JONES SODA CO
Form 10QSB
November 09, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the Quarterly Period Ended September 30, 2005

¨ **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	**91-1696175**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification Number)**
234 9th Avenue North	
Seattle, Washington 98109	**(206) 624-3357**
(Address of principal executive office)	**(Registrant s telephone number,**
	including area code)

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

As of September 30, 2005, the issuer had 21,591,596 shares of common stock outstanding.

Transitional Small Business Disclosure Format: Yes ¨ No x

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JONES SODA CO.

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EXPLANATORY NOTE

Unless otherwise indicated or the context otherwise requires, all references in this Report on Form 10-QSB 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-QSB 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. 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 historical results as well as those expressed in, anticipated or implied by these forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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 the results expressed in, 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 Other Factors that May Affect Operating Results as well as those discussed elsewhere in this Report, and the risks discussed in our most recently filed Annual Report on Form 10-KSB 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.

CURRENCY TRANSLATION

Unless otherwise stated, all dollar figures stated in this Report are in United States dollars. Our financial statements are reported in United States dollars.

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PART I. FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

JONES SODA CO. AND SUBSIDIARIES

Consolidated Balance Sheets

(Expressed in U.S. dollars)

September 30, 2005 with comparative figures for December 31, 2004

	September 30, 2005	December 31, 2004
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents (note 4)	$ 303,308	$ 333,533
Accounts receivable	3,513,839	2,834,882
Inventory (note 3)	4,931,303	3,550,595
Prepaid expenses	212,873	399,779
	8,961,323	7,118,789
Capital assets	715,903	682,439
Intangible assets	50,127	49,444
	$ 9,727,353	$ 7,850,672
Liabilities and Shareholders Equity		
Current liabilities:		
Bank indebtedness	$ 110,000	$ 480,285
Accounts payable and accrued liabilities	3,624,685	2,745,602
Current portion of capital lease obligations	115,948	63,549
Current portion of deferred revenue	52,273	50,000
	3,902,906	3,339,436
Capital lease obligations	115,882	113,509
Deferred revenue	12,500	50,000
Shareholders equity		
Common stock:		
Authorized: 100,000,000 common stock, no par value. Issued and outstanding: 21,591,596 common shares (2004 20,956,346)	12,420,808	11,780,996
Additional paid-in capital	764,622	758,877
Accumulated other comprehensive income	107,752	107,752
Deficit	(7,597,117)	(8,299,898)
	5,696,065	4,347,727

	$ 9,727,353	$ 7,850,672

See accompanying notes to interim consolidated financial statements

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JONES SODA CO. AND SUBSIDIARIES

Consolidated Statements of Operations

(Expressed in U.S. dollars)

(Unaudited)

Three months and nine months ended September 30, 2005 and 2004

	Three months ended September 30, 2005	Three months ended September 30, 2004	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Revenue	$ 8,900,692	$ 7,785,054	$ 24,759,677	$ 21,045,323
Cost of goods sold	5,807,208	5,068,073	16,366,799	13,765,735
Gross profit	3,093,484	2,716,981	8,392,878	7,279,588
Licensing Revenue	266,967		600,758	
Operating expenses:				
Promotion and selling	1,765,594	1,712,784	5,938,483	4,356,749
General and administrative	761,925	594,631	2,373,563	1,691,756
Non-cash stock compensation		4,939	5,745	14,780
	2,527,519	2,312,354	8,317,791	6,063,285
Earnings from operations	832,932	404,627	675,845	1,216,303
Other income (expense):				
Interest expense, net	4,398	1,907	16,098	8,905
Other income, net	17,752	1,723	43,034	38,416
	13,354	(184)	26,936	29,511
Earnings for the period	$ 846,286	$ 404,443	$ 702,781	$ 1,245,814
Earnings per share, basic	$ 0.04	$ 0.02	$ 0.03	$ 0.06
Earnings per share, diluted	0.04	0.02	0.03	0.06
Weighted average common stock, basic	21,491,906	20,747,761	21,347,209	20,483,068
Weighted average common stock, diluted	22,683,354	22,376,415	22,537,821	22,060,797

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

(Expressed in U.S. dollars)

Nine months ended September 30, 2005 (Unaudited)

Year ended December 31, 2004

	Common stock		Additional paid-in	Accumulated other comprehensive	Accumulated	Comprehensive	Total shareholders
	Number	Amount	capital	income (loss)	Income (deficit)	Income	equity
Balance, December 31, 2003	20,089,096	$ 11,178,475	$ 739,140	$ 107,752	$ (9,630,258)		$ 2,395,109
Options exercised	867,250	602,521					602,521
Stock-based compensation			19,737				19,737
Comprehensive Income:							
Earnings for the year					1,330,360	$ 1,330,360	1,330,360
Balance, December 31, 2004	20,956,346	11,780,996	758,877	107,752	(8,299,898)		4,347,727
Options exercised	635,250	639,812					639,812
Stock-based compensation			5,745				5,745
Comprehensive Income:							
Earnings for the period					702,781	$ 702,781	702,781
Balance, September 30,2005	21,591,596	$ 12,420,808	$ 764,622	$ 107,752	$ (7,597,117)		$ 5,696,065

See accompanying notes to interim consolidated financial statements.

