

JONES SODA CO
Form 10-K
March 31, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

- o** **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2009
- o** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number: 000-28820

JONES SODA CO.

(Exact name of registrant as specified in its charter)

Washington
*(State or other jurisdiction of
incorporation or organization)*

52-2336602
*(I.R.S. Employer
Identification No.)*

**234 Ninth Avenue North
Seattle, WA 98109**
(Address of principal executive offices)

(206) 624-3357
(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, no par value	The NASDAQ Stock Market LLC

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

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

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

Indicate by checkmark 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 checkmark whether the registrant has submitted electronically and posted on its corporate Website, 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 (§ 229.405 of this chapter) 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

As of the last business day of the second fiscal quarter, June 30, 2009, the aggregate market value of such common stock held by non-affiliates was approximately \$28,835,505 using the closing price on that day of \$1.09.

As of March 10, 2010, there were 26,424,796 shares of the Company's common stock issued and outstanding.

Documents Incorporated By Reference:

None

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EXPLANATORY NOTE

Unless otherwise indicated or the context otherwise requires, all references in this Annual Report on Form 10-K to we, us, our, Jones, Jones Soda, and the Company are to Jones Soda Corporation, and our wholly-owned subsidiaries Jones Soda Co. (USA) Inc., Jones Soda (Canada) Inc., Jones.com Inc. and Whoopass USA Inc.

In addition, unless otherwise indicated or the context otherwise requires, all references in this Annual Report to *Jones Soda* and *Jones Pure Cane Soda* refer to our premium soda sold under the trademarked brand name *Jones Soda Co.*

CAUTIONARY NOTICE REGARDING FORWARD LOOKING STATEMENTS

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. This Annual Report on Form 10-K (Report) contains a number of forward-looking statements that reflect management's current views and expectations with respect to our business, strategies, products, future results and events and financial performance. All statements made in this Report other than statements of historical fact, including statements that address operating performance, the economy, events or developments that management expects or anticipates will or may occur in the future, including statements related to potential strategic transactions, distributor channels, volume growth, revenues, profitability, new products, adequacy of funds from operations, cash flows and financing, our ability to continue as a going concern, statements expressing future operating results and non-historical information, are forward-looking statements. In particular, the words such as believe, expect, intend, anticipate, estimate, may, will, can, plan, predict, could, future, variations of such words, and similar expressions in this Report are forward-looking statements, but are not the exclusive means of identifying such statements and their absence does not mean that the statement is not forward-looking.

Readers should not place undue reliance on these forward-looking statements, which are based on management's current expectations and projections about future events, are not guarantees of future performance, are subject to risks, uncertainties and assumptions and apply only as of the date of this Report. Our actual results, performance or achievements could differ materially from historical results as well the results expressed in, anticipated or implied by these forward-looking statements. Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

In particular, our business, including our financial condition and results of operations and our ability to continue as a going concern may be impacted by a number of factors, including, but not limited to, the following:

Our ability to successfully execute on our 2010 operating plan and obtain financing before 2011;

Whether our efforts to explore strategic transactions result in a definitive transaction, and the risks and uncertainties associated with the evaluation and negotiation of any proposed transaction, including management distraction and the effect of market assumptions regarding a proposed transaction on the price of our common stock;

Our ability to establish and maintain distribution arrangements with distributors, retailers, brokers and national retail accounts, on which our business plan and future growth are dependent in part;

Our ability to manage our inventory levels and to predict the timing and amount of our sales;

The inability of our exclusive manufacturer and distributor (National Beverage Corp.) of *Jones Soda* 12-ounce cans in the grocery and mass merchant channel to perform adequately, which could impair our ability to meet demand;

Our ability to modify our sponsorship arrangements in a timely manner to reduce our obligations or make any other changes or to realize the benefits expected from our sponsorship agreements, to which we have dedicated significant resources;

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Our reliance on third-party packers of our products, which could make management of our marketing and distribution efforts inefficient or unprofitable;

Our ability to secure a continuous supply and availability of raw materials, as well as other factors affecting our supply chain;

Our ability to source our flavors on acceptable terms from our key flavor suppliers;

Our ability to maintain brand image and product quality and the risk that we may suffer other product issues such as product recalls;

Our ability to attract and retain key personnel, which would directly affect our efficiency and results of operations;

Our inability to protect our trademarks, patents and trade secrets, which may prevent us from successfully marketing our products and competing effectively;

Litigation or legal proceedings (including pending securities class actions), which could expose us to significant liabilities and damage our reputation;

Our inability to build and sustain proper information technology infrastructure;

Our inability to regain compliance with the continued listing requirements of The Nasdaq Capital Market, including the \$1 minimum bid price requirement, or our inability to appeal the Nasdaq Staff's determination to delist our common stock which may adversely affect our market price and liquidity;

Our inability to create and maintain brand name recognition and acceptance of our products, which are critical to our success in our competitive, brand-conscious industry;

Our ability to compete successfully against much larger, well-funded, established companies currently operating in the beverage industry;

Our inability to continue developing new products to satisfy our consumers' changing preferences;

Global economic conditions that may adversely impact our business and results of operations;

Our ability to comply with the many regulations to which our business is subject.

