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PENNY SLEUTH SPECIAL REPORT INVESTMENT OPPORTUNITIES WITH BEVERAGE STOCKS

Beverage Stock Investment Opportunities: Profit from Soda Stocks

By Greg Guenther, Editor Penny Stock Fortunes and Penny Sleuth

There's a new trend in the beverage industry. More and more consumers are moving away from traditional soft drinks like Coca-Cola to healthier alternative drinks.

But Coke executives aren't just going to stand by as their market share erodes. In May, the soda giant paid more than \$4.1 billion for Glaceau, maker of the newly popular drink vitaminwater. It's the company's largest acquisition to date.

So it's no surprise that I have been working to uncover several new investment ideas within the alternative beverage industry. Look no further than relative newcomers Jones Soda and Hansen Natural. The former is a small cap, and the latter is a bit bigger, with a \$3.5 billion market cap.

And there's one tiny natural soda company that's just come on the market that we've had our eyes on. It's much too small and illiquid to even recommend to you, but we felt this was still a relevant story on an important industry...

Beverage Stock -The Penny Stock Soda Revolution

This is one of the only hippies I'd hand \$1 million over to, let alone \$8 million...He eschewed private equity guys and declined venture capital offers.

This is no average hippie. In fact, he's not even your average small-business entrepreneur. How many people can figure out on their own how to raise \$400,000 from a small corporate offering registration and then do an IPO of a then-19-year-old gourmet soda business?

Well, Chris Reed can.

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-Bruce Robertson, Director Marketing

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He's the self-labeled hippie and natural health fanatic behind **Reed's Inc. (REED:OTCBB)**. The company is best known for producing arguably the best ginger-brewed sodas in the world.

It's leveraged the ginger niche into sodas featuring six different ginger flavors, along with ginger ice

cream and candy. But with the rising levels of childhood obesity and Americans on health kicks, isn't the soda business one to avoid? Yes and no...

It's actually been a very good time to hold shares in giant-cap Coca-Cola. The soda-producing Buffett mainstay has been performing beautifully lately. First-quarter 2007 results were just released, with earnings beating what Wall Street had modeled and sales outdoing first quarter of last year.

Prev Close:	7.65
Open:	7.60
Bid:	7.10 x 500
Ask:	7.25 x 500
Target Price	\$10.00
Day's Range:	7.10-7.65
52-wk Range:	7.33-8.65
Volume:	26,838
Avg Vol (3m):	16,033.3
Market Cap:	51.79M
P/E (ttm):	N/A
EPS (ttm):	-0.41
Div & Yield:	N/A (N/A)

Give the credit to new products like Coke Zero and international markets.

But there's a black cloud hanging over Coke.

It's declining soda sales in North America. In fact, this year's first quarter brought a 3% drop in soda revenue in this key market, and fingers are being pointed at Americans' tastes running toward healthier alternatives like bottled waters, drinks with vitamins and traditional hot beverages.

Coke has warned that sales for the rest of this year will probably not reflect any major turnaround just yet in North America.

But for small-cap investors, there are ways to play soda stocks and ways to profit from the companies that are giving Coke some headaches...

Beverage Stock -Gourmet Soda: The New Giant-Killer and Savior

So-called "gourmet soda" growth is the story here. A few years ago, you could only buy Jones Soda products at record stores, surf shops and tattoo parlors. Now this maker of so-called "alternative" sodas with pure cane sugar has bottles in Starbucks, Target and 7-Eleven. The packaging is pretty distinctive - customers send in personal photos to Jones, and the best get printed on the soda labels.

Hansen markets itself as a natural soda maker and also markets bottled smoothies and various energy drinks. The company dates back to the 1930s, when the Hansen family was a juice supplier to the Hollywood film industry.

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What these two companies have in common financially, though, is tremendous top- and bottom-line growth. Jones has averaged 20% revenue growth for the past seven years, with earnings making the turn to the plus side in 2003, and posted 254% net income growth just last year. All the while, Jones has been consistently expanding margins, as well. Bigger brother Hansen has been even more impressive. Sales have grown an average of 31% over the last seven years, with last year posting a 94% jump. But that wouldn't be impressive without a jump in profitability...and Hansen hasn't disappointed. Earnings have grown an average 53% for the last seven years.

