AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-K
March 10, 2011
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2010
or

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

For the transition period from to
Commission File Number: 001-31911

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American Equity Investment Life Holding Company
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Iowa<br>(State or other jurisdiction of Incorporation) | 42-1447959<br>(I.R.S. Employer Identification No.) |
| 6000 Westown Parkway<br>West Des Moines, Iowa<br>(Address of principal executive offices) | 50266<br>(Zip Code) |

Registrant's telephone number, including area code: (515) 221-0002
Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common stock, par value $1 | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $1
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this From 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer x | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was $554,052,926 based on the closing price of $10.32 per share, the closing price of the common stock on the New York Stock Exchange on June 30, 2010.
Shares of common stock outstanding as of February 28, 2011: 59,291,669
Documents incorporated by reference: Portions of the registrant's definitive proxy statement for the annual meeting of shareholders to be held June 9, 2011, which will be filed within 120 days after December 31, 2010, are incorporated by reference into Part III of this report.

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PART I

Item 1. Business

Introduction

We are a leader in the development and sale of fixed index and fixed rate annuity products. We were incorporated in the state of Iowa on December 15, 1995. We are a full service underwriter of fixed annuity and life insurance products through our wholly-owned life insurance subsidiaries, American Equity Investment Life Insurance Company ("American Equity Life"), American Equity Investment Life Insurance Company of New York, and Eagle Life Insurance Company ("Eagle Life"). Our business consists primarily of the sale of fixed index and fixed rate annuities and, accordingly, we have only one business segment. Our business strategy is to focus on our annuity business and earn predictable returns by managing investment spreads and investment risk. We are currently licensed to sell our products in 50 states and the District of Columbia. Throughout this report, unless otherwise specified or the context otherwise requires, all references to "American Equity", the "Company", "we", "our" and similar references are to American Equity Investment Life Holding Company and its consolidated subsidiaries.

Investor related information, including periodic reports filed on Forms 10-K, 10-Q and 8-K and all amendments to such reports may be found on our internet website at www.american-equity.com as soon as reasonably practicable after such reports are filed with the Securities and Exchange Commission ("SEC"). In addition, we have available on our website our: (i) code of business conduct and ethics; (ii) audit committee charter; (iii) compensation committee charter; (iv) nominating/corporate governance committee charter; and (v) corporate governance guidelines. The information incorporated herein by reference is also electronically accessible from the SEC's website at www.sec.gov.

Annuity Market Overview

Our target market includes the group of individuals ages 45-75 who are seeking to accumulate tax-deferred savings. We believe that significant growth opportunities exist for annuity products because of favorable demographic and economic trends. According to the U.S. Census Bureau, there were 35 million Americans age 65 and older in 2000, representing 12% of the U.S. population. By 2030, this sector of the population is expected to increase to 20% of the total population. Our fixed index and fixed rate annuity products are particularly attractive to this group as a result of the guarantee of principal with respect to those products, competitive rates of credited interest, tax-deferred growth and alternative payout options.

According to AnnuitySpecs.com, total industry sales of fixed index annuities increased 7% to $32.3 billion in 2010 from $30.1 billion in 2009. Our wide range of fixed index and fixed rate annuity products has enabled us to enjoy favorable growth during volatile equity and bond markets.

Strategy

Our business strategy is to grow our annuity business and earn predictable returns by managing investment spreads and investment risk. Key elements of this strategy include the following:

Enhance our Current Independent Agency Network. We believe that our successful relationships with approximately 50 national marketing organizations represent a significant competitive advantage. Our objective is to improve the productivity and efficiency of our core distribution channel by focusing our marketing and recruiting efforts on those independent agents capable of selling $1 million or more of annuity premium annually. This level of production qualifies them for our Gold Eagle program which was introduced at the beginning of 2007. We believe the Gold Eagle program has been effective as evidenced by the increase in Gold Eagle agents to 1,021 in 2010 as compared to 891 in 2009 and 566 in 2008, accounting for 57%, 57% and 56% of total production, respectively. Gold Eagle qualifiers receive a combination of cash and equity-based incentives as motivation for producing business for us. The equity-based incentive compensation component of our Gold Eagle program is unique in our industry and distinguishes us from our competitors. Our continuing focus on relationships and efficiency will ultimately reduce our independent agents to a core group of professional annuity producers. We will also be alert to opportunities to establish relationships with national marketing organizations and agents not presently associated with us and will continue to provide all of our marketers with the highest quality service possible.

Continue to Introduce Innovative and Competitive Products. We intend to be at the forefront of the fixed index and fixed rate annuity industry in developing and introducing innovative and new competitive products. We were one of

the first companies to offer a fixed index annuity that allows a choice among interest crediting strategies which include both equity and bond indices as well as a traditional fixed rate strategy. We were also one of the first companies to include a living income benefit rider with our fixed index annuities. Most recently, we enhanced our living income benefit rider to provide policyholders with protection against inflation. We believe that our continued focus on anticipating and being responsive to the product needs of our independent agents and policyholders will lead to increased customer loyalty, revenues and profitability.

Use our Expertise to Achieve Targeted Spreads on Annuity Products. We have had a successful track record in achieving the targeted spreads on our annuity products. We intend to continue to leverage our experience and expertise in managing the investment spread during a range of interest rate environments to achieve our targeted spreads.

Maintain our Profitability Focus and Improve Operating Efficiency. We are committed to improving our profitability by advancing the scope and sophistication of our investment management and spread capabilities and continuously seeking out efficiencies within our operations. We have implemented competitive incentive programs for our national marketing organizations, agents and employees to stimulate performance.

