JONES SODA CO
Form 10-K
March 14, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

¨ **TRANSITION REPORT UNDER 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 small business issuer as specified in its charter)

Washington	**91-1696175**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

234 Ninth Avenue North

Seattle, WA 98109

(Address of principal executive offices)

(206) 624-3357

(Issuer s telephone number)

Securities registered under Section 12(b) of the Exchange Act

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

Securities registered under Section 12(g) of the Exchange Act: None

Check whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. ¨

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

Check if no disclosure of delinquent filers in response to Item 405 of Regulation S-K is contained in this form, and no disclosure will 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, or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ¨ Accelerated Filer x Non-Accelerated Filer ¨

Check whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Issuer s revenues for its most recent fiscal year: $39,035,125

As of March 6, 2007, there were 25,667,491 shares of the Company s common stock issued and outstanding. As of the last business day of the second fiscal quarter, June 30, 2006, the aggregate market value of such common stock held by non-affiliates was approximately $211,905,423 using the closing price on that day of $9.00.

Documents Incorporated By Reference: The information required by Part III of this Report, to the extent not set forth herein, is incorporated in this Report by reference to the Company s definitive proxy statement relating to its 2007 annual meeting of shareholders. The definitive proxy statement will be filed with the Securities and Exchange Commission within 120 days after the end of the 2006 fiscal year.

Table of Contents

EXPLANATORY NOTE

Unless otherwise indicated or the context otherwise requires, all references in this Annual Report on Form 10-K to we, us, our, and the Company are to Jones Soda Co., a Washington corporation, and our wholly owned subsidiaries Jones Soda Co. (USA) Inc., Jones Soda (Canada) Inc., myJones.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 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 other than statements of historical fact, including future results of operations or financial position, made in this Annual Report on Form 10-K are forward looking. In particular, the words believe, expect, intend, anticipate, estimate, may, will, variations of such words, and similar expressions identify forward-looking statements, but the exclusive means of identifying such statements and their absence does not mean that the statement is not forward-looking. These forward-looking statements are subject to certain risks and uncertainties, including those discussed below. Our actual results, performance or achievements could differ materially from our historical results as well as from those expressed in, anticipated or implied by these forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect any future events or circumstances.

For a discussion of some of the factors that may affect our business, results and prospects, see ITEM 1A. RISK FACTORS. Readers are urged to carefully review and consider the various disclosures made by us in this Report and in our other reports previously filed with the Securities and Exchange Commission, including our periodic reports on Forms 10-Q and 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.

Table of Contents

JONES SODA CO.

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Table of Contents

** Portions of Items 10 through 14 of Part III are incorporated by reference from the definitive proxy statement for our 2007 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2006 fiscal year.

Table of Contents

PART I

ITEM 1. OUR BUSINESS.
Overview

We develop, produce, market and distribute New Age or Premium beverages. We currently produce, market and distribute six unique beverage brands:

- *Jones Pure Cane Soda*, a premium soda;
- *Jones Organics*, a ready-to-drink organic tea;
- *Jones Energy*, a citrus energy drink;
- *WhoopAss*, a citrus energy drink;
- *Jones Naturals*, a non-carbonated juice & tea; and
- *Jones 24C*, an enhanced water beverage.

Our business strategy is to increase sales by expanding distribution of our brands in new and existing markets, stimulating consumer trial of our products and increasing consumer awareness of, and brand loyalty to, our unique brands and products. Key elements of our business strategy include:

- creating strong distributor relationships and key accounts;
- stimulating strong consumer demand for our existing brands and products with primary emphasis in the United States and Canada;
- developing unique alternative beverage brands and products; and
- licensing our brand equity for the creation of other beverage or non-beverage products.

We currently sell and distribute our products throughout the United States and Canada through our network of independent distributors (DSD) and our national retail accounts (DTR), as well as through licensing and distribution arrangements.

We also participate in the carbonated soft drink (CSD) industry through distribution and sales of our 12-ounce cans of Jones Pure Cane Soda through National Beverage in grocery and mass merchant channels in the U.S.

With respect to our distributors (DSD) we have focused our sales and marketing resources on the expansion and penetration of our products through our independent distributor network in our core markets consisting of the Northwest, Southwest and Midwest U.S., and Western

Canada, as well as targeted expansion into our less penetrated markets consisting of the Northeast and Southeast U.S., and Eastern Canada.

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. We currently have distribution arrangements with Barnes & Noble, Panera Bread Company, Cost Plus World Markets, Starbucks Coffee Company and Target Corporation.

Beginning in 2004, we launched our licensing business strategy as a method to extend our brand into non-alternative beverage products and non-beverage products. We currently have licensing arrangements with two companies: Lime-Lite Marketing Corporation and Big Sky Brands, Inc. With these licensing agreements, we believe that we are able to partner with companies that are able to manufacture Jones related products and extend our Jones brand into select products that we feel enhance our brand image.

Table of Contents

In December 2006, we announced the transition from high-fructose corn syrup (HFCS) to cane sugar for all our bottles and canned products. We were the first national major beverage company to switch over to pure cane sugar. Our co-packers commenced production of Jones Pure Cane Soda in January 2007 and we expect them to produce this product in the first quarter of 2007.