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JONES SODA CO. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Expressed in U.S. dollars)

Nine months ended September 30, 2005 and 2004 (Unaudited)

	2005	2004
Cash flows from (used in) operating activities:		
Earnings for the period	$ 702,781	$ 1,245,814
Items not involving cash:		
Depreciation and amortization	171,599	143,902
Non-cash stock based compensation	5,745	14,780
Changes in assets and liabilities:		
Accounts receivable	(678,957)	(775,404)
Inventory	(1,380,708)	(1,159,523)
Prepaid expenses	186,906	(3,885)
Accounts payable and accrued liabilities	879,083	653,521
Net cash from (used in) operating activities	(113,551)	119,205
Cash flows used in investing activities:		
Purchase of capital assets	(180,965)	(144,545)
Purchase of intangible assets	(24,781)	(8,305)
Net cash used in investing activities	(205,746)	(152,850)
Cash flows from (used in) financing activities:		
Net repayment of bank indebtedness	(370,285)	
Net borrowing (repayment) of capital lease assets acquired	54,772	(40,763)
Deferred revenue	(35,227)	(37,500)
Proceeds from exercise of options	639,812	440,231
Net cash from financing activities	289,072	361,968
Net increase (decrease) in cash and cash equivalents	(30,225)	328,323
Cash and cash equivalents, beginning of period	333,533	315,988
Cash and cash equivalents, end of period	$ 303,308	$ 644,311
Supplemental disclosure of non-cash financing and investing activities:		
Stock-based compensation	$ 5,745	$ 14,780
Increase in capital lease obligation	118,741	156,899
Cash paid during the period:		
Interest payments	16,098	8,905

See accompanying notes to interim consolidated financial statements.

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JONES SODA CO. AND SUBSIDIARIES

Notes to Interim Consolidated Financial Statements

(Expressed in U.S. dollars)

Three months ended September 30, 2005 and 2004 (Unaudited)

1. Nature of operations:

Jones Soda Co. (the Company or Jones Soda) develops, produces, markets, and distributes alternative or new age beverages. The Company s main product lines include the brands: Jones Soda Co.®, Jones Naturals, a non-carbonated juice & tea drink, Jones Energy, a high energy drink, WhoopAss, a high energy drink and Jones Organics, a tea drink. Urban Juice and Soda Company Limited, the Company s predecessor, was incorporated in 1986 under the Company Act (British Columbia). The Company has 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:

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

The accompanying unaudited interim consolidated financial statements are prepared in accordance with United States generally accepted accounting principles but do not include all information and footnotes required by United States generally accepted accounting principles 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 year or for any other 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, 2004 included in the Company s annual report on Form 10-KSB.

(b) Use of estimates:

The preparation of financial statements in accordance with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Areas of significant estimate include the assessment of collectibility of accounts receivable, net realizable value of inventory, and valuation allowance against deferred income tax assets. Accordingly, actual results may differ from these estimates.

(c) Foreign currency translation:

All foreign exchange gains or losses, including those arising from translating the net monetary assets of the Company s Canadian operations to the Company s functional currency of US dollars, have been included in income. For the nine-month period ended September 30, 2005, the Company incurred a foreign exchange gain of $25,657 (2004 gain $38,416), which is classified in Other income in the Consolidated Statement of Operations.

(d) Cash and cash equivalents:

The Company considers all short-term investments with a term to maturity at purchase of three months or less to be cash equivalents.

(e) Inventory:

Inventory has been stated at the lower of cost and estimated net realizable value and includes adjustments for estimated obsolescence. Cost includes laid-down cost and is determined principally using actual cost on a first-in first-out basis. Inventory that is older than 12 months is considered to be obsolete and is expensed as part of cost of goods sold.

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(f) Capital assets:

Capital assets are recorded at cost and are depreciated on the declining balance basis over the estimated useful lives of the assets as follows:

Asset	Rate
Equipment	20% to 50%
Automobile and computers	30%
Equipment under capital lease	Lease term

(g) Intangible assets:

The Company s intangible assets include costs associated with attaining trademarks and patents for the Company s products and are amortized on a straight-line basis over 5 years.

(h) Impairment of long-lived assets and long-lived assets to be disposed of:

Long-lived assets, which include fixed assets and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(i) Revenue recognition:

Sales are recorded when title passes, which is when goods are received by the customer, and represent amounts realized net of provisions for sales returns, discounts and allowances which are recognized at the time of sale. The Company s sales arrangements are not subject to warranty. Cash received in advance of delivery is recorded as deferred revenue in the consolidated balance sheet.

Licensing revenue is recorded when confirmation of the sale to third parties is received from the customer, and represents amounts realized net of provisions for sales returns.

The Company recognizes sale of concentrate relating to licensing agreements, in accordance with EITF 99-19 on Reporting Revenue Gross as a Principal versus Net as an Agent . As a result, the sale of the concentrate and associated costs are recorded on a net basis. As concentrate is sold at cost, there is no impact on the Company s statement of operations.

For sales returns, the Company issues a credit note to the customer once it has obtained the returned goods. Discounts are offered to customers via promotional events. Discounts are recorded at the time of sale by issuing a credit note for the discount relating to the shipment.

Consideration given by the Company to a customer (including a reseller of the Company s products) is accounted for as a reduction of revenue when recognized in the Company s income statement. For the nine-month period ended September 30, 2005, revenue was reduced by $212,815 (2004 $251,797).