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Take Advantage of the Growing Popularity of Index Products. We believe that the growing popularity of fixed index annuity products that allow equity and bond market participation without the risk of loss of the premium deposit presents an attractive opportunity to grow our business. We intend to capitalize on our reputation as a leading marketer of fixed index annuities in this expanding segment of the annuity market.

Focus on High Quality Service to Agents and Policyholders. We have maintained high quality personal service as one of our highest priorities since the inception of our business, and continue to strive for an unprecedented level of timely and accurate service to both our agents and policyholders. We believe this is one of our strongest competitive advantages.

Expand our Distribution Channels. We formed Eagle Life in 2008 with the vision of developing a network of affiliated and nonaffiliated broker-dealer firms to distribute a registered fixed index annuity product. We believe this to be the most effective means of building a core distribution channel of selling firms with registered representatives capable of selling $1 million or more of annuity premium annually.

Products

Annuities offer our policyholders a tax-deferred means of accumulating retirement savings, as well as a reliable source of income during the payout period. When our policyholders contribute cash to annuities, we account for these receipts as policy benefit reserves in the liability section of our consolidated balance sheet. The annuity deposits collected, by product type, during the three most recent fiscal years are as follows:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | 2009 | | 2008 | |
| | Deposits Collected | Deposits as a % of Total | Deposits Collected | Deposits as a % of Total | Deposits Collected | Deposits as a % of Total |
| | (Dollars in thousands) | | | | | |
| Fixed index annuities: | | | | | | |
| Index strategies | $2,401,891 | 52 % | $1,535,477 | 42 % | $1,303,871 | 57 % |
| Fixed strategy | 1,551,007 | 33 % | 1,849,833 | 50 % | 937,227 | 41 % |
| | 3,952,898 | 85 % | 3,385,310 | 92 % | 2,241,098 | 98 % |
| Fixed rate annuities | 715,821 | 15 % | 292,248 | 8 % | 47,908 | 2 % |
| | $4,668,719 | 100 % | $3,677,558 | 100 % | $2,289,006 | 100 % |

Fixed Index Annuities

Fixed index annuities allow policyholders to earn index credits based on the performance of a particular index without the risk of loss of their principal. Most of these products allow policyholders to transfer funds once a year among several different crediting strategies, including one or more index based strategies and a traditional fixed rate strategy. Approximately 95%, 94% and 93% of our fixed index annuity sales for the years ended December 31, 2010, 2009 and 2008, respectively, were "premium bonus" products. The initial annuity deposit on these policies is increased at issuance by a specified premium bonus ranging from 3% to 10%. Generally, there is a compensating adjustment in the commission paid to the agent or the surrender charges on the policy to offset the premium bonus.

The annuity contract value is equal to the sum of premiums paid, premium bonuses and interest credited ("index credits"), which is based upon an overall limit (or "cap") or a percentage (the "participation rate") of the annual appreciation (based in certain situations on monthly averages or monthly point-to-point calculations) in a recognized index or benchmark. Caps and participation rates limit the amount of annual interest the policyholder may earn in any one contract year and may be adjusted by us annually subject to stated minimums. Caps generally range from 4% to 12% and participation rates generally range from 25% to 100%. In addition, some products have an "asset fee" ranging from 1.5% to 5%, which is deducted from annual interest to be credited. For products with asset fees, if the annual appreciation in the index does not exceed the asset fee, the policyholder's index credit is zero. The minimum guaranteed contract values are equal to 87.5% of the premium collected plus interest credited at an annual rate ranging from 1.5% to 3.5%.

Fixed Rate Annuities

Fixed rate deferred annuities include annual reset and multi-year rate guaranteed products. Our annual reset fixed rate annuities have an annual interest rate (the "crediting rate") that is guaranteed for the first policy year. After the first policy year, we have the discretionary ability to change the crediting rate once annually to any rate at or above a guaranteed minimum rate. Our multi-year rate guaranteed annuities are similar to our annual reset products except that the initial crediting rate is guaranteed for up to a seven-year period before it may be changed at our discretion. The guaranteed rate on our fixed rate deferred annuities ranges from 2% to 4% and the initial guaranteed rate on our multi-year rate guaranteed policies ranges from 2.65% to 5.10%.

The initial crediting rate is largely a function of the interest rate we can earn on invested assets acquired with new annuity deposits and the rates offered on similar products by our competitors. For subsequent adjustments to crediting rates, we take into account the yield on our investment portfolio, annuity surrender assumptions, competitive industry pricing and crediting rate history for particular groups of annuity policies with similar characteristics. As of December 31, 2010, crediting rates on our outstanding fixed rate deferred annuities generally ranged from 2.5% to 5%. The average crediting rate on our outstanding fixed rate deferred annuities at December 31, 2010 was 3.38%.

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We also sell single premium immediate annuities ("SPIAs"). Our SPIAs are designed to provide a series of periodic payments for a fixed period of time or for life, according to the policyholder's choice at the time of issue. The amounts, frequency and length of time of the payments are fixed at the outset of the annuity contract. SPIAs are often purchased by persons at or near retirement age who desire a steady stream of payments over a future period of years. The implicit interest rate on SPIAs is based on market conditions when the policy is issued. The implicit interest rate on our outstanding SPIAs averaged 2.94% at December 31, 2010.