Our company is a Washington corporation and our principal place of business is located at 234 Ninth Avenue North, Seattle, Washington 98109. Our telephone number is (206) 624-3357.

The New Age or Alternative Beverage Industry

Jones Pure Cane Soda, *Jones Organics*, *Jones Energy*, *WhoopAss* and *Jones Naturals*, which are classified as New Age or alternative beverages, as well as other unique 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.

According to Beverage Marketing Corporation, the New Age or alternative beverage markets was approximately $16.9 billion in total sales in 2005.

New Age or alternative beverages are distinguishable from mainstream carbonated soft drinks in that they tend to contain less sugar, less carbonation, and natural ingredients. As a general rule, three criteria have been established for such a classification: (1) relatively new introduction to the market-place; (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 Beverage Marketing Corporation (*www.beverageworld.com*), for 2005, the New Age or alternative beverage category consisted of the following segments: 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; vegetable/fruit juice blends; and other New Age beverages.

The Carbonated Soft Drink (CSD) Industry

We currently participate in the carbonated soft drink (CSD) industry through the distribution and sale of our 12-ounce cans of *Jones Soda*.

The CSD industry includes all soda products that are sold primarily in 12-ounce cans and generally compete on price. According to Beverage Marketing Corporation, the carbonated soft drink category for the year ending 2005 was estimated at approximately $65.9 billion in total sales. Following many years of growth, in 1999, the CSD category began to experience six straight years of sub-1% growth and showed per capita consumption declines. However, the CSD category remains significant in size, in terms of both volume and sales, and its market share is far larger than any other beverage category. The primary companies participating in this category include Coca Cola, Pepsi, Dr. Pepper/Seven Up, Cott Corporation and National Beverage.

In October 2004, we entered the mainstream of the carbonated soft drink industry with the launch of our *Jones Soda* product in the 12-ounce can format. These 12-ounce cans of *Jones Soda* were sold under our two-year exclusive marketing and distribution agreement with Target Corporation, which expired on December 31, 2006.

In August 2006, we entered in an exclusive manufacturing and distribution agreement with National Beverage Co. to manufacture and distribute *Jones Soda* 12-ounce cans to the grocery and mass merchant channel in the U.S. Beginning in January 2007, National Beverage started selling *Jones Pure Cane Soda* to retailers in the U.S.

Table of Contents

Business Strategy

We believe that *Jones Soda* is a leading brand in the premium soda segment of the New Age beverage category, and we also participate in the broader, more competitive carbonated soft drink industry with our 12-ounce cans.

In late 1995, we launched *Jones Soda*, our premium soda product under our trademarked brand. By launching *Jones Soda*, we believed we were creating a new category in the New Age beverage market and that we were offering distributors something new to sell. In its January 1998 issue, Beverage Aisle magazine changed the name of the all-natural soda segment to the premium soda segment and cited *Jones Soda* as an example of a beverage in this category. Thus, we believe that the *Jones Soda* brand and product line helped to create a new segment in the New Age or alternative beverage industry. In developing the *Jones Soda* brand, we have marketed our products with a distinct fashion component consisting of black and white photos on our labels, which is representative of current overall fashion trends. See Products *Jones Soda*.

Utilizing creative but relatively low cost marketing and brand promotion techniques, we have focused on building a strong distributor network and presence with national retail accounts for our lead brand, *Jones Soda*. We believe that our past experience as a distributor of licensed and non-licensed New Age beverage brands has given, and will continue to give, our company credibility in connection with our efforts to build a quality network of independent distributors. Sales of our products through our distributor network, and the uniqueness and strength of our brand, provided us with opportunities to implement and grow our DTR strategy through national retail accounts. These national accounts have further increased the public awareness of and strength of our brand and have provided us with other cross-selling opportunities through our licensing business strategy.

Our business strategy is to attempt to increase sales by expanding product distribution in new and existing markets (primarily within North America), stimulating consumer trial of our products and creating and increasing consumer awareness of and brand loyalty to our unique brands and products. In 2006, through our independent distributor network, we continued to focus on our core markets, as well as targeted expansion into our less penetrated markets consisting of the Northeast and Southeast U.S., and Eastern Canada.

Since 2003, we grew our direct to retail distribution strategy to large national retail accounts, currently consisting of Target Corporation, Starbucks Coffee Company, Panera Bread Company, Barnes & Noble, Maggie Moos and Cost Plus World Markets. During 2007, we intend to continue servicing and expanding our direct to retail channel to national retail accounts.

In 2004, we also launched our licensing business strategy as a method to extend our brand into non-alternative beverage products and non-beverage products. In July 2004, we entered into a licensing agreement with Target Corporation to market and sell *Jones Soda* in a 12-ounce can format and we now compete directly in the carbonated soft drink industry. This agreement with Target expired on December 31, 2006. In September 2004, we entered into an agreement with Lime-Lite Marketing Corporation to manufacture and distribute Jones Soda lip balms. In September 2005, we entered into a licensing agreement with Big Sky Brands, Inc. to manufacture and distribute Jones Soda Flavor Booster hard candy. During 2006, we discontinued our licensing agreement with The Kroger Corporation to manufacture and distribution of Jones Soda Frozen Soda Pops.

