JONES SODA CO
Form 10-Q
May 10, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2007

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

For the Transition Period From _____ to _____

Commission File Number 0-28820

Jones Soda Co.

(Exact name of registrant as specified in its charter)

Washington **(State or other jurisdiction of** **incorporation or organization)**	**91-1696175** **(I.R.S. Employer** **Identification Number)**
234 9th Avenue North **Seattle, Washington 98109** **(Address of principal executive office)**	**(206) 624-3357** **(Registrant s telephone number,**

including area code)

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

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 and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

As of April 30, 2007, the issuer had 25,862,475 shares of common stock outstanding.

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EXPLANATORY NOTE

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

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 Report on Form 10-Q 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, events or developments that management expects or anticipates will or may occur in the future, including statements related to distributor channels, volume growth, revenues, profitability, new products, adequacy of funds from operations, statements expressing general optimism about future operating results and non-historical information, are forward looking statements. In particular, the words believe, expect, intend, anticipate, estimate, may, will, variations of such words, and similar expres identify 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 (including those described below) 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. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below in Risk Factors as well as those discussed elsewhere in this Report, and the risks discussed in our most recently filed Annual Report on Form 10-K and in the press releases and other communications to shareholders issued by us from time to time which attempt to advise interested parties of the risks and factors that may affect our business. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

JONES SODA CO. AND SUBSIDIARIES

Consolidated Balance Sheets

March 31, 2007 with comparative figures for December 31, 2006

	March 31, 2007 (Unaudited)	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 15,181,388	$ 13,905,870
Short-term investments	15,569,403	16,318,510
Accounts receivable	5,638,389	6,914,422
Inventory (note 3)	5,744,333	5,783,067
Deferred income tax asset (note 7)	2,221,386	1,507,145
Prepaid expenses	784,837	712,690
	45,139,736	45,141,704
Deferred income tax asset (note 7)	419,863	427,993
Capital assets	914,708	756,618
Other assets	1,420,974	1,414,138
Intangible assets	200,042	211,931
	$ 48,095,323	$ 47,952,384
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 4,232,749	$ 5,446,953
Current portion of capital lease obligations	42,349	70,471
Taxes payable	146,414	150,141
	4,421,512	5,667,565
Capital lease obligations, less current portion	15,192	15,329
Shareholders equity		
Common stock:		
Authorized: 100,000,000 common stock, no par value		
Issued and outstanding: 25,761,225 common shares (2006 25,637,491)	42,479,225	41,890,777
Additional paid-in capital	3,584,236	2,832,865
Accumulated other comprehensive income	87,014	96,016
Deficit	(2,491,856)	(2,550,168)
	43,658,619	42,269,490
	$ 48,095,323	$ 47,952,384

See accompanying notes to interim consolidated financial statements.

JONES SODA CO. AND SUBSIDIARIES

Consolidated Statements of Operations

(Unaudited)

Three months ended March 31, 2007 and 2006

	Three months ended March 31, **2007**	**Three months ended March 31,** **2006**
Revenue	$ 9,189,089	$ 8,760,380
Cost of goods sold	5,671,879	5,640,710
Gross profit	3,517,210	3,119,670
Licensing revenue	145,947	137,571
	3,663,157	3,257,241
Operating expenses (1):		
Promotion and selling	2,358,720	2,052,421
General and administrative	1,732,221	1,159,988
	4,090,941	3,212,409
Earnings (loss) before interest income and income taxes	(427,784)	44,832
Interest income, net:	441,086	12,710
Earnings before income tax	13,302	57,542
Income tax benefit (expense) (note 7)		
Current	3,727	(55,000)
Deferred	41,283	
	45,010	(55,000)
Earnings for the period	$ 58,312	$ 2,542
Earnings per share, basic	$ 0.00	$ 0.00
Earnings per share, diluted	$ 0.00	$ 0.00
Weighted average number of common stock		
Basic	25,667,806	21,746,947
Diluted	26,449,564	22,627,053
(1) Includes non-cash stock-based compensation as follows:		
Promotion and selling	$ 68,004	$ 116,010
General and administrative	$ 139,896	$ 270,693

See accompanying notes to interim consolidated financial statements

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JONES SODA CO. AND SUBSIDIARIES

Consolidated Statements of Shareholders   Equity and Comprehensive Income

Three months ended March 31, 2007 (Unaudited)

