PORTUGAL TELECOM SGPS SA
Form 6-K
December 01, 2014
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of the

Securities Exchange Act of 1934

For the month of November 2014

Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

Av. Fontes Pereira de Melo, 40
1069 - 300 Lisboa, Portugal

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F xForm 40-F o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes oNo x

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Portugal Telecom

Consolidated Report

First Nine Months 2014

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Consolidated report

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Financial review

On 5 May 2014, Portugal Telecom subscribed a share capital increase of Oi through the contribution in kind of the PT Assets, defined as its 100% interest in PT Portugal, which as of that date included all operational businesses of Portugal Telecom Group except for the subsidiaries Bratel BV, Bratel Brasil, S.A., PTB2, S.A. and Marnaz, S.A. and the investments in Oi, Contax and its controlling shareholders. As a result of the contribution to the Oi share capital increase on 5 May 2014:

- PT increased its effective interest in Oi from 23.2%, previously held through Bratel Brasil, to an economic interest of 39.7%, held through a total direct interest of 35.8% (32.8% in Portugal Telecom and 3.0% in Bratel Brasil) and an indirect interest of 3.9% held through the controlling shareholders of Oi.

- The investment in Oi is classified in accordance with the provisions of IFRS 5 as from 5 May 2014 and accordingly measured at fair value based on the quote prices of Oi s shares at the balance sheet date.

- As a result of all transactions that were necessary to implement in connection with the contribution of PT Assets to Oi s capital increase and the low historical carrying value of some of the assets in PT s consolidated statement of financial position, Portugal Telecom recorded a gain of Euro 701 million that was partially offset by the write off of deferred tax assets related to tax losses carried forward recognized amounting to Euro 208 million as of 5 May 2014, following the discontinuing of the Portuguese operations that supported theses tax losses.

- The earnings and losses of all businesses contributed to Oi share capital increase were presented as discontinued operations and accordingly the income statements for the 9M13 and 3Q13 were restated.

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Consolidated income statement

Euro million

	3Q14	3Q13 Restated	9M14	9M13 Restated
Wages and salaries	1.5	2.9	8.1	8.9
Supplies and external services	16.9	0.6	21.3	2.4
Provisions and adjustments	0.2	0.0	0.3	(0.8)
Indirect taxes	3.9	0.3	5.6	1.1
Other operating expenses	0.0	0.0	0.0	0.0
EBITDA	**(22.5)**	**(3.8)**	**(35.3)**	**(11.7)**
Depreciation	0.0	0.1	0.1	0.2
EBIT	**(22.6)**	**(3.9)**	**(35.4)**	**(11.9)**
Other gains, net	0.0	0.0	(0.9)	(126.0)
Income (loss) before financial results and taxes	**(22.6)**	**(3.9)**	**(34.5)**	**114.1**
Net interest income	(0.4)	(4.4)	(10.8)	(12.5)
Losses in joint ventures		8.9	38.0	68.4
Net losses on financial assets and other investments	266.3	1.2	337.7	1.2
Net other financial losses	0.7	11.2	19.6	22.6
Income (loss) before taxes	**(289.2)**	**(20.8)**	**(418.9)**	**34.4**
Income taxes	(5.6)	9.8	(10.1)	14.2
Net income (loss) from continuing operations	**(283.6)**	**(30.6)**	**(408.8)**	**20.3**
Net income from discontinued operations		68.8	484.1	328.3
Net income (loss)	**(283.6)**	**38.3**	**75.2**	**348.5**
Non-controlling interests		17.2	13.6	43.5
Net income (loss) attributable to controlling interests	**(283.6)**	**21.0**	**61.7**	**305.0**

Consolidated operating costs amounted to Euro 35 million in 9M14 and Euro 12 million in 9M13, reflecting higher third party expenses related to business combination between Portugal Telecom and Oi and also higher indirect taxes related to those expenses.

Net other gains of Euro 126 million in 9M13 includes mainly a gain of Euro 134 million resulting from the settlement of contractual obligations related to the acquisition of the investment in Oi in 2011, for an amount of Euro 16 million that was lower than the liability initially recognised.

Net interest income amounting to Euro 11 million in 9M14 and Euro 12 million in 9M13 relate mainly to term deposits held by Portugal Telecom and Bratel Brasil, as Portugal Telecom s debt prior to the Oi share capital increase was transferred to Oi as part of PT Assets.

Losses in joint ventures correspond to Portugal Telecom s share in the losses of joint ventures up to 5 May 2014, based on the equity method of accounting, since as from that date the investment in Oi is measured at fair value based on the share price of Oi s shares with the related changes in fair value being included under the caption Net losses on financial assets and other investments . PT s share in the losses of joint ventures decreased to Euro 38 million in 9M14 as compared to Euro 68 million in 9M13, reflecting mainly a capital gain recorded by Oi in the first quarter of 2014 relating to the disposal of mobile telecommunication towers, amounting to R$ 1,247 million (equivalent to approximately Euro

60 million corresponding to PT s share, net of taxes), and lower interest expenses from Oi s controlling shareholders, which in 2014 relate to only four months as compared to nine months in 2013.

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These effects were partially offset by higher interest costs, higher net other financial expenses and lower revenues at Oi.

Net losses on financial assets and other investments in 9M14 correspond to the loss resulting from the reduction in the fair value of the investment in Oi between 5 May and 30 September 2014, since as from 5 May 2014 this investment is classified as held for distribution to owners and accordingly measured at fair value based on the quote price of Oi s shares.

Net other financial losses reflect mainly certain bank commissions and other financial services, including certain financial costs incurred in 2Q14 in connection with the business combination between Portugal Telecom and Oi, namely financial taxes paid for the transfer of funds to Brazil.

Income taxes amounted to a gain of Euro 10 million in 9M14, corresponding basically to the tax effect on operating costs and other financial expenses net of interest income. The change compared to the same period of last year reflects mainly higher operating and net other financial costs.

Net income from discontinued operations in 9M14 includes primarily a gain recorded in connection with Oi s share capital increase, totaling Euro 701 million, partially offset by the write-off of deferred tax assets relating to tax losses of Euro 208 million that was recorded on the same date due to the discontinuing of Portuguese businesses that supported the recognition of those deferred tax assets. Adjusting for these effects, discontinued operations reported a net loss of Euro 9 million in 9M14, as compared to a net income of Euro 328 million in 9M13 that reflects primarily the gain recorded in connection with the disposal of the equity investment in CTM in 2Q13 (Euro 310 million), partially offset by certain provisions and adjustments recorded in the same period to adjust the carrying value of certain assets to their corresponding recoverable amounts.

Net income attributable to non-controlling interests amounted to Euro 14 million in 9M14 and Euro 43 million in 9M13, reflecting mainly lower income from African businesses in 2014 up to 5 May, when these businesses were contributed to Oi s share capital increase.

Net income decreased to Euro 62 million in 9M14 as compared to Euro 305 million in 9M13, reflecting primarily: (1) the loss of Euro 338 million due to the reduction in the fair value of the investment in Oi as from 5 May 2014; (2) the gain of Euro 310 million recorded in connection with the disposal of the equity investment in CTM in 2Q13, and (3) the net other gains recorded in 9M13 (Euro 126 million). These effects were partially offset by the gain recorded in connection with Oi s share capital increase, as described above, and by lower losses in joint ventures recorded through the equity method of accounting.

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Consolidated Statement of Financial Position

Euro million

	30 Sep 2014	31 Dec 2013
ASSETS		
Cash and cash equivalents	105.6	1,659.0
Short-term investments		914.1
Accounts receivable	0.0	1,170.7
Non-current assets held for distribution to owners	1,910.8	
Investments in joint ventures		2,408.2
Investments in associated companies		511.3
Goodwill		380.6
Intangible assets		717.7
Tangible assets	0.2	3,438.5
Deferred taxes	1.4	564.9
Other assets	6.4	255.4
Total assets	**2,024.5**	**12,020.4**
LIABILITIES		
Gross debt	0.1	7,371.1
Accounts payable	5.9	587.7
Accrued expenses	35.2	534.7
Post retirement benefits		960.9
Deferred taxes	1.7	243.8
Provisions	27.0	91.1
Other liabilities	1.4	364.3
Total liabilities	**71.4**	**10,153.6**
Equity excluding non-controlling interests	**1,953.1**	**1,641.3**
Non-controlling interests		225.5
Total equity	**1,953.1**	**1,866.8**
Total liabilities and shareholders equity	**2,024.5**	**12,020.4**

The decrease in **total assets** and **total liabilities** reflects the assets and liabilities of the businesses that were contributed to Oi s share capital on 5 May 2014, explaining the reduction across the majority of captions of the consolidated statement of financial position.

Non-current assets held for distribution to owners as at 30 September 2014 correspond to the fair value of the investment in Oi based on quote prices of Oi s shares as of that date. The investment in Oi is classified in accordance with the provisons of IFRS 5 and accordingly measured at fair value based on the quote prices of Oi s shares, since this fair value is lower than the previous carrying amount.

Shareholders equity excluding non-controlling interests amounted to Euro 1,953 million as at 30 September 2014, compared to Euro 1,641 million as at 31 December 2013, an increase of Euro 312 million reflecting (1) the net income generated in the period (Euro 62 million), (2) positive foreign currency translation adjustments of Euro 160 million, related mainly to the impact of the appreciation of the Brazilian Real against the Euro, and (3) the reversal of treasury shares related to the 10% interest in Portugal Telecom held by Oi (Euro 159 million), following the

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remeasuring of this investment from the equity accounting to fair value. These effects were partially offset by dividends attributed to PT s shareholders on 30 April 2014 (Euro 86 million) and paid on 30 May 2014.

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Business performance

The Business Combination of Portugal Telecom and Oi

Following the memorandum of understanding disclosed to the market on 2 October 2013 (the Memorandum of Understanding), Portugal Telecom, Oi and the main shareholders of both companies announced their intention to implement a combination of the businesses of Portugal Telecom and Oi (the Business Combination) into a single listed company governed by the laws of Brazil, which has now been determined to be Telemar Participações, S.A. (TmarPart ou CorpCo).

The Business Combination transaction, as initially considered, involved three principal steps:

- A first step involving a share capital increase of Oi (the Oi Capital Increase), completed on 5 May 2014, with the issuance of common shares and preferred shares in a subscription offer totaling R$8,250 million in cash, including the proceeds resulting from the exercise of the greenshoe option, and the issuance of common shares and preferred shares to Portugal Telecom in exchange for Portugal Telecom s transferring to Oi (i) all of Portugal Telecom s operational assets, except for interests held directly or indirectly through Bratel Brasil, SA (Bratel Brasil) and PTB2 SA (PTB2) - in Oi, Contax Participações, SA, and Bratel BV, and (ii) substantially all of Portugal Telecom s liabilities at the time of transfer, which the valuation report valued at a net value (i.e. assets minus liabilities) of R$5,709.9 million. Concurrently with the Oi Capital Increase, Portugal Telecom subscribed, through its Brazilian subsidiaries, convertible debentures issued by companies within the chain of control of AG Telecom Participações SA (AG Telecom) and of LF Tel SA (LF Tel), and these companies subscribed convertible debentures of TmarPart. All of such debentures have been converted, and, as a result, PT acquired an additional stake in these companies within the chain of control of AG Telecom and LF Tel and, indirectly, in TmarPart and Oi;

- A second step involving a Brazilian law incorporation of shares (the Merger of Shares), pursuant to which, subject to the approval of holders of Oi and CorpCo common shares, all Oi shares, other than those held by CorpCo, would be exchanged for CorpCo common shares, with Oi thereby becoming a wholly-owned subsidiary of CorpCo. At the same time, CorpCo would become listed on the Novo Mercado segment of the BM&FBOVESPA, SA Bolsa de Valores, Mercadorias e Futuros (the BM&FBOVESPA). Concurrently with the Merger of Shares, the control structure of CorpCo was expected to be simplified through the corporate reorganization of the various holding companies having direct and indirect shareholder interests in CorpCo, as a result of which, among other effects, PT would directly hold the Oi shares corresponding to its indirect interest in CorpCo (the Corporate Reorganization); and

- A third step involving the later merger through incorporation, under Portuguese and Brazilian law, of Portugal Telecom by and into CorpCo, with the latter being the surviving company (the Merger), and as a result of which the shareholders of Portugal Telecom would receive a total amount of shares of CorpCo equal to the amount of shares of that company held by Portugal Telecom immediately prior to the Merger. The shares of

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CorpCo, the entity resulting from the abovementioned transactions, would be listed on the Novo Mercado segment of the BM&FBOVESPA, on the NYSE Euronext Lisbon regulated market (Euronext Lisbon), and on the New York Stock Exchange (NYSE).

The transaction resulted thus from an agreement, and it was left to the management of both companies (which included certain members exercising management positions at both companies as a result of the cross-shareholdings between the companies) to implement such transactions, subject to approval by the shareholders at general meetings. With respect to PT, the first and third steps of the Business Combination were to be subject to the approval of PT s shareholders at general meetings.

Oi Capital Increase

In the context of the Business Combination, the Oi Capital Increase has already taken place, whereby, as expected, part of the new shares issued by Oi were subscribed by Portugal Telecom through a contribution in kind corresponding to all of the shares of PT Portugal, SGPS, SA (PT Portugal), a company that held all the operational assets corresponding to the businesses of the companies of the Portugal Telecom group (Portugal Telecom Group) (with the exception of the interests held, directly or indirectly, in Oi, Contax Participações, SA, and Bratel BV) and the respective liabilities on the date of their contribution (PT Assets). The PT Assets were contributed based on the value set forth in a proposal of the Board of Directors of Oi to the general meeting of Oi s shareholders, based on a valuation report issued by an independent and specialized institution - Banco Santander (Brasil) SA, engaged by Oi for that purpose in accordance with applicable Brazilian legislation, the valuation report of which was approved at the Oi general shareholders meeting held on 27 March 2014. For more information regarding the valuation methods and criteria used by Banco Santander (Brasil) SA for the issuance of the valuation report, see the copy attached as Annex 1 to the proposal of the PT Board of Directors to the general shareholders meeting held last 27 March, and available at www.cmvm.pt.

As indicated above, given its importance, PT s subscription to the Oi Capital Increase was subject to and approved by the shareholders of PT at a general shareholders meeting.

Upon completion of the Oi Capital Increase, Oi became a company with significant presence in the principal segments of the telecommunications markets in Portugal and Brazil, while at the same time holding the interests previously held by PT in Africa.

On 27 March 2104, the general meeting of Oi s shareholders approved the aforementioned valuation report and the contribution of the PT Assets to Oi, which assets were valued at R$5,709.9 million - corresponding to Euro 1,750 million, using the conversion rate from Reais to Euros on 20 February 2014 (that is, R$3.2628 per Euro), as set forth in the previous agreements - the amount for which the general shareholders meeting of Portugal Telecom, also held on 27 March 2014, approved the contribution of the PT Assets in the context of the Oi Capital Increase.

The Oi Capital Increase was completed on 5 May 2014, where Portugal Telecom subscribed for 1,045,803,934 common shares and 1,720,252,731 preferred shares of Oi in exchange for the contribution of all of the shares of PT Portugal, owner of the PT Assets. As a result, Portugal Telecom currently owns, as its sole material asset, a direct and indirect interest of 39.7% of Oi s share capital, including 39.0% of the voting share capital (excluding indirect interests through TmarPart, AG Telecom and LF Tel in Oi).