Jones Soda understands the importance of creating new beverage items that meet the ever changing consumer taste profile. Our strategy is to be focused on innovating new products that will be accepted by the 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 the consumer trends in the beverage industry.

Table of Contents

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 unique brand names, slogans and trade dress. In addition to unique labeling on our products, we provide each of our distributors with point-of-sale promotional materials and branded apparel items. We promote interaction with our customers through the use of these point-of-sale items, such as posters, stickers, table cards, shelf danglers, post cards, hats, pins, T-shirts, and our proprietary lighted display box. In addition, 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* and *Jones Naturals* labels. 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.

Independent Distributor Network (DSD)

We distribute our finished products through a network of independent distributors in the United States and Canada. We have also obtained listings for selected skus of our *Jones Pure Cane Soda*, *Jones Organics, Jones Energy*, *Whoopass* and *Jones Naturals* brands with certain key retail grocery accounts, including QFC, Meijer, Allsups, Kroger, Albertsons, Safeway and Speedway Super America, which are serviced through our independent distributor network. We have pursued this strategy both in an effort to increase sales and to encourage distributors to distribute our brands and products to our key accounts and other accounts of our distributors.

We usually grant independent distributors the right to distribute finished cases of one or more of our brands in a particular region, province, state or local territory, subject to our overall management directives. We select distributors who we believe will have the ability to get our unique 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 upon their perceived ability to build our brand franchise. We currently maintain a network of approximately 208 distributors in 48 states in the United States and 9 provinces in Canada.

Direct to Retail National Accounts (DTR)

Beginning in 2003, we launched our direct to retail business strategy as a complementary channel of distribution, 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 by the retailer s appointed distribution system. We currently have distribution arrangements with the following national retail accounts:

- Target Corporation launched in October 2004, currently for 3 flavors of *Jones Soda*;

- Starbucks Coffee Company launched in March 2004, originally for 2 flavors of *Jones Soda*, and recently increased to 3 flavors in 2006, in all Starbucks stores in the United States (which is in addition to our DSD arrangement for Starbucks stores in Canada that has been in place since 1999);

- Panera Bread Company launched in June 2003, currently for 6 flavors of *Jones Soda* and 3 flavors of *Jones Naturals* in all Panera bakery cafés in the United States;

- Barnes & Noble launched in February 2003, currently for 5 flavors of *Jones Naturals* in all Barnes & Noble café stores in the United States;

- Cost Plus World Markets launched in November 2003, currently for 4 flavors of *Jones Soda* and 5 flavors of Jones Naturals in all Cost Plus stores in the United States.

4

Table of Contents

Carbonated Soft Drink

In October 2004, we entered the carbonated soft drink industry with the launch of our Jones Soda product in the 12-ounce can format under an exclusive two-year exclusive marketing and distribution agreement with Target Corporation. With the expiration of this exclusive agreement on December 31, 2006, beginning in 2007 we expanded distribution to the grocery and mass merchant channel in the United States with our exclusive manufacturing and distribution agreement with National Beverage Co. Through this arrangement, we will identify and secure retailers across the United States for our premium carbonated 12-ounce soft drinks and 16 ounce Energy drink products, and we will be solely responsible for all sales efforts, marketing, advertising and promotion. Using concentrate supplied by Jones, National Beverage will both manufacture and sell on an exclusive basis the products directly to retailers. National Beverage will be responsible for the manufacturing, delivery and invoicing of the sales of our products in this channel.

Licensing Arrangements

Beginning in 2004, we launched our licensing business strategy as a method to extend our brand into non-alternative beverage products and non-beverage products. We currently have licensing arrangements with two companies. In September 2004, we entered into an agreement with Lime-Lite Marketing Corporation to manufacture and distribute Jones Soda lip balms. In September 2005, we entered into a licensing agreement with Big Sky Brands, Inc. to manufacture and distribute Jones Soda Flavor Booster hard candy. With these licensing agreements, we believe that we are able to partner with companies that are able to manufacture Jones related products and extend our Jones brand into select products that we feel enhance our brand image.

In-House Brand and Product Development

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 perform a complete review of the beverage industry in general, including a review of existing beverage categories and segments, and the product life cycle stages of such categories and segments. 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 prepare a thorough analysis of 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 unique 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. Although we control all aspects of the creation of each brand or product extension, we contract with outside creative artists to help design our brand labels and imagery. Our technical services department then works with various flavor concentrate houses to test, choose and develop product flavors for the brand.

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.

Table of Contents

Products

We currently produce, market and distribute six unique beverage brands: *Jones Pure Cane Soda, Jones Organics, Jones Energy*, *WhoopAss, Jones Naturals* and *Jones 24C*.

Jones Pure Cane Soda

We believe that our trademarked *Jones Soda* brand and product line is a leader in the Premium Soda segment of the New Age beverage category. We originally launched *Jones Soda* in November 1995. The *Jones Soda* product line currently consists of 11 flavors.

In December 2006, we announced a changeover to pure cane sugar for our entire product line up. We were the first national brand to convert to pure cane sugar and we have received a very enthusiastic response from our customers. We started producing pure cane soda products in the first quarter of 2007. We have rebranded our soda to Jones Pure Cane Soda.