Withdrawal Options—Fixed Index and Fixed Rate Annuities

Policyholders are typically permitted penalty-free withdrawals up to 10% of the contract value in each year after the first year, subject to limitations. Withdrawals in excess of allowable penalty-free amounts are assessed a surrender charge during a penalty period which ranges from 5 to 17 years for fixed index annuities and 3 to 15 years for fixed rate annuities from the date the policy is issued. This surrender charge initially ranges from 4.7% to 20% for fixed index annuities and 8% to 25% for fixed rate annuities of the contract value and generally decreases by approximately one to two percentage points per year during the surrender charge period. Surrender charges are set at levels aimed at protecting us from loss on early terminations and reducing the likelihood of policyholders terminating their policies during periods of increasing interest rates. This practice lengthens the effective duration of the policy liabilities and enhances our ability to maintain profitability on such policies. The policyholder may elect to take the proceeds of the annuity either in a single payment or in a series of payments for life, for a fixed number of years or a combination of these payment options.

Beginning in July 2007, substantially all of our fixed index annuity policies were issued with a living income benefit rider. This rider provides an additional liquidity option to policyholders who elect to receive a guaranteed living income from their contract without requiring them to annuitize their contract value. The amount of the living income benefit available is determined by the growth in the policy's income account value as defined in the policy and the policyholder's age at the time the policyholder elects to begin receiving living income benefit payments. Living income benefit payments may be stopped and restarted at the election of the policyholder.

Life Insurance

These products include traditional ordinary and term, universal life and other interest-sensitive life insurance products. We have approximately $2.6 billion of life insurance in force as of December 31, 2010. We intend to continue offering a complete line of life insurance products for individual and group markets. Premiums related to this business accounted for 1% of revenues for the years ended December 31, 2010 and 2009 and 4% of revenues for the year ended December 31, 2008.

Investments

Investment activities are an integral part of our business, and net investment income is a significant component of our total revenues. Profitability of many of our products is significantly affected by spreads between interest yields on investments, the cost of options to fund the annual index credits on our fixed index annuities and rates credited on our fixed rate annuities. We manage the index-based risk component of our fixed index annuities by purchasing call options on the applicable indices to fund the annual index credits on these annuities and by adjusting the caps, participation rates and asset fees on policy anniversary dates to reflect the change in the cost of such options which varies based on market conditions. All options are purchased to fund the index credits on our fixed index annuities on their respective anniversary dates, and new options are purchased at each of the anniversary dates to fund the next annual index credits. All credited rates on non-multi-year rate guaranteed fixed rate deferred annuities may be changed annually, subject to minimum guarantees. Changes in caps, participation rates and asset fees on fixed index annuities and crediting rates on fixed rate annuities may not be sufficient to maintain targeted investment spreads in all economic and market environments. In addition, competition and other factors, including the potential for increases in surrenders and withdrawals, may limit our ability to adjust or to maintain caps, participation rates, asset fees and crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions. For the year ended December 31, 2010, the weighted average yield, computed on the average amortized cost basis of our investment portfolio, was 6.06% and the weighted average cost of our liabilities, excluding amortization of deferred sales inducements, was 2.91%.

For additional information regarding the composition of our investment portfolio and our interest rate risk management, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition—Investments, Quantitative and Qualitative Disclosures About Market Risk and note 3 to our audited consolidated financial statements.

Marketing

We market our products through a variable cost brokerage distribution network of approximately 50 national marketing organizations and, through them, 37,000 independent agents as of December 31, 2010. We emphasize high quality service to our agents and policyholders along with the prompt payment of commissions to our agents. We believe this has been significant in building excellent relationships with our existing agency force.

Our independent agents and agencies range in profile from national sales organizations to personal producing general agents. We actively recruit new agents and terminate those agents who have not produced business for us in recent periods and are unlikely to sell our products in the future. In our recruitment efforts, we emphasize that agents have direct access to our executive officers, giving us an edge in recruiting over larger and foreign-owned competitors. We also emphasize our products and our Gold Eagle program which provides unique cash and equity-based incentives to those agents selling $1 million or more of annuity premium annually. We also have favorable relationships with our national marketing organizations, which have enabled us to efficiently sell through an expanded number of independent agents.

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The insurance distribution system is comprised of insurance brokers and marketing organizations. We are pursuing a strategy to increase the efficiency of our distribution network by strengthening our relationships with key national and regional marketing organizations and are alert for opportunities to establish relationships with organizations not presently associated with us. These organizations typically recruit agents for us by advertising our products and our commission structure through direct mail advertising or seminars for insurance agents and brokers. These organizations bear most of the cost incurred in marketing our products. We compensate marketing organizations by paying them a percentage of the commissions earned on new annuity policy sales generated by the agents recruited by such organizations. We also conduct incentive programs for marketing organizations and agents from time to time, including equity-based programs for our leading national marketers and those agents qualifying for our Gold Eagle program. We believe the Gold Eagle program has been effective as evidenced by the increase in Gold Eagle agents to 1,021 in 2010 as compared to 891 in 2009 and 566 in 2008, accounting for 57%, 57% and 56% of total production, respectively. For additional information regarding our equity-based programs for our leading national marketers and independent agents, see note 11 to our audited consolidated financial statements. We generally do not enter into exclusive arrangements with these marketing organizations.

One of our national marketing organizations accounted for more than 10% of the annuity deposits collected during 2010 and we expect this organization to continue as a marketer for American Equity Life with a focus on selling our products. The states with the largest share of direct premiums collected during 2010 were: Florida (11.5%), California (8.8%), Texas (7.0%), Illinois (6.1%) and Pennsylvania (5.2%).