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The PT Assets contributed by PT in the context of the Oi Capital Increase included a creditor position with respect to Rio Forte Investments, SA (Rioforte) - a company with Grupo Espírito Santo (GES) - corresponding to certain short-term investments subscribed for or acquired by two companies which at the time were wholly-owned subsidiaries of Portugal Telecom namely PT Portugal and Portugal Telecom International Finance, BV (PTIF) in the aggregate amount of Euro 897 million, detailed below as Rioforte Instruments .

On 15 July 2014, the Rioforte Instruments held by the above mentioned subsidiaries in the amount of Euro 847 million matured. On 17 July 2014 the additional portion of Euro 50 million of the Rioforte Instruments also matured.

Rioforte failed to repay the amounts due under the Rioforte Investments on their respective maturity dates, and on 22 July and 24 July 2014, the additional grace periods during which the payment of the Rioforte Instruments due on 15 July and 17 July 2014, respectively, could have been made, also lapsed without the amounts due having been paid.

Shareholder agreements

Under the agreements relating to the Business Combination as currently in effect below, if the second step of the Business Combination, which includes the Merger of Shares and the Corporate Reorganization, is not completed by 31 March 2015, the parties will no longer be bound to exercise their respective voting rights in the applicable companies in favor of approving all the steps for Corporate Reorganization and the Merger of Shares expected to occur during this second step of the Business Combination.

In this case, the shareholders agreements relating to TmarPart (the TmarPart Shareholder Agreements) entered into or amended on 25 January 2011, on 19 February 2014 and on 8 September 2014, will remain in force, with the quorum requirements provided for in the agreements to be adjusted in consideration of the percentage interests held by AG Telecom, LF Tel, BNDES Participações SA - BNDESPAR (BNDESPAR), Caixa de Previdência dos Funcionários do Banco do Brasil (PREVI), Fundação Atlântico de Seguridade Social (FATL), Fundação Petrobras de Seguridade Social - PETROS (PETROS), Fundação dos Economiários Federais - FUNCEF (FUNCEF) and Bratel brasil (Bratel Brasil) on 31 March 2015, in order to ensure that the voting rights of such shareholders are equal to those on 19 February 2014, and provided they have not reduced their respective shareholder interests before 31 March 2015 through the sale of shares to third parties that are not original signatories of the Global Shareholders Agreement (as defined below) or their related parties.

The TmarPart Shareholder Agreements included (a) a general shareholders agreement, entered into by all TmarPart shareholders - AG Telecom, LF Tel, FATL, Bratel Brasil, BNDESPAR, PREVI, PETROS, and FUNCEF - as parties, and by TmarPart and Portugal Telecom, as intervening parties (Global Shareholders Agreement) and (b) a separate shareholders agreement entered into only among AG Telecom, LF Tel, and FATL as parties, and TmarPart as intervening party (Control Group Shareholders Agreement).

The TmarPart Shareholder Agreements provide for the following relevant rights and obligations:

(1) Global Shareholders Agreement

(i) The initial term for the Global Shareholders Agreement expires on 25 April 2048, or on the expiration date of the last to expire of the concessions or authorizations held by TmarPart or

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any of its subsidiaries, whichever occurs last, subject to the agreement of the parties to the Global Shareholders Agreement. The Global Shareholders Agreement may be extended for successive periods of ten years with the consent of all the parties.

(ii) The following provisions apply to the election of members of the board of directors and the executive officers, and the voting of their shares, in TmarPart and every TmarPart subsidiary that has net operating revenues equal to or in excess of R$ 100 million, which will be referred to as the controlled subsidiaries :

a. The board of directors of TmarPart will consist of eleven effective members and an equal number of alternates;

b. AG Telecom, LF Tel, and FATL will, together, have the right to designate a majority of the members of the board of directors of TmarPart, and of each of the controlled subsidiaries;

c. Each increment of 7% of the voting share capital of TmarPart held by a party to the Global Shareholders Agreement will entitle such party to designate one member of the board of directors of TmarPart and of each of the controlled subsidiaries, as well as the respective alternate;

d. So long as Portugal Telecom holds at least 7% of the voting share capital of TmarPart, it will be entitled to designate one member of the board of directors of TmarPart and two members of the board of directors of Oi, and the respective alternates, from among the directors and executive officers of Portugal Telecom;

e. Each increment of 7% of the voting share capital of TmarPart held by BNDESPAR, PREVI, PETROS, and FUNCEF will entitle these entities to collectively designate (a) one member of the board of directors of TmarPart and of each of the controlled subsidiaries, as well as the respective alternate; and (b) one effective member of the Oi board of directors and its respective alternate;

f. TmarPart management will consist of four executive officers;

g. AG Telecom, LF Tel, and FATL shall be entitled, together, to appoint the CEO of TmarPart and another member of TmarPart s management;

h. so long as they hold, together, at least 12% of the voting share capital of TmarPart, PREVI, PETROS, and FUNCEF will be entitled, together, to nominate a member of TmarPart management;

i. So long as it holds at least 12% of the voting share capital of TmarPart, Portugal Telecom will be entitled to nominate a member of TmarPart management;

j. AG Telecom, LF Tel, BNDESPAR, Bratel Brasil, FATL, PREVI, PETROS and FUNCEF will, together, elect the CEO for each of the controlled subsidiaries pursuant to the rules established in the Global Shareholders Agreement;

k. BNDESPAR, PREVI, PETROS, and FUNCEF have the right, together, to designate a member of TmarPart s fiscal board, and one for each of the controlled subsidiaries; and

l. AG Telecom, LF Tel, BNDESPAR, Bratel Brasil, FATL, PREVI, FUNCEF, and PETROS will hold pre-meetings prior to shareholders and board of directors meetings of TmarPart and the controlled subsidiaries, and will exercise their voting rights in TmarPart and the controlled subsidiaries, and instruct their representatives on these boards of directors to vote in accordance with the decisions made at the pre-

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meetings. Such parties will not be entitled to exercise their voting rights, including for the interests held directly in Oi and in the other controlled subsidiaries, against matters already approved at a pre-meeting held pursuant to the Global Shareholders Agreement.

(iii) Under the Global Shareholders Agreement, each of the parties agreed:

a. Not to enter into other shareholders agreements with respect to TmarPart shares, other than (i) the Global Shareholders Agreement, (ii) the Control Group Shareholders Agreement, (iii) the shareholders agreements entered into among Bratel Brasil, Andrade Gutierrez SA (AGSA) and Jereissati Telecom SA (Jereissati Telecom), and (iv) the shareholders agreement entered into among BNDESPAR, PREVI, FUNCEF and PETROS;

b. Not to amend the Global Shareholders Agreement, the Control Group Shareholders Agreement, the shareholder agreements entered into among Bratel Brasil, AGSA and Jereissati Telecom, and the shareholders agreement entered into among BNDESPAR, PREVI, FUNCEF and PETROS, without the consent of all the parties to the Global Shareholders Agreement;

c. Not to grant any encumbrances on the shares held in TmarPart, with the exception of a pledge or security, according to Global Shareholders Agreement;

d. To grant certain pre-emptive rights and tag-along rights to the other parties to the Global Shareholders Agreement in relation to any transfer of shares held in TmarPart and to any transfer of shares representing the control of TmarPart, respectively;

e. That the other parties to the Global Shareholders Agreement have the right to sell, and Portugal Telecom (via Bratel Brasil) has the obligation to buy, up to all of the other parties shares of TmarPart, in the event that Bratel Brasil acquires control of TmarPart;

f. To offer its shares of TmarPart to the other parties to the Global Shareholders Agreement in the event of a transfer of control of such party; and

g. That the other shareholders have the right to acquire all TmarPart shares held by Bratel Brasil in the event of a change in the control of PT.

(2) Control Group Shareholders Agreement

(i) The initial term of the Control Group Shareholders Agreement expires on 25 April 2048 and can be extended for successive ten-year terms with the consent of all the parties.

(ii) Under the Control Group Shareholders Agreement, each of the parties agreed:

a. To hold pre-meetings between themselves prior to the pre meetings to be held pursuant to the Global Shareholders Agreement and to vote their TmarPart shares in accordance with the decisions made at such pre-meetings;

b. That any TmarPart common shares sold by a party to the Control Group Shareholders Agreement to any other party to this agreement will remain subject to the terms of this agreement; and

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c. If one of the parties to the Control Group Shareholders Agreement sells all or part of its common shares of TmarPart to any other party or a third party, the purchaser(s) and the seller, as applicable, will be considered one voting block for the purposes of exercising voting rights under the Control Group Shareholders Agreement (even if the purchaser(s) is/are already a party to the agreement), and such voting block will hold pre-meetings to the pre-meetings of the parties to the Control Group Shareholders Agreement.

In addition to the TmarPart Shareholders Agreements, if the second step of the Business Combination between Portugal Telecom and Oi, which includes the Merger of Shares and the Corporate Reorganization, is not completed by 31 March 2015, the shareholder agreements entered into among Bratel Brasil, AGSA and Jereissati Telecom, which include the following shareholder agreements entered into by such parties on 25 January 2011 and amended on 19 February 2014 and 8 September 2014, will remain in force: (i) the shareholders agreement entered into between Jereissati Telecom and Bratel Brasil in relation to EDSP75 Participações (EDSP), with EDSP, LF Tel, AGSA, Pasa Participações (PASA), Andrade Gutierrez Telecomunicações Ltda. (which later merged with and into AGSA), AG Telecom, Portugal Telecom, Sayed RJ Participações S.A. (Sayed), Venus RJ Participações S.A. (Venus) and PTB2 S.A. (PTB2) as intervening parties (the EDSP Shareholders Agreement), and (ii) the shareholders agreement entered into between AGSA and Bratel Brasil in relation to PASA, with PASA, AG Telecom, Jereissati Telecom, ESDP, LF Tel, Portugal Telecom, Sayed, Venus and PTB2 as intervening parties (the PASA Shareholders Agreement). The initial terms of these shareholder agreements also expire on 25 April 2048 but can be extended for successive ten-year periods with the consent of all the parties thereto.

These EDSP and PASA shareholder agreements are intended to coordinate PASA and EDSP s corporate governance and to simplify the decision-making process among Jereissati Telecom, AGSA and Portugal Telecom as shareholders of TmarPart. Under these shareholders agreements, among other things:

- Pre-meetings are to be held between the shareholders to decide in advance the matters to be analyzed during pre-meetings to be held under the Global Shareholders Agreement and the Control Group Shareholders Agreement;

- The approval of certain issues is subject to a qualified majority vote of the shareholders, including:

- Approval of, and amendments to, the annual budget and annual investment plans of PASA, EDSP, AG Telecom, and LF Tel, which are subject to a qualified majority of 83% of the votes;

- The entering by PASA, EDSP, AG Telecom, or LF Tel, into any loans or financing agreements in excess of R$50 million, or the entering of any agreement imposing a pecuniary obligation on PASA, EDSP, AG Telecom, or LF Tel in excess of R$50 million, or the granting of any guarantees by PASA, EDSP, AG Telecom, or LF Tel on behalf of third parties obligations in excess of R$50 million, which are subject to a qualified majority of 90% of votes; and

- Any amendments to the Global Shareholders Agreement or the issuance of preferred shares by PASA, AG Telecom, or LF Tel, the approval of any decision subject to a qualified majority under the scope Global Shareholders Agreement (defined as a material decision according to the PASA Shareholders Agreement and the EDSP Shareholders Agreement), among other issues, which are subject to a unanimous vote of the shareholders.

- Rights of first offer are granted to the shareholders with respect to the transfer of shares issued by PASA and EDSP;

- Tag-along rights are granted in favor of Portugal Telecom, in the event of the sale of PASA and EDSP shares by AGSA or Jereissati Telecom, as applicable; and

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- A general restriction on the sale of shares issued by PASA and EDSP by AGSA or Jereissati Telecom, as applicable, to competitors of Portugal Telecom.

If the Business Combination is not completed by 31 March 2015, any of the shareholders party to the PASA Shareholders Agreement or the EDSP Shareholders Agreement may send a notification of non-occurrence of the reorganization and require the adoption of the necessary measures in order for Bratel Brasil, PTB2, AGSA and Jereissati Telecom to receive shares of capital stock of Oi held by AG Telecom and LF Tel, in proportion to their respective direct and indirect capital interests in those entities.

The implementation of the second step of the Business Combination, which includes the Corporate Reorganization and the Merger of Shares, requires a further pre-meeting of the shareholders of CorpCo to approve the valuation reports required for the implementation of such transactions, among other matters.

Final agreement on the terms to proceed with the Business Combination

On 28 July 2014, PT SGPS and Oi S.A. announced that they had reached an agreement on the final terms of the key contracts following the Memorandum of Understanding (MOU) announced on 16 July 2014. The main terms of these contracts established that:

- PT SGPS would be exchange (Exchange) with Oi the treasury applications in Rio Forte Investments SA (Rioforte debt), amounting to Euro 897 million, for 474,348,720 Oi ON shares plus 948,697,440 Oi PN shares (the Oi Call Shares);

- PT SGPS would be granted a non-transferrable American-type call (Call) to repurchase the Oi Call Shares (strike prices of R$2.0104 ON and R$1.8529 PN), which would be adjusted by the Brazilian CDI rate plus 1.5% per year;

- The Call on the Oi Call Shares would become effective on the date of the Exchange, will have a 6-year maturity, and the Oi Call Shares that PT SGPS has the right to call would be reduced by 10% at the end of the first year and by 18% per year thereafter;

- Any proceeds received as a result of a monetization of the Call through the issuance of derivatives or back to back instruments must be used to exercise the Call;

- PT SGPS could only acquire Oi or CorpCo shares through the exercise of the Call;

- The Call would be cancelled if (i) PT SGPS s bylaws would be voluntarily amended to remove the 10% voting limitation, (ii) PT SGPS act as a competitor to Oi, or (iii) PT SGPS breach certain obligations under the definitive documentation, and

- The contracts would be executed as soon as all corporate approvals had been obtained and the Exchange should be subject to the approval of Comissão de Valores Mobiliários in Brazil and should be executed before or on 31 March 2015.

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The terms of the agreements also included an agreed alternative to the incorporation of PT SGPS into CorpCo as previously announced, aimed at achieving the following objectives:

- Allow for the merger of Oi and CorpCo and migration to the Novo Mercado to be implemented as soon as possible, with the listing of CorpCo on BM&F Bovespa, Euronext Lisboa and NYSE;

- Subject to approval by the Board of Directors and at a General Shareholders Meeting, to be specifically convened for such purpose, PT SGPS shareholders will receive all shares of CorpCo held by PT SGPS, corresponding to the ownership interest in CorpCo of 25.6%, adjusted for the treasury shares resulting from the execution of the Exchange and prior to any exercise of the Call, and

- PT SGPS to remain listed with the Rioforte Instruments and the Call as its only material assets.

The terms of the agreements, as described above, were approved on 8 September 2014 at the General Shareholders Meeting of PT SGPS, and the definitive agreements were concluded on the same day. However, the Exchange is still subject to the approval of Comissão de Valores Mobiliários in Brazil. Such approval should be granted until 31 March 2015.

Subsequent events

- On 9 November 2014, Terra Peregrin - Participações SGPS, S.A. published a preliminary announcement for the launch of a public takeover bid for the acquisition of the total ordinary and category A shares, representative of the whole share capital and voting rights of Portugal Telecom (including the shares corresponding to the share capital of Portugal Telecom which are underlying to the ADRs). The offeror s voting rights are entirely attributable to Mrs. Isabel dos Santos and/or one or more companies (with registered offices in Portugal or abroad) in a control or group relationship with the offeror and/or with Mrs. Isabel dos Santos.