In 2003, we launched a sugar-free version of our *Jones Soda* line. These sugar-free sodas are sweetened with Splenda® and have zero calories and zero carbohydrates. We believe that the launch of our sugar-free *Jones Soda* provides a healthier alternative to our regular *Jones Soda* line and is an important product extension, especially in light of the recent concern and media coverage regarding obesity in young people. We currently have 4 flavors of sugar-free *Jones Soda*.

Jones Soda beverage products come in 12-ounce (355 ml) clear long-neck bottles with primarily black and white photos on our labels displaying a variety of urban images. We also encourage consumers of *Jones Soda*, through the labels on our bottles, to send in photographs that may potentially be used on one of the *Jones Soda* labels. We launched the 12-ounce can format in 2004.

Jones Organics

In April 2005, we launched *Jones Organics*, a ready-to-drink organic tea, with 60 calories per serving, sweetened with organic cane sugar. *Jones Organics* comes in 14-ounce proprietary clear glass bottles with a design of the fruit on the front label, but does not contain the usual black and white photograph labels used on *Jones Soda* and *Jones Naturals* product labels. The *Jones Organics* line currently consists of 6 flavors.

Jones Energy

In November 2001, we launched *Jones Energy*, a citrus energy drink containing vitamin B6, riboflavin, niacin, thiamin, caffeine and coQ-10. Jones Energy is currently available in a 16-ounce can and in an 8.4 ounce four-pack carrier format in three different flavors Mixed Berry, Orange and Lemon Lime. Our *Jones Energy* products compete in the Energy Drink category of the New Age beverage industry.

Whoopass

We originally launched *WhoopAss* in October 1999. *WhoopAss* is a citrus energy drink in an 8.4 ounce (250 ml) slim can containing riboflavin, niacin, vitamin B6 and thiamin. In 2005, we launched a 16 ounce version of our Whoopass energy drink. *WhoopAss* competes in the Energy Drink category of the New Age beverage industry.

Jones Naturals

In April 2001, we launched *Jones Naturals*, our non-carbonated beverage. The *Jones Naturals* products have 100% natural flavors and contain ingredients such as ginseng, zinc, and various vitamins. *Jones Naturals*

Table of Contents

comes in 20 ounce (591 ml) clear bottles with primarily black and white photograph labels, similar to the *Jones Soda* product labels. The *Jones Naturals* line currently consists of 8 flavors. In 2007, we plan to introduce *Jones Naturals* in 14 ounce glass bottles.

Jones 24C

In June 2006, we purchased the trademark rights to 24C. We plan to launch Jones 24C, an enhanced water beverage in the first half of 2007. The Jones 24C products will have 100% natural flavors and contain daily vitamin requirements and will consist of 6 flavors. We expect production and distribution of Jones 24C in the first quarter of 2007.

Marketing, Sales and Distribution

Marketing

Our pricing policies for our products take into consideration competitors prices and our perception of what a consumer is willing to pay for the particular brand and product. The goal is to price our unique products at a premium to other premium sodas and New Age beverages.

We primarily use point-of-sale materials such as posters, stickers, table cards, shelf danglers, post cards, hats, pins, T-shirts and jackets 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 web site *(http://www.jonessodastore.com)*. Through cooperative advertising, the majority of our independent distributors fund a portion of our marketing budget, based upon case sales. In selected cities, we participate on a grass roots level at certain events in an attempt to create and increase brand awareness and loyalty. We also have a program of sponsoring alternative sport athletes to promote our products, and we have signed up several athletes in the skateboard, snowboard and bmx bike arenas. We also use recreational vehicles and vans painted with the *Jones* colors and logos to create consumer awareness and enthusiasm 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.

We maintain and utilize our unique website, *www.myjones.com* to allow our *Jones Soda* consumers to create their own personalized 12-pack of *Jones Soda* (12-ounce bottles) with their unique photo in the labels. The strategy of *www.myjones.com* is to provide a unique product offering to our consumers as well as provide a unique marketing opportunity for our *Jones Soda* brand. Consumers can upload their photos through the web and crop and create their own myjones labels. The unique labels are downloaded at our warehouse and we send out 12-packs of the personalized soda to the consumer. We believe this strategy has increased awareness for the *Jones Soda* brand as well as provided for increased consumer interactivity with the *Jones Soda* brand, and we anticipate that it will continue to do so. 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 business operation. The patent is titled Method and Apparatus for Creating and Ordering Branded Merchandise over a Computer Network.

In 2002, we launched a new program, yourjones, which is the customization of the front panel of the label of *Jones Soda* similar to our myjones business, however on a larger, commercial scale. The premise behind yourjones is to create uniquely customized *Jones Soda* or *Jones Naturals* bottles, with a unique 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 can add their own photo/brand and words. We have negotiated arrangements with our co-packing facilities to create short-run productions for these purposes.

Sales

Our products are sold in 48 states in the United States and 9 provinces in Canada primarily in convenience stores, delicatessens, sandwich shops and selected supermarkets, as well as through our national accounts with several large retailers. During 2006, sales in the U.S. represented approximately 88% of total sales, while sales in Canada represented approximately 11%, and we had approximately 1% in other international sales. We may consider expanding sales of our products to select international markets in the future.