The Beverage Marketing Corp. has the carbonated soda pop business pegged at \$65.9 billion in total annual sales last year. But traditional soda growth has been spotty and lackluster for many years this decade.

While Jones' and Hansen's products are called "sodas" and are definitely competing for Coke and Pepsi consumer dollars, industry insiders refer to these niche drink companies as "New Age beverages." And this segment hasn't been sliding in recent years. The most recent data we have show that this is an almost \$17 billion industry at the wholesale level, and growing.

Investors have noticed, too. Jones is up 103% in just the last two months alone. Hansen is up 281% since June 2005.

Beverage Stock -Reed's Is Set to Be the Next Big Soda Performer

While Reed's is trading at close to double its IPO price from January 2007, there is still growth left to come from what is considered a sexy penny stock with good fundamentals.

Sodas are still the biggest segment in the entire beverage industry. And of course, the old giants in the business are still the giants: Coca-Cola and Pepsi are clearly still at the top, followed by Cadbury Schweppes and the lower-profile Cott and National Beverage.

Today, we enter the niche soda producers. They're smaller and have focused product portfolios. They convey exclusivity, and while typical sodas compete on price, the niche category is not afraid to put a premium-priced product into the channel. This is an exercise in psychographic pricing, in which you may or may not actually get value for your soda-paying dollar.

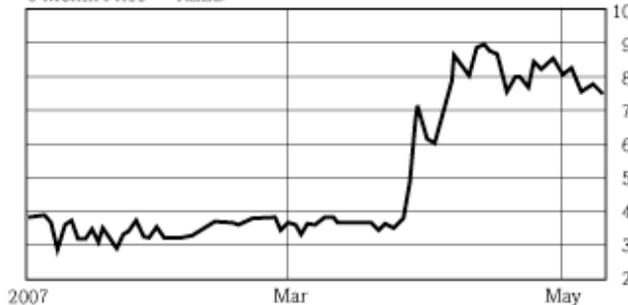
In the case of Reed's, it plays on history, as brewed drinks, like the brewed ginger drinks, were around well before sodas existed. It also plays upon the health benefits of ginger, an angle most mainstream soda players don't even touch. In fact, playing up the health benefits of products people intuitively feel are unhealthy is working well for several companies of late. Hershey's, for example, has been marketing its dark chocolates as potent antioxidants.

growing companies!

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It Took 3 Months, but REED Has Reached More Than a 100% Return

6 Month Price — REED



It's Chris Reed's passion for natural health that led him to ginger. The former chemical engineer was taken by ginger's ability to remedy motion sickness and its anti-cancer properties. But none of the ale on the market was actually made with real ginger. So Reed set off to brew his own.

In the late 1980s, Chris Reed rented out space at a small brewery and made a small batch of ginger beer. He bottled the concoction himself with a funnel, and even glued his own labels that read "Reed's Ginger Brew." He then hit the streets, where he peddled his product to local grocery stores and cafes. Little did he know his small venture would turn into a fiercely growing \$55-million enterprise.

Within a couple of hours, all of the stores had sold out. After 18 months, Reed's Ginger Brew became a national brand.

Beverage Stock *-A Price Run That Will Continue*

Reed's has been public only since January of this year, so we have limited trading data to go on as far as liquidity. This \$55-million company is currently trading at about \$8.50 per share. Volume so far today has been about 22,000, and average volume numbers for the last three months have yet to be posted. Its spread is not terrible - no 18-wheelers will fit through this one, fortunately. It's about 24 cents at the moment.

The company's rapid growth should continue, as well. Reed's Ginger Brew is outselling natural soda leader Hansen at Whole Foods, Trader Joe's and Wild Oats stores. And believe it or not, this has all been possible, for the most part, through organic growth.

For the first 15-plus years of its existence, Chris Reed allowed his soda company to grow passively. Store reps would approach him at trade shows, or distributors would seek him out for new deals. His ginger brews had a growing cult following, so he let the business come to him.

However, now that the firm has gone public, Chris Reed is looking to take a more active approach to growing the brew business. He's seeking out new deals with major supermarkets and other mainstream stores. And you can bet that when he does land his brews in some of the bigger chains, it's going to have a major impact on the bottom line.

