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White Paper Study

Energy Drink Due Diligence Report:

Jones Soda Company

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The following abridged report profiles Jones Soda Company and their penetration into the Energy Drink industry.

The report will touch upon its:

1. Industry Overview
2. History and Background
3. WhoopAss Energy Drink
4. Business Model and Strategy
5. Building the Brand
6. Competition
7. Sales and Marketing
8. Licensing Agreements

INDUSTRY OVERVIEW

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;
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.

HISTORY/BACKGROUND

Jones Soda is a Washington state corporation formed in 2000 as a successor to Urban Juice and Soda Company Ltd., a Canadian company formed in 1986. The actual Jones Soda product was originated in 1995.

Founded by Peter van Stolk in 1986, Jones Soda Company started off as a beverage distributor in western Canada in the late 1980s. As the company grew, they gained significant knowledge of the beverage industry and decided to get into the market with alternative beverages as the Urban Juice & Soda Company. In 2000, the company officially changed its name to Jones Soda and moved from its headquarters in Vancouver, British Columbia to Seattle, Washington to improve US sales. Jones products are also sold in the Republic Of Ireland.

Until 1995, the company was a distributor of other beverage lines such as AriZona Iced Tea and Thomas Kemper sodas in western Canada. The Urban Juice and Soda Company changed its name to Jones Soda Co. on August 1, 2000, most likely hoping to benefit from the fact that over 85% of the total revenues came from the Jones Soda brand.

Jones Soda develops, produces, markets and distributes a range of premium beverages:

1. Jones Pure Cane Soda - a premium carbonated soft drink with three new extensions launched in targeted markets during 2009:
2. Jones Refresco De Caña Pura
3. Jones JumbleTM, our seasonal soda, and
4. Jones ZilchTM, our zero calorie offering;
5. Jones 24C®, an enhanced water beverage;
6. Jones GABA®, a functional tea juice blend; and
7. WhoopAss Energy Drink®, a citrus energy drink.

Jones Soda sells and distributes its products primarily throughout the United States (U.S.) and Canada through a network of independent distributors, which they refer to as their direct store delivery (DSD) channel and national retail accounts, which they refer to as their direct to retail (DTR) channel, and they sell concentrate through an exclusive manufacturing and distribution agreement. Jones does not directly manufacture their products but instead outsource the manufacturing process to third party contract packers. They also sell various products on-line, which they refer to as an interactive channel, including soda with customized labels, wearables, candy and other items, and they license their trademarks for use on products sold by other manufacturers. In addition, they are expanding their 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.

WHOOP ASS ENERGY DRINK

In October 1999, Jones introduced Jones Soda WhoopAss (later shortened to simply "Whoop Ass"). Whoop Ass is another citrus energy drink containing riboflavin, niacin, vitamin B6 and thiamin. It is currently available in 8.4-ounce (250 ml) slim can and 16-ounce version.

In the fourth quarter of 2010, the original Jones Soda WhoopAss Energy Drink will receive a facelift for a more improved product. It will now come in an all-black 16-ounce can with an Iron Cross graphic. The updated version of WhoopAss will be a deep bruise purple color, instead of the bright yellow color of the original.

Along with an energy boost, the new WhoopAss will contain the antioxidant kick of 2.5 servings of vegetables and help with muscle recovery. The antioxidants will come from yerba mate, grape extracts and green tea. It's also stuffed with taurine, L-Arginine, L-Carnitine, L-Lysine. The energy will be provided by a blend of B2, B3, B6 and B12 vitamins.

The new version of WhoopAss Energy Drink will retail for a wallet-punching $2.39 per can and will hit the stores sometime in November.

New CEO, William Meissner, plans to relaunch the product in November with a fresh look and marketing campaign. He went on to say that WhoopAss represents less than 10 percent of Jones' revenue, mostly through online and Northwest sales. Meisner and his 40 person staff, down from 150 a couple of years ago - - are devising a new look that involves the color black and the Iron Cross, a centuries-old symbol now part of the skate, surf and mixed-martial-arts cultures.

Meissner has history with energy drinks. At Fuze Beverage, he launched the NOS brand, now Coca-Cola's best-selling energy drink, and he worked on SoBe Beverages' introduction of No Fear, now part of Pepsi. Like most energy-drink aficionados, Meissner prefers them to coffee. He also likes their high profit margins. Energy drinks cost about the same as soda pop to make but sell for considerably more -- $2.39 and up for one 16-ounce can.