For a discussion of some of the factors that may affect our business, results and prospects, see Item 1A. Risk Factors. Readers are also urged to carefully review and consider the various disclosures made by us in this Report and in our other reports we file with the Securities and Exchange Commission, including our periodic reports on Forms 10-Q and current reports on Form 8-K, and those described from time to time in our press releases and other communications, which attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

JONES SODA CO.

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009

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PART I

ITEM 1. BUSINESS.

Overview

We develop, produce, market and distribute a range of premium beverages, including the following four brands as of the date of this Report:

Jones Pure Cane Soda[®], a premium carbonated soft drink with three new extensions launched in targeted markets during 2009:

Jones Refresco De Caña Pura,

Jones Jumble[™], our seasonal soda, and

Jones Zilch[™], our zero calorie offering;

Jones 24C[®], an enhanced water beverage;

Jones GABA[®], a functional tea juice blend; and

WhoopAss Energy Drink[®], a citrus energy drink.

We sell and distribute our products primarily throughout the United States (U.S.) and Canada through our network of independent distributors, which we refer to as our direct store delivery (DSD) channel and national retail accounts, which we refer to as our direct to retail (DTR) channel, and we sell concentrate through an exclusive manufacturing and distribution agreement. We do not directly manufacture our products but instead outsource the manufacturing process to third party contract packers. We also sell various products on-line, which we refer to as our interactive channel, including soda with customized labels, wearables, candy and other items, and we license our trademarks for use on products sold by other manufacturers. In addition, we are expanding our international business outside of North America and have secured distribution through independent distributors in Ireland, the United Kingdom, Australia, Japan and the United Arab Emirates.

Our company is a Washington corporation formed in 2000 as a successor to Urban Juice and Soda Company Ltd., a Canadian company formed in 1986. Our principal place of business is located at 234 Ninth Avenue North, Seattle, Washington 98109. Our telephone number is (206) 624-3357.

As we discuss in this Report under the heading Liquidity and Capital Resources, the challenges and uncertainties we face in our business, including our liquidity position, our inability to implement further meaningful cost containment measures beyond those we have already undertaken and the extremely difficult environment in which to obtain additional equity or debt financing, continue to raise substantial doubt about our ability to continue as a going concern. In light of this, we have evaluated a broad range of strategic alternatives over the last months. On March 9, 2010, we announced that we had entered into a Letter of Intent (LOI) with Reed's, Inc. (Reed's), maker of sodas sold in natural food stores nationwide, regarding a potential merger transaction in which Reed's would acquire Jones Soda for a combination of cash and Reed's common stock. On March 22, 2010, we announced that we had terminated the exclusivity provisions of the LOI in order to explore an unsolicited, nonbinding transaction proposal submitted by

another third party. We intend to continue to explore strategic transactions that may be in the best interest of the Company and our shareholders, which may include, without limitation, mergers or other business combinations, public or private offerings of debt or equity financings, joint ventures with one or more strategic partners and other strategic alternatives. However, there can be no assurance that we will enter into a definitive agreement with respect to a transaction, or that any transaction we may enter into will ultimately be consummated.

Segment Information

The Company has one operating segment with operations primarily in the United States and Canada (see Note 14 in Item 8 of this Report).

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Products

Our four beverage brands include the following:

Jones Pure Cane Soda

In November 1995, we launched *Jones Soda*, a premium carbonated soft drink, under our trademarked brand creating a new category in the New Age beverage market (see Industry Background below for a description of the New Age market). *Jones Soda* comes in 12-ounce, clear long-neck bottles, and every bottle label carries a photo sent to us by our consumers. Over 1,000,000 photos have been submitted to us. We believe this unique interaction between the consumer and the brand creates a distinguishable point of difference and strong competitive advantage for *Jones Soda*. Equally differentiating is the bright colorful look of our drinks with distinctive names such as FuFu Berry® and Blue Bubble Gum. *Jones Soda* is made with the highest quality ingredients and flavors. We currently sell *Jones Soda* in eleven flavors in the United States.