Beverage Stock *-Is It Worth Double the IPO Price?*

IPOs are typically priced about 18% below their intrinsic values. At least that's what the market tells us about 24 hours after new issues are priced and begin trading. We've all seen it - most of the time when a new offering goes public, its shares shoot through the roof.

Sixteen percent of IPOs don't jump at all on the first day. REED was pretty much one of those...However, the company has since become a media darling, and the stock has rocketed. Don't get scared of the run-up. And don't anchor yourself to the bygone days of \$4 a share.

Hansen started trading over the counter on Nov. 8, 1990, before moving to the Nasdaq. Jones has been trading OTC since 2000 and on the Nasdaq since November 2005. Both provide good bases for comparison for REED.

Don't be misled into thinking that since these companies have been around for so long that they're not in an initial growth phase. Beverage companies like these can be making respectable sums and growing furtively without much notice, but when they go public, it's well and truly "off to the races" time.

Let's take Hansen ([HANS](#)). This one ticks off all the boxes for being in initial growth mode, despite its roots being established in the 1930s. Earnings growth is very high: 214% in 2004 and 199% in 2005, to be exact. Capital investment is higher than it has been in previous years. Profit margins, in the 17% range, are much higher than the paltry 3% net margins we saw as recently as 2003. Free cash flow right now is negative, not so much from capital expenditures as from high-dollar acquisitions. Return on equity is high, greater than the stock's required rate of return. Dividend payout is zilch. All of these factors are

stereotypical for an initial-growth-stage company.

Jones Soda ([JSDA](#)) - same thing across the board, but the size of this company is much more in line with Reed's. These two companies make interesting comparisons for Reed's.

They are clearly the models for our ginger company, and Reed's should follow along a similar path.

But let's face it. This is a risky proposition. "Speculative" should be the operative word for Reed's. It's a great business with a great portfolio of products, no doubt, but it's got a little over a million-and-a-half bucks in cash in the company coffers. And at the current rate, it is being burned at about \$250,000 each quarter, so there's not much cushion here, and it's our biggest risk. That's about six quarters in cash left, if the company doesn't accelerate the burn rate. At the end of 2006, Reed's had \$1.4 million in borrowings, and it has the ability to borrow a total of about \$2 million under currently negotiated lines.

Assuming additional financing is tapped into and/or cash flow levels surpass our estimates for the next two years, we've modeled a consistent turn to profitability by 2009. And our discounted cash flow forecast, as usual, is based on some fairly softball assumptions. First, we're modeling 15% revenue growth per year - less than half of what Hansen has achieved and 7% less than Jones. We think operating margins long term will trend toward what Hansen has achieved, and we're also sharing its beta coefficient as a proxy for risk. All of this points to a \$10 value for Reed's today.

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The company itself is forecasting 2007 sales to rise 20-40%. Our 15% is a long-term average, so we'll need several strong early years like this to justify our \$10 target. Jones and Hansen prove that it can be done, and the beverage market is clearly moving in Reed's favor.

Based on their underlying businesses, Jones and Hansen have tangible P/E values of between 13-16 times trailing earnings. Typically, Hansen trades at about 23 times, pretty much with the industry. Today, it's up around 43 times. Jones trades anywhere from 50-100 times, and is currently riding high at 111.1 times the last 12 months' earnings. So there is a lot of growth factor baked into Jones, with a good bit as well in Hansen. In a market sell-off, both of these names would be very attractive even around the 30 range, and I think that's ultimately where you'll see Reed's settle when it starts to post consistent

earnings.

Until next time,

Greg Guenther

P.S.: I recently put together a NEW REPORT: [3 Little-Known Powerhouse Stocks](#) that are primed to go through the roof. Check it out and capitalize on the investment potential of these stocks.

Additional Information about Investing in Soda and Beverage Stocks:

[Beverage Stocks](#)

[Jones Soda Company: Growth Stock Story](#)

[Does Jones Soda Have Game?](#) Motely Fool

[Golman Postive on Beverage Space](#) Yahoo Finance

[Reeds Inc](#)



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