The offer is general and voluntary and the consideration offered, to be paid in cash, is of 1.35 per share, which represents a premium of *circa* 11% in relation to the last closing price of the shares of Portugal Telecom on 7 November 2014 (1.217). The effectiveness of the offer is subject to the acquisition of, at least, 50.01% of the voting rights corresponding to the share capital of Portugal Telecom.

According to the preliminary announcement, the launch of the offer is subject to:

1. Obtaining the prior registration of the offer with the Portuguese Securities Market Commission (CMVM);

2. The declaration by CMVM of the derogation of the duty to launch the subsequent takeover bid, as a result of the acquisition of shares of Portugal Telecom in the context of this offer;

3. Obtaining the legal and administrative approvals and authorisations that may be required under Portuguese law and/or any applicable foreign legislation, notably from the competent competition authorities in Portugal, Brazil and/or the European Union (however, the offeror understands that its offer does not entail any competition issues on any jurisdiction);

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4. Obtaining the authorisation of the shareholders general meeting of Portugal Telecom (even if conditional upon the success of the offer) for the offeror to acquire a shareholding greater than 10% of the shares representing the share capital of Portugal Telecom, without the establishment of any other limit or condition;

5. The amendment of the articles of association of Portugal Telecom (even if conditional upon the success of the offer or even if only applicable to the offeror or entities in the position of the offeror) so that there is no limit on the counting of votes issued by a single shareholder, by itself or through a representative, in its own name or as the representative of another shareholder;

6. The adoption of resolutions by the competent body or bodies of Portugal Telecom and/or of Oi and/or of other companies involved in the Business Combination, aimed at the immediate suspension (up to the 30th day following the physical and financial settlement of the offer) of the process of the Business Combination;

7. The elimination or non-enshrinement (as applicable) of limits in the articles of association on the counting of votes issued by a single shareholder, by itself or through a representative, in its own name or as representative of another, regardless of the shareholding that each shareholder holds in CorpCo and/or Oi (even if conditional upon the success of the offer or even if only applicable to Portugal Telecom and to the offeror or entities in the position of the offeror);

8. The change of the terms of the Call Option agreed with Oi (even if conditional upon the success of the offer) so to (i) eliminate the obligation imposed on Portugal Telecom to only be able to acquire shares of Oi or of CorpCo by exercising the Call Option and (ii) not to grant Oi with the option to cancel or extinguish the Call Option in case of (a) amendment of the articles of association of Portugal Telecom as referred to in paragraph 5 above, and (b) direct or indirect carrying on by Portugal Telecom of activities that compete with those carried on by Oi and of the entities it controls in the countries in which they operate;

9. The modification (even if conditional upon the success of the offer) of any instruments that establish negative consequences in the event of a change of control of Portugal Telecom;

10. The adoption of resolutions by the competent body or bodies of Portugal Telecom, and/or of Oi, and/or of CorpCo, and/or of companies that are their controlling shareholders, and/or of other companies involved in processes, whether or not they have been announced, to divest or encumber relevant assets, that approve the interruption or the non-pursuit, in any form, of said processes, or the rejection of any proposals presented in this context.

In addition, the preliminary announcement mentions several assumptions on which the offer is based.

On 10 November, Oi published an announcement in which it stated that the conditions for the launch of the offer whose adoption would imply the change of the terms of the Business Combination, recently renegotiated by Portugal Telecom and Oi notably, the conditions mentioned in

paragraphs 6, 7, 8 and 9 above were unacceptable. Oi also mentioned that it would not proceed to any change of the

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corporate acts, definitive agreements and other instruments executed in order to meet any of the conditions for the launch of the offer.

Further to Oi s announcement, on 17 November 2014, Terra Peregrin - Participações SGPS, S.A. issued an announcement in which it stated its willingness to waive certain conditions previously established for the launch of the offer over Portugal Telecom s shares:

a. Firstly, the offeror stated it was willing to waive the condition mentioned in paragraph 6 above. However, the offeror added a new assumption of the offer, consisting on the non-conclusion of the process of the Business Combination before the 15th day prior to the physical and financial settlement of the offer.

b. In addition, the offeror stated it was willing to waive the condition mentioned in paragraph 7 above.

c. Thirdly, the offeror stated it was willing to waive the condition mentioned in paragraph 8 above. Within this context, the offeror stated it would amend this condition so that it would consist on the change (even if conditional upon the success of the offer) of the instruments which grant Oi with the option to cancel or extinguish the Call Option in case the situations mentioned in (a) and (b) of paragraph 8 above occur, in such a way that the Call Option would only be granted to Portugal Telecom s shareholders who do not sell their shares in the offer, i.e., in such a way that the offeror does not benefit from the Call Option.

d. Finally, the offeror stated it was willing to waive the conditions mentioned in paragraphs 9 and 10 above. However, the offeror added a new assumption of the offer, consisting on the inexistence of (i) any instruments that establish negative consequences in the event of a change of control of Portugal Telecom, and (ii) resolutions to divest or encumber relevant assets by the competent body or bodies of Portugal Telecom, and/or of Oi, and/or of CorpCo, and/or of companies that are their controlling shareholders, and/or of other companies involved in processes, whether or not they have been announced, to divest or encumber relevant assets.

On the same date, the CMVM issued an announcement on the change of the conditions by the offeror and stated that (i) the offeror had announced its willingness to waive or amend certain conditions included in the preliminary announcement for the launch of the offer, and that any definitive decision should be formalised through an alteration of the conditions established in said preliminary announcement and be included in the request for registration to be presented to the CMVM until 1 December 2014; and (ii) since the consideration mentioned in the preliminary announcement does not comply with the weighted average price in the six-month period prior to the preliminary announcement, the CMVM would evaluate, at the time of the registration of the offer, the justification and equity of the consideration proposed, to be duly explained by the offeror in its request for the registration of the offer, and then decide whether the offer should be deemed as derogating the duty to launch the subsequent takeover bid as a result of the acquisition of more than 50% of the voting rights of Portugal Telecom.

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Under article 181 of the Portuguese Securities Code, the Board of Directors will issue a statement within 8 days counting from the reception of the draft of the prospectus and of the offer announcement that shall be delivered by the offeror until 1 December 2014.

- In November 2014, Africatel GmbH and Portugal Telecom were informed that Samba Luxco S.à.r.L. (Samba), holder of a 25% interest in Africatel Holdings B.V., had initiated an arbitration proceeding against Africatel GmbH (a former subsidiary of Portugal Telecom now owned by Oi S.A.) and Portugal Telecom in the Court of Arbitration of the International Chamber of Commerce relating to its purported put right to sell a interest in Africatel Holdings B.V., which Samba believes was triggered by the transfer of the shares of Africatel GmbH to Oi S.A. in the share capital increase of Oi in May 2014, among other claims. Both Africatel GmbH and Portugal Telecom intend to vigorously defend this proceeding.

Under the Subscription Agreement entered into by Portugal Telecom and Oi S.A. in connection with the Oi S.A. share capital increase, Oi S.A. agreed to succeed to Portugal Telecom in any right or obligation contracted by it, as long as the agreements generating that right or obligation have been indicated in the documents for the global offering that formed part of the Oi share capital increase. The prospectus for the Oi S.A. share capital increase disclosed, among other things, that Samba had asserted that the business combination between Portugal Telecom and Oi S.A. triggered certain rights under the Africatel shareholders agreement, including a put right in respect of Samba s interest in Africatel Holdings B.V.

- On 8 October 2014, some shareholders of the Company brought a civil lawsuit before the District Court of Lisbon (Tribunal Judicial da Comarca de Lisboa) seeking a declaration of invalidity and/or the nullification of a shareholders resolution that was approved at the General Meeting of Shareholders held on 8 September 2014, on the grounds of alleged impediment to vote of certain shareholders of the Company, violation of the purpose or object of the Company and abusive vote. The Company was summoned in order to present its statement defense on 13 October 2014 and submitted it on 12 November 2014.

In addition, on 19 September 2014, a shareholder holding 500 shares of the Company has initiated an injunction proceedings before the District Court of Lisbon (Tribunal Judicial da Comarca de Lisboa) in order to suspend the shareholders resolution that was approved at the General Meeting of Shareholders held on 8 September 2014. Although the claimant lacks legal standing for the required purpose to the extent that such proceedings could only be initiated by shareholders who, alone or jointly, hold shares corresponding to at least 0.5% of the share capital -, the Court ordered the Company to be summoned in order to present its statement of opposition, which occurred last 5 November 2014. The Company submitted its statement of opposition on 17 November 2014 and now waits for a Court decision on the granting of the protective order.

- On 18 November 2014, at Oi s Extraordinary General Meeting, shareholders approved a reverse stock split of all the ordinary and preferred shares issued by Oi at a ratio of 10: 1, such that each lot of ten shares of each class was grouped into a single share of the same class, with a related amendment to Article 5 of Oi s bylaws.

As a result of the reverse stock split, the current 2,861,553,190 ordinary shares and 5,723,166,910 preferred shares now represent 286,155,319 ordinary shares and 572,316,691 preferred shares,

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respectively, with the resulting amendment of Article 5 of Oi s bylaws. Similarly, at the Extraordinary General Meeting held on 18 November 2014, Oi s shareholders also approved the amendment of the first paragraph of Article 5 of Oi s bylaws to reflect the changes in share capital and number of shares of Oi approved by the Board, such that the share capital is represented by 858,472,010 shares, comprised of 286,155,319 ordinary shares and 572,316,691 preferred shares, without par value.

The reverse stock split proposal was aimed at reducing the volatility of Oi s shares resulting from the reduced share price in the market, in order to protect Oi and its shareholders from percentage fluctuations resulting from small changes in the share price and, at the same time, to prevent shareholders, especially foreign investment funds, from being precluded from investing in Oi shares because of its share price. In addition, the reverse stock split was aimed at meeting the requirements of NYSE Listing Rules, which require, among other things, that the average closing price of the shares of listed companies remain equal to or greater than USD1 per share during any consecutive period of 30 trading days.

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Consolidated financial statements

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PORTUGAL TELECOM, SGPS, S.A.

CONSOLIDATED INCOME STATEMENT

NINE AND THREE MONTH PERIODS ENDED 30 SEPTEMBER 2014 AND 2013

Euro

	Notes	9M14	9M13 Restated	3Q14	3Q13 Restated
CONTINUING OPERATIONS					
COSTS, LOSSES AND (INCOME)					
Wages and salaries	5	8,058,183	8,935,163	1,534,927	2,939,738
Commercial costs		29,763	24,324	25,000	5,864
Supplies, external services and other expenses	6	21,328,488	2,447,248	16,926,051	637,718
Indirect taxes	7	5,620,927	1,075,181	3,858,481	253,688
Provisions and adjustments		276,792	(797,542)	203,292	1,050
Depreciation and amortisation		85,733	179,828	21,234	53,602
Losses (gains) on disposal of fixed assets, net		31,690	(18,281)		
Net other losses (gains)	8	(922,169)	(125,993,199)	68	5,822
		34,509,407	**(114,147,278)**	**22,569,053**	**3,897,482**
Income (loss) before financial results and taxes		**(34,509,407)**	**114,147,278**	**(22,569,053)**	**(3,897,482)**
FINANCIAL LOSSES AND (GAINS)					
Net interest income	9	(10,842,355)	(12,499,249)	(384,394)	(4,391,467)
Net foreign currency exchange losses (gains)		87,050	241,073	(224,351)	4,290,429
Net losses on financial assets and other investments	16	337,677,151	1,199,426	266,299,279	1,152,021
Equity in losses of joint ventures	17	38,027,775	68,400,567		8,900,064
Net other financial expenses	10	19,483,539	22,402,707	932,782	6,907,464
		384,433,160	**79,744,524**	**266,623,316**	**16,858,511**
Income (loss) before taxes		**(418,942,567)**	**34,402,754**	**(289,192,369)**	**(20,755,993)**
Income taxes	11	(10,107,250)	14,150,951	(5,634,976)	9,816,156
Net income (loss) from continuing operations		**(408,835,317)**	**20,251,804**	**(283,557,393)**	**(30,572,148)**
DISCONTINUED OPERATIONS					
Net income from discontinued operations	12	484,071,230	328,274,093		68,846,054
NET INCOME		**75,235,913**	**348,525,897**	**(283,557,393)**	**38,273,906**
Attributable to non-controlling interests		13,554,384	43,480,984		17,230,538
Attributable to equity holders of the parent	13	**61,681,529**	**305,044,913**	**(283,557,393)**	**21,043,368**
Earnings per share from continuing operations					
Basic	13	(0.49)	(0.03)	(0.32)	(0.06)
Diluted	13	(0.49)	(0.03)	(0.32)	(0.06)
Earnings per share					
Basic	13	0.07	0.36	(0.32)	0.02
Diluted	13	0.07	0.35	(0.32)	0.02

The accompanying notes form an integral part of these financial statements.

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PORTUGAL TELECOM, SGPS, S.A.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

NINE AND THREE MONTH PERIODS ENDED 30 SEPTEMBER 2014 AND 2013

Euro

	Notes	9M14	9M13 Restated	3Q14	3Q13 Restated
Net income recognised in the income statement		**75,235,913**	**348,525,897**	**(283,557,393)**	**38,273,906**
Income (expenses) recognised directly in shareholders equity					
Items that may be reclassified subsequently to the income statement					
Foreign currency translation adjustments					
Translation of foreign investments (i)		158,750,163	(402,188,450)	(54,239,816)	(185,153,726)
Transfers to income statement		(3,784,493)	(3,129,234)		
Hedge accounting of financial instruments					
Change in fair value			2,488,621		1,510,618
Tax effect			(622,155)		(377,654)
Share in other comprehensive income (loss) of joint ventures		7,183,894	(3,323,254)		988,002
Items that will not be reclassified to the income statement					
Post retirement benefits					
Net actuarial gains (losses)	19	28,349,892	(13,539,460)		11,319,867
Tax effect		(6,520,475)	3,384,865		(2,818,652)
Other gains (expenses) recognised directly in shareholders equity, net		(9,015,825)	(24,577,839)	(275,553)	(10,112,611)
Total earnings and reserves recognised directly in shareholders equity		**174,963,156**	**(441,506,906)**	**(54,515,369)**	
Total liabilities		5,446			
Common stock, $.0001 par value, 19,500,000 shares authorized, 9,107,177 shares issued and outstanding at March 31, 2009		1			
Series A Preferred Stock, $10 par value, 500,000 shares authorized, 47,121 shares outstanding at March 31, 2009		471			
Series B Preferred Stock, $10 par value, 300,000 shares authorized, none issued and outstanding at March 31, 2009					

Additional paid-in capital		18,698
Accumulated Deficit		(15,417)
Total stockholders' Equity		3,753
Total liabilities and stockholders' equity	$	9,199

DILUTION

Purchasers of our Series B Preferred in the rights offering will experience an immediate and substantial dilution of the net tangible book value per share of our common stock. Our net tangible book value as of March 31, 2009 was approximately $2,953,000, or $0.32 per share of our common stock (based upon 9,107,177 shares of our common stock outstanding). Net tangible book value per share is equal to our total net tangible book value, which is our total tangible assets less our total liabilities, divided by the number of shares of our outstanding common stock. Dilution per share equals the difference between the amount per share of common stock underlying the Series B Preferred paid by purchasers in this rights offering and the net tangible book value per share of our common stock immediately after the rights offering.