In 2003, we launched a sugar-free version of our *Jones Soda* line providing an alternative for consumers to our regular *Jones Soda* line. We believe these sugar-free sodas, which are sweetened with Splenda® and contain zero calories, are an important product extension, especially in light of the recent concern and media coverage regarding obesity in young people. In the fourth quarter of 2009, we re-branded this line-up as *Jones Zilch*™. The new line-up is still sweetened with Splenda, has zero calories and now includes Vitamin C as an added ingredient. We currently have three flavors of *Jones Zilch*™, including the traditional favorite, Black Cherry, and two new flavors: Pomegranate, and Vanilla Bean.

In 2004, we expanded the *Jones Soda* package lineup to include 12-ounce cans, which are produced and distributed by National Beverage Corp. (National Beverage) primarily through the grocery channel. We believe our can business provides our customers with an alternative method of consuming our premium soda.

In keeping with our commitment to produce the highest quality beverage, in the second quarter of 2007, we launched *Jones Pure Cane Soda* by converting our sweetener system from high fructose corn syrup to pure cane sugar, which we believe improves the taste and mouth feel of our products and is understood to digest easier in the body.

During 2009, we launched three extensions of our *Jones Pure Cane Soda* including *Jones Zilch*™, *Jones Refresco De Caña Pura*, launched in our West coast markets, and *Jones Jumble*™, our seasonal soda launched in targeted markets. We currently have four flavors of the *Jones Refresco* line and treat *Jones Jumble*™ as a rotating flavor for the seasonal soda.

Jones 24C

In June 2006, we purchased the trademark rights and related assets of *24C*. *Jones 24C*, an enhanced water beverage sweetened with pure cane sugar, has 100% natural flavors, contains daily vitamin requirements (including 500% RDA of Vitamin C) and is available in five flavors primarily in the Northeast region of the country. We began production and distribution of *Jones 24C* in the first quarter of 2007. *24C* is available in 20-ounce PET bottles.

Jones GABA

We introduced our first line of beverages containing Pharma GABA in February 2009. The product, branded *Jones GABA* and offered in 12-ounce slim cans, is available in the following flavors: Lemon Honey Tea, Fuji Apple, Nectarine and Grapefruit tea and juice blends. Pharma GABA is a naturally produced form of the amino acid, gamma amino butyric acid (GABA), which studies have shown to be a key neurotransmitter in the human brain that improves

mental focus, balance and clarity, while reducing stress. We believe our launch has been hampered by the persisting adverse economic conditions. *Jones GABA* is our first entry in the new emerging category of Functional Beverages and is our first beverage product containing GABA.

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WhoopAss Energy Drink

We launched *WhoopAss* in October 1999. *WhoopAss* is a citrus energy drink in a 16-ounce slim can containing riboflavin, niacin, vitamin B6 and thiamin. *WhoopAss* competes in the Energy Drink category of the New Age beverage industry.

Discontinued Product Jones Naturals and Jones Organicstm

In the first quarter of 2010, due to the loss of our significant DTR accounts carrying these brands, including Barnes & Noble Inc. and Panera Bread Company, and the costs of maintaining inventory for low volume brands, we discontinued *Jones Naturals* (launched in April 2001) and *Jones Organicstm* (launched in April 2005). *Jones Naturals* was a non-carbonated beverage containing 100% natural flavors and ingredients and consisted of five flavors. *Jones Organicstm* was a ready-to-drink organic tea and consisted of four flavors.

Industry Background

The New Age or Alternative Beverage Category

Jones Pure Cane Soda, *Jones 24C*, and *WhoopAss Energy Drink*, which are classified as New Age or alternative beverages, as well as other brands and products that we may develop in the future, compete with beverage products of all types including soft drinks, fruit juices and drinks and bottled water.

New Age or alternative beverages are distinguishable from mainstream carbonated soft drinks in that they tend to contain natural ingredients combined with less sugar and carbonation. As a general rule, three criteria have been established for the New Age or alternative beverage classification: (1) relatively new introduction to the marketplace, (2) a perception by consumers that consumption is healthful compared to mainstream carbonated soft drinks, and (3) the use of natural ingredients and flavors in the products. According to market research, the New Age or alternative beverage category includes: energy drinks, premium soda, ready-to-drink (RTD) coffee, RTD tea; RTD tea (nutrient-enhanced), shelf-stable dairy (regular/diet), shelf-stable dairy (nutrient-enhanced), single-serve-fruit beverages (regular/diet), single-serve-fruit beverages (nutrient enhanced), smoothies, sparkling water, sports drinks and vegetable/fruit juice blends.

