing Advisory Board.

Charles Cargile is a Director and Chairman of the Audit Committee. Mr. **Cargile** has a distinguished career as a financial and strategic management executive. Most recently, Mr. Cargile was Senior Vice President, Chief Financial Officer and Treasurer of NASDAQ listed Newport Corporation from 2000 to 2016. He successfully oversaw the acquisition of Newport by MKS Instruments in April, 2016 for \$980 million; an acquisition price 11 times 2015 EBITDA and at a 53% premium to the share price. Prior to his time at Newport Corporation, from 1998 to 2000 Mr. Cargile was Vice President of Finance and Corporate Development at York International Corporation (now part of Johnson Controls). From 1992 to 1998 Mr. Cargile was Corporate Controller and Chief Accounting Officer at BW/IP, Inc. (now Flowserve Corporation). Currently, Mr. Cargile is head of Cargile Financial and Advisory Services based in Newport Coast, CA. He is the lead independent director at Netlist and was recently appointed Chief Executive Officer at Sunworks.

Mr. Cargile holds a Bachelor of Science degree in Accounting from Oklahoma State University and a Master's degree in Business Administration from the Marshall School of Business at the University of Southern California. Mr. Cargile has his Professional Director Certification from the American College of Corporate Directors.

Legal Proceedings

To the best of our knowledge, none of our executive officers or directors are parties to any material proceedings adverse to Reed's, have any material interest adverse to Reed's or have, during the past ten years been subject to legal or regulatory proceedings required to be disclosed hereunder.

Corporate Governance

We are committed to having sound corporate governance principles. We believe that such principles are essential to running our business efficiently and to maintaining our integrity in the marketplace. There have been no changes to the procedures by which stockholders may recommend nominees to our board of directors.

Director Qualifications

We believe that our directors should have the highest professional and personal ethics and values, consistent with our longstanding values and standards. They should have broad experience at the policy-making level in business or banking. They should be committed to enhancing stockholder value and should have sufficient time to carry out their duties and to provide insight and practical wisdom based on experience. Their service on other boards of public companies should be limited to a number that permits them, given their individual circumstances, to perform responsibly all director duties for us. Each director must represent the interests of all stockholders. When considering potential director candidates, the board of directors also considers the candidate's character, judgment, diversity, age and skills, including financial literacy and experience in the context of our needs and the needs of the board of directors.

Director Independence

The board of directors has determined that three members of our board of directors, Mr. Bello, Mr. Cargile and Mr. Jaffe, are independent under the New York Stock Exchange Listed Company Manual. We intend to maintain at least three independent directors on our board of directors in the future.

Code of Ethics

Our Chief Executive Officer and all senior financial officers, including the Chief Financial Officer, are bound by a Code of Ethics that complies with Item 406 of Regulation S-B of the Exchange Act. Our Code of Ethics is posted on our website at www.reedsinc.com.

Board Structure and Committee Composition

As of the date of this Annual Report, our board of directors has five directors and the following three standing committees: an Audit Committee, a Compensation Committee and a Nominations and Governance Committee. These committees were formed in January 2007.

Audit Committee. Our Audit Committee oversees our accounting and financial reporting processes, internal systems of accounting and financial controls, relationships with independent auditors and audits of financial statements. Specific responsibilities include the following:

- selecting, hiring and terminating our independent auditors;
- evaluating the qualifications, independence and performance of our independent auditors;
- approving the audit and non-audit services to be performed by our independent auditors;
- reviewing the design, implementation, adequacy and effectiveness of our internal controls and critical accounting policies;
- overseeing and monitoring the integrity of our financial statements and our compliance with legal and regulatory requirements as they relate to financial statements or accounting matters;
- reviewing with management and our independent auditors, any earnings announcements and other public announcements regarding our results of operations; and
- preparing the audit committee report that the SEC requires in our annual proxy statement.

Our Audit Committee is comprised of Chairman Cargile, Mr. Jaffe and Mr. Freeman. The board of directors has determined that the three members of the Audit Committee are independent under the rules of the SEC Section 803A of the NYSE MKT Listed Company Guide and that Mr. Cargile qualifies as an “audit committee financial expert,” as defined by the rules of the SEC. Our board of directors has adopted a written charter for the Audit Committee meeting applicable standards of the SEC and the New York Stock Exchange.

Compensation Committee. Our Compensation Committee assists our board of directors in determining and developing plans for the compensation of our officers, directors and employees. Specific responsibilities include the following:

- approving the compensation and benefits of our executive officers;
- reviewing the performance objectives and actual performance of our officers; and
- administering our stock option and other equity compensation plans.