Competition and Ratings

We operate in a highly competitive industry. Many of our competitors are substantially larger and enjoy substantially greater financial resources, higher ratings by rating agencies, broader and more diversified product lines and more widespread agency relationships. Our annuity products compete with index, fixed rate and variable annuities sold by other insurance companies and also with mutual fund products, traditional bank investments and other investment and retirement funding alternatives offered by asset managers, banks, and broker-dealers. Our insurance products compete with products of other insurance companies, financial intermediaries and other institutions based on a number of features, including crediting rates, policy terms and conditions, service provided to distribution channels and policyholders, ratings, reputation and broker compensation.

The sales agents for our products use the ratings assigned to an insurer by independent rating agencies as one factor in determining which insurer's annuity to market. In recent years, the market for annuities has been dominated by those insurers with the highest ratings. Following is a summary of American Equity Life's financial strength ratings:

| | Financial Strength Rating | Outlook Statement |
|---|---|---|
| A.M. Best Company | | |
| January 2011—current | A- | Stable |
| November 2008—January 2011 | A- | Negative |
| August 2006—October 2008 | A- | Stable |
| July 2002—July 2006 | B++ | Stable |
| Standard & Poor's | | |
| September 2010—current | BBB+ | Positive |
| July 2010—September 2010 | BBB+ | Stable |
| July 2008—July 2010 | BBB+ | Negative |
| July 2002—June 2008 | BBB+ | Stable |

The degree to which ratings adjustments have affected sales and persistency is unknown. We believe the rating upgrade from A.M. Best Company in 2006 enhanced our competitive position and improved our sales. However, the degree to which this rating will affect future sales and persistency is unknown.

Financial strength ratings generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their ratings upon information furnished to them by the insurer and upon their own investigations, studies and assumptions. Ratings are based upon factors of concern to policyholders, agents and intermediaries and are not directed toward the protection of investors

and are not recommendations to buy, sell or hold securities.
In addition to the financial strength ratings, rating agencies use an "outlook statement" to indicate a medium or long-term trend which, if continued, may lead to a rating change. A positive outlook indicates a rating may be raised and a negative outlook indicates a rating may be lowered. A stable outlook is assigned when ratings are not likely to be changed. Outlook statements should not be confused with expected stability of the issuer's financial or economic performance. A rating may have a "stable" outlook to indicate that the rating is not expected to change, but a "stable" outlook does not preclude a rating agency from changing a rating at any time without notice.
In July 2010, A.M. Best revised its rating outlook on the U.S. life/annuity sector to stable from negative. In December 2010, Standard & Poor's revised its outlook on the U.S. life insurance sector to stable from negative. Both agencies had their outlook on our industry stated as negative since late 2008. Strengthening balance sheets and recovering financial markets have been listed as reasons for the improved outlook. We believe the rating agencies think the economic recovery will continue to be slow, which may leave the potential for further credit losses. The rating agencies have heightened the level of scrutiny they apply to insurance companies, increased the frequency and scope of their credit reviews, and may adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels.

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A.M. Best Company ratings currently range from "A++" (Superior) to "F" (In Liquidation), and include 16 separate ratings categories. Within these categories, "A++" (Superior) and "A+" (Superior) are the highest, followed by "A" (Excellent) and "A-" (Excellent) then followed by "B++" (Good) and "B+" (Good). Publications of A.M. Best Company indicate that the "A-" rating is assigned to those companies that, in A.M. Best Company's opinion, have demonstrated an excellent ability to meet their ongoing obligations to policyholders.
Standard & Poor's insurer financial strength ratings currently range from "AAA (extremely strong)" to "R (under regulatory supervision)", and include 21 separate ratings categories, while "NR" indicates that Standard & Poor's has no opinion about the insurer's financial strength. Within these categories, "AAA" and "AA" are the highest, followed by "A" and "BBB". Publications of Standard & Poor's indicate that an insurer rated "BBB" is regarded as having good financial security characteristics, but is more likely to be affected by adverse business conditions than are higher rated insurers.
A.M. Best Company and Standard & Poor's review their ratings of insurance companies from time to time. There can be no assurance that any particular rating will continue for any given period of time or that it will not be changed or withdrawn entirely if, in their judgment, circumstances so warrant. If our ratings were to be negatively adjusted for any reason, we could experience a material decline in the sales of our products and the persistency of our existing business.
Reinsurance
Coinsurance
American Equity Life has two coinsurance agreements with EquiTrust Life Insurance Company ("EquiTrust"), covering 70% of certain of our fixed index and fixed rate annuities issued from August 1, 2001 through December 31, 2001, 40% of those contracts issued during 2002 and 2003, and 20% of those contracts issued from January 1, 2004 to July 31, 2004, when the agreement was suspended by mutuae to Craft Brands based upon a contractually determined formula.

Until the effective date of the Merger, the Company and Widmer were each 50% members of Craft Brands, with each holding rights to designate two directors to Craft Brands six member board. A-B held the rights to designate the other two directors. Profits and losses of Craft Brands were generally shared between the Company and Widmer based on the cash flow percentages of 42% and 58%, respectively. The Company and Widmer had entered into an operating agreement with regards to Craft Brands ( Operating Agreement ), which governed the operations of Craft Brands and the obligations of its members, including capital contributions, loans and allocations of profits and losses. In connection with the Merger, Craft Brands was also merged with and into the Company effective July 1, 2008. All existing agreements, including the Operating Agreement, all associated future commitments and obligations between the Company and Craft Brands and between Craft Brands and Widmer terminated as a result of the merger of Craft Brands.

As a result of the merger with Craft Brands, the Company adjusted its residual investment in and wrote off its net receivable from Craft Brands to the total purchase consideration, which resulted in increases to goodwill of $339,000 and $21,000, respectively.