The Carbonated Soft Drink Category

Our soda originated in the New Age category and our products meet the above mentioned definitions for the New Age or alternative beverage classification, but over time these definitions evolve and categories overlap and blend together. While we intend to maintain our niche alternative positioning, we also strive to expand our sources of growth by attempting to be within the consideration set of shoppers and drinkers of mainstream brands so that it is easier for them to switch to our brands. For that reason, we have attempted to expand our points of availability within all stores, including the shelves that are normally restricted to national mainstream brands manufactured by companies such as The Coca-Cola Company and PepsiCo. Our primary package within the mainstream aisle is the 12-ounce can multi-pack, but we have also penetrated this space with the four-pack *Jones Soda* glass package. These packages and shelf locations allow us to penetrate the larger carbonated soft drink category, providing us access to the important take home market.

Business Strategy

Our business strategy is to increase sales by expanding distribution of our brands in new and existing markets (primarily within North America), stimulating consumer awareness and trial of our products, thus leading to increased

relevance and purchase intent of our brands. Our business strategy focuses on:

expanding points of distribution of our products;

creating strong alignment with our key distributors;

developing innovative beverage brands and products;

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stimulating strong consumer demand for our existing brands and products, with primary emphasis in the U.S. and Canada;

inviting consumers to participate in our brand through submission of photographs to be placed on labels through our interactive application of myJones.com;

licensing our brand equity for the creation of other beverage or non-beverage products; and

exploring opportunities to license our patented custom-label process to non-competitive products.

Key elements of our business strategy include the following:

Building our Brand

We believe the market for alternative beverages is dependent to a large extent on image as well as taste, and that this market is driven by trendy, young consumers between the ages of 12 and 24. Accordingly, our strategy is to develop innovative brand names, relevant programs and trade dress. In addition to creative labeling on our products, we provide our distributors with point-of-sale promotional materials and branded apparel items. Through the labels on our bottles, we invite consumers to access our website and to send in photographs to be featured on the *Jones Soda* labels. We select photos throughout the year to be placed on our bottles in distribution. We also invite consumers to celebrate special occasions and memories by creating their own label through myJones.com. In that space, consumers have the ability to customize their own label and product with a photo and short caption using a patented process owned by Jones Soda. We believe that our labeling, marketing and promotional materials are important elements to creating and increasing distributor, retailer and consumer awareness of our brands and products. Additionally, the industry continues to see a shift towards diet or zero calorie soft drinks, and we believe the launch of *Jones Zilch*[™] is on trend and maintains the spirit of the *Jones* brand in a new zero calorie platform. We believe this launch will expand the consumer base for our soda products and provide a healthier, fun alternative to the current options in this sector.

In-House Brand and Product Development

We understand the importance of creating new beverage items and enhancing our existing beverage items to meet the ever changing consumer taste profile. Our strategy is to be focused on innovative products that will be accepted by retailers, distributors and consumers. We believe this is accomplished by keeping open dialog with our retail and distributor partners to ensure we are current with consumer trends in the beverage industry.

We have developed and intend to continue to develop the majority of our brands and products in-house. We used a similar process initially to create the *Jones Soda* brand, and we intend to continue utilizing this process in connection with the creation of our future brands. This process primarily consists of the following steps:

Market Evaluation. We evaluate the strengths and weaknesses of certain categories and segments of the beverage industry with a view to pinpointing potential opportunities.

Distributor Evaluation. We analyze existing and potential distribution channels, whether DSD or DTR. This analysis addresses, among other things, which companies will distribute particular beverage brands and products, where such companies may distribute such brands and products, and what will motivate these distributors to distribute such brands and products.

Production Evaluation. We review all aspects of production in the beverage industry, including current contract packing capacity, strategic production locations, and quality control, and prepare a cost analysis of the various considerations that will be critical to producing our brands and products.

Image and Design. In light of our market, distributor and production evaluations, we create and develop the concept for a beverage brand or product extension. Our technical services department then works with various flavor concentrate houses to test, choose and develop product flavors for the brand.

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Due to the limited life cycle of beverages in the New Age or alternative category, we believe that the ongoing process of creating new brands, products and product extensions will be an important factor in our long-term success.