(j) Research and development:

Research and development costs, which consist primarily of product development costs, are expensed in the period incurred and are included in general and administrative expenses. For the nine-month period ended September 30, 2005, research and development costs were $32,596 (2004 nil).

(k) Stock-based compensation:

The Company accounts for its stock-based compensation arrangements with employees in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and related interpretations. As such, compensation expense under fixed plans is recorded on the date of grant only if the market value of the underlying stock at that date exceeds the exercise price.

SFAS No. 123, Accounting for Stock Based Compensation , requires entities that continue to apply the provisions of APB Opinion No. 25 for transactions with employees to provide pro forma earnings and pro forma

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earnings per share disclosures for employee stock option grants as if the fair-value-based method in SFAS No. 123 had been applied to these transactions.

The Company recognizes compensation expense for stock options, common stock and other equity instruments issued to non-employees for services received based upon the fair value of the equity instruments issued at the date of performance completion.

Under APB 25, compensation expense is measured as the excess, if any, of the market price of the underlying stock over the exercise price on the measurement date of the grant. Had stock compensation expense for grants to employees under the Company s stock option plan been determined based on the fair value methodology under SFAS 123, the Company s net earnings for the periods ended September 30, 2005 and 2004 are presented as follows:

	Three Months ended September 30		Nine Months ended September 30	
	2005	2004	2005	2004
Earnings for the period	$ 846,286	$ 404,443	$ 702,781	$ 1,245,814
Add: Stock-based employee compensation expense included in reported earnings		4,939	5,745	14,780
Deduct: Total stock-based employee compensation expenses determined under fair value method for all awards	(189,282)	(82,777)	(579,094)	(245,988)
Pro forma earnings	$ 657,004	$ 326,605	$ 129,432	$ 1,014,606
Earnings per share				
Basic - as reported	0.04	0.02	0.03	0.06
Basic - pro forma	0.03	0.01	0.01	0.05
Diluted - as reported	0.04	0.02	0.03	0.06
Diluted - pro forma	0.03	0.01	0.01	0.04

The comparative period expense figures for the three and nine months ended September 30, 2004 were reduced by $56,790 and $37,662, respectively, for an adjustment to the pro forma stock based compensation calculation.

The fair value of these options was estimated at the date of grant using the Black-Scholes option pricing model, which takes into account (1) the market price of the underlying stock at the grant date, (2) the exercise price, (3) an expected life ranging from one to five years, (4) 0% dividend yield, (5) a risk-free interest rate of 4.18% (2004 2.50% to 2.55%), and (6) an estimated volatility of 80% (2004 83%)

The weighted average fair value of options granted in the third quarter 2005 and 2004 was $2.26 and $1.80, respectively.

(l) Advertising:

The Company expenses advertising costs as incurred. During the nine-month period ended September 30, 2005, the Company incurred advertising costs of $3,968,922 (2004 - $2,175,679).

(m) Income taxes:

The Company follows the asset and liability method of accounting for income taxes. Under this method, current taxes are recognized for the estimated income taxes payable for the current period. Deferred income taxes are provided based on the estimated future tax effects of temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases as well as the benefits of losses available to be carried forward to future years for tax purposes.

Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets when it is not more likely than not that such deferred tax assets will be realized.

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(n) Earnings per share:

Basic earnings per share is computed using the weighted average number of common shares outstanding during the periods, excluding reacquired stock and common stock held in escrow that is subject to cancellation if certain criteria are not achieved. Diluted earnings per share is computed by adjusting the weighted average number of common shares by the effective net exercise or conversion of all dilutive securities.

(o) Comprehensive income:

SFAS No. 130, Reporting Comprehensive Income , establishes standards for reporting and disclosure of comprehensive income and its components in a full set of general-purpose financial statements. The Company discloses the comprehensive income in the Consolidated Statements of Shareholders Equity.

(p) Volume rebates from vendors:

The Company follows EITF 02-16 on Accounting by a Customer for Certain Consideration Received from a Vendor . As a result, consideration received by the Company from the vendor is accounted for as a reduction of cost of sales if sold or inventory if the associated product has yet to be sold. For the nine months ended September 30, 2005, the reduction against cost of goods sold was $99,579 (2004 nil).

(q) Recent accounting pronouncements:

In December 2004, the Financial Accounting Standards Board (FASB) issued revised Statement of Financial Accounting Standards No. 123 entitled Share Based Payment (FAS No. 123R). This revised statement addresses accounting for stock-based compensation and results in the fair value of all stock-based compensation arrangements, including options, being recognized as an expense in a company s financial statements as opposed to supplemental disclosure in the notes to financial statements. The revised Statement eliminates the ability to account for stock-based compensation transactions using APB Opinion No. 25. FAS No. 123R is effective for public entities that file as small business issuers as of the beginning of the first annual reporting period that begins after December 15, 2005. The Company is currently assessing the implications of FAS 123R to its consolidated financial statements.

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 151 entitled Inventory Costs an amendment of ARB No. 43, Chapter 4 (FAS No. 151). This statement amends the guidance in ARB No. 43 to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage. FAS No. 151 requires that these items be recognized as current period charges. The Company has adopted FAS No. 151 in the year ended December 31, 2004, which had no effect on our consolidated financial statements.