After giving effect to our sale of 300,000 shares of Series B Preferred, at a public offering price of $10.00 per share of Series B Preferred, or 1,500,000 shares of common stock issuable upon conversion of the Series B Preferred at a conversion ratio of five (5) shares of common stock for each share of Series B Preferred held at the time of conversion, representing an initial conversion price of $2.00 per share , and after deduction of estimated offering expenses of $391,358 payable by us, our net tangible book value as of March 31, 2009 would have been approximately $5,561,642 , or $0.52 per share of common stock. This represents an immediate increase of $0.20 in net tangible book value per share of common stock to our existing stockholders and an immediate dilution in net tangible book value of $1.48 per share of common stock to purchasers of units in this offering. The following table illustrates this per share dilution (assuming a fully subscribed for rights offering of 300,000 shares of Series B Preferred at the subscription price of $10.00 per share):

Subscription price per share of common stock upon conversion of Series B Preferred	$2.00	
Net tangible book value per share of common stock prior to the rights offering	$0.32	
Increase per share of common stock attributable to the rights offering	$0.20	
Pro forma net tangible book value per share of common stock after the rights offering	$	0.52
Dilution in net tangible book value per share of common stock to purchasers	$	1.48

DESCRIPTION OF SECURITIES TO BE REGISTERED

The following is a summary of some of the terms of the Series B Preferred and a description of our common stock. This summary contains a description of the material terms of the securities but is not necessarily complete. We refer you to our certificate of incorporation, certificates of designation of our preferred stock and by-laws, copies of which are available upon request as described under “Where You Can Find Additional Information.”

We have the authority to issue 20,000,000 shares of capital stock, consisting of 19,500,000 shares of common stock, $0.0001 par value per share, and 500,000 of preferred stock, $10.00 par value per share, which can be issued from time to time by our board of directors on such terms and conditions as they may determine. As of the date of this prospectus, there were approximately [ ] shares of common stock outstanding, 47,121 shares of Series A Convertible Preferred Stock outstanding and no shares of Series B Preferred outstanding.

Series B Convertible Preferred Stock

General. We expect to issue 300,000 shares of Series B Preferred in the rights offering and have designated an aggregate of 500,000 of our preferred shares as Series B Preferred.

Ranking. With respect to the payment of dividends and amounts upon liquidation, the Series B Preferred will rank equally with any other class or series of our stock that ranks on a par with the Series B Preferred in the payment of dividends and in the distribution of assets on any dissolution, winding-up and liquidation of Reed’s, Inc., if any, which we refer to as “Parity Stock,” will rank senior to our common stock and any other class or series of our stock over which the Series B Preferred has preference or priority in the payment of dividends or in the distribution of assets on any dissolution, winding-up and liquidation of Reed’s Inc., which we refer to as “Junior Stock,” and will rank junior, in all matters expressly provided, to our preferred stock designated as Series A Convertible Preferred stock and any class or series of capital stock of Reed’s, Inc. specifically ranking by its terms senior to the Series B Preferred “Senior Stock”.

Dividends. Subject to the prior payment in full of any dividends to which any Senior Stock is entitled pursuant to the Certificate of Incorporation, the holders of the Series B Preferred shall be entitled to receive dividends payable in kind, in common stock or in cash, in our sole discretion. Such dividends shall be cumulative and non-compounding and accrue on a daily basis for a period of three (3) years from the date of issuance of the Series B Preferred, at an annual rate equal to five percent (5%) of the original purchase price of $10.00. If we elect to pay any Series B Dividend due in common stock (“Interest Shares”), the issuance price of the Interest Shares will be equal to the 10-day volume-weighted average price of the common stock on the principal national securities exchange on which such common stock is traded.

Conversion Rights. Each share of the Series B Preferred will be convertible at the election of the holder into shares of our common stock by dividing the $10.00 stated value of the Series B Preferred by a conversion price, which will initially be $2.00 . The conversion price will be adjusted to reflect subdivisions or combinations of our common stock such as stock splits, stock dividends, recapitalizations or reverse splits.

Mandatory Conversion at Our Option. At any time after the original purchase date, if the closing price of our common stock as reported by the principal exchange or quotation system on which such common stock is traded or reported equals or exceeds $2.75 per share of common stock for five (5) consecutive trading days , then we shall have the right to cause all (but not less than all) outstanding shares of Series B Preferred Stock to be automatically converted into shares of common stock.

Mandatory Redemption. At any time after the second anniversary of the original purchase date, we may redeem all, but not less than all, of the outstanding shares of Series B Preferred at our sole discretion, at a price equal to the greater of (i) one hundred ten percent (110%) of the original purchase price, plus an amount equal to any unpaid and accrued dividends and (ii) the Fair Market Value of such number of shares of common stock which the holder of the redeemed Series B Preferred would be entitled to receive had the redeemed Series B Preferred been converted immediately prior to the redemption.

Voting. Holders of the Series B Preferred will have no voting rights, except as required by law.

Liquidation. In the event of any liquidation, dissolution or winding up of Reed's, whether voluntary or involuntary, after payment or provision for payment of debts and other liabilities of Reed's and all amounts due and owing to the holders of outstanding shares of Senior Stock, if any, each holder of Series B Preferred, before any distribution or payment is made upon any Junior Stock, shall be entitled to receive, out of our assets legally available for distribution to stockholders, an amount equal to the greater of (i) the sum of (A) the original purchase price of such shares of Series B Preferred plus (B) an amount equal to any unpaid and accrued dividends thereon up to and including the date of the liquidation event and (ii) if such share of Series B Preferred were then convertible into common stock, such amount which the holder of Series B Preferred would be entitled to receive in connection with a liquidation event if such holder had converted his, her or its Series B Preferred immediately prior to the occurrence of the liquidation event.

Anti-Dilution Rate Adjustment. The conversion rate will be adjusted, without duplication, if certain events occur:

Adjustments for Subdivisions or Combinations of Common Stock. In the event the outstanding shares of common stock shall be subdivided by stock split, stock dividend or otherwise, into a greater number of shares of common stock, the conversion price of the Series B Preferred then in effect shall, concurrently with the effectiveness of such subdivision, be proportionately decreased. In the event the outstanding shares of common stock shall be combined or consolidated into a lesser number of shares of common stock, the conversion price of the Series B Preferred then in effect shall, concurrently with the effectiveness of such combination or consolidation, be proportionately increased.

Adjustments for Non-Cash Dividends and Other Distributions. In the event Reed's makes, or fixes a record date for the determination of holders of common stock entitled to receive, any distribution (excluding repurchases of securities by the corporation not made on a pro rata basis) payable in property or in securities of Reed's other than shares of common stock, then and in each such event the holders of Series B Preferred shall receive, at the time of such distribution, the amount of property or the number of securities of Reed's that they would have received had their Series B Preferred been converted into common stock on the date of such event.

Adjustments for Reorganizations, Reclassifications or Similar Events. If the common stock shall be changed into the same or a different number of shares of any other class or classes of stock or other securities or property, whether by capital reorganization, reclassification or otherwise, then each share of Series B Preferred shall thereafter be convertible into the number of shares of stock or other securities or property to which a holder of the number of shares of common stock of Reed's deliverable upon conversion of such shares of Series B Preferred shall have been entitled upon such reorganization, reclassification or other event.

Common Stock

Holders of our common stock are entitled to one vote per share on all matters requiring a vote of stockholders, including the election of directors.

We are a Delaware corporation and our certificate of incorporation does not provide for cumulative voting. However, we may be subject to section 2115 of the California Corporations Code. Section 2115 provides that, regardless of a company's legal domicile, specified provisions of California corporations law will apply to that company if the company meets requirements relating to its property, payroll and sales in California and if more than one-half of its outstanding voting securities are held of record by persons having addresses in California, and such company is not listed on certain national securities exchanges or on the NASDAQ National Market. Among other things, section 2115 may limit our ability to elect a classified board of directors and requires cumulative voting in the election of directors. Cumulative voting is a voting scheme which allows minority stockholders a greater opportunity to have board representation by allowing those stockholders to have a number of votes equal to the number of directors to be elected multiplied by the number of votes to which the stockholder's shares are entitled and to "cumulate" those votes for one or more director nominees. Generally, cumulative voting allows minority stockholders the possibility of board representation on a percentage basis equal to their stock holding, where under straight voting those stockholders may receive less or no board representation. The Supreme Court of Delaware has recently ruled, on an issue unrelated to voting for directors, that section 2115 is an unconstitutional exception to the "internal affairs doctrine" that requires the law of the incorporating state to govern disputes involving a corporation's internal affairs, and is therefore inapplicable to Delaware corporations. The California Supreme Court has not definitively ruled on section 2115, although certain lower courts of appeal have upheld section 2115. As a result, there is a conflict as to whether section 2115 applies to Delaware corporations. Pending the resolution of these conflicts, in the event our shares are not listed on a national exchange, we will not elect directors by cumulative voting.

Christopher J. Reed, our President, Chief Executive Officer and Chairman of the board of directors, holds approximately 35% of our outstanding common stock. Consequently, Mr. Reed, as our principal stockholder, has the power, and may continue to have the power, to have significant control over the outcome of any matter on which the stockholders may vote.

Holders of our common stock are entitled to receive dividends only if we have funds legally available and the board of directors declares a dividend.

Holders of our common stock do not have any rights to purchase additional shares. This right is sometimes referred to as a preemptive right.

Upon a liquidation or dissolution, whether in bankruptcy or otherwise, holders of common stock rank behind our secured and unsecured debt holders, and behind any holder of any series of our preferred stock.

Anti-Takeover Effects of Delaware Law and Our Certificate of Incorporation

Certain provisions of Delaware law and our certificate of incorporation could make more difficult the acquisition of us by means of a tender offer or otherwise, and the removal of incumbent officers and directors. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of us.

Our Certificate of Incorporation and Bylaws include provisions that allow the board of directors to issue, without further action by the stockholders, up to 500,000 shares of undesignated preferred stock.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law regulating corporate takeovers. In general, Section 203 prohibits a publicly-held Delaware corporation from engaging under certain circumstances, in a business combination with an interested stockholder for a period of three years following the date the person became an interested stockholder unless:

- prior to the date of the transaction, the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder.

- upon completion of the transaction that resulted in the stockholder becoming an interested stockholder, the stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding (1) shares owned by persons who are directors and also officers and (2) shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer.

- on or subsequent to the date of the transaction, the business combination is approved by the board and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66 2 /3 % of the outstanding voting stock which is not owned by the interested stockholder.

Generally, a business combination includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. An interested stockholder is a person who, together with affiliates and associates, owns or, within three years prior to the determination of interested stockholder status, did own 15% or more of a corporation's outstanding voting securities. The existence of this provision may have an anti-takeover effect with respect to transactions our board of directors does not approve in advance. Section 203 may also discourage attempts that might result in a premium over the market price for the shares of common stock held by stockholders.

These provisions of Delaware law and our certificate of incorporation could have the effect of discouraging others from attempting hostile takeovers and, as a consequence, they may also inhibit temporary fluctuations in the market price of our common stock that often result from actual or rumored hostile takeover attempts. These provisions may also have the effect of preventing changes in our management. It is possible that these provisions could make it more difficult to accomplish transactions that stockholders may otherwise deem to be in their best interests.

Transfer Agent

Transfer On-Line, Inc., 317 SW Alder Street, 2nd Floor, Portland, Oregon, 92704 is our registrar and transfer agent for our common stock. We have engaged Continental Stock Transfer & Trust Company to act as the subscription agent in connection with this offering and to act as transfer agent for the rights to be distributed in this offering.

INTERESTS OF NAMED EXPERTS AND COUNSEL

Weinberg & Company, P.A., independent registered public accounting firm, has audited our financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008, as set forth in their report, which is incorporated by reference in the prospectus and elsewhere in this registration statement. Our financial statements are incorporated by reference in reliance on Weinberg & Company, P.A.'s report, given on their authority as experts in accounting and auditing. The validity of the shares of Series B Preferred offered hereby has been passed upon for us by Qashu & Schoenthaler LLP, Los Angeles, California. Weinstein Smith LLP, New York, New York, has acted as counsel to the dealer-manager. None of these experts have been employed by us on a contingent basis with respect to the sale or registration under this prospectus of the securities. None of these experts have been employed by us on a contingent basis with respect to the sale or registration under this prospectus of the securities.

THE RIGHTS OFFERING

Terms of the Offer

We are distributing at no charge to the holders of our common stock on August [ ], 2009, subscription rights to purchase up to an aggregate of 300,000 shares of our Series B Preferred. We expect the total purchase price for the securities offered in this rights offering to be $3,000,000, assuming full participation in the rights offering. See below for additional information regarding subscription by DTC participants.

Each record date stockholder is being issued one right for every share of our Series B Preferred owned on the record date. Each right carries with it a basic subscription right and an over-subscription right.

Four (4) rights entitle the holder to purchase one share of Series B Preferred at the subscription price of $10.00 per share, which we refer to as the basic subscription right.

Holders who fully exercise their basic subscription rights will be entitled to subscribe for additional shares of Series B Preferred that remain unsubscribed as a result of any unexercised basic subscription rights, which we refer to as the over-subscription right. The over-subscription right allows a holder to subscribe for an additional amount equal to up to 400% of the shares for which such holder was otherwise entitled to subscribe. Over-subscription rights are exercisable at the same price per whole share as basic subscription rights. Over-subscription rights will be allocated pro rata among rights holders who over-subscribed, based on the number of over-subscription shares to which they subscribed. Rights may only be exercised for whole numbers of shares; no fractional shares of Series B Preferred will be issued in this offering. The percentage of remaining shares each over-subscribing rights holder may acquire will be rounded down to result in delivery of whole shares. You must exercise your rights with respect to the basic subscription right and the over-subscription right at the same time.

Rights may be exercised at any time during the subscription period, which commences on August [ ], 2009 and ends at 5:00 p.m., New York City time, on [ ], 2009, the expiration date, unless extended by us for up to an additional 30 trading days, in our sole discretion.

The rights will be evidenced by subscription rights certificates which will be mailed to stockholders, except as discussed below under "Foreign Stockholders." The subscription rights are transferable and will be listed for trading on the NASDAQ Capital Market under the symbol "REEDR" during the course of this offering.

For purposes of determining the number of shares a rights holder may acquire in this offering, brokers, dealers, custodian banks, trust companies or others whose shares are held of record by Cede & Co. or by any other depository or nominee will be deemed to be the holders of the rights that are issued to Cede or the other depository or nominee on their behalf.

There is no minimum subscription amount. We will we not raise more than $3,000,000 in this offering.

Allocation and Exercise of Over-Subscription Rights

In order to properly exercise an over-subscription right, a rights holder must: (i) indicate on its subscription rights certificate that it submits with respect to the exercise of the rights issued to it how many additional shares it is willing to acquire pursuant to its over-subscription right and (ii) concurrently deliver the subscription payment related to your over-subscription right at the time you make payment for your basic subscription right.