Independent Distributor Network (DSD)

We have focused our sales and marketing resources on the expansion and penetration of our products through our independent distributor network throughout the U.S. and Canada. We have obtained listings for selected stock keeping units (SKUs) of our *Jones Pure Cane Soda*, *Jones 24C*, *Jones GABA*, and *WhoopAss Energy Drink* brands with certain key retail grocery, convenience and mass merchandiser accounts, including but not limited to Quality Food Centers (QFC), Winn Dixie Stores, Inc., Hy Vee, Inc., Target Corporation, Meijer, Inc., 7-Eleven, Inc., The Stop and Shop Supermarket Company, Allsup's Convenience Stores, The Kroger Co., Albertsons, Speedway Super America LLC and key Canadian retailers such as Loblaw Companies Limited, all of which are serviced through our independent distributor network.

We grant certain independent distributors the exclusive right in defined territories to distribute finished cases of one or more of our brands through written agreements. These agreements typically include invasion fee provisions to those distributors in the event we provide product directly to one of our national retailers located in the distributor's region. We are also obligated to pay termination fees for cancellations of most of these written distributor agreements, which have terms generally ranging from one to three years. We select distributors that we believe will have the ability to get our brands and products on the street level retail shelves in convenience stores, delicatessens, sandwich shops and selected supermarkets.

Ultimately, we have chosen, and will continue to choose, our distributors based on their perceived ability to build our brand franchise. We currently maintain a network of approximately 150 distributors in 50 states in the United States and nine provinces in Canada. In 2009, we secured distribution with independent distributors in Ireland, the United Kingdom, Australia, Japan and the United Arab Emirates.

Direct to Retail National Accounts (DTR)

We launched our direct to retail business strategy in 2003 as a complementary channel of distribution to our DSD channel, targeting large national retail accounts. Through these programs we negotiate directly with large national retailers, primarily premier food-service based businesses, to carry our products serviced through the retailer's appointed distribution system. As of the date of this Report, our most significant DTR accounts are the following:

Costco Canada – launched in 2000, we offer a 24-count variety pack which includes six flavors of *Jones Soda*;

Starbucks Canada – launched in 2000, we offer two flavors of *Jones Soda* in all Starbucks locations;

Cost Plus – launched in 2005, we offer a variety of flavors of *Jones Soda* and occasional season related packaging;

Harris Teeter – launched in 2006, we offer a variety of *Jones Soda* flavors.

These arrangements are not long-term and are terminable at any time by these retailers or us. There are no minimum purchase commitments for any of these retailers. In 2010, three of our significant DTR accounts chose not to continue with us; these are Barnes & Noble Inc., Panera Bread Company, and Alaska and Horizon Airlines. We will continue to look for new opportunities to service and expand our DTR channel of business.

Concentrate Soda Distribution (CSD)

In October 2004, we entered into a test of our *Jones Soda* product in the 12-ounce can format under a two-year exclusive marketing and distribution agreement with Target Corporation (Target). With the expiration of this exclusive agreement with Target in December 2006, beginning in 2007 we expanded distribution to the grocery and mass merchant channel in the U.S. with our exclusive manufacturing and distribution agreement

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with National Beverage. This agreement continues through December 31, 2011 (Initial Term), and automatically renews in perpetuity for successive five year terms (Renewal Term). Any termination by us at the end of the Initial Term or any Renewal Term or in the event of a material transaction, results in a material termination payment by us to National Beverage.

National Beverage purchases concentrate from us in order to manufacture our products (which we refer to as our CSD channel), and it places orders for concentrate as required to manufacture and sell on an exclusive basis the products directly to retailers. National Beverage is not required to place any minimum monthly or quarterly concentrate orders with us. Through this arrangement, we identify and secure retailers across the U.S. for our *Jones Soda* 12-ounce cans and are responsible for sales efforts, marketing, advertising and promotion. National Beverage is responsible for the manufacturing, delivery and invoicing of the sales of our products in this can package. Beginning in 2009, we have changed our strategic direction, emphasizing our higher-margin, core products, including our *Jones Pure Cane Soda* glass bottle business, with less emphasis on our CSD channel, which is a lower margin business for us.

Sponsorship Arrangements

We currently have three major sponsorship agreements with professional sports franchises. We entered into Sponsorship Agreements with Football Northwest LLC d/b/a Seattle Seahawks of the National Football League and First and Goal, Inc. (the Seahawks Sponsorship); Brooklyn Arena, LLC and New Jersey Basketball, LLC, (the Nets Sponsorship); and Trail Blazers Inc. (the Trail Blazers Sponsorship), which provide us with the beverage rights to sell our beverages at sports venues as well as signage, advertising and other promotional benefits to enhance our brand awareness. While we believe that sponsorship arrangements are a way to continue to increase the public awareness and strength of our brand and provide us with other cross-selling opportunities through our licensing business strategy, given our limited cash resources, we intend to attempt to renegotiate these sponsorship agreements as they continue to require us to make significant annual cash payments. There can be no assurance that we will be able to modify these sponsorship arrangements in a timely manner to reduce our obligations or make any other changes.