In December 2003, the FASB issued a revised Interpretation of FIN No. 46. FIN No. 46R, Consolidation of Variable Interest Entities clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements , to require consolidation of business entities under certain circumstances particularly with respect to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. To the extent that one party holds the majority of the residual risks or estimated returns of the variable interest entity, they are defined to be the primary beneficiary and are required to consolidate said entity, and is effective in the Company s 2004 fiscal year. Application of FIN 46R in 2004 did not impact the Company s financial position or results of operations.

(r) Comparative figures:

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

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3. Inventory:

	September 30 2005	December 31 2004
Finished goods	$ 3,348,906	$ 1,964,875
Raw materials	1,582,397	1,585,720
	$ 4,931,303	$ 3,550,595

4. Bank indebtedness:

On June 25, 2005, the Company s credit facility with Capco Financial Company, a division of Greater Bay Bank N.A, was renewed for a further one-year revolving line of credit of up to $5,000,000. The amount available for borrowing from time to time under the revolving line of credit is dependent upon the levels of certain accounts receivable and inventory of the Company. This revolving line of credit is secured by all of the Company s assets, including accounts receivable, inventory, trademarks and other intellectual property, and certain equipment. Borrowings under the credit facility bear interest at prime plus 0.5% per annum (7.25% at September 30, 2005). The credit facility does not impose any financial covenants. As of September 30, 2005, the Company had $110,000 outstanding under the line of credit, out of a total of $2,770,026 available for borrowing based on eligible accounts receivable and inventory at that time. In addition, as part of the agreement, all receivables collected are submitted to Capco as collateral on the line of credit, if no amounts are outstanding on the line of credit, the payments received by Capco are subject to a 1-day hold to allow for the application of funds. As of September 30, 2005, $35,208 included in cash and cash equivalents was subject to this 1-day hold.

5. Segmented information and export sales:

The Company operates in one industry segment, with operations in the United States, Canada, Guam, the United Kingdom and Bermuda. During the nine-month period ended September 30, 2005 sales in the United States were approximately $21,613,912 (2004 - $18,386,670), sales in Canada were approximately $3,056,331 (2004 - $2,588,593), and sales in Guam, the United Kingdom and Bermuda were approximately $89,434 (2004 $70,061).

6. Earnings per share:

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

	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
Earnings for the period	$ 846,286	$ 404,443	$ 702,781	$ 1,245,814
Weighted average number of common stock outstanding:				
Basic	21,491,906	20,747,761	21,347,209	20,483,068
Dilutive stock options	1,191,448	1,628,654	1,190,612	1,577,729

Diluted	22,683,354	22,376,415	22,537,821	22,060,797
Earnings per share:				
Basic	$ 0.04	$ 0.02	$ 0.03	$ 0.06
Diluted	$ 0.04	$ 0.02	$ 0.03	$ 0.06

7. Shareholders equity:

(a) Stock options:

In 1996, the Company adopted a stock option plan (the 1996 Plan) that provides for the issuance of incentive and non-qualified stock options to officers, directors, employees and consultants. In addition, in 2002 the Company adopted another stock option plan for the issuance of incentive and non-qualified stock options to officers, directors, employees and consultants (the 2002 Plan). (The 1996 Plan and 2002 Plan are collectively referred to as the Plans.)

The Board of Directors determines the terms and conditions of the options granted under the Plans, including the exercise price and vesting schedule. The exercise price for qualified incentive stock options cannot be less than the fair

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market value of the underlying stock at the date of grant, and the maximum term is five years from the date of grant. Options granted generally vest over a period of 18 months.

Where options issued after January 18, 2001 have an exercise price in currency that is not either the (a) functional currency of the Company or (b) the currency in which the employee is paid, the options are to be accounted for as variable plan options and compensation expense will be recorded equal to changes in the market value of the underlying common shares at each reporting period.

For the nine-month period ended September 30, 2005, the Company granted all options in US dollars. Included in general and administrative expenses for the nine-month period ended September 30, 2005 is stock-based compensation of $5,745 (2004 $14,780).

A summary of the Company s stock option activity is as follows:

	Outstanding options		
		Average exercise price	
	Number of shares	US	CDN
Balance at December 31, 2003	2,404,500	$ 0.58	$ 0.76
Option granted	560,500	2.39	2.88
Options exercised	(867,250)	(0.69)	(0.90)
Options cancelled	(65,500)	(0.44)	(0.54)
Balance at December 31, 2004	2,032,250	1.06	1.27
Option granted	613,500	4.00	4.67
Options exercised	(635,250)	(1.01)	(1.18)
Options cancelled	(160,750)	(3.13)	(3.65)
Balance at September 30, 2005	1,849,750	$ 1.89	$ 2.21

The following table summarizes information about stock options outstanding and exercisable under the Plans at September 30, 2005:

			Weighted average exercise price			Weighted average exercise prices	
Range of exercise	Number outstanding	Weighted average remaining contractual life (years)	US	CDN	Number exercisable	US	CDN
$0.70 to $0.86	161,500	0.54	$ 0.76	$ 0.89	161,500	$ 0.76	$ 0.89
$0.25 to $0.50	732,000	2.00	0.41	0.47	732,000	0.41	0.47
$1.10 to $2.99	402,250	3.25	2.10	2.45	402,250	2.10	2.45

$3.00 to $4.00	508,625	4.06	3.95	4.61	262,313	3.93	4.59
$4.01 to $5.01	45,375	4.86	5.01	5.85	12,750	5.01	5.85
	1,849,750		$ 1.89	$ 2.21	1,570,813	$ 1.50	$ 1.75

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

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 alternative or New Age beverages. We currently produce, market and distribute five unique beverage brands:

Jones Soda Co.®, a premium soda;

Jones Naturals , a non-carbonated juice & tea;

Jones Energy , a citrus energy drink; and

WhoopAss , a citrus energy drink; and

Jones Organics , an organic tea.