During 2006, our DSD sales force was organized into seven regional groups, consisting of the Northwest, Southwest, Midwest, Northeast and Southeast regions of the United States and Western and Eastern regions of Canada. We have two Vice Presidents of Sales, one of whom is responsible for our Midwest U.S. regions and the other is responsible for the Eastern and Southern U.S. regions. Regional Managers are ultimately responsible for the separate regions. Senior sales personnel are responsible for large retail grocery accounts located in their regions, the management of existing independent distributor relations and the selection of new independent distributors as may be required. Junior sales personnel work closely with our independent distributors and their sales representatives to help them open street level retail accounts and train them in our sales and marketing techniques.

During 2006, our CSD sales were co-ordinated and led by our Executive VP of Sales and our newly hired VP Sales CSD East. They are responsible for calling on all national and regional grocery and mass merchant accounts in the CSD category. National Beverage Co. will manufacture, pack and distribute directly to retailers.

In February 2007, we hired a Vice-President Sales Food Services who will be responsible for leading all our sales efforts with the direct to retail accounts and food service accounts. He will be supported by personnel to manage our direct to retail national accounts.

Distribution

We sell a majority of our products through our DSD network, and we currently have relationships with approximately 208 independent distributors throughout North America. Our policy is to grant our distributors rights to sell particular brands within a defined territory. We believe that substantially all of our distributors also carry other beverage products. Agreements with our distributors vary; we have entered into written agreements with many of our top distributors for varying terms of years; most of our other distribution relationships are oral (based solely on purchase orders) and are terminable by either party at will.

In addition, we sell our products directly to certain large national retail accounts, such as Target Corporation, Starbucks Coffee Company, Panera Bread Company, Barnes & Noble and Cost Plus World Markets. Distribution of our products into these DTR accounts is handled by the retailer s distribution system or by its designated food-service or other distributors.

For the year ended December 31, 2006, three of our customers represented approximately 28% of total revenues. We anticipate that, as consumer awareness of our brands develops and increases, we will 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 accounts.

We generally require our independent distributors to place their purchase orders for our products at least 10 days in advance of delivery. To the extent we have additional product available in inventory, we will fulfill other purchase orders when and as received. We contract with independent trucking companies to have product shipped from our contract packers to independent warehouses, and then on to our distributors. Distributors then sell and deliver our products either to sub-distributors or directly to retail outlets, and such distributors or sub-distributors stock the retailers shelves with our products. We recognize revenue upon receipt by our distributors and customers of our products, net of discount and allowances, and all sales are final and we have a no return policy; however, in limited instances, due to credit issues or distributor changes, we may take back product.

Table of Contents

Production

Contract Packing Arrangements

We currently use six primary independent contract packers known as co-packers to prepare, bottle and package our products. Our contract packers are located in the Canadian Provinces of British Columbia and Ontario and the States of Missouri, Oregon, Minnesota, and California. 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. A majority of our co-packing is handled in Canada, and with the recent strengthening of the Canadian dollar against the U.S. dollar, our co-packing costs have increased. We expect to continue to look for alternative or lower-cost co-packing arrangements for our products in the United States and in Canada.

As is customary in the contract packing industry, we are expected to arrange for our contract packing needs sufficiently in advance of anticipated requirements. Accordingly, it is our business practice to require our independent distributors to place their purchase orders for our products at least 10 days in advance of delivery. Other than minimum case volume requirements per production run for most co-packers, we only have annual minimum production commitments of 800,000 cases with one of our co-packers.

With respect to our 12-ounce cans of Jones Soda and 16-ounce cans of Energy sold by National Beverage Co. through the grocery products and mass merchant channel, National Beverage is responsible for all manufacturing, packing and distribution.

Raw Materials

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. The raw materials used in the preparation and packaging of our products consist primarily of concentrate, glass, labels, caps and packaging. These raw materials are purchased from suppliers selected by us or by our contract packers.

We believe that we have adequate sources of raw materials, which are available from multiple suppliers. Currently, we purchase our flavor concentrate from our two flavor concentrate suppliers. We anticipate that for future flavors and additional products, we may purchase flavor concentrate from other flavor houses with the intention of developing other sources of flavor concentrate for each of our products. In addition, with our shift to production using pure cane sugar rather than high fructose corn syrup, we utilize considerable quantities of pure cane sugar. The water used to produce our products is filtered and is also treated to reduce alkalinity.

Quality Control

Our products are made from high quality ingredients and natural and/or artificial flavors. We seek to ensure that all of our products satisfy our quality standards. Contract packers are selected and monitored by our own quality control representatives in an effort to assure adherence to our production procedures and quality standards. Samples of our products from each production run undertaken by each of our contract packers are analyzed and categorized in a reference library.

For every run of product, our contract packer undertakes extensive on-line testing of product quality and packaging. This includes testing levels of sweetness, carbonation, taste, product integrity, packaging and various regulatory cross checks. For each product, the contract packer must transmit all quality control test results to us for reference following each production run.