Prior to Craft Brands merger into the Company, the Company had assessed its investment in Craft Brands pursuant to the provisions of FASB Interpretation No. 46 Revised, *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51* ( FIN 46R ). In applying FIN 46R, the Company did not consolidate the financial statements of Craft Brands with the financial statements of the Company, but instead accounted for its investment in Craft Brands under the equity method, as outlined by Accounting Principles Board ( APB ) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* ( APB 18 ). The Company recognized its share of the net earnings of Craft Brands by an increase to its investment in Craft Brands on the Company s balance sheet and recognized income from equity investment in the Company s statements of operations. Any cash distributions received or the Company s share of losses reported by Craft Brands were reflected as a decrease in investment in Craft Brands on the Company s balance sheet. Prior to the merger of Craft Brands, the Company did not control the amount or timing of cash

distributions by Craft Brands.

Prior to Craft Brands merger, the Company s share of the earnings of Craft Brands contributed a significant portion of income to the Company s results of operations. In accordance with Rule 8-03(b)(3) of

Regulation S-X, the Company has presented selected financial data for Craft Brands in Part II, Item 8. Financial Statements and Supplementary Data, Note 7. *Equity Investments.*

### Sales and Marketing

The Company promotes its products through a variety of means, including a) creating and executing a range of advertising programs with its wholesalers; b) training and educating wholesalers and retailers about the Company s products; c) promoting the Company s name, product offering and brands, and experimental beers at local festivals, venues and pubs; d) utilizing the pubs located at the Company s three production breweries; e) discounting its sales price to create competitive advantage within the market place; and f) until the Merger, utilizing Craft Brands to create greater brand identity.

The Company advertises its products through an assortment of media, including television, radio, billboard, print and the internet, in key markets and by participating in a co-operative program with its distributors whereby the Company s spending is matched by the distributor. The Company believes that the financial commitment by the distributor helps align the distributor s interests with those of the Company, and the distributor s knowledge of the local market results in an advertising and promotion program that is targeted in a manner that will best promote the Company s products.

The Company incurs costs for the promotion of its products through a variety of advertising programs with its wholesalers and downstream retailers. The Company s sales and marketing staff offers education, training and other support to wholesale distributors of the Company s products. Because the Company s wholesalers generally also distribute much higher volume national beer brands and frequently other specialty brands, a critical function of the sales and marketing staff is to elevate each distributor s awareness of the Company s products and to maintain the distributor s interest in promoting increased sales of these products. This is accomplished primarily through personal contact with each distributor, including on-site sales training, educational tours of the Company s breweries, and promotional activities and expenditures shared with the distributors. The Company s sales representatives also provide other forms of support to wholesale distributors, such as direct contact with restaurant and grocery chain buyers, direct involvement in the in-store display design; stacking, merchandising and exhibition of beer inventory, and dissemination of point-of-sale materials to the off-premise retailer.

The Company s sales representatives devote considerable effort to the promotion of on-premise consumption at participating pubs and restaurants. The Company believes that educating retailers about the freshness and quality of the Company s products will in turn allow retailers to assist in educating consumers. The Company considers on-premise product sampling and education to be among its most effective tools for building brand awareness with consumers and establishing word-of-mouth reputation. On-premise marketing is also accomplished through a variety of other point-of-sale tools, such as neon signs, tap handles, coasters, table tents, banners, posters, glassware and menu guidance. The Company seeks to identify its products with local markets by participating in or sponsoring cultural and community events, local music and other entertainment venues, local craft beer festivals and cuisine events, and local sporting events.

The Company s breweries also play a significant role in increasing consumer awareness of the Company s products and enhancing its image as a craft brewer. Many visitors take tours at the Company s breweries. All of the Company s breweries have a retail pub on-site where the Company s products are served. In addition, the breweries have meeting rooms that the public can rent for business meetings, parties and holiday events, and that the Company uses to entertain and educate distributors, retailers and the media about the Company s products. See Item 2. *Properties*. At its pubs, the Company also sells various items of apparel and memorabilia bearing the Company s trademarks, which creates further awareness of the Company s beers and reinforces the Company s quality image.

To further promote retail bottled product sales and in response to local competitive conditions, the Company regularly offers post-offs, or price discounts, to distributors in most of its markets. Distributors and retailers usually participate in the cost of these price discounts.

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Prior to the Merger, the Craft Brands joint sales and marketing organization served the operations of Redhook and Widmer in the Western Territory by advertising, marketing, selling and distributing both companies products to wholesale outlets through a distribution agreement between Craft Brands and A-B. Similar to the Company, Craft Brands promoted its products through a variety of advertising programs with its wholesalers, through training and education of wholesalers and retailers, through promotions at local festivals, venues, and pubs, by utilizing the pubs located at the Company s three breweries, and through price discounting. Management believes that, in addition to having achieved certain synergies through combined sales and marketing forces, Craft Brands was able to capitalize on both companies sales and marketing skills and complementary product portfolios. The Company believes that the combination of the two brewers complementary brand portfolios, led by one focused sales and marketing organization, will not only deliver financial benefits, but will also deliver greater impact at the point-of-sale.

**Seasonality**

Sales of the Company s products generally reflect a degree of seasonality, with the first and fourth quarters historically being the slowest and the other two quarters typically demonstrating stronger sales. The volume of sales may also be affected by weather conditions. Therefore, the Company s results for any quarter may not be indicative of the results that may be achieved for the full fiscal year.

**Competition**

The Company competes in the highly competitive craft brewing market as well as in the much larger specialty beer market, which encompasses producers of imported beers, major national brewers that have introduced fuller-flavored products, and large spirit companies and national brewers that produce flavored alcohol beverages. Beyond the beer market, craft brewers have also faced increasing competition from producers of wines and spirits. See *Industry Background* above.