We currently sell and distribute our products primarily in 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.

With respect to our distributors (DSD), during the past two years, 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 U.S. Northwest, U.S. Southwest, U.S. Midwest and Western Canada. In 2004 and 2005, we continued to focus on our four core markets, although in certain limited instances we re-expanded into the U.S. Northeast, U.S. Southeast and Eastern Canada. In addition, in the fourth quarter of 2004, we added sales personnel in Eastern Canada and the U.S. Northeast.

We launched our direct to retail (DTR) 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, and which are serviced by the retailer s appointed distribution system. During 2003, we entered into distribution arrangements with Barnes & Noble, Panera Bread Company and Cost Plus World Markets to carry certain of our products in their stores nationwide in the United States. In March 2004 we entered into a distribution arrangement with Starbucks Coffee Company for two flavors of our Jones Soda product to be carried in all of its stores in the United States. This distribution arrangement with Starbucks in the United States was in addition to our existing arrangement for their stores in Canada that has been in place since 1999. As well in October, 2004, in addition to our licensing arrangement with Target Corporation for our 12-ounce cans (described below), we added Target to our DTR accounts and began selling Jones Soda (in 12-ounce bottles) and Jones Energy (in our 8.4 ounce four-pack format) to Target for distribution through their stores in the United States.

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. In July 2004, we entered into a two-year licensing and distribution agreement with Target Corporation which provides Target with the exclusive rights in the United States to market and sell 12-ounce cans of Jones Soda. We launched our 12-ounce cans in a fridge pack format into Target Corporation in October 2004, and under this licensing arrangement Target arranges for the production of our product under license from us, and we receive royalty payments from Target based on case sales throughout the chain. In September 2004, we entered into an agreement with Lime-Lite Marketing Corporation to manufacture and distribute Jones Soda lip balms. In March 2005, we announced a licensing and distribution agreement with The Kroger Corporation, providing Kroger exclusive rights to manufacture and distribute Jones Soda Frozen Pops through all Kroger and Kroger affiliated grocery stores in the United States. As well, in September 2005, we entered into an agreement with Big Sky Brands, Inc., to manufacture and distribute Jones Soda flavor booster candy.

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. 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.

Revenue Recognition

Our products are sold to distributors and 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 the sale confirmation from the third party is received by the company, and represents amounts realized net of provisions for sales returns. We recognize sale of concentrate relating to the licensing agreements, and as a result, the sale of concentrate and associated costs are recorded on a net basis resulting in no impact to our statement of operations.

We also pay lump sum slotting fees to certain of our retailers for shelf space in their stores. Effective January 1, 2002, these slotting fees have been recorded as a reduction of revenue which resulted in a reduction in revenue for the nine-month period ended September 30, 2005 of $212,815 (2004 - $251,797). We amortize the lump sum payment over a 1-year 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

Our management must estimate the collectibility of our accounts receivable. Management analyzes accounts receivable and analyzes 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 60 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. To date, other than as a result of specific customer bankruptcies in 2001, we have not incurred material write offs of accounts receivable. 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

At December 31, 2004, we had net operating loss carryforwards for federal income tax purposes of approximately $5,658,000 in the U.S., which are available to offset future federal taxable income, if any. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the 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. As of September 30, 2005, we do not believe we meet the criteria to recognize the deferred tax asset, and we have accordingly provided a full valuation allowance.

Results of Operations for the Three and Nine Months Ended September 30, 2005

Revenue

	Three Months Ended September 30			Nine Months Ended September 30		
(Dollars in Thousands)	**2005**	**2004**	**Change**	**2005**	**2004**	**Change**
Revenue	$ 8,901	$ 7,785	14.3%	$ 24,760	$ 21,045	17.7%

For the three months ended September 30, 2005, revenues were approximately $8,901,000, an increase of $1,116,000, or 14.3% over the $7,785,000 in revenues for the three months ended September 30, 2004. As described in greater detail below, the increase in revenues in the third quarter of 2005 over the comparable period of 2004 was primarily attributable to higher case sales of Jones Soda, Jones Energy and Jones Naturals, a higher overall per case selling price, as well as new case sales for the third quarter of 2005 of Jones Organics, all partially offset by a decrease in case sales of Whoopass. The increase in revenue for the nine-month period over the comparable period of 2004 was primarily attributable to higher case sales of Jones Soda and Jones Energy, a higher overall per case selling price, as well as new case sales for the nine-month period of 2005 of Jones Organics, all partially offset by a decrease in case sales of Jones Naturals and Whoopass. For the nine-month period ended September 30, 2005, revenues were approximately $24,760,000, an increase of $3,715,000, or 17.7% over the $21,045,000 in revenues for the nine-month period ended September 30, 2004.