Year ended December 31, 2006

				Accumulated		
	Common stock		Additional	other		Total
			paid-in	comprehensive		shareholders
	Number	Amount	capital	income (loss)	Deficit	equity
Balance, December 31, 2005	21,616,596	$ 12,491,133	$ 764,622	$ 107,752	$ (7,016,872)	$ 6,346,635
Cumulative effects of adjustments resulting from the adoption of SAB No. 108					(107,735)	(107,735)
Shares issued for PIPE	3,157,895	28,077,350				28,077,350
Options exercised	863,000	1,223,950				1,223,950
Stock options exercised, including benefits		98,344	1,011,116			1,109,460
Stock-based compensation expense			1,057,127			1,057,127
Other comprehensive income, unrealized loss on available-for-sale short-term investments				(11,736)		
Earnings for the year					4,574,439	
Comprehensive income for the year						4,562,703
Balance, December 31, 2006	25,637,491	$ 41,890,777	$ 2,832,865	$ 96,016	$ (2,550,168)	$ 42,269,490
Options exercised	123,734	477,616				477,616
Stock-based compensation expense			207,900			207,900
Exercise of stock options		110,832	(110,832)			
Tax benefit on option exercise			654,303			654,303
Other comprehensive income, unrealized loss on available-for-sale short-term investments				(9,002)		
Earnings for the period					58,312	
Comprehensive income for the period						49,310
Balance, March 31, 2007	25,761,225	$ 42,479,225	$ 3,584,236	$ 87,014	$ (2,491,856)	$ 43,658,619

See accompanying notes to interim consolidated financial statements.

JONES SODA CO. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

Three months ended March 31, 2007 and 2006

	Three months ended March 31, 2007	**Three months ended March 31, 2006**
Cash flows from (used in) operating activities:		
Earnings for the period	$ 58,312	$ 2,542
Items not involving cash:		
Depreciation and amortization	133,879	59,134
Deferred income taxes	(41,283)	
Stock based compensation expense	207,900	386,703
Changes in assets and liabilities:		
Accounts receivable	1,276,033	(888,554)
Inventory	38,734	744,905
Prepaid expenses	(83,395)	(57,599)
Taxes payable	(3,727)	
Accounts payable and accrued liabilities	(1,214,204)	808,890
Net cash from operating activities	372,249	1,056,021
Cash flows from (used in) investing activities:		
Sale of short-term investments- net	740,104	
Purchase of capital assets	(208,651)	(15,734)
Purchase of intangible assets		(5,218)
Purchase of other assets	(77,542)	
Net cash from (used in) investing activities	453,911	(20,952)
Cash flows from (used in) financing activities:		
Net repayment of capital lease obligations	(28,259)	(34,809)
Proceeds from exercise of options	477,617	626,791
Net cash from financing activities	449,358	591,982
Net increase in cash and cash equivalents	1,275,518	1,627,051
Cash and cash equivalents, beginning of period	13,905,870	1,176,101
Cash and cash equivalents, end of period	$ 15,181,388	$ 2,803,152
Cash paid (received) during the period:		
Interest paid (received)	$ (310,656)	$ 3,544
Income tax paid	6,225	6,475

See accompanying notes to interim consolidated financial statements.

JONES SODA CO. AND SUBSIDIARIES

Notes to Interim Consolidated Financial Statements

Three months ended March 31, 2007 and 2006 (Unaudited)

1. Nature and continuance of operations:

Jones Soda Co. develops, produces, markets, licenses and distributes alternative beverages and related products. Our primary product lines include the brands Jones Soda Co.®, Jones Organics , a ready to drink organic tea, Jones Energy , a high energy drink, WhoopAss , a high energy drink, Jones Naturals , a non-carbonated juice and tea drink and Jones 24C , an enhanced water beverage. We are a Washington corporation and our corporate offices are located at 234 9th Avenue North, Seattle, Washington. We have three operating subsidiaries, Jones Soda Co. (USA) Inc., Jones Soda (Canada) Inc., and myJones.com Inc., as well as one non-operating subsidiary, Whoopass USA Inc.

2. Significant accounting policies:

(a) Basis of presentation:

These interim consolidated financial statements have been prepared using generally accepted accounting principles in the United States of America (GAAP) and United States Securities and Exchange Commission (SEC) rules and regulations applicable to interim financial reporting.

The financial statements include our company and our wholly-owned subsidiaries accounts. All significant inter-company accounts and transactions have been eliminated on consolidation.

The accompanying unaudited interim consolidated financial statements are prepared in accordance with GAAP but do not include all information and footnotes required by GAAP for annual financial statements. However, in the opinion of management, all adjustments (which consist only of normal recurring adjustments) necessary for a fair presentation of the results of operations for the relevant periods have been made. Results for the interim period are not necessarily indicative of the results to be expected for the full fiscal year or for any other interim period. These financial statements should be read in conjunction with the summary of accounting policies and the notes to the consolidated financial statements for the year ended December 31, 2006, as amended by note 2(f) below, included in our annual report on Form 10-K.