Testing includes microbiological checks and other tests to ensure the production facilities meet the standards and specifications of our quality assurance program. Water quality is monitored during production and at scheduled testing times to ensure compliance with beverage industry standards. Flavors are pre-tested before shipment to contract packers from the flavor manufacturer. We are committed to an on-going program of product

Table of Contents

improvement with a view toward ensuring the high quality of our product through a program for stringent contract packer selection, training, and communication.

We believe we source and select only those suppliers that use quality components.

Regulation

The production and marketing of our licensed and proprietary beverages are subject to the rules and regulations of various federal, provincial, state and local health agencies, including in particular Health Canada, Agriculture and Agri-Food Canada and the U.S. Food and Drug Administration. The FDA and Agriculture and Agri-Food Canada also regulate labeling of our products. From time to time, we may receive notifications of various technical labeling or ingredient reviews with respect to our licensed products. We believe that we have a compliance program in place to ensure compliance with production, marketing and labeling regulations on a going-forward basis. There are no regulatory notifications or actions currently outstanding. See Risk Factors below.

Trademarks, Flavor Concentrate Trade Secrets and Patent

We own a number of trademarks, including, in the United States and Canada, *Jones Soda Co.*®, *Jones Pure Cane Soda*, *Jones Naturals*, *Jones Energy* and *WhoopAss*. In the United States our trademarks expire 10 years from the registration date and in Canada 15 years from the registration date, although in both Canada and the United States, they may be renewed for a nominal fee. In addition, we have trademark protection in the United States and Canada for a number of other trademarks for slogans and product designs, including *Wet Yourself*®, *I ve Got A Jones For A Jones*®, Jones Soda Co. and Design, *Whoopass and Design*® and *My Jones*®. We have also applied for trademark protection for several marks, including *Jones Soda Co.*®, in the United Kingdom, Germany, Japan, and other foreign jurisdictions.

We have the exclusive rights to 30 flavor concentrates developed with our current flavor concentrate suppliers, which we protect as trade secrets. We will continue to take appropriate measures, such as entering into confidentiality agreements with our contract packers and exclusivity agreements with our flavor houses, to maintain the secrecy and proprietary nature of our flavor concentrates.

We have a patent on our myjones.com business operation. In December 2002, the U.S. Patent and Trademark Office issued us Patent No. 6,493,677, titled Method and Apparatus for Creating and Ordering Customized Branded Merchandise over a Computer Network . The term of U.S. patents is 20 years from the date of filing and this patent can be viewed by accessing the U.S. Patent Office s website at *www.uspto.gov*. We intend to explore potential licensing arrangements with third parties to commercialize this patented methodology and defend patent violations.

We consider our trademarks, patent and trade secrets to be of considerable value and importance to our business. No successful challenges to our registered trademarks have arisen and we have no reason to believe that any such challenges will arise in the future. See Item 1A RISK FACTORS below.

Competition

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

- distribution,
- brand name,
- brand image,
- price,

- labeling and packaging,
- advertising,
- product quality and taste,
- trade and consumer promotions, and
- the 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 who 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 we have. We also compete with regional beverage producers and private label soft drink suppliers. Our direct competitors in the alternative beverage industry include Cadbury Schweppes (Stewarts and IBC) and Thomas Kemper. We also compete against Coke, Pepsi, Hansen s, Stewarts, IBC and other traditional soft drink manufacturers and distributors. We also compete against other category leaders such as Redbull and Monster for the energy drink category.

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 Organics, Jones Energy*, *WhoopAss*, *Jones Natural* and *Jones 24C* as complementary products that may replace other non-carbonated single-serve fruit beverages or 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 intend to introduce new products and product extensions, and when warranted, new brands. Although we believe that we will be able to continue to create unique, exciting and fashionable brands, 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. See Item 1A RISK FACTORS below.

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 currently have distribution arrangements with National Beverage, Target Corporation, Starbucks Coffee Company, Panera Bread Company, Barnes & Noble, and Cost Plus World Markets. 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 Organics, Jones Energy*, *Whoopass, Jones 24C* and *Jones Naturals* products are priced in the same price range or higher than competitive New Age beverage brands and products.

Employees

As of December 31, 2006, we had 67 full-time employees, 38 of whom were employed in sales and marketing capacities, 22 were employed in administrative capacities, and 7 were employed in manufacturing and quality control capacities. None of our employees is represented by labor unions. We believe that our relationships with our employees are good.

Table of Contents

ITEM 1A. RISK FACTORS

The following discussion in this Annual Report on Form 10-K contains forward-looking statements regarding our business, prospects and results of operations that involve risks and uncertainties. Our actual results could differ materially from the results that may be anticipated by such forward-looking statements and discussed elsewhere in this Report. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below, as well as those discussed under the captions Business and Management s Discussion and Analysis of Financial Condition and Results of Operations as well as those discussed elsewhere in this Report. In evaluating our business, prospects and results of operations, readers should carefully consider the following factors in addition to other information presented in this Report and in our other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations. See Cautionary Notice Regarding Forward Looking Statements above.

Risk Factors Relating to Our Company and Our Business

Our business plan and future growth is dependent in part on our distribution arrangements directly with retailers and national retail accounts. There are risks associated with this distribution strategy. The loss of any of our national DTR accounts could adversely affect us.