The overall increase in revenues between the comparable third quarters was due primarily to increased case sales of Jones Soda through our distributor (DSD) network in our core markets of the Midwest, Southwest and Western Canada, as well as in our non-core markets of the Northeast and Eastern Canada. Case sale increases occurred in these markets due to either the addition of new chain accounts and/or new distributor coverage within the territory. The overall increase in revenues between the comparable periods also reflects our launch of Jones Organics to select distributor markets in the period, namely in the Southwest and Northeast. The increased case sales in the majority of our markets more than offset a decrease in case sales in our Northwest and Southeastern market between the comparable quarters. The decrease in case sales in our Northwest market was due to decreases in Jones Energy, Whoopass and Jones Naturals offset by an increase in our Jones Soda product. The decrease in the 3 product platforms, and not our Jones Soda brand, was due to the competition within those particular product categories, namely energy drinks and non-carbonated juices and teas, with particular focus being placed on these competitive product categories by our Northwest distributor. The decline in case sales in the

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Southeastern region was due primarily to the loss of sales to a chain account which we sold to in the comparable quarter of 2004.

The increase in revenues was also due to our strategy of adding certain national accounts as part of our DTR strategy. In September 2004, we added Target as a DTR account (Jones Soda 12 ounce bottles and Jones Energy 8.4 ounce) in the U.S. During the three and nine months ended September 30, 2005, we also had increased revenues over the comparable periods of 2004 from our other DTR accounts such as Panera Bread Company (Jones Soda and Jones Naturals), Starbucks (Jones Soda) and Barnes & Noble (Jones Naturals).

Revenues for the three and nine months ended September 30, 2005 also reflect certain increased selling prices on Jones Soda implemented in February 2005 to our distributor network.

Consolidated case sales for the three months ended September 30, 2005 were 678,000, an increase of 12.0% from case sales of 605,000 for the three months ended September 30, 2004. The increase in case sales between comparable three-month periods reflects higher case sales of Jones Soda (up 11.3% from the same period of 2004), higher case sales of Jones Energy, combined 16 ounce and 8.4 ounce (up 10.0% from the same period of 2004), higher case sales of Jones Naturals (up 7.4% from the same period of 2004), and new case sales of Jones Organics. The increase in case sales of Jones Soda, Jones Energy, Jones Naturals and Jones Organics more than offset decreased case sales for Whoopass, combined 16 ounce and 8.4 ounce (down 10.7% from the same period of 2004). Consolidated case sales for the nine months ended September 30, 2005 were 1,881,000, an increase of 14.8% from case sales of 1,638,000 for the nine months ended September 30, 2004. Consolidated case sales do not include sales of our 12-ounce can fridge pack through our licensing arrangement with Target, which are reflected under licensing revenue.

Case sales in the beverage industry are generally compared on a 288-ounce equivalent basis. Consolidated case sales for the three months ended September 30, 2005, with a translation to 288-ounce equivalent case sales were approximately 709,000, an increase of 10.6% from 288-ounce equivalent case sales for the three months ended September 30, 2004 of approximately 641,000. Consolidated case sales for the nine months ended September 30, 2005, with a translation to 288 ounce equivalent case sales were approximately 1,967,000, an increase of 12.7% from 288-ounce equivalent case sales for the nine months ended September 30, 2004 of approximately 1,746,000.

Gross Profit

	Three Months Ended September 30			Nine Months Ended September 30		
(Dollars in Thousands)	**2005**	**2004**	**Change**	**2005**	**2004**	**Change**
Gross profit	$ 3,093	$ 2,717	13.8%	$ 8,393	$ 7,280	15.3%
Percentage of revenue	34.8%	34.9%		33.9%	34.6%	

For the three and nine-month periods ended September 30, 2005, gross profit before licensing revenue was approximately $3,093,000 and $8,393,000 respectively. Gross profit increased by approximately $376,000 or 13.8% over the $2,717,000 in gross profit for the three months ended September 30, 2004, and $1,113,000 or 15.3% over the $7,280,000 in gross profit for the nine months ended September 30, 2004. For the three-month period ended September 30, 2005, gross profit as a percentage of revenue (before licensing revenue) was 34.8% and compared to 34.9% for the three-month period ended September 30, 2004. For the nine-month period ended September 30, 2005, gross profit as a percentage of revenue (before licensing revenue) decreased to 33.9% from 34.6% for the nine-month period ended September 30, 2004. The increase in gross profit was primarily attributable to increased revenues, partially offset by a slightly overall lower gross margin. The decrease in gross profit as a percentage of revenue for the nine-month period was attributable to a higher cost of product on Jones Soda and Jones Naturals primarily due to higher freight and fuel costs and strengthening of the Canadian dollar year over year. Despite increased fuel costs, during the third quarter of 2005 we maintained relatively flat overall freight costs on a per case basis, due in part to our use of six freight suppliers compared to one such carrier in 2004, as well as setting up smaller hub warehouse locations for delivery to our DTR accounts. We have experienced higher co-packing costs in Canada due to the strengthening of the Canadian dollar against the U.S. dollar in 2004 and in an effort to mitigate the impact of a rising Canadian dollar, 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 2004. In February 2005, we implemented a minimal price increase on our Jones Soda product to our DSD network in an attempt to assist in offsetting these rising costs. In addition, we have taken advantage of early payment discounts offered by our suppliers to also assist us in reducing our cost of goods.