Our Compensation Committee is comprised of Mr. Freeman, Mr. Jaffe, Mr. Cargile and Mr. Bello. The board of directors has determined that all of the members of the Compensation Committee are independent under Section 803A of the NYSE MKT Company Guide. In affirmatively determining the independence of a director who will serve on the compensation committee, the Company’s board considered all factors specifically relevant to whether the director

has a relationship to the Company which is material to the director's ability to be independent from management in connection with the duties of a committee member, including, without limitation: (1) the source of compensation of the director, including any consulting, advisory or other compensatory fee paid by the Company; and (2) whether the director is affiliated with the Company, or an affiliate of the Company. The position of Interim Chief Executive Officer falls within an exception and does not invalidate an independence determination.

Our board of directors has adopted a written charter for the Compensation Committee.

Nominations and Governance Committee. Our Nominations and Governance Committee assists the board of directors by identifying and recommending individuals qualified to become members of our board of directors, reviewing correspondence from our stockholders, and establishing, evaluating and overseeing our corporate governance guidelines. Specific responsibilities include the following:

evaluating the composition, size and governance of our board of directors and its committees and making recommendations regarding future planning and the appointment of directors to our committees;

establishing a policy for considering stockholder nominees for election to our board of directors; and

evaluating and recommending candidates for election to our board of directors.

Our Nominations and Governance Committee is comprised of Chairman Jaffe and Mr. Cargile. The board of directors has determined that all of the members of the Nominations and Governance Committee are independent under the rules of Section 803A of the NYSE MKT Company Guide. Our board of directors has adopted a written charter for the Nominations and Corporate Governance Committee.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) requires our directors and executive officers and beneficial holders of more than 10% of our common stock to file with the SEC initial reports of ownership and reports of changes in ownership of our equity securities.

To our knowledge, based solely upon a review of Forms 3 and 4 and amendments thereto furnished to Reed’s under 17 CFR 240.16a-3(e) during our most recent fiscal year and Forms 5 and amendments thereto furnished to Reed’s with respect to our most recent fiscal year or written representations from the reporting persons, we believe that during the year ended December 31, 2015 our directors, executive officers and persons who own more than 10% of our common stock complied with all Section 16(a) filing requirements.

Item 11. Executive Compensation

The following table summarizes all compensation for fiscal years 2016 and 2015 received by our principal executive officer, current and former principal financial officers, current and former chief operating officers, and our current Senior Vice principal of Sales who were and currently are our “Named Executive Officers”.

| Name and Principal Position | Year | Salary | Bonus | Stock Awards | Option Awards (\$)(1) | Non-Equity Incentive | Non-Qualified Deferred Compensation Earnings | All Other Compensation | Total |
|--|------|---------|--------|--------------|-----------------------|----------------------|--|------------------------|---------|
| Christopher J. Reed Chief Executive Officer | 2015 | 226,583 | 4,000 | | | | | | 230,583 |
| | 2016 | 227,000 | 40,000 | | | | | 4,320 | 271,320 |
| Daniel V. Miles Principal Financial Officer | 2015 | 113,414 | 4,000 | - | - | - | - | 1,800 | 119,214 |
| | 2016 | 175,000 | 40,000 | - | - | - | - | 4,320 | 219,320 |
| Lawrence W. Tomsic (former Principal Financial Officer) (3) | 2015 | 84,706 | | | | | | 22,500 | 107,206 |
| | 2016 | | | | | | | | 0 |
| Mark Beaton Chief Operating Officer | 2015 | 109,252 | 40,000 | - | - | - | - | 1,800 | 151,052 |
| | 2016 | 158,328 | | | | | | 4,320 | 162,648 |
| Neal Cohane SVP sales | 2015 | 210,000 | 25,000 | - | - | - | - | 21,067 | 256,067 |
| | 2016 | 210,000 | 40,000 | | | | | 12,000 | 262,000 |

(1) The amounts represent the fair value for share-based payment awards issued during the year. The award is calculated on the date of grant in accordance with Financial Accounting Standards, excluding any impact of assumed forfeiture rates.

(2) Other compensation include both cash payments and the estimated value of the use of company assets.

(3) Reed's and Lawrence W. Tomsic agreed to a mutual separation on May 29, 2015 and includes severance of \$22,500

Employment Agreements

There are no employment agreements with our executive officers. Mr. Reed is currently paid an annual salary of \$227,000. Mr. Cohane is paid an annual salary of \$210,000. Mr. Miles and Mr. Beaton are currently paid an annual salary of \$175,000. Any bonuses are discretionary.