Competition within the domestic craft beer segment and the specialty beer market is based on product quality, taste, consistency and freshness, ability to differentiate products, promotional methods and product support, transportation costs, distribution coverage, local appeal and price.

The craft beer segment is highly competitive due to the proliferation of small craft brewers, including contract brewers, and the large number of products offered by such brewers. Craft brewers have also encountered more competition as their peers expand distribution. Just as the Company expanded distribution of its products to markets outside of its home in the Pacific Northwest, so have other craft brewers expanded distribution of their products to other regions of the country, leading to an increase in the number of craft brewers in any given market. Competition also varies by regional market. Depending on the local market preferences and distribution, the Company has encountered strong competition from microbreweries, from regional specialty brewers as well as several national craft brewers. Because of the large number of participants and number of different products offered in this segment, the competition for bottled product placements and especially for draft beer placements has intensified. Although certain of these competitors distribute their products nationally and may have greater financial and other resources than the Company, management believes that the Company possesses certain competitive advantages, including its Company-owned production facilities and its relationships with A-B.

The Company also competes against producers of imported brands, such as Heineken, Corona Extra, and Guinness. Most of these foreign brewers have significantly greater financial resources than the Company. Although imported beers currently account for a greater share of the U.S. beer market than craft beers, the Company believes that craft brewers possess certain competitive advantages over some importers, including lower transportation costs, no importation costs, proximity to and familiarity with local consumers, a higher degree of product freshness, eligibility for lower federal excise taxes and absence of currency fluctuations.

In response to the growth of the craft beer segment, most of the major domestic national brewers have introduced fuller-flavored beers, including some of their bigger product launches in the wheat category. While these product offerings are intended to compete with craft beers, many of them are brewed according to methods used by these brewers in their other product offerings. The major national brewers have significantly

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greater financial resources than the Company and have access to a greater array of advertising and marketing tools to create product awareness of these offerings. Although increased participation by the major national brewers increases competition for market share and can heighten price sensitivity within the craft beer segment, the Company believes that their participation tends to increase advertising, distribution and consumer education and awareness of craft beers, and thus may ultimately contribute to further growth of this industry segment.

In the past several years, several major distilled spirits producers and national brewers have introduced flavored alcohol beverages. Products such as Smirnoff Ice, Bacardi Silver and Mike s Hard Lemonade have captured sizable market share in the higher priced end of the malt beverage industry. The Company believes sales of these products, along with strong growth in the imported and craft beer segments of the malt beverage industry, contributed to an increase in the overall U.S. alcohol market. The success of the flavored alcohol beverages will likely subject the Company to increased competition.

Competition for consumers of craft beers has also come from wine and spirits. Some of the growth in the past five years in the wine and spirits market, industry sources believe, has been drawn from the beer market. Media reports indicate that the U.S. beer market has lost nearly 1% share of alcohol beverage servings per year since 2003. This trend showed signs of abating in 2008, with wine and spirits being also impacted by the economic downturn. Despite this, industry sources indicate that the wine industry will experience its fourteenth consecutive year of growth by volume and the spirits industry its tenth consecutive year of growth by volume. This growth appears to be attributable to competitive pricing, television advertising, increased merchandising, and increased consumer interest in wine and spirits. Recently, the wine industry has been aided, on a limited basis, by its ability to sell outside of the three tier system allowing sales to be made directly to the consumer.

A significant portion of the Company s sales continue to be in the Pacific Northwest and in California, which the Company believes are among the most competitive craft beer markets in the United States, both in terms of number of participants and consumer awareness. The Company believes that these areas offer significant competition to its products, not only from other craft brewers but also from the growing wine market and from flavored alcohol beverages. This intense competition is magnified because some of the Company s brands are viewed as being relatively mature. Focus studies in the past have indicated that, while the Company s brands do possess brand awareness among target consumers, it also appeared to not attract key consumers who seem to be more interested in experimenting with new products. The Company s recent marketing efforts have been to focus on new product introductions and generating consumer interest in these offerings while strengthening the identities of the Company s flagship brands.

## Regulation

The Company s business is highly regulated at Federal, state and local levels. Various permits, licenses and approvals necessary to the Company s brewery and pub operations and the sale of alcoholic beverages are required from various agencies, including the U.S. Treasury Department, Alcohol and Tobacco Tax and Trade Bureau ( TTB ), the U.S. Department of Agriculture, the U.S. Food and Drug Administration, state alcohol regulatory agencies for the states in which the Company sells its products, and state and local health, sanitation, safety, fire and environmental agencies. In addition, the beer industry is subject to substantial federal and state excise taxes, although smaller brewers producing less than two million barrels annually, including the Company, benefit from favorable treatment.

Management believes that the Company currently has all of the licenses, permits and approvals required for its current operations. However, existing permits or licenses could be revoked if the Company was to fail to comply with the terms of such permits or licenses and additional permits or licenses may be required in the future for the Company s existing operations or as a result of the Company expanding its operations in the future. If licenses, permits or approvals required for the Company s brewery or pub operations were unavailable or unduly delayed, or if any such

permits or licenses that it currently holds were to be revoked, the Company s ability to conduct its business could be substantially and adversely affected.

*Alcoholic Beverage Regulation and Taxation.* All of the Company s breweries and pubs are subject to licensing and regulation by a number of governmental authorities. The Company operates its breweries under

federal licensing requirements imposed by the TTB. The TTB requires the filing of a Brewer s Notice upon the establishment of a commercial brewery; and the filing of an amended Brewers Notice any time there is a material change in the brewing or warehousing locations, brewing or packaging equipment, brewery s ownership, officers or directors. The Company s operations are subject to audit and inspection by the TTB at any time.