We currently have distribution arrangements with several large national retail accounts to distribute our products directly through their stores, including Barnes & Noble, Panera Bread Company, Cost Plus World Markets, Starbucks Coffee Company and Target Corporation. Although we believe that our direct to retail program has increased our national visibility among consumers, there are several risks associated with this distribution strategy. First, we do not have long-term agreements in place with each of these accounts. In particular, we do not have a distribution agreement with Starbucks and we operate based solely on purchase orders we receive from Starbucks. We may not be able to maintain continuing relationships with any of these national accounts, and we may not be able to renew any of these accounts upon expiration of the term of the existing arrangements. Any of these agreements may be terminated early. The loss of any of these high-profile national accounts could negatively impact our revenues and our reputation. In addition, we may not be able to establish additional distribution arrangements with other national retailers. Second, as we become more dependent on national retail chains, these retailers may assert pressure on us to reduce our pricing to them or seek significant product discounts. Any increase in our costs for their carrying our product, reduction in price, or demand for product discounts could have a material adverse affect on our profit margin. Finally, our direct to retail distribution arrangements may have an adverse impact on our existing relationships with our independent regional distributors, although we believe that increased visibility of our product through these national retailers may lead to increased product sales through our network of independent distributors.

Our expansion of sales of our cans through National Beverage beginning in 2007 may not be successful

During 2006 we entered into a manufacturing and distribution agreement with National Beverage Corp to distribute Jones Soda 12 ounce cans in the grocery and mass merchant channel beginning in 2007. There is no assurance that we may be able to secure favorable listing arrangements with retailers or acceptance of our products. We will need to maintain operational controls to execute our marketing programs and manage the expenses during the roll-out. We may not be able to effectively and efficiently manage our growth. Any inability to do so could increase our expenses and negatively impact our profit margin.

We need to effectively manage our growth and resources in order to execute on our business plan. Any failure to do so would negatively impact our profitability.

To manage operations effectively and maintain profitability, we must continue to improve our operational, financial and other management processes and systems. Our success also depends largely on our ability to maintain high levels of employee utilization, manage our production costs and general and administrative

Table of Contents

expense, and otherwise execute on our business plan. In addition, in order to grow and execute on our business plan and opportunities, we need to have available to us adequate resources, including capital and personnel, which may not be available when needed. We also need to maintain adequate operational controls and focus as we add new brands and products, distribution channels, and business strategies. We may not be able to effectively and efficiently manage our growth. Any inability to do so could increase our expenses and negatively impact our profit margin.

Our business plan and future growth is dependent in part on licensing strategy. There are risks associated with this licensing strategy.

Over the past three years, we entered into several licensing agreements. These licensing agreements provide for each company with which we partner to manufacture and distribute products carrying the Jones Soda Co. brand. Although we believe that our licensing strategy will increase our national visibility among consumers, there are several risks associated with implementing this licensing strategy. First, there is no assurance that the licensing partner will maintain the same level of quality assurance, inventory management and oversight we are able to maintain with products directly under our supervision. Second, our expertise is in beverages and there is no assurance to us that the same quality standards are required of other products in other industries. Finally, there is no assurance that the licensing partner will provide the same focus on distribution or management of the brand as is done with our own products. In addition, any of our agreements may be terminated early.

We have a lean management team.

We currently have a lean management structure, with our Chief Executive Officer, Chief Financial Officer and Executive Vice President of Sales responsible for most of our management. As we grow and execute our business plan, our management may be too thin and we may need to bring in additional members of management. We may not be successful in finding appropriate executives when needed, which could negatively impact our operations, growth and profitability.

Failure of our internal control over financial reporting could harm our business and financial results

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the financial reporting for external purposes in accordance with U.S. generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected. Any failure to maintain an effective system of internal control over financial reporting could limit our ability to report our financial results accurately and timely or to detect and prevent fraud.

The loss of key personnel would directly affect our efficiency and profitability.

We are dependent upon the creative skills and leadership of our founder, Peter M. van Stolk, who serves as President and Chief Executive Officer. We have in place with Mr. van Stolk a two-year employment agreement that expires on November 30, 2007. The loss of Mr. van Stolk s services could have a material adverse affect on our business and operations, including our ability to develop and execute on a long-term, profitable business plan. In addition, our management team consists of several key production, distribution, sales and financial personnel who have been recruited within the past several years. The loss of any of these key personnel could delay or negatively impact our operations, profitability and employee morale.

Our concentrate sales to National Beverage Company are determined solely by their production and inventory needs to fulfill their customer orders.

National Beverage Company will place orders for concentrate as required by their production and inventory needs to fulfill their customer orders and they are not required to place any minimum monthly or quarterly

Table of Contents

concentrate orders with us. This could lead to fluctuating sales of concentrate during any given quarter or year and have an adverse effect on our results of operations.

We are solely dependent on National Beverage s production capacity and capabilities to meet the demand for Jones products in the grocery and mass merchant channel in the U.S.

The ability to meet demand for Jones products in the grocery and mass merchant category is solely dependent on National Beverage Company s production capacity and capabilities. In the event of a shortfall in agreed upon capacity or significantly increased demand, we may be unable to meet customer requirements resulting in decreased sales for our products which could have an adverse effect on our results of operations.