Outstanding Equity Awards At Fiscal Year-End

The following table sets forth information regarding unexercised options and equity incentive plan awards for each Named Executive Officer outstanding as of December 31, 2016

| Name and Position | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options | Option Exercise Price | Option Expiration Date |
|--|---|---|--|-----------------------|------------------------|
| Christopher J. Reed, Chief Executive Officer | 25,000 | | -1 | \$ 4.00 | 3/3/2018 |
| | 30,000 | 10,000 | -2 | \$ 4.60 | 4/9/2019 |
| | 40,000 | 30,000 | -4 | \$ 5.01 | 1/15/2020 |
| Daniel Miles, Chief Financial Officer | 66,667 | 33,333 | -3 | \$ 5.01 | 5/8/2020 |
| Neal Cohane, SVP Sales | 30,000 | | -2 | \$ 4.00 | 3/3/2018 |
| | 30,000 | 10,000 | -2 | \$ 4.60 | 4/9/2019 |
| | 40,000 | 30,000 | -4 | \$ 5.01 | 1/15/2020 |
| Mark Beaton, Chief Operating Officer | 66,667 | 33,333 | -3 | \$ 5.01 | 3/16/2020 |

(1) Options vest 25% immediately and 25% per year.

(2) These options vest 33% per year.

(3) These options vest 50% per year.

(4) These options vest 25% per year.

Director Compensation

The following table summarizes the compensation paid to our directors for the fiscal year ended December 31, 2016

| Name | Fees Earned or Paid in Cash | Stock Awards | Option Awards | Non-Equity Incentive Plan Compensation | All Other Compensation | Total |
|----------------------------|--------------------------------------|-----------------|------------------|--|---------------------------|----------|
| Judy Holloway Reed (1) | \$4,062 | | | | | \$4,062 |
| Mark Harris (2) | - | \$ 900 | | | | \$900 |
| Daniel S.J. Muffoletto (1) | \$11,230 | | | | | \$11,230 |
| Michael Fischman | \$3,000 | | | | | \$3,000 |
| Stefan Freeman | \$1,667 | | | | | \$1,667 |
| Lewis Jaffe | \$2,117 | | | | | \$2,117 |
| Charles Cargile | \$1,667 | | | | | \$1,667 |
| John Bello | \$16,666 | | | | | \$16,666 |

(1) Former directors, term ended November 29, 2016

(2) Former director, resigned June 1, 2016

Item 12. Security Ownership of Certain Beneficial Owners, Management and Related Stockholder Matters

The following table reflects, as of March 31, 2017, the beneficial common stock ownership of: (a) each of our directors, (b) each of our current named executive officers, (c) each person known by us to be a beneficial holder of 5% or more of our common stock, and (d) all of our executive officers and directors as a group.

Except as otherwise indicated below, the persons named in the table have sole voting and investment power with respect to all shares of common stock held by them. Unless otherwise indicated, the principal address of each listed executive officer and director is 13000 South Spring Street, Los Angeles, California 90061.

| Named Beneficial Owner | Number of Shares Beneficially Owned | Percentage of Shares Beneficially Owned (1) | |
|---|--|--|---|
| Directors and Named Executive Officers | | | |
| Christopher J. Reed ⁽²⁾ | 2,478,890 | 18 | % |
| John Bello* | 16,666 | 0 | % |
| Stefan Freeman* | 10,000 | 0 | % |
| Lewis Jaffe* | 10,000 | 0 | % |
| Charles Cargile* | 10,000 | 0 | % |
| Daniel V. Miles | 138,000 | 1 | % |
| Mark Beaton* | 100,000 | 1 | % |
| Neal Cohane | 245,677 | 2 | % |
| Directors and executive officers as a group (9 persons) | 3,009,233 | 22 | % |
| 5% or greater stockholders | | | |
| Robert Reed | 800,000 | 6 | % |

* Less than 1%.

Beneficial ownership is determined in accordance with the rules of the SEC. Shares of common stock subject to options or warrants currently exercisable or exercisable within 60 days of March 24, 2016 are deemed outstanding for computing the percentage ownership of the stockholder holding the options or warrants but are not deemed outstanding for computing the percentage ownership of any other stockholder. Unless otherwise indicated in the footnotes to this table, we believe stockholders named in the table have sole voting and sole investment power with respect to the shares set forth opposite such stockholder's name. Percentage of ownership is based on 13,908,247 shares of common stock outstanding as of March 24, 2016.

(2) Jointly owned with his wife, Judy Reed.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Our board of directors has adopted written policies and procedures for the review of any transaction, arrangement or relationship between Reed's and one of our executive officers, directors, director nominees or 5% or greater stockholders (or their immediate family members), each of whom we refer to as a "related person," in which such related person has a direct or indirect material interest.