(b) Use of estimates:

The preparation of the consolidated financial statements requires management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of inventory, capital assets and intangible assets, valuation allowances for receivables, stock-based compensation expense, valuation allowance for deferred income tax assets and state and city taxes. Actual results could differ from those estimates.

(c) Seasonality:

Our sales are seasonal and we experience significant fluctuations in quarterly results as a result of many factors. We generate a substantial percentage of our revenues during the warm weather months of April through September. Timing of customer purchases will vary each year and sales can be expected to shift from one quarter to another. As a result, management believes that period-to-period comparisons of results of operations are not necessarily meaningful and should not be relied upon as any indication of future performance or results expected for the fiscal year.

(d) Advertising:

We expense advertising costs as incurred. During the three-month period ended March 31, 2007, we incurred advertising costs of $1,151,929 (2006-$1,337,652).

(e) Cash and cash equivalents:

We consider all highly liquid and short-term investments with a maturity date at purchase of three months or less to be cash equivalents.

(f) Income taxes:

In June 2006, the FASB issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

We and our subsidiaries file income tax returns in the U.S. federal jurisdiction, and various states and a foreign jurisdiction. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years prior to 2003. We may from time to time be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been minimal and immaterial to our financial results. In the event we have received an assessment for interest and/or penalties, it has been classified in the financial statements as general and administrative expense. There is no material interest expense or penalties accrued at March 31, 2007. We believe that we have appropriate support for the income tax positions taken and to be taken on our tax returns and that our accruals for tax liabilities are adequate for all open years based on an assessment of many factors including past experience and interpretations of tax law applied to the facts of each matter. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48.

We adopted the provisions of FIN 48 on January 1, 2007. The adoption of FIN 48 did not impact the consolidated financial condition, results of operations or cash flows. As of January 1, 2007, we are evaluating the deductibility of stock option expenses not included in previously filed tax returns. To the extent these unrecognized potential tax benefits may be ultimately recognized, they will impact the effective tax rate in a future period.

(g) Recently issued accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. We are currently evaluating the potential impact of this statement.

(h) Reclassifications

Certain prior year amounts have been reclassified to conform to the presentation adopted in the current period.

3. Inventory:

	March 31,	**December 31,**
	2007	**2006**
Finished goods	$ 3,731,259	$ 2,919,396
Raw materials	2,013,074	2,863,671
	$ 5,744,333	$ 5,783,067

4. Segmented information and export sales:

We operate in one industry segment, with operations during 2007 primarily in the United States and Canada. During the three-month period ended March 31, 2007 sales in the United States were approximately $8,019,792 (2006 $7,531,528), sales in Canada were approximately $1,084,274 (2006 $1,201,002), and sales to other countries totaled approximately $85,023 (2006 $27,850). Sales have been assigned to geographic locations based on the location of customers.

5. Earnings per share:

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

	Three months ended March 31, 2007	 2006
Earnings for the period	$ 58,312	$ 2,542
Weighted average number of common stock outstanding:		
Basic	25,667,806	21,746,947
Dilutive stock options	781,758	880,106
Diluted	26,449,564	22,627,053
Earnings per share:		
Basic	$ 0.00	$ 0.00
Diluted	$ 0.00	$ 0.00

6. Shareholders equity:

(a) Common stock:

On June 8, 2006, we completed a private placement in public equity (PIPE) of 3,157,895 shares of our common stock at a price of $9.50 per share, and received $28,077,350 in net proceeds after underwriting costs and expenses.

(b) Stock options:

A summary of our stock option activity is as follows:

	Outstanding options Number of shares	 Average exercise price
Balance at December 31, 2005	1,782,000	$ 1.83
Option granted	585,400	7.08
Options exercised	(863,000)	(1.42)
Options cancelled	(80,375)	(5.02)
Balance at December 31, 2006	1,424,025	4.05
Option granted	281,500	18.67
Options exercised	(123,734)	(3.86)
Options cancelled	(8,500)	(8.46)
Balance at March 31, 2007	1,573,291	$ 6.66
Exercisable, March 31, 2007	1,097,828	$ 3.38

The following table summarizes information about stock options outstanding and exercisable under the Plans at March 31, 2007:

		Weighted				**Weighted**
		average	**Weighted**		**Weighted**	**average**
		remaining	**average**		**average**	**remaining**
	Number	**contractual**	**exercise**	**Number**	**exercise**	**contractual**
	outstanding	**life (years)**	**price**	**exercisable**	**price**	**life (years)**
$0.25 to $0.50	332,500	0.33	0.43	332,500	0.43	0.33
$1.10 to $2.99	169,500	1.75	2.09	169,500	2.09	1.75
$3.00 to $4.00	286,250	1.80	3.98	286,250	3.98	1.80
$4.01 to $5.01	12,500	3.36	5.01	12,500	5.01	3.36
$5.01 to $9.33	491,041	4.19	7.17	297,078	6.78	4.19
$9.34 to $18.67	281,500	4.95	18.67		18.67	4.95
	1,573,291		$6.66	1,097,828	$3.38	

The total intrinsic value for options exercised during the three months ended March 31, 2007 was $1,860,000. The total intrinsic value for options exercised during the three months ended March 31, 2006 was $1,688,000.

During the three-month period ended March 31, 2007, no modifications were made to outstanding stock options, and there were no stock-based compensation costs capitalized as part of the cost of any asset.

(c) Stock-based compensation expense:

SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions. The expected life selected for options granted during the quarter represents the period of time that the options are expected to be outstanding based on historical data of option holder exercise and termination behavior. Expected volatilities are based upon historical volatility of our monthly stock closing prices over a period equal to the expected life of each option grant. The risk-free interest rate was selected based on yields from Government Bond yields with a term equal to the expected term of the options being valued.

	Three months ended	
	March 31,	
	2007	**2006**
Expected dividend yield		
Expected stock price volatility	55%	56%
Risk-free interest rate	4.62%	4.82%
Expected term (in years)	2.75 years	3.0 years
Weighted-average grant date fair-value	$ 4.30	$ 2.26

Under the terms of our stock option plan, our Board of Directors may grant options to employees, officers, directors and consultants. The plan provides for granting of options at the fair market value of our stock at the grant date. Historically, options generally vested over a period of eighteen months, with the first 25% vesting at the date of grant and the balance vesting in equal amounts every six months thereafter. Effective during the quarter ended September 30, 2006, we changed the vesting schedule for our prospective stock option grants, to vest over a period of forty-two months, with the first 1/7 vesting six months from the grant date and the balance vesting in equal amounts every six months thereafter. We determine the term of each option at the time it is granted, historically, options granted generally have a five-year term.

At March 31, 2007, we had $2,441,000 of unrecognized compensation expense related to stock options, which we expect to recognize over a weighted-average period of up to 41 months.

7. Income Taxes:

We account for income taxes in accordance with SFAS 109, Accounting for Income Taxes, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements which differ from our tax returns.

In assessing whether and to what extent we may realize deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Historically, we did not believe we met the criteria to recognize deferred tax assets, and accordingly, we provided a full valuation allowance.

During the second quarter of 2006, we re-evaluated our valuation allowance after recording taxable income for two successive years and we determined that is more likely than not we would realize the deferred tax assets. Accordingly, during the three months ended June 30, 2006, we recorded a tax benefit by reversing a significant portion of the valuation allowance and recording the tax benefit. No such tax benefit was recorded in the three-month period ended March 31, 2006.

The current and deferred tax provision rates are calculated at the effective federal statutory rate, taking into consideration expected permanent differences, state income taxes, and alternative minimum taxes.

A portion of our granted options qualify as incentive stock options (ISO) for income tax purposes. As such, a tax benefit is not recorded at the time the compensation cost related to the options is recorded for book purposes due to the fact that an ISO does not ordinarily result in a tax benefit unless there is a disqualifying disposition. Stock option grants of non-qualified options result in the creation of a deferred tax asset, which is a temporary difference, until the time the option is exercised. Due to the treatment of incentive stock options for tax purposes, our effective tax rate during any quarter is subject to variability.

8. Commitments

During the quarter ended March 31, 2007, we had commitments to invest approximately $1,500,000 in co-packing equipment and commitments to purchase approximately $1,445,000 of pure cane sugar and approximately $900,000 of glass bottles.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with our consolidated financial statements and related notes included elsewhere in this Report. Except for historical information, the following discussion contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. See Cautionary Notice Regarding Forward Looking Statements above.

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 and packages, 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 relationships with distributors, retailers 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 Co. 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 Eastern and Western Canada, as well as targeted expansion into the less penetrated Northeast and Southeast U.S markets.

We launched our DTR, or 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.

In addition to our efforts in the DSD and DTR channels, we entered the mainstream of the carbonated soft drink industry (CSD) with the launch of our *Jones Soda* product in the 12-ounce can format in October 2004. 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.

As part of our CSD channel, in August 2006, we entered into 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 producing and selling *Jones Pure Cane Soda* to retailers in the U.S.