In addition to the regulations imposed by the TTB, the Company s breweries are subject to federal and state regulations applicable to wholesale and retail sales, pub operations, deliveries and selling practices in those states in which the Company sells its products. Failure of the Company to comply with these regulations could result in limitations on the Company s ability to conduct its business. Revocation of a TTB permit may result from failure to pay taxes, to keep proper accounts, to pay fees, to bond premises, to abide by federal alcoholic beverage production and distribution regulations, or if holders of 10% or more of the Company s shares are found to be of questionable character. Permits issued by state regulatory agencies may be revoked for many of the same reasons.

The U.S. federal government currently levies an excise tax of $18 per barrel on beer sold for consumption in the United States; however, brewers that produce less than two million barrels annually are taxed at $7 per barrel on the first 60,000 barrels shipped, with shipments above this amount taxed at the normal rate. While the Company is not aware of any plans by the federal government to reduce or eliminate this benefit to small brewers, any such reduction in a material amount would have an adverse effect on the Company. In addition, the Company will lose the benefit of this rate structure if its annual production exceeds the two million barrel threshold. Certain states also levy excise taxes on alcoholic beverages, which have also been subject to change. It is possible that excise taxes may be increased in the future by the federal government or any state government or both. In the past, increases in excise taxes on alcoholic beverages have been considered in connection with various governmental budget-balancing or funding proposals. Any such increases in excise taxes, if enacted, could adversely affect the Company.

*Federal and State Environmental Regulation.* The Company s brewery operations are subject to environmental regulations and local permitting requirements and agreements regarding, among other things, air emissions, water discharges and the handling and disposal of hazard wastes. While the Company has no reason to believe the operations of its facilities violate any such regulation or requirement, if such a violation were to occur, or if environmental regulations were to become more stringent in the future, the Company could be adversely affected.

*Dram Shop Laws.* The serving of alcoholic beverages to a person known to be intoxicated may, under certain circumstances, result in the server being held liable to third parties for injuries caused by the intoxicated customer. The Company s pubs have addressed this issue by maintaining relatively reasonable hours of operations and routinely performing training for their personnel. Significant uninsured damage awards against the Company could adversely affect the Company s financial condition.

**Trademarks**

The Company has obtained U.S. trademark registrations for its numerous products including its proprietary bottle designs. Trademark registrations generally include specific product names, marks and label designs. The Widmer and Redhook marks and certain other Company marks are also registered in various foreign countries. The Company regards its Widmer, Redhook and other trademarks as having substantial value and as being an important factor in the marketing of its products. The Company is not aware of any infringing uses that could materially affect its current business or any prior claim to the trademarks that would prevent the Company from using such trademarks in its business. The Company s policy is to pursue registration of its trademarks in its markets whenever possible and to oppose vigorously any infringement of its trademarks.

**Employees**

At December 31, 2008, the Company employed approximately 400 people, including 150 employees in the pubs, restaurant and retail stores, 126 employees in production, 85 personnel in sales and marketing, and

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33 employees in corporate and administration. Of these, 87 people in the pubs and 1 person in production were part-time employees. The Company believes its relations with its employees to be good.

### Available Information

Our Internet address is www.craftbrewers.com. There we make available, free of charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file such material with or furnish it to the Securities and Exchange Commission ( SEC ). Our SEC reports can be accessed through the investor relations section of our Web site. The information found on our Web site is not part of this or any other report we file with or furnish to the SEC.

## Item 1A. *Risk Factors*

***Cautionary Language Regarding Forward-Looking Statements.*** *This report contains forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include the discussion of our business strategies and expectations concerning future operations, margins, profitability, liquidity and capital resources. In addition, in certain portions of this report, the words anticipate, project, believe, estimate, may, will, expect, plan and intend and similar expressions, as they relate to us or our management, are intended to identify forward looking statements. These forward looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward looking statements. These statements are based upon the current expectations and assumptions of, and on information available to, our management. Further, investors are cautioned that, unless required by law, we do not assume any obligation to update forward-looking statements based on unanticipated events or changed expectations. In addition to specific factors that may be described in connection with any particular forward-looking statement, factors that could cause actual results to differ materially from those expressed or implied by the forward looking statements include (but are not limited to) the following:*

*Our business is sensitive to reductions in discretionary consumer spending, which may result from the recent downturn in the U.S. economy.* Consumer demand for luxury or perceived luxury goods, including craft beer, are sensitive to downturns in the economy and the corresponding impact on discretionary spending. Changes in discretionary consumer spending or consumer preferences brought about by the factors such as perceived or actual general economic conditions, job losses and the resultant rising unemployment rate, the current housing crisis, the current credit crisis, perceived or actual disposable consumer income and wealth, the current U.S. economic recession and changes in consumer confidence in the economy, could significantly reduce customer demand for craft beer in general, and the products we offer specifically. Certain of our core markets, particularly in the West, have been harder hit by the economic recession, with job loss and unemployment rates in excess of the national averages. Furthermore, any of these factors may cause consumers to substitute our products with the fuller-flavored national brands or other more affordable, although lower quality, alternatives available to the consumers. In either event, this would likely have a significant negative impact on our operating results.