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Licensing Revenue

(Dollars in Thousands)	Three Months Ended September 30 2005	Three Months Ended September 30 2004	Change	Nine Months Ended September 30 2005	Nine Months Ended September 30 2004	Change
Licensing revenue	$ 267	$ 0	n/a	$ 601	$ 0	n/a

For the three and nine months ended September 30, 2005, we received licensing revenue of approximately $267,000 and $601,000 respectively. We did not have comparable revenue in the three and nine months ended September 30, 2004. For the third quarter of 2005, the substantial majority of our licensing revenue was derived from our licensing and distribution arrangements with Target Corporation (12-ounce can fridge pack and our Halloween 8-ounce can program), and to a lesser extent from The Kroger Corporation (Jones Soda Frozen Pops). Licensing revenue for the nine months ended September 30, 2005 also included revenues from our licensing and distribution arrangement with Lime-Lite Marketing Corporation (Jones Soda lip balms).

Total Operating Expenses

(Dollars in Thousands)	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Change	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Change
Promotion and selling	$ 1,766	$ 1,713	3.1%	$ 5,938	$ 4,357	36.3%
General and administrative	$ 762	$ 599	27.2%	$ 2,380	$ 1,706	39.5%
Total operating expenses	$ 2,528	$ 2,312	9.3%	$ 8,318	$ 6,063	37.2%
Percentage of revenue (excluding licensing revenue)	28.4%	29.7%		33.6%	28.8%	

Total operating expenses for the three and nine-month periods ended September 30, 2005 were approximately $2,528,000 and $8,318,000 respectively. Total operating expenses increased by $216,000, or 9.3%, over operating expenses of $2,312,000 for the three months ended September 30, 2004, and increased by $2,255,000, or 37.2%, over operating expenses of $6,063,000 for the nine months ended September 30, 2004. For the three month period ended September 30, 2005, operating expenses as a percentage of revenue (excluding licensing revenue) decreased to 28.4% from 29.7% over the comparable period in 2004. For the nine-month period ended September 30, 2005, total operating expenses as a percentage of revenue (excluding licensing revenue) increased to 33.6% from 28.8% over the comparable period in 2004. The increase in total operating expenses in absolute dollars was primarily attributable to an increase in general and administrative expenses as well as to an increase in promotion and selling expenses both for the three and nine-month periods.

Promotion and Selling Expenses

	Three Months Ended September 30	Nine Months Ended September 30

(Dollars in Thousands)	**2005**	**2004**	**Change**	**2005**	**2004**	**Change**
Promotion and selling	$ 1,766	$ 1,713	3.1%	$ 5,938	$ 4,357	36.3%
Percentage of revenue (excluding licensing revenue)	19.8%	22.0%		24.0%	20.7%	

Promotion and selling expenses for the three and nine-month periods ended September 30, 2005 were approximately $1,766,000 and $5,938,000, respectively. Promotion and selling expenses increased by $53,000, or 3.1%, over promotion and selling expenses of $1,713,000 for the three months ended September 30, 2004, and increased by $1,581,000, or 36.3%, over promotion and selling expenses of $4,357,000 for the nine months ended September 30, 2004. Promotion and selling

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expenses as a percentage of revenue (excluding licensing revenue) decreased to 19.8% for the three months ended September 30, 2005 from 22.0% over the comparable period in 2004. Promotion and selling expenses as a percentage of revenue (excluding licensing revenue) increased to 24.0% for the nine months ended September 30, 2004 from 20.7% over the comparable period in 2004. The small increase in promotion and selling expenses for the three-month period was primarily attributable to an increase in trade marketing expenses due to the variable nature of distributor programming and higher case sales for the third quarter of 2005, as well as our DTR vendor trade shows occurring in the third quarter of 2005 (whereas in 2004 our DTR vendor trade shows took place in the second quarter), partially offset by a lower per case spending amount on our DSD business. Also, our promotion and selling expenses for the third quarter last year included expenses associated with launching our Target account. Expenses for the nine-month period including a sampling program in June 2005 for our new 12 ounce Jones Soda can at Target Corporation, and an overall increase in trade marketing expenses during primarily the first half of 2005, including a buyout payment of one of our distributors. Another factor for the increase in promotion and selling expenses for the nine-month period was an increase in salaries and wages and other sales team expenses associated with our expanding sales force. At September 30, 2005, we had 29 employees in sales and marketing compared to 23 such employees at the end of the third quarter of 2004. Other promotion and selling expenses in the first nine months of 2005 include increased expenses associated with our corporate marketing, including specific event sponsorships, that occurred in June 2005, including our sponsorship for the Zumiez Couch Tour as well as launch and development costs associated with our new product, Jones Organics and the launch of the Jones Soda Frozen Pops in the Kroger chain.

General and Administrative Expenses

	Three Months Ended September 30			Nine Months Ended September 30,		
(Dollars in Thousands)	**2005**	**2004**	**Change**	**2005**	**2004**	**Change**
General and administrative	$ 762	$ 599	27.2%	$ 2,380	$ 1,706	39.5%
Percentage of revenue (excluding licensing revenue)	8.6%	7.7%		9.6%	8.1%	

General and administrative expenses for the three- and nine-month periods ended September 30, 2005 were approximately $762,000 and $2,380,000, respectively, compared to $599,000 and $1,706,000 for comparable periods in 2004. General and administrative expenses increased by $163,000 or 27.2% for the three months ended September 30, 2005, and $674,000 or 39.5% for the nine months ended September 30, 2005. General and administrative expenses as a percentage of revenue (excluding licensing revenue) increased to 8.6% for the three months ended September 30, 2005 from 7.7% over the comparable period in 2004. General and administrative expenses as a percentage of revenue (excluding licensing revenue) increased to 9.6% for the nine months ended September 30, 2005 from 8.1% over the comparable period in 2004. The increase in general and administrative expenses in absolute dollars is primarily due to an increase accounting fees (including compliance with the Sarbanes-Oxley Act requirements), an increase in insurance and tax expenses, higher bad debt expense and higher legal and shareholder expenses.