In addition to the above, 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 marketing companies: Lime-Lite Marketing Corporation and Big Sky Brands, Inc. With these licensing arrangements, we believe that we are better positioned with companies that are able to manufacture Jones related products and extend the Jones brand into select products that we believe will enhance our brand image. In the first quarter of 2007, we entered into a licensing agreement with J&J Snack Foods Corporation to license the Jones Soda trademark for use in frozen novelty food products, frozen confections and frozen beverages.

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

Critical Accounting Estimates and Policies

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

We have identified below some of our accounting policies that we consider critical to our business operations and the understanding of our results of operations. This is not a complete list of all of our accounting policies, and there may be other accounting policies that are significant to us. For a detailed discussion on the application of these and our other accounting policies, see Note 2 to the Consolidated Financial Statements included in this report and the summary of accounting policies and notes to the financial statements for the year ended December 31, 2006, included in our annual report on Form 10-K.

Revenue Recognition

Our products are sold to distributors, various customers and retailers for cash or on credit terms. Our credit terms, which are established in accordance with local and industry practices, typically require payment within 30 days of delivery. We recognize revenue upon receipt by our customers of our products, in accordance with written sales terms, net of provisions for discounts and allowances. All sales to distributors and customers are final sales and we have a no return policy; however, in limited instances, due to credit issues or distributor changes, we may take back product.

Licensing revenue is recorded when we receive a sale confirmation from the third party, and reflect amounts realized net of provisions for sales returns.

Revenue from the sale of concentrate to National Beverage Co. is recognized on a gross basis and is recognized in income upon receipt of concentrate by National Beverage Co., in accordance with our agreement with them. Our credit terms from the sale of concentrate typically require payment within 30 days of delivery. All sales of concentrate to National Beverage Co. are final sales and we have a no return policy with them.

Cash consideration (including slotting fees) that we pay to a customer (including a reseller of the our products) is accounted for as a reduction of revenue when recognized in our statements of operations. For the three month period ended March 31, 2007, revenue was reduced by $86,884 (2006 $68,850). We amortize the lump sum slotting fee payments over a twelve month period, which is based on current data of product maintenance on retail shelves for that period of time.

Allowance for Doubtful Accounts; Bad Debt Reserve

Management routinely estimates the collectibility of our accounts receivable. Management analyzes accounts receivable, historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. In general, we have historically and continue today to provide an allowance for doubtful accounts equal to 100% of any unpaid balance outstanding greater than 90 days since invoice, unless considered collectible. We believe that in general bad debt reserves for other companies in the beverage industry represent approximately 2% of total sales. Historically, our bad debt reserve has represented approximately 0.3% of total sales. Bad debt expense is classified within general and administrative expenses in our Consolidated Statements of Operations.

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

Inventory

We hold raw materials and finished goods inventories, which are manufactured and procured based on our sales forecasts. We value inventory at the lower of cost and estimated net realizable value, and include adjustments for estimated obsolescence, on a first in-first out basis. These valuations are subject to customer acceptance and demand for the particular products, and our estimates of future realizable values based on these forecasted demands. We regularly review inventory detail to determine whether a write-down is necessary. We consider various factors in making this determination, including recent sales history and predicted trends, industry market conditions and general economic conditions. Differences could result in the amount and timing of write-downs for any period if we make different judgments or use different estimates. We also determine an allowance for obsolescence based on products that are over 12 months from production date.

Deferred Income Taxes

The determination of our provision of income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing, among other things, the timing and amounts of deductible and taxable items. Prior to the second quarter of 2006, we maintained a valuation allowance for all of the U.S. and foreign deferred taxes (in accordance with SFAS 109, Accounting for Income Taxes) due to the uncertainty regarding the full utilization of our deferred tax asset. With our improved profitability over the past three years, during which time we generated taxable income to utilize some of these loss carry-forwards, management has determined it is more likely than not that the deferred tax asset will be realized and has, as such, reversed the valuation allowance against U.S. federal deferred tax assets in 2006. As at December 31, 2006, we have loss carryforwards of approximately $4,024,000 that can be deducted against income in future periods.

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We adopted the provisions of FIN 48 on January 1, 2007. The adoption of FIN 48 did not impact the consolidated financial condition, results of operations or cash flows. We believe that we have appropriate support for the income tax positions taken and to be taken on our tax returns and that our accruals for tax liabilities are adequate for all open years based on an assessment of many factors including past experience and interpretations of tax law applied to the facts of each matter. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48.

Stock-based compensation

We have adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), using the modified prospective transition method. Under this method, stock-based compensation expense is recognized using the fair-value based method for all awards granted on or after the date of adoption. We have adopted the Black-Scholes option pricing model to estimate fair value of each option grant.

SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Results of Operations for the Three Months Ended March 31, 2007

Revenue

	Three months ended		
		March 31,	
(Dollars in Thousands)	**2007**	**2006**	**Change**
Revenue	$ 9,189	$ 8,760	4.9%

For the three months ended March 31, 2007, revenues were approximately $9,189,000, an increase of $429,000, or 4.9% over the $8,760,000 in revenues for the three months ended March 31, 2006. The increase in revenues was primarily attributable to a) the sales of concentrate to National Beverage Co. and b) increased sales through our DTR network. However, our revenue increases were partially offset by a decrease in sales in our DSD network and decrease in sales of special packs, primarily Valentine Packs. We had no concentrate sales in the comparable period in 2006.

The increase in revenues in our DTR network was due to increased case sales to Starbucks and Panera Bread, as well initial shipments of Jones Soda 12 ounce bottles to Sam s Club and Ruby Tuesday.

The overall decrease in revenues in our DSD network during the quarter was due to decreased case sales in the Northwest, Midwest and Southwest partially offset by increased case sales in the Northeast. One factor causing the decrease in revenues was a delayed start up in pure cane bottle production and reduced distributor pure cane sugar purchases until High Fructose bottle inventory had sold through the distribution channels.

Revenues for the quarter also reflect a price increase for certain products, comparable to a price increase in the same period last year.

Consolidated case sales of all products (finished products and concentrate) for the quarter ended March 31, 2007 expressed as 288-ounce equivalent cases were 1,722,000, an increase of 191% or 1,130,000 cases from total case sales on 592,000 in 2006. We had no sales of concentrate in the comparable period in 2006.

288-ounce equivalent case sales

	Three months ended		
		March 31,	
	2007	**2006**	**Change**
Finished products case sales	598,000	592,000	1%

Concentrate case sales	1,124,000		N/A
Total case sales	1,722,000	592,000	191%

Gross Profit

	Three months ended		
		March 31,	
(Dollars in Thousands)	2007	2006	Change
Gross profit	$ 3,517	$ 3,120	12.7%
Percentage of revenue	38.3%	35.6%	

For the three-month period ended March 31, 2007, gross profit increased by approximately $397,000 or 12.7% over the $3,120,000 in gross profit for the three-month period ended March 31, 2006. The increase in gross profit is primarily attributable to sales of concentrate during the period. Other factors impacting gross profit include the overall increase in the average selling price per case offset by increases in co-packing costs and product mix.

The increase in gross profit as a percentage of revenue for the three-month period ended March 31, 2007, was due to higher margin concentrate sales.

Licensing Revenue

	Three months ended		
		March 31,	
(Dollars in Thousands)	2007	2006	Change
Licensing revenue	$ 146	$ 138	5.80%

Licensing revenue during the first quarter of 2007 is due primarily to our exclusive arrangements with Big Sky Brands for Jones Soda Flavor Booster Hard Candy and royalties from the sale of the remaining 12-ounce can High Fructose corn syrup inventory at Target Corporation during the quarter. For the three-month period ended March 31, 2007 we received royalty payments under these arrangements of approximately $146,000 (up 5.80% from the same period last year). Licensing revenue for the first quarter of 2006 was due to our exclusive arrangement with Target Corporation for the 12-ounce can fridge packs.

Total Operating Expenses

	Three months ended		
		March 31,	
(Dollars in Thousands)	2007	2006	Change
Promotion and selling	$ 2,359	$ 2,052	15.0%
General and administrative	$ 1,732	$ 1,160	49.3%
Total operating expenses	$ 4,091	$ 3,212	27.3%
Percentage of revenue	44.5%	36.7%	

Total operating expenses for the three-month period ended March 31, 2007 were approximately $4,091,000, an increase of $879,000 or 27.3% over operating expenses of approximately $3,212,000 for the three-month period ended March 31, 2006. The increase in total operating expenses was attributable to an increase in promotion and selling expenses and general and administrative expenses for the three-month period. Changes in these categories are explained below.

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), using the modified prospective transition method. Under this method, stock-based compensation expense is recognized using the fair-value based method for all awards granted on or after the date of adoption. The total amount of stock-based compensation recorded for the three-month period ended March 31, 2007 was approximately $208,000, a decrease of approximately $179,000 or 46.3% over stock-based compensation expense recognized for the three-month period ended March 31, 2006.