Changes in accounting standards and subjective assumptions, estimates and judgements by management related to complex accounting matters could significantly affect our financial results

Generally accepted accounting principles and related pronouncements, implementation guidelines and interpretations with regard to a wide variety of matters that are relevant to our business, such as revenue recognition, stock-based compensation and income taxes are highly complex and involve many subjective assumptions, estimates and judgments by our management. Changes to these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance.

There are no assurances that we will be able to continue profitable operations into the future.

We believe that to continue to operate at a profit we must:

- increase the sales volume and gross margins for our unique brands and products;
- achieve and maintain efficiencies in operations;
- manage our operating expenses to sufficiently support operating activities:
- maintain fixed costs at or near current levels; and
- avoid significant increases in variable costs relating to production, marketing and distribution.

We may not be able to meet these objectives and sustain profitability. We have incurred significant operating expenses in the past and may do so again in the future and, as a result, will need to increase revenues in order to maintain profitability. Our ability to increase sales from current sales levels will depend primarily on success in expanding our current markets, improving our distribution base, entering into direct to retail arrangements with national accounts, and introducing new unique brands, products or product extensions to the market. Our ability to successfully enter new distribution areas and obtain national accounts will, in turn, depend on various factors, many of which are beyond our control including, but not limited to, the continued demand for our brands and products in target markets, the ability to price our products at levels competitive with competing products, the ability to establish and maintain relationships with distributors in each geographic area of distribution and the ability in the future to create, develop and successfully introduce one or more new brands, products, and product extensions.

We face currency risks associated with fluctuating foreign currency valuations.

For the year ended December 31, 2006, approximately 11.0% of our sales were denominated in the Canadian dollar. A decrease in the value of the Canadian dollar in relation to the U.S. dollar after establishing prices and before our receipt of payment and conversion of such payment to U.S. dollars would have an adverse effect on our operating results. Although the recent strengthening of the Canadian dollar has had a positive impact on our revenues attributable to sales in Canada, it has also negatively impacted our costs of goods. The majority of our products are produced and bottled in Canada through two of our co-packers. Accordingly, an

14

Table of Contents

increase in the value of the Canadian dollar in relation to the U.S. dollar has similar relative adverse effect on our production costs. In an attempt to reduce the impact of these currency fluctuations on our production costs, during the second quarter of fiscal 2005 we established a new bottling relationship in the U.S. and shifted a portion of our bottling requirements to this facility beginning in the third quarter of fiscal 2005. In addition, the financial statements for our Canadian subsidiary are denominated in Canadian dollars; accordingly, on a consolidated financial statement reporting basis these numbers are converted into U.S. dollars and are affected by currency conversion rates. As of December 31, 2006, we have not entered into foreign currency contracts or other derivatives to mitigate the potential impact of foreign currency fluctuations.

We rely on our independent distributors, and this could affect our ability to efficiently and profitably distribute and market our products, and maintain our existing markets and expand our business into other geographic markets.

Our ability to establish a market for our unique brands and products in new geographic distribution areas, as well as maintain and expand our existing markets, is dependent on our ability to establish and maintain successful relationships with reliable independent distributors strategically positioned to serve those areas. Most of our larger distributors sell and distribute competing products, including non-alcoholic and alcoholic beverages, and our products may represent a small portion of their business. To the extent that our distributors are distracted from selling our products or do not employ sufficient efforts in managing and selling our products, including re-stocking the retail shelves with our products, our sales and profitability will be adversely affected. Our ability to maintain our distribution network and attract additional distributors will depend on a number of factors, many of which are outside our control. Some of these factors include

- the level of demand for our brands and products in a particular distribution area,
- our ability to price our products at levels competitive with those offered by competing products, and
- our ability to deliver products in the quantity and at the time ordered by distributors.

We may not be able to meet all or any of these factors in any of our current or prospective geographic areas of distribution. Our inability to achieve any of these factors in a geographic distribution area will have a material adverse effect on our relationships with our distributors in that particular geographic area, thus limiting our ability to expand our market, which will likely adversely effect our revenues and financial results.

We generally do not have long-term agreements with our distributors, and we incur significant time and expense in attracting and maintaining key distributors.

Our marketing and sales strategy depends in large part on the availability and performance of our independent distributors. We have entered into written agreements with many of our top distributors for varying terms and duration; however, most of our other distribution relationships are oral (based solely on purchase orders) and are terminable by either party at will. We currently do not have, nor do we anticipate in the future that we will be able to establish, long-term contractual commitments from many of our distributors. In addition, despite the terms of the written agreements with many of our top distributors, there are no minimum levels of performance under those agreements, and any of those agreements may be terminated early. We may not be able to maintain our current distribution relationships or establish and maintain successful relationships with distributors in new geographic distribution areas. Moreover, there is the additional possibility that we may have to incur additional expenditures to attract and maintain key distributors in one or more of our geographic distribution areas in order to profitably exploit our geographic markets.

Because our distributors are not required to place minimum orders with us, we need to carefully manage our inventory levels, and it is difficult to predict the timing and amount of our sales.

Our independent distributors are not required to place minimum monthly or annual orders for our products. In order to reduce inventory costs, independent distributors endeavor to order products from us on a just in