Other Income (Expense)

Other income for the three-month period ended September 30, 2005 was approximately $13,000 and other income for the nine-month period ended September 30, 2005 was $27,000. For the three-month period of 2005 other income was primarily capital equipment rental income, and for the nine-month period other income was primarily a foreign exchange gain. This compared to other expense of $(184) for the three-month period ended September 30, 2004 and other income of $30,000 for the nine-month period ended September 30, 2004.

Net Income

Net income for the three and nine-month periods ended September 30, 2005 was approximately $846,000 and $703,000, respectively, compared to a net income of $404,000 and $1,246,000 for the respective comparable periods in 2004. The increase in net income for the comparable three-month period was due primarily to an increase in gross profit and new licensing revenue, with a small increase in total expenses. The decrease in net income for the comparable nine-month period was due primarily to an increase in gross profit and new licensing revenue, more than offset by a higher increase in total expenses, primarily in the first six months of 2005.

Liquidity and Capital Resources

Our operations historically have primarily been funded through the issuance of common stock and external borrowings.

As of September 30, 2005, we had working capital of approximately $5,058,000 compared to working capital of $3,779,000 as of December 31, 2004. The increase in working capital was primarily attributable to increased accounts receivable (as a result of increases in sales and increased number of days in our accounts receivable turnover) and increased inventory, more than offsetting increases in accounts payable. The increase in inventory for the period ended September 30, 2005 was due to the build-up of inventory for seasonal inventory, namely our Holiday Packs, as well as overall higher inventory levels, a result of an increase in the number of our co-packing plants and an increased number of product lines and SKUs within the product lines.

On June 25, 2005, we renewed our credit facility with Capco Financial Company, a division of Greater Bay Bank N.A., consisting of a one-year revolving line of credit for an increased amount of up to $5,000,000. The amount available for borrowing from time to time under the new revolving line of credit is dependent upon the levels of certain eligible accounts receivable and inventory. This revolving line of credit is secured by all of our assets, including accounts receivable, inventory, trademarks and other intellectual property, and certain equipment. Borrowings under the credit facility bear interest at the prime rate plus 0.5% per annum (7.25% as of September 30, 2005). The credit facility does not impose any financial covenants. As of September 30, 2005, we had $110,000 outstanding under the line of credit, out of a total of $2,770,026 available for borrowing based on eligible accounts receivable and inventory at that time.

Cash and cash equivalents were approximately $303,000 as of September 30, 2005 compared to approximately $334,000 as of December 31, 2004. Net cash used in operating activities was approximately $114,000 for the nine months ended September 30, 2005 primarily due to an increase in the levels of our finished goods inventory to ramp up for orders planned for the fourth quarter, due to Holiday Packs and increased SKUs, partially offset by positive cash flows from operations. Our use of cash in operating activities also included prepayment on some of our accounts payable entitling us to early-payment discounts from some suppliers. We used $206,000 in investing activities for the nine months ended September 30, 2005, primarily for the purchase of certain equipment for one of our co-packers to ensure a dedicated line for our product and secondarily for the registration of certain trademarks. Cash flow from financing activities was $289,000 for the nine months ended September 30, 2005 and consisted primarily of the proceeds from the exercise of stock options and secondarily from proceeds for capital leases obtained on the co-packing equipment, partially offset by repayment on our line of credit.

We do not have any current material commitments for capital expenditures aside from existing capital lease obligations.

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 dependent upon the performance of our independent distributors, 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 September 30, 2005, we completed all investor relations activities in-house. We sent out copies of news or press releases, our corporate brochure, and communicated to shareholders with a monthly newsletter and a quarterly investor conference call.

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Other Factors that May Affect Operating Results

Our operating results may fluctuate due to a number of factors, including, but not limited to:

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;

our ability to develop and implement our direct-to-retail sales channels and national retail accounts, as well as our yourjones and 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 generate sufficient cash flows to support general operating activities, promotion and sales activities, and capital expansion, and our ability to sustain profitability;

the availability of financing, whether on terms acceptable to us or at all, including the terms and availability of our credit facility and the actions of our creditors;

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 or management;

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

our success in introducing new products to the market, including in managing the development and launch costs associated with such new products, 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 3. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer/Chief Operating Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer/Chief Operating Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

During the most recent fiscal quarter, there have been no significant changes in our internal controls or in other factors that have materially affected, or are reasonably likely to materially affect our internal controls.

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PART II. OTHER INFORMATION

ITEM 6. EXHIBITS

31.1	Certification of Peter van Stolk, Chief Executive Officer
31.2	Certification of Jennifer L. Cue, Chief Financial Officer and Chief Operating 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 Jennifer L. Cue, Chief Financial Officer and Chief Operating 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.

November 9, 2005

JONES SODA CO.

By: /s/ Peter van Stolk
Peter van Stolk
President and Chief Executive Officer
(principal executive officer)

By: /s/ Jennifer L. Cue
Jennifer L. Cue
Chief Financial Officer and Chief Operating Officer
(principal financial and accounting officer)