BUSINESS MODEL AND STRATEGY

To help break into the soft drink marketplace, Jones pursued what it calls an “alternative distribution strategy” to attract consumer attention, selling soft drinks in venues such as clothing and music stores, tattoo and piercing parlors, and sporting equipment shops.

Eventually Jones Soda was available nationwide in larger chain stores such as 7-Eleven, Safeway, Albertsons, Wal-Mart, Winn-Dixie, and Barnes & Noble. Recent business distribution deals have further expanded the company, placing some basic flavors in stores such as Meijer, World Market, and Panera.

On October 12, 2004, Jones Soda introduced 12oz cans for the first time with an exclusive distribution deal with Target, though other stores (including some Kmart, Food Pyramid, and Albertsons locations) now also sell the cans. Jones Soda is also sold at Ruby Tuesday’s.

In 2007, Jones expanded their distribution to the grocery and mass merchant channel in the U.S. with an exclusive manufacturing and distribution agreement with National Beverage Corp. (National Beverage), which they refer to as their concentrate soda distribution (CSD) channel. Through this arrangement, they identify and secure retailers across the U.S. for Jones Soda 12-ounce cans, and Jones is responsible for sales efforts, marketing, advertising and promotion. Using concentrate supplied by Jones, National Beverage both manufactures and sells on an exclusive basis the products directly to retailers. However, beginning in 2009, Jones have changed their strategic direction, emphasizing their higher-margin, core products, including their

Jones Pure Cane Soda glass bottle business, with less emphasis on our CSD channel, which is a lower margin business for us.

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

In 2004, Jones launched their licensing business strategy as a method to extend their brand into non-alternative beverage products and non-beverage products. They currently have licensing arrangements with three companies. With these licensing agreements, Jones believes that they are able to partner with companies that will manufacture Jones-related products and extend the Jones name into select products that they feel enhance their brand image.

Jones’ business strategy is to increase sales by expanding distribution of their brands in new and existing markets (primarily within North America), stimulating consumer awareness and trial of their products, thus leading to increased relevance and purchase intent of their brands. Jones’ business strategy focuses on:

1. Expanding points of distribution for their products;
2. Creating strong alignment with their key distributors;
3. Developing innovative beverage brands and products;
4. Stimulating strong consumer demand for their existing brands and products, with primary emphasis in the U.S. and Canada;
5. Inviting consumers to participate in their brand through submission of photographs to be placed on labels through our interactive application of myJones.com;
6. Licensing their brand equity for the creation of other beverage or non- beverage products; and

7. Exploring opportunities to license their patented custom-label process to non-competitive products.

During 2009, Jones refined their 2009 operating plan each quarter to contemplate lower case sales than they had previously contemplated, but their actual case sales continued to be lower than their revised expectations. Despite the further refinements and cost cutting measures Jones implemented during 2009, they may no longer have sufficient margin in their 2010 operating plan to absorb further declines against their expectations with regard to the economy or their business. Jones believes that their 2010 operating plan already includes the majority of attainable cost cutting measures, which places greater emphasis on the need to meet their case sales projections in order to effectively operate their business. The economic conditions in 2009 and the beginning of 2010 have made forecasting demand for the Jones product extremely difficult, so there is continued uncertainty regarding their ability to meet our revised case sales projections.

Their current 2010 operating plan does not depend upon obtaining financing and if achieved, would allow us to meet their anticipated cash needs for the next 12 months. However as they build inventory to prepare for their stronger shipping months of April through September, they expect their cash balance to fall to approximately $1 million, excluding the impact of any funding through potential debt or equity financing, before they would expect their cash balance to increase in the second half of the year.

Additionally, if their sales volumes further decline in a material way from their expectations during 2010 as a result of worsening economic conditions or otherwise, and since they would not likely be able to further reduce their costs by a sufficient amount, they may be unable to generate enough cash flow from operations to cover their working capital and capital expenditure requirements for the balance of the year. Further, based on their current projections beyond 2010, they expect that they will deplete their cash in the first half of 2011. As such, they believe they will likely need to secure financing during 2010 or early 2011 in order to fund their working capital and capital expenditure requirements in 2011. Although they believe they have financing alternatives available to them, these alternatives would likely involve significant interest and other costs or would likely be highly dilutive to their existing shareholders.

BUILDING THE BRAND

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, the strategy is to develop innovative brand names, relevant programs and trade dress. In addition to creative labeling on products, Jones provides their distributors with point-of-sale promotional materials and branded apparel items. Through the labels on their bottles, they invite consumers to access their website and to send in photographs to be featured on the Jones Soda labels. Jones selects photos throughout the year to be placed on their bottles in distribution.