Promotion and Selling Expenses

(Dollars in Thousands)	**Three months ended** **2007**	**March 31,** **2006**	**Change**
Promotion and selling	$ 2,359	$ 2,052	15.0%
Percentage of revenue	25.7%	23.4%	

Promotion and selling expenses for the three months ended March 31, 2007 were approximately $2,359,000, an increase of $307,000 over promotion and selling expenses of approximately $2,052,000 for the three-month period ended March 31, 2006. Promotion and selling expenses as a percentage of revenue increased to 25.7% for the three-month period ended March 31, 2007 from 23.4% over the comparable period in 2006. The increase in promotion and selling expenses for the three months ended March 31, 2007 was due to an increase in the hiring of selling and marketing employees resulting in increased salaries and wages. During the quarter we incurred salaries for our Vice President Sales for DSD East, Vice President Sales for CSD East and Vice-President for Natural Foods and Direct to Retail for which there were no comparable executive expenses in 2006. This increase was offset by decreases in trade promotion spending and stock-based compensation expense from the same period last year.

At March 31, 2007, we had 45 employees in sales and marketing compared to 25 such employees at March 31, 2006.

General and Administrative Expenses

(Dollars in Thousands)	**Three months ended** **2007**	**March 31,** **2006**	**Change**
General and administrative	$ 1,732	$ 1,160	49.3%
Percentage of revenue	18.8%	13.2%	

General and administrative expenses for the three-month period ended March 31, 2007 were approximately $1,732,000, an increase of $572,000, or 49.3% compared to approximately $1,160,000 for the three-month period ended March 31, 2006. General and administrative expenses as a percentage of revenue increased to 18.8% for the three months ended March 31, 2007 from 13.2% for the comparable period in 2006. The increase in general and administrative expenses is primarily due to a significant increase in audit fees, increase in tax consulting fees, consulting fees related to SOX 404, depreciation and amortization, directors fees and legal fees. This increase was offset by a decrease in stock-based compensation expense from the same period last year.

Interest income, net

For the three-month period ended March 31, 2007, interest income was approximately $441,000 compared to interest income of approximately $13,000 in same period in 2006. Interest income consists of interest income earned on the PIPE proceeds received in June 2006 and increased cash from operations during the quarter. Currently, the funds from the PIPE offering and cash from operations are invested in money market and short-term fixed-income instruments.

Net Income

Net income for the three ended March 31, 2007 were approximately $58,312 compared to net income of $2,542 respectively, for the three months ended March 31, 2006. The increase in net income for the comparable periods was due to an increase in gross profit from increased sales, interest income and tax benefits and partially offset by an increase in operating expenses in the first quarter of 2007.

Liquidity and Capital Resources

Cash, cash equivalents and short-term investments were approximately $30,751,000 as of March 31, 2007 compared to approximately $30,224,000 as of December 31, 2006. Net cash from operating activities was approximately $372,000 for the three-month period ended March 31, 2007, primarily due to add back of non cash items such as depreciation and amortization and stock based compensation expense.

Investing activities generated $454,000 for the three-month period ended March 31, 2007, primarily from the sale of short-term investments offset by increases in purchases of capital assets and other assets. Net cash provided by financing activities was $449,000 for the three-month period ended March 31, 2007, and consisted of proceeds from the exercise of stock options and partially offset by repayments of capital leases.

On June 27, 2006, we renewed our existing $5,000,000 revolving credit facility with Capco Financial Company, a division of Greater Bay Bank N.A., for a further one-year term. The amount available for borrowing from time to time under the revolving line of credit is dependent upon the levels of our accounts receivable and inventory. Borrowings under the credit facility bear interest at prime plus 0.5% per annum (8.25% at March 31, 2007). As of March 31, 2007, we had no borrowings outstanding. As of March 31, 2007, $4,733 included in cash and cash equivalents is subject to a one-day hold with Capco to allow for the application of funds.

As of March 31, 2007, we had working capital of approximately $40,718,000 compared to working capital of $39,474,000 as of December 31, 2006. There was no material change in working capital from December 31, 2006.

We expect cash flows from operations, cash, cash equivalents, short-term investments and our revolving line of credit will provide sufficient liquidity to meet our foreseeable cash requirements for operations, planned capital expenditures and slotting fees for at least the next twelve months.

Accounts receivable decreased from December 31, 2006 to March 31, 2007 from $6,914,000 to $5,638,000 was due principally to increased collections of receivables at year-end. Similarly, accounts payable decreased from December 31, 2006 to March 31, 2007 from $5,447,000 to $4,233,000 due principally to payment of outstanding invoices from year-end.

During the quarter ended March 31, 2007, we had commitments to invest approximately $1,500,000 in co-packing equipment and commitments to purchase approximately $1,445,000 of pure cane sugar and approximately $900,000 of glass bottles.