If there are sufficient remaining shares, all over-subscription requests will be honored in full. If requests for shares pursuant to the over-subscription right exceed the remaining shares available, the available remaining shares will be allocated pro rata among rights holders who over-subscribe based on the number of over-subscription shares to which they subscribe. The percentage of remaining shares each over-subscribing rights holder may acquire will be rounded down to result in delivery of whole shares. The allocation process will assure that the total number of remaining shares available for over-subscriptions is distributed on a pro rata basis. The formula to be used in allocating the available excess shares is as follows:

Number of Over-Subscription Shares Subscribed to by Exercising Rights Holder Total Number of Over-Subscription Shares Available for Rights Holders Exercising Their Over-Subscription Right	X	Shares Available for Rights Holders Exercising Their Over-Subscription Right

Rights payments for basic subscriptions and over-subscriptions will be deposited upon receipt by the subscription agent and held in a segregated account with the subscription agent pending a final determination of the number of shares to be issued pursuant to the over-subscription right. If the pro rated amount of shares allocated to you in connection with your over-subscription right is less than your over-subscription request, then the excess funds held by the subscription agent on your behalf will be returned to you promptly without interest or deduction. We will deliver certificates representing your shares of our Series B Preferred or credit your account at your nominee holder with shares of our Series B Preferred that you purchased pursuant to your over-subscription right as soon as practicable after the rights offering has expired and all proration calculations and reductions contemplated by the terms of the rights offering have been effected.

Brokers, dealers, custodian banks, trust companies and other nominee holders of rights will be required to certify to the subscription agent, before any over-subscription right may be exercised with respect to any particular beneficial owner, as to the aggregate number of rights exercised pursuant to the basic subscription right and the number of shares subscribed for pursuant to the over-subscription right by such beneficial owner.

Pro Rata Allocation if Insufficient Shares are Available for Issuance

If we receive a sufficient number of subscriptions, the aggregate dollar amount of the exercises could exceed the maximum dollar amount of this offering. In each case, we would reduce on a pro rata basis, the number of subscriptions we accept so that: (i) we will not become obligated to issue, upon exercise of the subscriptions, a greater number of shares of Series B Preferred than we have authorized and available for issuance and (ii) the gross proceeds of this offering will not exceed the maximum dollar amount of this offering. In the event of any pro rata reduction, we would first reduce over-subscriptions prior to reducing basic subscriptions.

Expiration of the Rights Offering and Extensions, Amendments, and Termination

Expiration and Extensions. You may exercise your subscription rights at any time before 5:00 p.m., New York City time, on [ ] , 2009, the expiration date of the rights offering, unless extended. If the rights offering is undersubscribed, our board of directors may extend the expiration date for exercising your subscription rights for up to an additional 30 trading days, in their sole discretion. If we extend the expiration date, you will have at least ten trading days during which to exercise your rights. Any extension of this offering will be followed as promptly as practicable by an announcement, and in no event later than 9:00 a.m., New York City time, on the next business day following the previously scheduled expiration date.

We may choose to extend the expiration date of the rights in order to give investors more time to exercise their subscription rights in the rights offering. We may extend the expiration date of the rights offering by giving oral or written notice to the subscription agent and information agent on or before the scheduled expiration date. If we elect to extend the expiration date, we will issue a press release announcing such extension no later than 9:00 a.m., New York City time, on the next business day after the most recently announced expiration date.

Any rights not exercised at or before that time will have no value and expire without any payment to the holders of those unexercised rights. We will not be obligated to honor your exercise of subscription rights if the subscription agent receives the documents relating to your exercise after the rights offering expires, regardless of when you transmitted the documents.

Termination; Cancellation. We may cancel or terminate the rights offering at any time prior to the expiration date. Any cancellation or termination of this offering will be followed as promptly as practicable by an announcement or termination.

Reasons for the Rights Offering; Determination of the Offering Price

We are making the rights offering to raise funds for production of inventory, as well as for general working capital purposes. Prior to approving the rights offering, our board of directors carefully considered current market conditions and financing opportunities, as well as the potential dilution of the ownership percentage of the existing holders of our common stock that may be caused by the rights offering.

After weighing the factors discussed above and the effect of the $3,000,000 in additional capital, before expenses, that may be generated by the sale of shares pursuant to the rights offering, our board of directors believes that the rights offering is in the best interests of our company. As described in the section of this prospectus entitled “Use of Proceeds,” the proceeds from the rights offering, less fees and expenses incurred in connection with this offering, will be used for production of inventory, as well as for general working capital purposes. Although we believe that the rights offering will strengthen our financial condition, our board of directors is not making any recommendation as to whether you should exercise your subscription rights.

The subscription price per share for the rights offering was set by our board of directors. In determining the subscription price, the board of directors considered, among other things, the following factors:

the historical and current market price of our common stock;

the fact that holders of rights will have an over-subscription right;

the terms and expenses of this offering relative to other alternatives for raising capital,

the size of this offering; and

the general condition of the securities market.

Information Agent

MacKenzie Partners, Inc. will act as the information agent in connection with this offering. The information agent will receive for its services a fee estimated to be approximately $6,500 plus reimbursement of all reasonable out-of-pocket expenses related to this offering. The information agent can be contacted at the address below:

MacKenzie Partners, Inc.
105 Madison Avenue
New York, NY 10016
Collect: (212) 929-5500
Toll-free: (800) 322-2885
Email: reedrights@mackenziepartners.com

Subscription Agent

Continental Stock Transfer & Trust Company will act as the subscription agent in connection with this offering. The subscription agent will receive for its administrative, processing, invoicing and other services a fee estimated to be approximately $15,000 plus reimbursement for all reasonable out-of-pocket expenses related to this offering.

Completed subscription rights certificates must be sent together with full payment of the subscription price for all shares subscribed for through the exercise of the subscription right and the over-subscription right to the subscription agent by one of the methods described below.

We will accept only properly completed and duly executed subscription rights certificates actually received at any of the addresses listed below, at or prior to 5:00 p.m., New York City time, on the expiration date of this offering. See "Payment for Shares" below. In this prospectus, close of business means 5:00 p.m., New York City time, on the relevant date.

Subscription Rights Certificate Delivery Method	Address/Number
By Mail/Commercial Courier/Hand Delivery:	Continental Stock Transfer & Trust Company 17 Battery Place, 8th Floor New York, NY 10004 (212) 509-4000, x 536

Delivery to an address other than the address listed above will not constitute valid delivery and, accordingly, may be rejected by us.

Any questions or requests for assistance concerning the method of subscribing for shares or for additional copies of this prospectus or subscription rights certificates may be directed to the subscription agent at its telephone number and address listed below:

Continental Stock Transfer & Trust Company
Attn: [ ]
17 Battery Place, 8th Floor
New York, NY 10004
(212) 509-4000, x 536

Stockholders may also contact their broker, dealer, custodian bank, trustee or other nominee for information with respect to this offering.

Methods for Exercising Rights

Rights are evidenced by subscription rights certificates that, except as described below under "Foreign Stockholders," will be mailed to record date stockholders or, if a record date stockholder's shares are held by a depository or nominee on his, her or its behalf, to such depository or nominee. Rights may be exercised by completing and signing the subscription rights certificate that accompanies this prospectus and mailing it in the envelope provided, or otherwise delivering the completed and duly executed subscription rights certificate to the subscription agent, together with payment in full for the shares at the subscription price by the expiration date of this offering. Completed subscription rights certificates and related payments must be received by the subscription agent prior to 5:00 p.m., New York City time, on or before the expiration date, at the offices of the subscription agent at the address set forth above.

Exercise of the Over-Subscription Right

Rights holders who fully exercise all basic subscription rights issued to them may participate in the over-subscription right by indicating on their subscription rights certificate the number of shares they are willing to acquire. If sufficient remaining shares are available after the basic subscription, all over-subscriptions will be honored in full; otherwise, remaining shares will be allocated on a pro rata basis as described under “Allocation of Over-Subscription Right” above.

Record Date Stockholders Whose Shares are Held by a Nominee

Record date stockholders whose shares are held by a nominee, such as a broker, dealer, custodian bank, trustee or other nominee, must contact that nominee to exercise their rights. In that case, the nominee will complete the subscription rights certificate on behalf of the record date stockholder and arrange for proper payment by one of the methods set forth under “Payment for Shares” below.

Nominees

Nominees, such as brokers, dealers, custodian banks, trustees or depositories for securities, who hold shares for the account of others, should notify the respective beneficial owners of the shares as soon as possible to ascertain the beneficial owners’ intentions and to obtain instructions with respect to the rights. If the beneficial owner so instructs, the nominee should complete the subscription rights certificate and submit it to the subscription agent with the proper payment as described under “Payment for Shares” below.

General

All questions as to the validity, form, eligibility (including times of receipt and matters pertaining to beneficial ownership) and the acceptance of subscription forms and the subscription price will be determined by us, which determinations will be final and binding. No alternative, conditional or contingent subscriptions will be accepted. We reserve the right to reject any or all subscriptions not properly submitted or the acceptance of which would, in the opinion of our counsel, be unlawful.

We reserve the right to reject any exercise if such exercise is not in accordance with the terms of this rights offering or not in proper form or if the acceptance thereof or the issuance of shares of our Series B Preferred thereto could be deemed unlawful. We reserve the right to waive any deficiency or irregularity with respect to any subscription rights certificate. Subscriptions will not be deemed to have been received or accepted until all irregularities have been waived or cured within such time as we determine in our sole discretion. We will not be under any duty to give notification of any defect or irregularity in connection with the submission of subscription rights certificates or incur any liability for failure to give such notification.

Rights are Transferable

The rights are transferable and will be listed for trading on the NASDAQ Capital Market under the symbol “REEDR” during the course of this offering.

Foreign Stockholders

Subscription rights certificates will not be mailed to foreign stockholders. A foreign stockholder is any record holder of common stock on the record date whose address of record is outside the United States and Canada, or is an Army Post Office (APO) address or Fleet Post Office (FPO) address. Foreign stockholders will be sent written notice of this offering. The subscription agent will hold the rights to which those subscription rights certificates relate for these

stockholders' accounts, subject to that stockholder making satisfactory arrangements with the subscription agent for the exercise of the rights, and follow the instructions of such stockholder for the exercise of the rights if such instructions are received by the subscription agent at or before [ ], New York City time, on [ ] , 2009, three business days prior to the expiration date (or, if this offering is extended, on or before three business days prior to the extended expiration date). If no instructions are received by the subscription agent by that time, the rights will expire worthless without any payment to the holders of those unexercised rights.

Payment for Shares

A participating rights holder may send the subscription rights certificate together with payment for the shares acquired in the subscription right and any additional shares subscribed for pursuant to the over-subscription right to the subscription agent based on the subscription price of $10.00 per share. To be accepted, the payment, together with a properly completed and executed subscription rights certificate, must be received by the subscription agent at one of the subscription agent's offices set forth above (see "—Subscription Agent"), at or prior to 5:00 p.m., New York City time, on the expiration date.

All payments by a participating rights holder must be in U.S. dollars by money order or check or bank draft drawn on a bank or branch located in the U.S. and payable to [ ]. Payment also may be made by wire transfer to [ ] , ABA No. [ ], Account No. [ ], [ ] for benefit of (FBO) Reed's, Inc., with reference to the rights holder's name. The subscription agent will deposit all funds received by it prior to the final payment date into a segregated account pending pro-ration and distribution of the shares.

The method of delivery of subscription rights certificates and payment of the subscription price to us will be at the election and risk of the participating rights holders, but if sent by mail it is recommended that such certificates and payments be sent by registered mail, properly insured, with return receipt requested, and that a sufficient number of days be allowed to ensure delivery to the subscription agent and clearance of payment prior to 5:00 p.m., New York City time, on the expiration date. Because uncertified personal checks may take at least five business days to clear, you are strongly urged to pay, or arrange for payment, by means of certified or cashier's check or money order.

Whichever of the methods described above is used, issuance of the shares purchased is subject to collection of checks and actual payment.

If a participating rights holder who subscribes for shares as part of the subscription right or over-subscription right does not make payment of any amounts due by the expiration date, the subscription agent reserves the right to take any or all of the following actions: (i) reallocate the shares to other participating rights holders in accordance with the over-subscription right; (ii) apply any payment actually received by it from the participating rights holder toward the purchase of the greatest whole number of shares which could be acquired by such participating rights holder upon exercise of the basic subscription any over-subscription right; and/or (iii) exercise any and all other rights or remedies to which it may be entitled, including the right to set off against payments actually received by it with respect to such subscribed for shares.

All questions concerning the timeliness, validity, form and eligibility of any exercise of rights will be determined by us, whose determinations will be final and binding. We, in our sole discretion, may waive any defect or irregularity, or permit a defect or irregularity to be corrected within such time as we may determine, or reject the purported exercise of any right. Subscriptions will not be deemed to have been received or accepted until all irregularities have been waived or cured within such time as we determine in our sole discretion. The subscription agent will not be under any duty to give notification of any defect or irregularity in connection with the submission of subscription rights certificates or incur any liability for failure to give such notification.

Participating rights holders will have no right to rescind their subscription after receipt of their payment for shares.

Delivery of Stock Certificates

Stockholders whose shares are held of record by Cede & Co. or by any other depository or nominee on their behalf or on behalf of their broker, dealer, custodian bank, trustee or other nominee will have any shares that they acquire credited to the account of Cede & Co. or the other depository or nominee. With respect to all other stockholders, stock certificates for all shares acquired will be mailed promptly after payment for all the shares subscribed for has cleared.

Distribution Arrangements

Source Capital Group, Inc., which is a broker-dealer and member of FINRA (formerly the NASD), is the dealer-manager for this offering. The principal business address of the dealer-manager is 276 Post Road West, Westport, CT 06880.

Under the terms and subject to the conditions contained in a dealer-manager agreement which we will enter into, the dealer-manager will act as sole placement agent and provide marketing services in connection with this offering and will solicit the exercise of rights and participation in the over-subscription right. This offering is not contingent upon any number of rights being exercised. Source Capital Group, Inc. is not underwriting any of the rights or the shares of our Series B Preferred being sold in this offering.

Pursuant to the dealer-manager agreement, we are obligated to pay to Source Capital Group, Inc. as compensation 7% of the gross proceeds of this offering in cash, warrants to purchase 5% of the shares of common stock underlying the Series B Preferred sold in this offering priced at 125% of the effective initial conversion price and a non-accountable expense allowance equal to $10,000 upon completion of the rights offering and to indemnify the dealer-manager for, or contribute to losses arising out of, certain liabilities, including liabilities under the Securities Act of 1933. The warrants will not be redeemable. The warrants and the shares issuable upon exercise of the warrants will be non-transferable for a period of six months following the expiration date of the offering, except that they may be transferred to any successor, manager or member of Source Capital Group, Inc. as permitted by FINRA Rule 5110(g). The warrants may be exercised in full or in part as of the date of issuance and provide for cashless exercise, customary anti-dilution rights and contain provisions for one demand registration of the sale of the underlying shares of common stock for a period of five years after the expiration date of the offering at our expense, an additional demand registration at the warrant holder’s expense and piggyback registration rights for a period of five years after the expiration date of the offering at our expense. Pursuant to the dealer-manager agreement we will enter into with Source Capital Group, Inc., Source Capital Group, Inc. will not be subject to any liability to us in rendering the services contemplated by the dealer-manager agreement except for any act of bad faith or gross negligence of Source Capital Group, Inc.

Source Capital Group, Inc. and its affiliates may provide to us, from time to time, in the future, in the ordinary course of their business, certain financial advisory, investment banking and other services for which they will be entitled to receive fees.