Effective July 2007, we entered into the Seahawks Sponsorship that provides us with exclusive beverage rights for certain soft drinks at Qwest Field and Events Center in Seattle, Washington, as well as signage, advertising and other promotional benefits to enhance our brand awareness, including sponsorship and trademark rights regarding the use of Seattle Seahawks trademarks. In consideration for our rights under the agreement, we are obligated to pay annual sponsorship fees.

Effective June 15, 2009, we entered into an Amended Sponsorship Agreement with the Seattle Seahawks under which we will pay reduced annual sponsorship fees in exchange for a reduction in certain rights and benefits provided under the original agreement. We will continue to be the exclusive provider of soft drinks, but will no longer provide energy drinks or water at Qwest Field and Events Center. The amended agreement expires on June 30, 2012, and continues to provide Jones Soda with a right of first renewal with respect to its renewal or extension. Generally, either party may terminate the agreement only if the other party breaches any material term of the agreement and fails to cure such breach within 30 days of receiving notice of the breach, or if either party becomes insolvent or bankrupt. However, the Seattle Seahawks may terminate the agreement without cause at the end of the 2009 National Football League season by giving written notice to Jones Soda on or before June 30, 2010.

Effective October 2007, we entered into the Nets Sponsorship. The agreement expires on the seventh anniversary of the date the Brooklyn Arena has obtained a temporary Certificate of Occupancy (the Opening Date), which has not yet occurred, or the equivalent of seven Nets seasons, whichever is longer. This agreement provides us with exclusive beverage rights for all carbonated soft-drinks and certain other non-alcoholic beverages, as well as sponsorship, promotional, media, hospitality and other rights in connection with the New Jersey Nets basketball team and a proposed new sports and entertainment arena that the Brooklyn Arena and the New Jersey Nets intend to develop in

Brooklyn, New York. In consideration for our rights under the agreement, we are obligated to pay annual sponsorship fees. The Brooklyn Arena and the New Jersey Nets may terminate the agreement if we commit one of several events of default and subsequently

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fail to cure such event of default within the applicable cure period. We may terminate the agreement if the Brooklyn Arena and the New Jersey Nets commit one of several events of default and subsequently fail to cure such event of default within the applicable cure period, but only if equitable adjustment, make-goods or other remedies implemented by the Brooklyn Arena and the New Jersey Nets are not suitable or appropriate for such event of default. Additionally, we may exercise our Early Expiration Option as of the fifth anniversary of the Opening Date by providing written notice of our intent to exercise no later than 18 months prior to the fifth anniversary date along with payment of \$375,000.

Effective October 2008, we entered into the Trail Blazers Sponsorship that provides us with beverage rights at the Rose Garden and Memorial Coliseum in Portland, Oregon as well as signage, advertising and other promotional benefits to enhance our brand awareness, including sponsorship and trademark rights regarding the use of Portland Trail Blazers trademarks. In consideration for our rights under the agreement, we are obligated to pay annual sponsorship fees. This agreement has an effective date of October 1, 2008 and expires on June 30, 2011 and may be extended by mutual agreement. The agreement may be terminated prior to the expiration of the term if either party materially defaults and subsequently fails to cure such event of default within the applicable cure period. Additionally, the Trail Blazers may terminate the agreement effective June 30, 2010 by providing written notice to us no later than April 10, 2010.

Licensing Arrangements

We launched our licensing business strategy in 2004 as a method to extend our brand into non-alternative beverage products and non-beverage products. We currently have licensing arrangements with three companies. In September 2005, we entered into a licensing agreement with Big Sky Brands, Inc. to manufacture and distribute Jones Soda Flavor Booster hard candy. In February 2007, we entered into a licensing agreement with J&J Snack Foods for the use of our flavors and brand name for their ICEE and Slush Puppy iced beverages. In December 2008, we entered into a licensing broker agreement with FOG Studios for the use of hard line items such as apparel, glassware and alternative products. With these licensing agreements, we believe that we are able to partner with companies that will manufacture Jones related products and extend our Jones brand into select products that we feel enhance our brand image.

Marketing, Sales and Distribution

Marketing

The Jones marketing team has developed brand positioning and architecture frameworks that we believe enable us to have disciplined control over our brand identity and other marketing parameters. The strategic frameworks steer us in the development and selection of programs that allow direct consumer ownership and participation in management of the brand while still maintaining brand integrity. We have also developed channel, package, price and promotion strategies designed to allow the sales team to realize optimum price points.