We have no off-balance sheet arrangements.

Seasonality

We have experienced significant fluctuations in quarterly results that have been the result of many factors. In particular, like many other companies in the beverage industry, we generate a substantial percentage of our revenues during the warm weather months of April through September. Management believes that the demand for our products will continue to reflect such seasonal consumption patterns. In addition, our operating results are highly dependent upon the performance of our independent distributors and retailers, as well as competition in the industry and general economic conditions.

Due to these and other factors, our results of operations have fluctuated from period to period. As a result, management believes that period-to-period comparisons of results of operations are not necessarily meaningful and should not be relied upon as any indication of future performance. While we look to expand our distribution network and increase market penetration, however, such seasonality may not be easily discernible from results of operations. Due to all of the foregoing factors, our operating results in a particular quarter may fail to meet market expectations.

Investor Relations

During the three months ended March 31, 2007, we conducted our investor relations activities with in-house personnel and with our investor relations consulting firm, Integrated Corporate Relations Inc. We sent out copies of news or press releases, corporate brochures, made presentations at investor conferences and held a quarterly investor conference call.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of our business, our financial position is routinely subject to a variety of risks. The principal market risks to which we are exposed are competition within the beverage industry and fluctuations in energy and commodity prices affecting the cost of raw materials and also the limited availability of certain raw materials and co-packer capacity. We are also subject to market risks with respect to the cost of commodities because of our ability to recover increased costs through higher pricing is limited by the competitive environment in which we operate. We are subject to foreign exchange risk due our sales and co-packing operations in Canada. We are also subject to other risks associated with the business environment in which we operate, including the collectibility of accounts receivable.

At March 31, 2007, the majority of our debt consisted of variable rate debt under our capital leases and we have no long-term debt. During the three months ended March 31, 2007, we did not make any draws on our line of credit.

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ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our filings under the Securities Exchange Act of 1934 is (a) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (b) accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q and have determined that such disclosure controls and procedures are effective.

There has been no material change in our internal controls over financial reporting in connection with this evaluation that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

Please see the discussion under Risk Factors contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. In addition, our operating results may fluctuate due to a number of factors, including, but not limited to, the following:

the ability of our third party distributors to successfully promote and sell our products;

our ability to (i) develop and expand distribution channels, (ii) develop favorable arrangements with third party distributors of our products and (iii) minimize or reduce issues associated with engaging new distributors, including, but not limited to, transition costs and expenses and down time resulting from the initial deployment of our products in each new distributor s network;

sales of our cans through National Beverage Corp., including our ability to secure favorable listing arrangements with retailers, our ability to manage expenses of the roll-out, our ability to execute our marketing programs, market acceptance of our products, and the impact of the can expansion on our other distribution channels;

the seasonality of our sales;

our ability to develop, expand and implement our direct-to-retail sales channels and national retail accounts, as well as our myjones programs;

our ability to increase distribution in our four core regions consisting of the Northwest, the Southwest, the Midwest and Western Canada, and our ability to expand and manage distributor growth in areas outside of the core regions;

unilateral decisions by distributors, grocery store chains, specialty chain stores, club stores, mass merchandisers and other customers to discontinue carrying all or any of our products that they are carrying at any time;

competitive products and pricing pressures and our ability to gain or maintain share of sales in the marketplace as a result of actions by competitors;

our ability to manage our operating expenses to sufficiently support general operating activities, promotion and sales activities, and capital expansion, and our ability to sustain profitability;

our ability to develop and maintain favorable arrangements with third party packers and suppliers of our products;

our ability to effectively manage changes in key personnel and management;

our ability to develop and maintain brand awareness for our products;

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

costs of compliance with federal, state and provincial laws and regulations affecting our business;

changes in consumer tastes, preferences and demographic patterns;

changes in the cost and availability of raw materials and our ability to procure timely and adequate production of our products;

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

our ability to penetrate new markets;

the effectiveness of our advertising, marketing and promotional programs; and

adverse weather conditions, which could reduce demand for our products.

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ITEM 6. EXHIBITS

31.1 Certification of Peter van Stolk, Chief Executive Officer

31.2 Certification of Hassan N. Natha, Chief Financial Officer

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

32.2 Certification of Hassan N. Natha, Chief Financial Officer of Jones Soda Co., pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

May 10, 2007

JONES SODA CO.

By: /s/ Peter van Stolk
Peter M.van Stolk

President and Chief Executive Officer

(principal executive officer)

By: /s/ Hassan N. Natha
Hassan N. Natha

Chief Financial Officer

(principal financial and accounting officer)