PLAN OF DISTRIBUTION

On or about August ____, 2009, we will distribute the rights, subscription rights certificates and copies of this prospectus to the holders of our common stock on the record date. Rights holders who wish to exercise their rights and purchase shares of our Series B Preferred must complete the rights certificate and return it with payment for the shares to the subscription agent at the following address:

Continental Stock Transfer & Trust Company
Attn: Reorganization Department
17 Battery Place, 8th Floor
New York, NY 10004

See “The Rights Offering — Method of Exercising Rights.” If you have any questions, you should contact Continental Stock Transfer & Trust Company.

Other than as described in this prospectus, we do not know of any existing agreements between any shareholder, broker, dealer, underwriter or agent relating to the sale or distribution of the underlying common stock.

To the extent required, we will file, during any period in which offers or sales are being made, a supplement to this prospectus which sets forth, with respect to a particular offering, the specific number of shares of common stock to be sold, the name of the holder, the sales price, the name of any participating broker, dealer, underwriter or agent, any applicable commission or discount and any other material information with respect to the plan of distribution not previously disclosed.

Source Capital Group, Inc., which is a broker-dealer and member of FINRA (formerly the NASD), is the dealer-manager for this offering. The principal business address of the dealer-manager is 276 Post Road West, Westport, CT 06880.

Under the terms and subject to the conditions contained in a dealer-manager agreement which we will enter into, the dealer-manager will act as sole placement agent and provide marketing services in connection with this offering and will solicit the exercise of rights and participation in the over-subscription right. This offering is not contingent upon any number of rights being exercised. Source Capital Group, Inc. is not underwriting any of the rights or the shares of our Series B Preferred being sold in this offering.

Pursuant to the dealer-manager agreement, we are obligated to pay to Source Capital Group, Inc. as compensation 7% of the gross proceeds of this offering in cash, warrants to purchase 5% of the shares of common stock underlying the Series B Preferred sold in this offering priced at 125% of the effective initial conversion price and a non-accountable expense allowance equal to $10,000 upon completion of the rights offering and to indemnify the dealer-manager for, or contribute to losses arising out of, certain liabilities, including liabilities under the Securities Act of 1933. The warrants will not be redeemable. The warrants and the shares issuable upon exercise of the warrants will be non-transferable for a period of six months following the expiration date of the offering, except that they may be transferred to any successor, manager or member of Source Capital Group, Inc. as permitted by FINRA Rule 5110(g). The warrants may be exercised in full or in part as of the date of issuance and provide for cashless exercise, customary anti-dilution rights and contain provisions for one demand registration of the sale of the underlying shares of common stock for a period of five years after the expiration date of the offering at our expense, an additional demand registration at the warrant holder's expense and piggyback registration rights for a period of five years after the expiration date of the offering at our expense. Pursuant to the dealer-manager agreement we will enter into with Source Capital Group, Inc., Source Capital Group, Inc. will not be subject to any liability to us in rendering the services contemplated by the dealer-manager agreement except for any act of bad faith or gross negligence of Source Capital Group, Inc.

Source Capital Group, Inc. and its affiliates may provide to us, from time to time, in the future, in the ordinary course of their business, certain financial advisory, investment banking and other services for which they will be entitled to receive fees.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a summary of the material federal income tax consequences of the rights offering to holders of common stock that hold such stock as a capital asset for federal income tax purposes. This discussion is based on laws, regulations, rulings and decisions in effect on the date of this prospectus, all of which are subject to change (possibly with retroactive effect) and to differing interpretations. This discussion applies only to holders that are U.S. persons, which is defined as a citizen or resident of the United States, a domestic partnership, a domestic corporation, any estate the income of which is subject to U.S. federal income tax regardless of its source, and any trust so long as a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.

This discussion does not address all aspects of federal income taxation that may be relevant to holders in light of their particular circumstances or to holders who may be subject to special tax treatment under the Internal Revenue Code of 1986, as amended, including, but not limited to, holders who are subject to the alternative minimum tax, holders who are dealers in securities or foreign currency, foreign persons (defined as all persons other than U.S. persons), U.S. holders that have a principal place of business or "tax home" outside the U.S., any entity treated as a partnership for U.S. federal income tax purposes, insurance companies, tax-exempt organizations, banks, financial institutions, broker-dealers, holders who hold common stock as part of a hedge, straddle, conversion or other risk reduction transaction, or who acquired common stock pursuant to the exercise of compensatory stock options or warrants or otherwise as compensation.

We have not sought, and will not seek, an opinion of counsel or a ruling from the Internal Revenue Service regarding the federal income tax consequences of the rights offering or the related share issuances. The IRS could take positions concerning the tax consequences of the rights offering or the related share issuances that are different from those described in this discussion and, if litigated, a court could sustain any such positions taken by the IRS. In addition, the following summary does not address the tax consequences of the rights offering or the related share issuances under foreign, state, or local tax laws.

THIS SUMMARY IS ONLY A GENERAL DISCUSSION AND IS NOT INTENDED TO BE, AND SHOULD NOT BE CONSTRUED TO BE, LEGAL, OR TAX ADVICE. THE U.S. FEDERAL INCOME TAX TREATMENT OF THE RIGHTS IS COMPLEX AND POTENTIALLY UNFAVORABLE TO U.S. HOLDERS. ACCORDINGLY, EACH U.S. HOLDER WHO ACQUIRES RIGHTS IS STRONGLY URGED TO CONSULT HIS, HER OR ITS OWN TAX ADVISER WITH RESPECT TO THE U.S. FEDERAL, STATE, LOCAL AND FOREIGN INCOME, ESTATE AND OTHER TAX CONSEQUENCES OF THE ACQUISITION OF THE RIGHTS, WITH SPECIFIC REFERENCE TO SUCH PERSON'S PARTICULAR FACTS AND CIRCUMSTANCES.

THE FEDERAL TAX DISCUSSION CONTAINED IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, BY ANY PERSON FOR THE PURPOSE OF AVOIDING ANY PENALTIES THAT MAY BE IMPOSED BY THE CODE. THE FEDERAL TAX DISCUSSION CONTAINED IN THIS PROSPECTUS WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTION DESCRIBED IN THIS PROSPECTUS. PROSPECTIVE INVESTORS SHOULD SEEK ADVICE FROM THEIR OWN INDEPENDENT TAX ADVISORS CONCERNING THE FEDERAL, STATE AND LOCAL TAX CONSEQUENCES OF AN INVESTMENT IN THE COMPANY BASED ON THEIR PARTICULAR CIRCUMSTANCES.

Subscription Rights

Receipt. Generally, the distribution by a corporation to the holders of its common stock of rights to acquire its convertible preferred stock will be treated for tax purposes as a distribution of the convertible preferred stock itself. The distribution by a corporation of convertible preferred stock to holders of its common stock will not be taxable unless the distribution of such stock would result in a "disproportionate" distribution. A distribution of convertible preferred stock will be treated as disproportionate when considering all relevant facts and circumstances such as the time within which the conversion right must be exercised, the dividend rate, the marketability of the stock and the conversion price, the distribution is likely to result in some shareholders exercising their conversion rights and receiving common stock and others receiving money or other property. According to applicable Treasury regulations, a distribution of convertible preferred stock is unlikely to result in a disproportionate distribution under circumstances where (i) the conversion right may be exercised over a long period (e.g., 20 years) and (ii) the dividend rate is consistent with market conditions at the time the convertible preferred stock is distributed. In contrast, Treasury regulations provide that a distribution of convertible preferred stock is likely to result in a disproportionate distribution under circumstances where (i) the conversion right must be exercised within a relatively short period (e.g., four

months) and (ii) taking into account additional factors such as the conversion price, dividend rate, redemption provisions and marketability of the convertible preferred stock it may be anticipated that some shareholders will exercise their conversion right and some will not. Because the determination of whether a distribution of convertible preferred stock will be treated as disproportionate or not is based on all relevant facts and circumstances, and because the applicable Treasury regulations only provide specific guidance in the more extreme cases, it is not possible to definitively conclude whether the distribution of the Series B Preferred to holders of common stock would be considered to result in a “disproportionate” distribution.

In the event the IRS successfully asserts that your receipt of subscription rights is currently taxable, the discussion under the heading “Alternative Treatment of Subscription Rights” describes the tax consequences that will result from such a determination. The remainder of the discussion under this heading “Subscription Rights” assumes that the distribution of the subscription rights in the rights offering will not result in a “disproportionate” distribution.

Tax Basis and Holding Period. The tax basis of the subscription rights received by a holder in the rights offering will be zero, unless (a) the fair market value of the subscription rights on the date such subscription rights are distributed is equal to at least 15% of the fair market value on such date of the common stock with respect to which the subscription rights are received, or (b) you elect, by attaching a statement to your federal income tax return for the taxable year in which the subscription rights are received, to allocate basis to the subscription rights, in either of which cases, your tax basis in the common stock will be allocated between the common stock and the subscription rights in proportion to their respective fair market values on the date the subscription rights are distributed. Your holding period for the subscription rights received in the rights offering will include your holding period for the common stock with respect to which the subscription rights were received.

Expiration. You will not recognize any gain or loss if you allow the subscription rights received in the rights offering to expire, and your tax basis is the common stock with respect to which such subscription rights were distributed will be equal to the tax basis of such common stock immediately before the receipt of the subscription rights in the rights offering.

Alternative Treatment of Subscription Rights

Receipt. If the IRS were to successfully assert that the distribution of the subscription rights in the rights offering resulted in a “disproportionate” distribution, each holder would be considered to have received a distribution with respect to such holder’s common stock in an amount equal to the fair market value of the subscription rights received by such holder on the date of the distribution. This distribution generally would be taxed as dividend income to the extent of your ratable share of our current and accumulated earnings and profits. Under current law for taxable years beginning prior to January 1, 2011, so long as certain holding period requirements are satisfied, the maximum federal income tax rate on most dividends received by individuals is generally 15%. Your tax basis in the subscription rights received pursuant to the rights offering would be equal to their fair market value on the date of distribution and the holding period for the rights would begin upon receipt. The remainder of the discussion under this heading “Alternative Treatment of the Subscription Rights” assumes that a holder’s receipt of subscription rights in the rights offering is a taxable event.

Expiration. If your subscription rights lapse without being exercised, you will recognize a capital loss equal to your tax basis in such expired subscription rights. The deductibility of capital losses is subject to limitations.

Exercise; Tax Basis in and Holding Period of Series B Convertible Preferred Stock

You will not recognize any gain or loss upon the exercise of the subscription rights received in the rights offering. The tax basis of the Series B Preferred acquired through exercise of the subscription rights will equal the sum of the subscription price for the Series B Preferred and your tax basis, if any, in the subscription rights as described above. Your holding period for the Series B Preferred acquired through exercise of the subscription rights will begin on the date the subscription rights are exercised.

Series B Convertible Preferred Stock

The following is a summary of certain U.S. federal income tax and, for non-U.S. holders (as defined below), estate tax consequences of the purchase, ownership, conversion and disposition of the Series B Preferred and our common stock received in respect thereof as of the date hereof. Except where noted, this summary deals only with the Series B Preferred and our common stock held as capital assets. As used herein, the term "U.S. holder" means a beneficial owner of the Series B Preferred or our common stock that is for U.S. federal income tax purposes:

an individual citizen or resident of the United States;

a corporation (or any other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia;

an estate the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust if it (1) is subject to the primary supervision of a court within the United States and one or more United States persons have the authority to control all substantial decisions of the trust or (2) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a United States person.

As used herein, the term "non-U.S. holder" means a beneficial owner of the Series B Preferred or our common stock that is neither a U.S. holder nor a partnership (or other entity treated as a partnership for U.S. federal income tax purposes).

This summary is not a detailed description of the U.S. federal income tax consequences applicable to you if you are subject to special treatment under the U.S. federal income tax laws, including if you are:

a dealer in securities or currencies;
a financial institution;
a regulated investment company;
a real estate investment trust;
an insurance company;
a tax-exempt organization;
a person holding the Series B Preferred or our common stock as part of a hedging, integrated, conversion or constructive sale transaction or a straddle;
a trader in securities that has elected the mark-to-market method of accounting for your securities;
a person liable for alternative minimum tax;
a partnership or other pass-through entity for U.S. federal income tax purposes;
a person who is an investor in a pass-through entity;
a U.S. holder whose "functional currency" is not the U.S. dollar;
a "controlled foreign corporation";
a "passive foreign investment company"; or
a United States expatriate.

This summary is based upon the provisions of the Internal Revenue Code of 1986, as amended (the "Code"), and regulations, rulings and judicial decisions as of the date hereof. Those authorities may be changed, perhaps retroactively, so as to result in U.S. federal income and estate tax consequences different from those summarized below.

If a partnership holds the Series B Preferred or our common stock, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. If you are a partner of a partnership holding the Series B Preferred or our common stock, you should consult your own tax advisors.

This summary does not contain a detailed description of all the U.S. federal income and estate tax consequences to you in light of your particular circumstances and does not address the effects of any state, local or non-U.S. tax laws. If you are considering the purchase, ownership or disposition of the Series B Preferred, you should consult your own tax advisors concerning the U.S. federal income and estate tax consequences to you in light of your particular situation as well as any consequences arising under the laws of any other taxing jurisdiction.

U.S. Holders

Dividends. Distributions on the Series B Preferred or our common stock will be dividends for U.S. federal income tax purposes to the extent paid out of our current or accumulated earnings and profits, as determined for U.S. federal income tax purposes, and will be taxable as ordinary income, although possibly at reduced rates, as discussed below. We cannot guarantee that our current and accumulated earnings and profits will be such that all distributions paid with respect to the Series B Preferred or our common stock will qualify as dividends for U.S. federal income tax purposes. Our accumulated earnings and profits and our current earnings and profits in future years will depend in significant part on our future profits or losses, which we cannot accurately predict. To the extent that the amount of any distribution paid on the Series B Preferred or our common stock exceeds our current and accumulated earnings and profits attributable to that share of the Series B Preferred or our common stock, the distribution will be treated first as a tax-free return of capital and will be applied against and will reduce the U.S. holder's adjusted tax basis (but not below zero) in that share of the Series B Preferred or our common stock. This reduction in basis will increase any gain, or reduce any loss realized by the U.S. holder on the subsequent sale, redemption or other disposition of the Series B Preferred or our common stock. The amount of any such distribution in excess of the U.S. holder's adjusted tax basis will be taxed as capital gain. For purposes of the remainder of the discussion under this heading, it is assumed that distributions paid on the Series B Preferred or our common stock will constitute dividends for U.S. federal income tax purposes.

If a U.S. holder is a corporation, dividends that are received by it will generally be eligible for a 70% dividends received deduction under the Code. However, the Code disallows this dividends received deduction in its entirety if the Series B Preferred or our common stock with respect to which the dividend is paid is held by such U.S. holder for less than 46 days during the 91-day period beginning on the date which is 45 days before the date on which the Series B Preferred or our common stock becomes ex-dividend with respect to such dividend. (A 91-day minimum holding period applies to any dividends on the Series B Preferred that are attributable to periods in excess of 366 days.)

Under current law, if a U.S. holder is an individual or other non-corporate holder, dividends received by such U.S. holder generally will be subject to a reduced maximum tax rate of 15% for taxable years beginning before January 1, 2011, after which the rate applicable to dividends is scheduled to return to the tax rate generally applicable to ordinary income. The rate reduction does not apply to dividends received to the extent that U.S. holders elect to treat the dividends as "investment income," for purposes of the rules relating to the limitation on the deductibility of investment-related interest, which may be offset by investment expense. Furthermore, the rate reduction will also not apply to dividends that are paid to such holders with respect to the Series B Preferred or our common stock that is held by the holder for less than 61 days during the 121-day period beginning on the date which is 60 days before the date

on which the Series B Preferred or our common stock become ex-dividend with respect to such dividend. (A 91-day minimum holding period applies to any dividends on the Series B Preferred that are attributable to periods in excess of 366 days.)