In December 2009, we introduced our new packaging for our core glass bottles, the first time our packaging had been completely refreshed in almost 12 years. The new look is distinctly Jones updated with higher resolution printing that is designed to provide improved shelf presence for our brand. We believe the new packaging highlights our portfolio of flavors while also delivering a cohesive, sustainable brand message to our consumers.

We have a successful history of positioning ourselves in alternative outlets with the intent to be where national mainstream brands are not sold. We also have a program of sponsoring alternative sport athletes to promote our products, and we market in youth alternative sports such as surfing, hockey, roller derby, and snowboard, skateboard and BMX bike arenas. We believe this effort to position our products in alternative outlets has drawn a younger

generation of customers that value their independence away from the larger soft drink brands.

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Another core marketing pillar is the open source access consumers have to define the brand. We invite our consumers to send us photos of their lives for use on our label. Every *Jones Soda* glass bottle has a picture provided to us by a consumer.

We also maintain and utilize our website to allow our *Jones Soda* consumers to create personalized 12-packs of *Jones Soda* (12-ounce bottles) with their own photos on the labels. The strategy of *www.myjones.com* is to provide a personalized product offering to our consumers as well as an innovative marketing opportunity for our *Jones Soda* brand. Consumers can upload their photos through our patented web-based process and crop and create their own myJones labels. The personalized labels are downloaded at our warehouse, applied to 12-packs of *Jones Soda* and delivered to the consumer. We believe this strategy has increased awareness for, as well as provided for increased consumer interactivity with, the *Jones Soda* brand.

In December 2002, we received notice of issuance of a patent (Patent No. 6,493,677) from the U.S. Patent and Trademark Office for our myJones.com customized branded label process. The patent is titled Method and Apparatus for Creating and Ordering Branded Merchandise over a Computer Network. In January 2005, we were granted a second patent by the U.S. Patent and Trademark Office (Patent No. 6,845,362 B2) which is also entitled Method and Apparatus for Creating and Ordering Branded Merchandise over a Computer Network.

In 2002, we launched the *yourJones* program, which allows the customization of the front panel of the label of *Jones Soda* in a manner similar to our *myJones* business, but on a larger, commercial scale. The premise behind *yourJones* is to create customized *Jones Soda* bottles, with a personalized photo or brand image, for cross promotion and co-branding purposes or for sale in retail accounts. Like *myJones.com*, the *Jones Soda* name always appears on the labels and customers add their own photo/brand and words. We have negotiated arrangements with our co-packing facilities to create short-run productions for these purposes.

We participate in blogs and several different social media campaigns as a way of live engagement with our consumers in order to better understand their needs and issues.

We use point-of-sale materials such as posters, stickers, hats and T-shirts to create and increase consumer awareness of our proprietary products and brands. In response to consumer demand, we also sell our products and our wearables on our website. In selected cities, we participate at a grass roots level at certain community and sporting events in an attempt to create and increase brand awareness and loyalty. We use recreational vehicles, vans and independent distributor vehicles painted with the Jones colors and logos to create consumer awareness and enthusiasm at these events and to assist distributors as they open new retail accounts and markets. In addition to these marketing techniques, we also pursue cross-promotional campaigns with other companies.

Sales

Our products are sold in 50 states in the U.S. and nine provinces in Canada, primarily in convenience stores, delicatessens, sandwich shops and selected supermarkets, as well as through our national accounts with several large retailers. In 2009, we secured distribution with independent distributors in Ireland, the United Kingdom, Australia, Japan and the United Arab Emirates. In 2009, sales in the U.S. represented approximately 79% of total sales, while sales in Canada represented approximately 18%, and we had approximately 3% in other international sales. In 2008, sales in the U.S. represented approximately 79% of total sales, while sales in Canada represented approximately 19%, and we had approximately 2% in other international sales.

Distribution

For the year ended December 31, 2009, we experienced an improved balance of business across the U.S. and Canada as we developed more regions of those countries. Our top ten DSD customers by revenue represent approximately 35% of revenue, one of which, A. Lassonde Inc., a Canadian DSD distributor, represents 13%. We anticipate that, as consumer awareness of our brands develops and increases, we will

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continue to upgrade and expand our distributor network and DTR accounts, which may result in a decreased dependence on any one or more of our independent distributors or national retail accounts.

We contract with independent trucking companies to have our product shipped from our contract packers to independent warehouses and then on to our distributors and national retail accounts. Distributors then sell and deliver our products either to sub-distributors or directly to retail outlets. We recognize revenue upon receipt by our distributors and customers of our products, net of discount and allowances and all sales are final; however, in limited instances, due to credit issues, quality or damage issues, or distributor changes, we may accept returned product, which to date, have not been material.