32

If a related person proposes to enter into such a transaction, arrangement or relationship, defined as a “related party transaction,” the related party must report the proposed related party transaction to our Chief Financial Officer. The policy calls for the proposed related party transaction to be reviewed and, if deemed appropriate, approved by the Nominations and Governance Committee. Our Nominations and Governance Committee is comprised of Dr. Muffoletto, Mark Harris and Mr. Fischman. The board of directors has determined that all of the members of the Nominations and Governance Committee are independent under the rules of the New York Stock Exchange Listed Company Manual. If practicable, the reporting, review and approval will occur prior to entry into the transaction. If advance review and approval is not practicable, the Nominations and Governance Committee will review, and, in its discretion, may ratify the related party transaction. Any related party transactions that are ongoing in nature will be reviewed annually at a minimum. The related party transactions listed below were reviewed by the full board of directors. Prior to August 2005, we did not have independent directors on our board to review and approve related party transactions. The Nominations and Governance Committee shall review future related party transactions.

During the years December 31, 2016 and 2014, we have participated in the following transactions in which a related person had or will have a direct or indirect material interest:

During the year ended December 31, 2008, the Company entered into an agreement for the distribution of its products internationally. The agreement is between the Company and a company controlled by two brothers of Christopher Reed, Chief Executive Officer of the Company. The agreement was terminated on January 1, 2015. During the year ended December 31, 2016, the Company paid no commissions and for the year ended December 31, 2015 paid commissions of \$1,000.

Item 14. Principal Accounting Fees and Services

Weinberg & Company, P.A. (“Weinberg”) was our independent registered public accounting firm for the years ended December 31, 2016 and 2015.

The following table shows the fees paid or accrued by us for the audit and other services provided by Weinberg for the years ended December 31, 2016 and 2015.

| | 2016 | 2015 |
|--------------------|------------|------------|
| Audit Fees | \$ 105,382 | \$ 142,000 |
| Audit-Related Fees | | 0 |
| Tax Fees | 30,902 | 24,000 |
| All Other Fees | | 0 |

| | | |
|-------|-----------|-----------|
| Total | \$136,284 | \$166,000 |
|-------|-----------|-----------|

As defined by the SEC, (i) “audit fees” are fees for professional services rendered by our principal accountant for the audit of our annual financial statements and review of financial statements included in our Form 10-K, or for services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years; (ii) “audit-related fees” are fees for assurance and related services by our principal accountant that are reasonably related to the performance of the audit or review of our financial statements and are not reported under “audit fees;” (iii) “tax fees” are fees for professional services rendered by our principal accountant for tax compliance, tax advice, and tax planning; and (iv) “all other fees” are fees for products and services provided by our principal accountant, other than the services reported under “audit fees,” “audit-related fees,” and “tax fees.”

Audit Fees

Services provided to us by Weinberg with respect to such periods consisted of the audits of our financial statements and limited reviews of the financial statements included in Quarterly Reports on Form 10-Q. Weinberg also provided services with respect to the filing of our registration statements in 2016 and 2015.

Audit Related Fees

Weinberg did not provide any professional services to us with which would relate to “audit related fees.”

Tax Fees

Weinberg prepared our 2015 and 2014 Federal and state income taxes.

All Other Fees

Weinberg did not provide any professional services to us with which would relate to “other fees.”

Audit Committee Pre-Approval Policies and Procedures

Under the SEC’s rules, the Audit Committee is required to pre-approve the audit and non-audit services performed by the independent registered public accounting firm in order to ensure that they do not impair the auditors’ independence. The Commission’s rules specify the types of non-audit services that an independent auditor may not provide to its audit client and establish the Audit Committee’s responsibility for administration of the engagement of the independent registered public accounting firm.

Consistent with the SEC’s rules, the Audit Committee Charter requires that the Audit Committee review and pre-approve all audit services and permitted non-audit services provided by the independent registered public accounting firm to us or any of our subsidiaries. The Audit Committee may delegate pre-approval authority to a member of the Audit Committee and if it does, the decisions of that member must be presented to the full Audit Committee at its next scheduled meeting. Accordingly, 100% of audit services and non-audit services described in this Item 14 were pre-approved by the Audit Committee.

There were no hours expended on the principal accountant’s engagement to audit the registrant’s financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant’s full-time, permanent employees.

PART IV

Item 15. Exhibits and Financial Statements

(a) 1. Financial Statements

See Index to Financial Statements in Item 8 of this Annual Report on Form 10-K, which is incorporated herein by reference.