In general, for purposes of meeting the holding period requirements for both the dividends received deduction and the reduced maximum tax rate on dividends described above, U.S. holders may not count towards their holding period any period in which they (a) have the option to sell, are under a contractual obligation to sell, or have made (and not closed) a short sale of the Series B Preferred or our common stock, as the case may be, or substantially identical stock or securities, (b) are the grantor of an option to buy the Series B Preferred or our common stock, as the case may be, or substantially identical stock or securities or (c) otherwise have diminished their risk of loss on the Series B Preferred or our common stock, as the case may be, by holding one or more other positions with respect to substantially similar or related property. The U.S. Treasury regulations provide that a taxpayer has diminished its risk of loss on stock by holding a position in substantially similar or related property if the taxpayer is, including, without limitation, the beneficiary of a guarantee, surety agreement or similar arrangement that provides for payments that will substantially offset decreases in the fair market value of the stock. In addition, the Code disallows the dividends received deduction as well as the reduced maximum tax rate on dividends if the recipient of a dividend is obligated to make related payments with respect to positions in substantially similar or related property. This disallowance applies even if the minimum holding period has been met. U.S. holders are advised to consult their own tax advisors regarding the implications of these rules in light of their particular circumstances.

U.S. holders that are corporations should consider the effect of Section 246A of the Code, which reduces the dividends received deduction allowed with respect to “debt-financed portfolio stock.” The Code also imposes a 20% alternative minimum tax on corporations. In some circumstances, the portion of dividends subject to the dividends received deduction will serve to increase a corporation’s minimum tax base for purposes of the determination of the alternative minimum tax. In addition, a corporate U.S. holder may be required to reduce its basis in stock with respect to certain “extraordinary dividends”, as provided under Section 1059 of the Code. U.S. holders should consult their own tax advisors in determining the application of these rules in light of their particular circumstances.

Sale or Other Disposition. A sale, exchange, or other disposition of the Series B Preferred or our common stock will generally result in gain or loss equal to the difference between the amount realized upon the disposition (not including any amount attributable to declared and unpaid dividends, which will be taxable as described above to U.S. holders of record who have not previously included such dividends in income) and a U.S. holder’s adjusted tax basis in the Series B Preferred or our common stock, as the case may be. Such gain or loss will be capital gain or loss and will be long-term capital gain or loss if the U.S. holder’s holding period for the Series B Preferred or our common stock, as applicable, exceeds one year. Under current law, if a U.S. holder is an individual or other non-corporate holder, net long-term capital gain realized by such U.S. holder is subject to a reduced maximum tax rate of 15%. For taxable years beginning on or after January 1, 2011, the maximum rate is scheduled to return to the previously effective 20% rate. The deduction of capital losses is subject to limitations.

Conversion of the Series B Convertible Preferred Stock into Common Stock. As a general rule, a U.S. holder will not recognize any gain or loss in respect of the receipt of common stock upon the conversion of the Series B Preferred. The adjusted tax basis of common stock received on conversion will equal the adjusted tax basis of the Series B Preferred converted (reduced by the portion of adjusted tax basis allocated to any fractional common stock exchanged for cash, as described below), and the holding period of such common stock received on conversion will generally include the period during which the converted Series B Preferred was held prior to conversion.

Cash received in lieu of a fractional share of our common stock will generally be treated as a payment in a taxable exchange for such fractional share of our common stock, and capital gain or loss will be recognized on the receipt of cash in an amount equal to the difference between the amount of cash received and the amount of adjusted tax basis allocable to the fractional share of our common stock. Any cash received attributable to any declared and unpaid dividends on the Series B Preferred will be treated as described above under “—U.S. Holders—Dividends.”

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In the event a U.S. holder's Series B Preferred is converted pursuant to certain transactions, including our consolidation or merger into another person (see "Description of the Series B Convertible Preferred Stock"), the tax treatment of such a conversion will depend upon the facts underlying the particular transaction triggering such a conversion. Each U.S. holder should consult its tax adviser to determine the specific tax treatment of a conversion under such circumstances.

Adjustment of Conversion Rate. The conversion rate of the Series B Preferred is subject to adjustment under certain circumstances. U.S. Treasury regulations promulgated under Section 305 of the Code would treat a U.S. holder of the Series B Preferred as having received a constructive distribution includable in such U.S. holder's income in the manner as described above under "—U.S. Holders—Dividends," above, if and to the extent that certain adjustments in the conversion rate increase the proportionate interest of a U.S. holder in our earnings and profits. For example, an increase in the conversion rate to reflect a taxable dividend to holders of common stock will generally give rise to a deemed taxable dividend to the holders of the Series B Preferred to the extent of our current and accumulated earnings and profits. In addition, an adjustment to the conversion rate of the Series B Preferred or a failure to make such an adjustment could potentially give rise to constructive distributions to U.S. holders of our common stock. Thus, under certain circumstances, U.S. holders may recognize income in the event of a constructive distribution even though they may not receive any cash or property. Adjustments to the conversion rate made pursuant to a bona fide reasonable adjustment formula which has the effect of preventing dilution in the interest of the U.S. holders of the Series B Preferred, however, will generally not be considered to result in a constructive dividend distribution.

Information Reporting and Backup Withholding. In general, information reporting will apply to dividends in respect of the Series B Preferred or our common stock and the proceeds from the sale, exchange or other disposition of the Series B Preferred or our common stock that are paid to a U.S. holder within the United States (and in certain cases, outside the United States), unless a U.S. holder is an exempt recipient such as a corporation. Backup withholding may apply to such payments if a U.S. holder fails to provide a taxpayer identification number or certification of other exempt status or fails to report in full dividend and interest income.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against a U.S. holder's U.S. federal income tax liability provided the required information is furnished to the IRS.

Non-U.S. Holders

Dividends. Dividends (including any constructive distributions taxable as dividends) paid to a non-U.S. holder of the Series B Preferred or our common stock generally will be subject to withholding of U.S. federal income tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. However, dividends that are effectively connected with the conduct of a trade or business within the United States by the non-U.S. holder (and, if required by an applicable income tax treaty, are attributable to a United States permanent establishment) are not subject to the withholding tax, provided certain certification and disclosure requirements are satisfied. Instead, such dividends are subject to U.S. federal income tax on a net income basis in the same manner as if the non-U.S. holder were a United States person as defined under the Code. Any such effectively connected dividends received by a foreign corporation may be subject to an additional "branch profits tax" at a 30% rate or such lower rate as may be specified by an applicable income tax treaty.

A non-U.S. holder of the Series B Preferred or our common stock who wishes to claim the benefit of an applicable treaty rate and avoid backup withholding, as discussed below, for dividends will be required (a) to complete Internal Revenue Service Form W-8BEN (or other applicable form) and certify under penalty of perjury that such holder is not a United States person as defined under the Code and is eligible for treaty benefits or (b) if the Series B Preferred or our common stock is held through certain foreign intermediaries, to satisfy the relevant certification requirements of applicable United States Treasury regulations. Special certification and other requirements apply to certain non-U.S.

holders that are pass-through entities rather than corporations or individuals.

A non-U.S. holder of the Series B Preferred or our common stock eligible for a reduced rate of United States withholding tax pursuant to an income tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the Internal Revenue Service.

Sale or Other Disposition. Any gain realized on the disposition of the Series B Preferred or our common stock (including, in the case of conversion, the deemed exchange that gives rise to a payment of cash in lieu of a fractional share of our common stock) generally will not be subject to U.S. federal income tax unless:

- the gain is effectively connected with a trade or business of the non-U.S. holder in the United States (and, if required by an applicable income tax treaty, is attributable to a United States permanent establishment of the non-U.S. holder);

- the non-U.S. holder is an individual who is present in the United States for 183 days or more in the taxable year of that disposition (or deemed to have been present in the United States for 183 days or more in such taxable year based on a weighted factor of the number of days present in the United States over the past three years), and certain other conditions are met; or

- we are or have been a "United States real property holding corporation" for U.S. federal income tax purposes.

An individual non-U.S. holder described in the first bullet point immediately above will be subject to tax on the net gain derived from the sale under regular graduated U.S. federal income tax rates. An individual non-U.S. holder described in the second bullet point immediately above will be subject to a flat 30% tax on the gain derived from the sale, which may be offset by United States source capital losses, even though the individual is not considered a resident of the United States. If a non-U.S. holder that is a foreign corporation falls under the first bullet point immediately above, it will be subject to tax on its net gain in the same manner as if it were a United States person as defined under the Code and, in addition, may be subject to the branch profits tax equal to 30% of its effectively connected earnings and profits or at such lower rate as may be specified by an applicable income tax treaty.

We believe we are not and do not anticipate becoming a "United States real property holding corporation" for U.S. federal income tax purposes so withholding rules related to such corporations will not be applicable.

Conversion into Common Stock. Non-U.S. holders will generally not recognize any gain or loss in respect of the receipt of common stock upon the conversion of the Series B Preferred, except with respect to any cash received in lieu of a fractional share of our common stock that is taxable as described above under "—Non-U.S. Holders—Sale or Other Disposition."

Adjustment of Conversion Rate. As described above under "—U.S. Holders—Adjustment of Conversion Rate", adjustments in the conversion rate (or failures to adjust the conversion rate) that increase the proportionate interest of a non-U.S. holder in our earning and profits could result in deemed distributions to the non-U.S. holder that are taxed as described under "—Non-U.S. Holders—Dividends."

Federal Estate Tax

The Series B Preferred and common stock owned or treated as owned by an individual who is not a citizen or resident of the United States (as specially defined for U.S. federal estate tax purposes) at the time of death will be included in the individual's gross estate for U.S. federal estate tax purposes, unless an applicable estate tax or other treaty provides otherwise and, therefore, may be subject to U.S. federal estate tax.

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Information Reporting and Backup Withholding

We must report annually to the Internal Revenue Service and to each non-U.S. holder the amount of dividends paid to such holder and the tax withheld with respect to such dividends, regardless of whether withholding was required. Copies of the information returns reporting such dividends and withholding may also be made available to the tax authorities in the country in which the non-U.S. holder resides under the provisions of an applicable income tax treaty.

A non-U.S. holder will be subject to backup withholding for dividends paid to such holder unless such holder certifies under penalty of perjury that it is a non-U.S. holder (and the payor does not have actual knowledge or reason to know that such holder is a United States person as defined under the Code), or such holder otherwise establishes an exemption.

Information reporting and, depending on the circumstances, backup withholding will apply to the proceeds of a sale of the Series B Preferred or our common stock within the United States or conducted through certain United States-related financial intermediaries, unless the beneficial owner certifies under penalty of perjury that it is a non-U.S. holder (and the payor does not have actual knowledge or reason to know that the beneficial owner is a United States person as defined under the Code), or such owner otherwise establishes an exemption.

Any amounts withheld under the backup withholding rules may be allowed as a refund or a credit against a non-U.S. holder's U.S. federal income tax liability provided the required information is furnished to the Internal Revenue Service.

CERTAIN ERISA CONSIDERATIONS

Each person considering the use of plan assets of a pension, profit-sharing or other employee benefit plan, individual retirement account, Keogh plan or other retirement plan, account or arrangement, or a "plan," to acquire or hold the Series B Preferred should consider whether an investment in the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) would be consistent with the documents and instruments governing the plan, and whether the investment would involve a prohibited transaction under Section 406 of the Employee Retirement Income Security Act of 1974, as amended, or "ERISA," or Section 4975 of the Code.

Section 406 of ERISA and Section 4975 of the Code prohibit plans subject to Title I of ERISA and/or Section 4975 of the Code including entities such as collective investment funds, partnerships and separate accounts or insurance company pooled separate accounts or insurance company general accounts whose underlying assets include the assets of such plans, or collectively, "Plans," from engaging in certain transactions involving "plan assets" with persons who are "parties in interest" under ERISA or "disqualified persons" under the Code, or "parties in interest," with respect to the Plan. A violation of these prohibited transaction rules may result in civil penalties or other liabilities under ERISA and/or an excise tax under Section 4975 of the Code for those persons, unless exemptive relief is available under an applicable statutory, regulatory or administrative exemption. Certain plans including those that are governmental plans (as defined in Section 3(32) of ERISA), certain church plans (as defined in Section 3(33) of ERISA) and foreign plans (as described in Section 4(b)(4) of ERISA) are not subject to the requirements of ERISA or Section 4975 of the Code but may be subject to similar provisions under applicable federal, state, local, foreign or other regulations, rules or laws, or "Similar Laws."

The acquisition or holding of the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) by a Plan with respect to which we or certain of our affiliates is or becomes a party in interest may constitute or result in prohibited transactions under ERISA or Section 4975 of the Code, unless the Series B Preferred (or such common stock) is acquired or held pursuant to and in accordance with an applicable exemption.

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Accordingly, the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) may not be purchased or held by any Plan or any person investing "plan assets" of any Plan, unless such purchase or holding is eligible for the exemptive relief available under a Prohibited Transaction Class Exemption, or "PTCE," such as PTCE 96-23, PTCE 95-60, PTCE 91-38, PTCE 90-1 or PTCE 84-14 issued by the U.S. Department of Labor or there is some other basis on which the purchase or holding of the Series B Preferred (or such common stock) is not prohibited, such as the exemption under Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code, or the "Service Provider Exemption," for certain transactions with non-fiduciary service providers for transactions that are for adequate consideration. Each purchaser or holder of the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) or any interest therein, and each person making the decision to purchase or hold the Series B Preferred (or such common stock) on behalf of any such purchaser or holder will be deemed to have represented and warranted in both its individual capacity and its representative capacity (if any), that on each day from the date on which the purchaser or holder acquires its interest in the Series B Preferred (or the common stock issuable upon conversion of the Series B Preferred) to the date on which the purchaser disposes of its interest in the Series B Preferred (or such common stock), that such purchaser and holder, by its purchase or holding of the Series B Preferred (or such common stock) or any interest therein that (a) its purchase and holding of the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) is not made on behalf of or with "plan assets" of any Plan, or (b) if its purchase and holding of the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) is made on behalf of or with "plan assets" of a Plan, then (i) its purchase and holding of the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) will not result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code and (ii) neither Reed's, Inc. nor any of our affiliates is acting as a fiduciary (within the meaning of Section 3(21)) of ERISA in connection with the purchase or holding of the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) and has not provided any advice that has formed or may form a basis for any investment decision concerning the purchase or holding of the Series B Preferred. Each purchaser and holder of the Series B Preferred (and the common stock issuable upon conversion of the Series B Preferred) or any interest therein on behalf of any governmental plan will be deemed to have represented and warranted by its purchase or holding of the Series B Preferred or any interest therein that such purchase and holding does not violate any applicable Similar Laws or rules.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in nonexempt prohibited transactions, it is important that fiduciaries or other persons considering purchasing the Series B Preferred on behalf of or with "plan assets" of any plan or plan asset entity consult with their counsel regarding the availability of exemptive relief under any of the PTCEs listed above or any other applicable exemption, or the potential consequences of any purchase or holding under similar laws, as applicable.

MATERIAL CHANGES

None.

INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

We incorporate by reference the filed documents listed below, except as superseded, supplemented or modified by this prospectus, and any future filings we make with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"):

(a) Our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, as filed March 27, 2009;

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(b) Our Quarterly Report on Form 10Q for the quarterly period ended March 31, 2009, filed May 13, 2009;

(c) Our Current Reports on Form 8-K filed with the SEC January 6, 2009, January 26, 2009, May 5, 2009 and June 22, 2009;

(d) All other reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), since the end of the fiscal year covered by the annual report referred to in paragraph (a) above; and

(e) The description of our capital stock that is contained in our Registration Statement on Form S-1 (File No.), as filed November 20, 2008.

In addition, all documents subsequently filed by the Registrant pursuant to Sections 13(a), 13(c), 14, and 15(d) of the Exchange Act, prior to the filing of a post-effective amendment which indicates that all securities offered have been sold or which deregisters all securities then remaining unsold, shall be deemed to be incorporated by reference into this Registration Statement and to be a part hereof from the date of filing of such documents.

Any statement contained herein or in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this Registration Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such earlier statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Registration Statement.

We will provide to each person, including any beneficial owner, to whom a prospectus is delivered a copy of any or all of the information that has been incorporated by reference herein without charge by written or oral request directed to Reed’s, Inc., 13000 South Spring Street, Los Angeles, California 90061, Attention: Christopher J. Reed or (310) 217-9400.

You should rely only on the information incorporated by reference or provided in this prospectus or any prospectus supplement. We have not authorized anyone else to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of those documents.

DISCLOSURE OF COMMISSION POSITION ON INDEMNIFICATION FOR SECURITIES ACT LIABILITIES

Section 145 of the Delaware General Corporation Law (the “DGCL”), as the same exists or may hereafter be amended, provides that a Delaware corporation may indemnify any persons who were, or are threatened to be made, parties to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of such corporation), by reason of the fact that such person is or was an officer, director, employee or agent of such corporation, or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding, provided such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation’s best interests and, with respect to any criminal action or proceeding, had no reasonable cause to believe that his or her conduct was illegal. A Delaware corporation may indemnify any persons who are, were or are threatened to be made, a party to any

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threatened, pending or completed action or suit by or in the right of the corporation by reason of the fact that such person was a director, officer, employee or agent of such corporation, or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys' fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit, provided such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation's best interests, provided that no indemnification is permitted without judicial approval if the officer, director, employee or agent is adjudged to be liable to the corporation. Where an officer, director, employee, or agent is successful on the merits or otherwise in the defense of any action referred to above, the corporation must indemnify him or her against the expenses which such officer or director has actually and reasonably incurred.

Section 145 of the DGCL further authorizes a corporation to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation or enterprise, against any liability asserted against him or her and incurred by him or her in any such capacity, arising out of his or her status as such, whether or not the corporation would otherwise have the power to indemnify him or her under Section 145 of the DGCL.

Our amended certificate of incorporation provides that, to the fullest extent permitted by Delaware law, as it may be amended from time to time, none of our directors will be personally liable to us or our stockholders for monetary damages resulting from a breach of fiduciary duty as a director. Our amended certificate of incorporation also provides discretionary indemnification for the benefit of our directors, officers, and employees, to the fullest extent permitted by Delaware law, as it may be amended from time to time. Pursuant to our bylaws, we are required to indemnify our directors, officers, employees and agents, and we have the discretion to advance his or her related expenses, to the fullest extent permitted by law.

We do currently provide liability insurance coverage for our directors and officers.

These indemnification provisions may be sufficiently broad to permit indemnification of our officers and directors for liabilities (including reimbursement of expenses incurred) arising under the Securities Act. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors or officers, or persons controlling us, pursuant to the foregoing provisions, we have been informed that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment of expenses incurred or paid by a director, officer or controlling person in a successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to the court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the SEC a registration statement on Form S-3 under the Securities Act with respect to the shares of Series B Preferred offered hereby. This prospectus, which constitutes a part of the registration statement, does not contain all of the information set forth in the registration statement or the exhibits and schedules filed therewith. For further information about us and the common stock offered hereby, reference is made to the registration statement and the exhibits and schedules filed therewith. Statements contained in this prospectus regarding the contents of any contract or any other document that is filed as an exhibit to the registration statement are not necessarily complete, and each such statement is qualified in all respects by reference to the full text of such contract or other document filed as an exhibit to the registration statement.

A copy of the registration statement and the exhibits and schedules filed therewith may be inspected without charge at the public reference room maintained by the SEC, located at 100 F Street, N.E., Room 1580, Washington, D.C. 20549, and copies of all or any part of the registration statement may be obtained from such offices upon the payment of the fees prescribed by the SEC. Please call the SEC at 1-800-SEC-0330 for further information about the public reference room. We also file annual, quarterly and current reports, proxy statements and other information with the SEC. The SEC also maintains an Internet web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of the site is www.sec.gov.

No dealer, salesperson or any other person is authorized to give any information or make any representations in connection with this offering other than those contained in this prospectus and, if given or made, the information or representations must not be relied upon as having been authorized by us. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any security other than the securities offered by this prospectus, or an offer to sell or a solicitation of an offer to buy any securities by anyone in any jurisdiction in which the offer or solicitation is not authorized or is unlawful.

10,000,000 Transferable Rights to Subscribe for up to 300,000 Shares of
Series B Convertible Preferred Stock at $10.00 per Share

_____

PROSPECTUS

_____

Dealer-Manager

SOURCE CAPITAL GROUP, INC.

August ____, 2009

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other Expenses of Issuance and Distribution.

The following table sets forth the expenses payable by us in connection with this offering of securities described in this registration statement. All amounts shown are estimates, except for the SEC and FINRA registration fee. The Registrant will bear all expenses shown below.

SEC filing fee	$	558
FINRA filing fee	$	800
Accounting fees and expenses	$	20,000
Dealer-manager fees	$	220,000
Legal fees and expenses	$	85,000
Printing and engraving expenses	$	15,000
Other (including subscription and information agent fees)	$	50,000
Total	$	391,358

(1) Assumes all of the 300,000 shares of Series B Preferred being registered are sold.

Item 15. Indemnification of Directors and Officers.

Section 145 of the Delaware General Corporation Law (the "DGCL"), as the same exists or may hereafter be amended, provides that a Delaware corporation may indemnify any persons who were, or are threatened to be made, parties to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of such corporation), by reason of the fact that such person is or was an officer, director, employee or agent of such corporation, or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding, provided such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation's best interests and, with respect to any criminal action or proceeding, had no reasonable cause to believe that his or her conduct was illegal. A Delaware corporation may indemnify any persons who are, were or are threatened to be made, a party to any threatened, pending or completed action or suit by or in the right of the corporation by reason of the fact that such person was a director, officer, employee or agent of such corporation, or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys' fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit, provided such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation's best interests, provided that no indemnification is permitted without judicial approval if the officer, director, employee or agent is adjudged to be liable to the corporation. Where an officer, director, employee, or agent is successful on the merits or otherwise in the defense of any action referred to above, the corporation must indemnify him or her against the expenses which such officer or director has actually and reasonably incurred.

Section 145 of the DGCL further authorizes a corporation to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation or enterprise, against any liability asserted against him or her and incurred by him or her in any such capacity, arising out of his or her status as such, whether or not the corporation would otherwise have the power to indemnify him or her under Section 145 of the DGCL.

Our amended certificate of incorporation provides that, to the fullest extent permitted by Delaware law, as it may be amended from time to time, none of our directors will be personally liable to us or our stockholders for monetary damages resulting from a breach of fiduciary duty as a director. Our amended certificate of incorporation also provides discretionary indemnification for the benefit of our directors, officers, and employees, to the fullest extent permitted by Delaware law, as it may be amended from time to time. Pursuant to our bylaws, we are required to indemnify our directors, officers, employees and agents, and we have the discretion to advance his or her related expenses, to the fullest extent permitted by law.

We do currently provide liability insurance coverage for our directors and officers.

These indemnification provisions may be sufficiently broad to permit indemnification of our officers and directors for liabilities (including reimbursement of expenses incurred) arising under the Securities Act. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors or officers, or persons controlling us, pursuant to the foregoing provisions, we have been informed that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

In the event that a claim for indemnification against such liabilities (other than the payment of expenses incurred or paid by a director, officer or controlling person in a successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to the court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

Item 16. Exhibits

See the Exhibit Index which follows the signature page of this Registration Statement on Form S-3, which is incorporated herein by reference.

Item 17. Undertakings

The undersigned registrant hereby undertakes that:

(a) The undersigned Registrant hereby undertakes:

(1) to file, during any period in which offers or sales are being made, a post-effective amendment to this Registration Statement: (i) to include any prospectus required by Section 10(a)(3) of the Securities Act; (ii) to reflect in the prospectus any facts or events arising after the effective date of the Registration Statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the Registration Statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high

end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and (iii) to include any material information with respect to the plan of distribution not previously disclosed in the Registration Statement or any material change to such information in the Registration Statement; provided, however , that paragraphs (i), (ii) and (iii) do not apply if the Registration Statement is on Form S-3 and the information required to be included in a post-effective amendment by those paragraphs is contained in reports filed with or furnished to the Commission by the Registrant pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the Registration Statement, or is contained in a form of prospectus filed pursuant to Rule 424(b) that is part of the registration statement;

(2) that, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof;

(3) to remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering;

(4) that, for the purpose of determining liability under the Securities Act of 1933 to any purchaser:

(A) Each prospectus filed by the Registrant pursuant to Rule 424(b)(3) shall be deemed to be part of the registration statement as of the date the filed prospectus was deemed part of and included in the registration statement; and

(B) Each prospectus required to be filed pursuant to Rule 424(b)(2), (b)(5) or (b)(7) as part of a registration statement in reliance on Rule 430B relating to an offering made pursuant to Rule 415(a)(1)(i), (vii) or (x) for the purpose of providing the information required by Section 10(a) of the Securities Act of 1933 shall be deemed to be part of and included in the registration statement as of the earlier of the date such form of prospectus is first used after effectiveness or the date of the first contract of sale of securities in the offering described in prospectus. As provided in Rule 430B, for liability purposes of the issuer and any person that is at that date an underwriter, such date shall be deemed to be a new effective date of the registration statement relating to the securities in the registration statement to which the prospectus relates, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. Provided, however , that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such effective date, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such effective date; and

(5) that, for the purpose of determining liability of the Registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities, the undersigned Registrant undertakes that in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

(i) Any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 424;

(ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned Registrant or used or referred to by the undersigned Registrant;

(iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of an undersigned Registrant; and

(iv) Any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.

(b) The undersigned Registrant hereby undertakes that, for purposes of determining any liability under the Securities Act, each filing of Registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act that is incorporated by reference in this Registration Statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(c) The undersigned registrant hereby undertakes that: (i) for purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of the registration statement in reliance upon Rule 430A and contained in the form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of the registration statement as of the time it was declared effective; and (ii) for the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. .

(d) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the provisions described under Item 15 above, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

SIGNATURES

In accordance with the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and authorized this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Los Angeles, State of California, on July 28 , 2009.

REED'S, INC.

By: /s/ Christopher J. Reed
Christopher J. Reed
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Christopher J. Reed his/her true and lawful attorney-in-fact and agent with full power of substitution and re-substitution, for him/her and in his/her name, place and stead, in any and all capacities to sign any or all amendments (including, without limitation, post-effective amendments) to this Registration Statement, any related Registration Statement filed pursuant to Rule 462(b) under the Securities Act of 1933 and any or all pre- or post-effective amendments thereto, and to file the same, with all exhibits thereto, and all other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully for all intents and purposes as he or she might or could do in person, hereby ratifying and confirming that said attorney-in-fact and agent, or any substitute or substitutes for him, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities and on the dates stated.

In accordance with the requirements of the Securities Act of 1933, as amended, this Registration Statement was signed by the following persons in the capacities and on the dates stated.

Signature	Title	Date
/s/ Christopher J. Reed Christopher J. Reed	Chief Executive Officer, Chairman of the board of directors (Principal Executive Officer)	July 28 , 2009
/s/ James Linesch James Linesch	Chief Financial Officer (Principal Accounting Officer)	July 28 , 2009
/s/ Judy Holloway Reed Judy Holloway Reed	Director	July 28 , 2009
/s/ Mark Harris	Director	July 28 , 2009

Mark Harris

/s/ Daniel S.J. Muffoletto Daniel S.J. Muffoletto	Director	July 28 , 2009
/s/ Michael Fischman Michael Fischman	Director	July 28 , 2009

EXHIBIT INDEX

1.1	Form of Dealer-Manager Agreement by and between Reed's, Inc. and Source Capital Group, Inc. (Previously filed as Exhibit 1.1 to this Registration Statement on Form S-3 (File No. 333-156908))
3.1	Certificate of Incorporation of Reed's, Inc. as filed September 7, 2001 (Incorporated by reference to Exhibit 3.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
3.2	Certificate of Amendment of Certificate of Incorporation of Reed's, Inc. as filed September 27, 2004 (Incorporated by reference to Exhibit 3.2 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
3.3	Certificate of Amendment of Certificate of Incorporation of Reed's, Inc. as filed December 18, 2007 (Incorporated by reference to Exhibit 3.3 to Reed's, Inc.'s Registration Statement on Form S-1 (File No. 333-156908))
3.4	Certificate of Designations, Preferences and Rights of Series A Preferred Stock of Reed's, Inc. as filed October 12, 2004(Incorporated by reference to Exhibit 3.3 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
3.5	Certificate of Correction to Certificate of Designations as filed November 10, 2004 (Incorporated by reference to Exhibit 3.4 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
3.6	Bylaws of Reed's Inc., as amended (Incorporated by reference to Exhibit 3.5 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
3.7	Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock (Incorporated by reference to Exhibit 3.1 to Reed's Inc. Current Report on Form 8K dated May 5, 2009)
3.8	Form of Certificate of Correction Regarding Designations, Preferences and Rights of Series B Convertible Preferred Stock of Reed's, Inc.+
4.1	Form of common stock certificate (Incorporated by reference to Exhibit 4.1 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
4.2	Form of Series A Convertible Preferred Stock certificate (Incorporated by reference to Exhibit 4.2 to Reed's, Inc.'s Registration Statement on Form SB-2 (File No. 333-120451))
4.3	Form of Subscription Rights Certificate (Previously filed as Exhibit 4.3 to this Registration Statement on Form S-3 (File No. 333-156908))
4.4	Form of Notice to Stockholders who are Record Holders (Previously filed as Exhibit 4.4 to this Registration Statement on Form S-3 (File No. 333-156908))
4.5	Form of Notice to Stockholders who are Acting as Nominees (Previously filed as Exhibit 4.5 to this Registration Statement on Form S-3 (File No. 333-156908))
4.6	Form of Notice to Clients of Stockholders who are Acting as Nominees (Previously filed as Exhibit 4.6 to this Registration Statement on Form S-3 (File No. 333-156908))
4.7	Form of Beneficial Owner Election Form (Previously filed as Exhibit 4.7 to this Registration Statement on Form S-3 (File No. 333-156908))
4.8	See exhibits 3.1 through 3.8 for provisions of Reed's, Inc.'s Certificate of Incorporation and Bylaws Defining the Rights of Stockholders
4.9	Form of Dealer-Manager Warrant+
5.1	Legal Opinion of Qashu & Schoenthaler LLP+
23.1	Consent of Weinberg & Co., P.A.*
23.2	Consent of Qashu & Schoenthaler LLP. (contained in Exhibit 5.1)

* Filed herewith
+ To be filed by amendment