Competition

The beverage industry is highly competitive. Principal methods of competition in the beverage industry include:

distribution;

shelf-management;

sponsorships;

licensing;

brand name and image;

price;

labeling and packaging;

advertising;

product quality and taste;

trade and consumer promotions; and

development of new brands, products and product extensions.

We compete with other beverage companies not only for consumer acceptance but also for shelf space in retail outlets and for marketing focus by our distributors, all of whom also distribute other beverage brands. Our products compete with all non-alcoholic beverages, most of which are marketed by companies with substantially greater financial resources than ours. We also compete with regional beverage producers and private label soft drink suppliers. Our direct competitors in the alternative beverage industry include Dr. Pepper Snapple (Stewarts and IBC), Boylans, Henry Weinhardts, Thomas Kemper, and other regional premium soft drink companies. We also compete against Coca Cola, Pepsi, Hansens, and other traditional soft drink manufacturers and distributors, as well as against other category leaders such as Red Bull and Monster for the energy drink category. As of the date of this report, we believe we are the only beverage company manufacturing and distributing product containing Pharma GABA in the U.S.

In order to compete effectively in the beverage industry, we believe that we must convince independent distributors that *Jones Pure Cane Soda* is a leading brand in the premium soda segment of the alternative or New Age beverage industry. In connection with or as a follow-up to the establishment of an independent distributor relationship for the

Jones Pure Cane Soda brand, we sell *Jones 24C*, *Jones GABA*, and *WhoopAss Energy Drink*, as complementary products that may replace other non-carbonated single-serve fruit beverages, ready-to-drink (RTD) teas or energy drinks. In addition, we have created *Jones Pure Cane Soda* in a 12-ounce can format that allows us to compete directly in the carbonated soft drink industry. As a means of maintaining and expanding our distribution network, we introduce new products and product extensions, and when warranted, new brands. Although we believe that we will be able to continue to create competitive and relevant brands to satisfy consumers' changing preferences, there can be no assurance that we will be able to do so or that other companies will not be more successful in this regard over the long term.

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In addition, in light of the competition for product placement with independent distributors, we obtained several national retail accounts as an additional distribution channel for our products. We believe that this diversification strategy is helpful in alleviating the risk inherent in competition for independent distributors.

Pricing of the products is also important. We believe that our *Jones Pure Cane Soda*, *Jones 24C*, *Jones GABA*, and *WhoopAss Energy Drink* products are priced in the same price range or higher than competitive New Age beverage brands and products and compete on quality through our premium product offerings.

Production

Contract Packing Arrangements

We do not directly manufacture our products but instead outsource the manufacturing process to third party bottlers and independent contract packers (co-packers). For our bottle products, we purchase certain raw materials which are delivered to our various third party co-packers. We currently use four primary co-packers to prepare, bottle and package our bottle products. Our contract packers are located in the Canadian Provinces of British Columbia and Ontario as well as in Memphis, Tennessee and Los Angeles, California. Once the product is manufactured, we store the finished product at that location or in nearby third party warehouses.

Other than minimum case volume requirements per production run for most co-packers, we do not typically have annual minimum production commitments with our co-packers. Our co-packers may terminate their arrangements with us at any time, in which case we could experience disruptions in our ability to deliver products to our customers. We continually review our contract packing needs in light of regulatory compliance and logistical requirements and may add or change co-packers based on those needs.

With respect to our 12-ounce cans of *Jones Soda* sold by National Beverage through the grocery products and mass merchant channel, National Beverage is responsible for all manufacturing, packing and distribution. Under the agreement, sales of product may be made only to our authorized retail accounts purchasing through warehouse distribution, and we are responsible for sales efforts, marketing, advertising and promotion. We sell concentrate to National Beverage for the manufacture of the product, and National Beverage is responsible for the manufacture, storage, inventory, delivery, invoicing, customer credit review and approval, and receivables collection with respect to sales of products to our authorized accounts. National Beverage carries, stores and maintains the finished products.

Our agreement with National Beverage has an initial term of five years, expiring on December 31, 2011. Thereafter, the agreement automatically renews in perpetuity for successive additional five-year periods unless terminated by either party as specified in the agreement. We may not terminate the agreement prior to the end of a five-year term unless National Beverage is in material default. National Beverage has the right to terminate our agreement upon six months notice at any time after December 31, 2009. The agreement also provides National Beverage the first right to pack and d