2. Financial Statement Schedules

All other financial statement schedules have been omitted because they are either not applicable or the required information is shown in the financial statements or notes thereto.

3. Exhibits

See the Exhibit Index, which follows the signature page of this Annual Report on Form 10-K, which is incorporated herein by reference.

(b) Exhibits

See Item 15(a) (3) above.

(c) Financial Statement Schedules

See Item 15(a) (2) above.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: April 24, 2017 **REED'S, INC.**
a Delaware corporation

By: */s/ Stefan Freeman*
Stefan Freeman
Interim Chief Executive Officer

In accordance with the Exchange Act, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|-------------------|
| <i>/s/ Stefan Freeman</i> Stefan Freeman | Interim Chief Executive Officer, (Principal Executive Officer) | April 24, 2017 |
| <i>/s/ Daniel V. Miles</i> Daniel V. Miles | Chief Financial Officer (Principal Financial Officer) | April 24, 2017 |
| <i>/s/ John Bello</i> John Bello | Chairman of the Board | April 24, 2017 |
| <i>/s/ Christopher J. Reed</i> Christopher J. Reed | Chief Innovation Officer, Director | April 24, 2017 |
| <i>/s/ Lewis Jaffe</i> Lewis Jaffe | Director | April 24, 2017 |
| <i>/s/ Charles Cargile</i> Charles Cargile | Director | April 24, 2017 |

EXHIBIT INDEX

- 3.1 Certificate of Incorporation of Reed's, Inc. as filed September 7, 2001 (Incorporated by reference to Exhibit 3.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.2 Certificate of Amendment of Certificate of Incorporation of Reed's, Inc. as filed September 27, 2004 (Incorporated by reference to Exhibit 3.2 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.3 Certificate of Amendment of Certificate of Incorporation of Reed's, Inc. as filed December 18, 2007 (Incorporated by reference to Exhibit 3.3 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
- 3.4 Certificate of Designations, Preferences and Rights of Series A Preferred Stock of Reed's, Inc. as filed October 12, 2004 (Incorporated by reference to Exhibit 3.3 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.5 Certificate of Correction to Certificate of Designations as filed November 10, 2004 (Incorporated by reference to Exhibit 3.4 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 3.7 Bylaws of Reed's Inc., as amended (Incorporated by reference to Exhibit 3.1 to Reed's, Inc.'s Current Report on Form 8-K filed December 19, 2012)
- 4.1 Form of common stock certificate (Incorporated by reference to Exhibit 4.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 4.2 Form of Series A preferred stock certificate (Incorporated by reference to Exhibit 4.2 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
- 4.3 Form of 2017- 1 Warrant (Incorporated by Reference to Exhibit 4.1 to Reed's Inc. Current Report on Form 8-K, as filed April 24, 2017)
- 4.4 Form of 2017-2 Warrant (Incorporated by Reference to Exhibit 4.2 to Reed's Inc. Current Report on Form 8-K, as filed April 24, 2017)
- 10.4* 2007 Stock Option Plan (Incorporated by reference to Exhibit 10.22 to Reed's, Inc.'s Form 10-K filed March 27, 2009)
- 10.5 Securities Purchase Agreement dated April 21, 2017 by and between Reed's Inc. and Raptor/ Harbor Reeds SPV, LLC (Incorporated by Reference to Exhibit 10.1 to Reed's Inc. Current Report on Form 8-K, as filed April 24, 2017)
- 10.6 Security Agreement by and between Reed's Inc. and Raptor/ Harbor Reeds SPV, LLC (Incorporated by Reference to Exhibit 10.2 to Reed's Inc. Current Report on Form 8-K, as filed April 24, 2017)
- 10.7

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

Registration Rights Agreement by and between Reed's Inc. and Raptor/ Harbor Reeds SPV, LLC (Incorporated by Reference to Exhibit 10.3 to Reed's Inc. Current Report on Form 8-K, as filed April 24, 2017)

- 10.8 Amendment Number Fifteen to Amended and Restated Loan and Security Agreement between Reed's Inc. and PMC Financial Services Group, LLC dated April 21, 2017 (Incorporated by Reference to Exhibit 10.4 to Reed's Inc. Current Report on Form 8-K, as filed April 24, 2017)
- 14.1 Code of Ethics (Incorporated by reference to Exhibit 14.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-157359))
- 21. Subsidiaries of Reed's, Inc., filed herewith.
- 23.1 Consent of Weinberg & Co., P.A., filed herewith.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 filed herewith.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 filed herewith.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

* Indicates a management contract or compensatory plan or arrangement.

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

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