They 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. Jones believes that their labeling, marketing and promotional materials are important elements to creating and increasing distributor, retailer and consumer awareness of their brands and products. Additionally, the industry continues to see a shift towards diet or zero calorie soft drinks, and they believe the launch of Jones ZilchTM is on trend and maintains the spirit of the Jones brand in a new zero calorie platform. They believe this launch will expand the consumer base for their soda products and provide a healthier, fun alternative to the current options in this sector.

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

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

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

2. Distributor Evaluation. They 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.

3. Production Evaluation. Jones reviews 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.

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

Independent Distributor Network (DSD)

Jones has focused their sales and marketing resources on the expansion and penetration of their products through their independent distributor network throughout the U.S. and Canada. They have obtained listings for selected stock keeping units (SKUs) of their 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, Allsups 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.

Jones grants certain independent distributors the exclusive right in defined territories to distribute finished cases of one or more of their brands through written agreements. These agreements typically include invasion fee provisions to those distributors in the event they provide product directly to one of their national retailers located in the distributor's region. Jones is 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. They select distributors that they believe will have the ability to get their brands and products on the street level retail shelves in convenience stores, delicatessens, sandwich shops and selected supermarkets.

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

Direct to Retail National Accounts (DTR)

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

These arrangements are not long-term and are terminable at any time by these retailers or Jones. There are no minimum purchase commitments for any of these retailers. In 2010, three of their significant DTR accounts chose not to continue with Jones; those companies are Barnes & Noble Inc., Panera Bread Company, and Alaska and Horizon Airlines.

COMPETITION

The beverage industry is highly competitive. Principal methods of competition in the beverage industry come from: distribution, shelf management, sponsorships, licensing, brand name and image, price, labeling, packaging, advertising, product quality and taste, trade and consumer promotions, and brand development.

Jones' products compete with all non-alcoholic beverages, most of which are marketed by companies with substantially greater financial resources than ours. They also compete with regional beverage producers and "private label" soft drink suppliers. Their direct competitors in the alternative beverage industry include Dr. Pepper Snapple (Stewarts and IBC), Boylans, Henry Weinhard's, Thomas Kemper, and other regional premium soft drink companies. They also compete against Coca Cola, Pepsi, Hansen's, 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, Jones believes that they 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, they 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, they 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, they have created Jones Pure Cane Soda in a 12-ounce can format that allows them to compete directly in the carbonated soft drink industry. As a means of maintaining and expanding our distribution network, they introduce new products and product extensions, and when warranted, new brands.

Pricing of the products is also important. Jones believes that their 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.

SALES AND MARKETING

The Jones marketing team has developed brand positioning and architecture frameworks that they believe enable them to have disciplined control over their 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. Jones has also developed channel, package, price and promotion strategies designed to allow the sales team to realize optimum price points.

Jones has a successful history of positioning themselves in alternative outlets with the intent to be where national mainstream brands are not sold. They also have a program of sponsoring alternative sport athletes to promote their products, and they market in youth alternative sports such as surfing, hockey, roller derby, and snowboard, skateboard and BMX bike arenas. They believe this effort to position their products in alternative outlets has drawn a younger generation of customers that value their independence away from the larger soft drink brands.

Jones participates 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. They 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, they also sell their products and our wearables on their website. In selected cities, they participate at a "grass roots" level at certain community and sporting events in an attempt to create and increase brand awareness and loyalty.

Jones uses 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, they also pursue cross-promotional campaigns with other companies.

Jones currently has three major sponsorship agreements with professional sports franchises. They 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 them with the beverage rights to sell their beverages at sports venues as well as signage, advertising and other promotional benefits to enhance our brand awareness. While they believe that sponsorship arrangements are a way to continue to increase the public awareness and strength of their brand and provide them with other cross-selling opportunities through their licensing business strategy, given their limited cash resources, they intend to attempt to renegotiate these sponsorship agreements as they continue to require us to make significant annual cash payments.

LICENSING ARRANGEMENTS

Jones launched their licensing business strategy in 2004 as a method to extend their brand into non-alternative beverage products and non-beverage products. They currently have licensing arrangements with three companies. In September 2005, they entered into a licensing agreement with Big Sky Brands, Inc. to manufacture and distribute Jones Soda Flavor Booster hard candy. In February 2007, they entered into a licensing agreement with J&J Snack Foods for the use of their flavors and brand name for their ICEE and Slush Puppy iced beverages. In December 2008, Jones 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, they believe that they 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.