*We are partially capitalized with long-term debt.* As of December 31, 2008, we have approximately $33.2 million in outstanding borrowed debt, principally financed by one lender. The terms of the loan agreement require that we meet certain financial covenants. Although we expect to meet these covenants in the future, we were unable to meet the covenants associated with our loan agreement in the past, requiring us to seek modification of the agreement and the associated covenants with our lenders. We may not be able to generate financial results sufficient to meet the financial covenant measurements, which would cause us to be in violation of the loan agreement. Failure to meet the covenants required by the loan agreement is an event of default and, at its option, the lender could deny a request for a waiver and declare the entire outstanding loan balance immediately due and payable. In such a case, we would seek to

refinance the loan with one or more lenders, potentially at less desirable terms. Given the current economic environment and the tightening of lending

standards by many financial institutions, including some of the banks that we might seek credit from, there can be no guarantee that additional financing would be available at commercially reasonable terms, if at all.

*We are dependent upon our continuing relationship with A-B.* Substantially all of our products are sold and distributed through A-B. If our relationship with A-B deteriorates, distribution of our products will suffer significant disruption and such event will have a long-term severe negative impact on our sales and results of operations, as it would be extremely difficult to rebuild a distribution network. In such an event, we would be faced with finding another national distribution partner similar to A-B, and entering into a complex distribution arrangement with that entity, or negotiating separate distribution agreements with individual distributors throughout the United States. Currently, we distribute our product through a network of more than 540 independent wholesale distributors, most of whom are geographically contiguous and independently owned and operated, and 12 branches owned and operated by A-B. If we had to negotiate separate agreements with individual distributors, such an undertaking would require a significant amount of time to complete, during which our products would not be distributed. It would also be extremely difficult for us to build a distribution network as seamless and contiguous as the one we currently enjoy through A-B. Additionally, we would need to raise significant capital to fund the development of a new distribution network and continue operations. There can be no guarantee that financing would be available when needed, or that any such financing would be on commercially reasonable terms. Given the difficulty that we would face if we needed to rebuild our distribution network, if the current distribution arrangement with A-B were to be terminated, we may not be able to continue as a going concern. We believe that the benefits of the relationship that we have enjoyed with A-B, in particular distribution and material cost efficiencies, have offset the costs associated with the relationship. However, there can be no assurance that these costs will not have a negative impact on our sales revenues and results of operations. A-B has introduced products and may in the future introduce additional new products or form relationships with other companies with products that compete with our products. Introduction of and support by A-B of these competing products may reduce wholesaler attention and financial resources committed to our products. There is no assurance that we will be able to successfully compete in the marketplace against other A-B supported products. Such an increase in competition could cause our sales and results of operations to be adversely affected.

*We may be unable to successfully integrate our operations and realize all of the anticipated benefits of the Merger.* We acquired Widmer with the expectation that, among other things, we would be able to capitalize on the opportunities for synergies in expanding the breweries and efficiently utilizing the available production capacity, implementing a national sales strategy and reducing costs associated with duplicate functions and to become a stronger and more competitive company. We have achieved some of these benefits; however, there are some benefits that we have not yet achieved and hope to achieve in the future. There can be no assurance that these synergies will be realized within the time periods contemplated or that they will be realized at all. There also can be no assurance that our integration with Widmer will result in the realization of the full benefits that we anticipated.

*Our cost saving initiatives may not generate sufficient liquidity.* Management has focused aggressively on identifying areas within the Company that can yield significant cost savings, whether driven by the synergies of the Merger and integration or generated by general cost-reduction programs, and has executed appropriate measures to secure these savings. The Company has been implementing these cost savings initiatives since the Merger and will continue to do so into 2009. Management believes that the Company can meet its normal cash flow requirements and comply with the terms of its loan agreement, but there is no assurance that it can do so. The failure to satisfy our working capital requirements could have a material adverse effect on our financial position and future operations.

*Our agreements with A-B contain limitations on our ability to engage in or reject certain transactions, including acquisitions and changes of control.* The amended Exchange Agreement requires us to obtain the consent of A-B prior to taking certain actions, or to offer to A-B a right of first refusal, including the following:

issuing equity securities;

acquiring or selling assets or stock;

amending our articles of incorporation or bylaws;

granting board representation rights to others;

entering into certain transactions with affiliates;

distributing our products in the United States other than through A-B or as provided in the amended distribution agreement with A-B;

distributing or licensing the production of any malt beverage product in any country outside of the United States; or

voluntarily delisting or terminating our listing on the Nasdaq Stock Market.

Additionally, A-B has the right to terminate the amended A-B Distribution Agreement if any competitor of A-B acquires more than 10% of our outstanding common stock.

Further, if the amended A-B Distribution Agreement is terminated, A-B has the right to solicit and negotiate offers from third parties to purchase all or substantially all of our assets or securities or to enter into a merger or consolidation transaction with us and the right to cause the board of directors to consider any such offer. The practical effect of the foregoing restrictions is to grant A-B the ability to veto certain transactions that management may believe to be in the best interest of our shareholders, including our expansion through acquisitions of other craft brewers or new brands, mergers with other brewing companies or our distribution of our products outside the United States. As a result, our results of operations and the trading price of our common stock may be adversely affected.

*A-B has significant control and influence over us.* As of December 31, 2008, A-B owns approximately 35.8% of our outstanding common stock and, under the amended Exchange Agreement, has the right to appoint two designees to our board of directors and to observe the conduct of all board committees. As a result, A-B is able to exercise significant control and influence over us and matters requiring approval of our shareholders, including the election of directors and approval of significant corporate transactions, such as another merger or other sale of our assets. This could limit the ability of other shareholders to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control of us. In addition, A-B may have actual or potential interests that diverge from the rest of our shareholders. The securities markets may also react unfavorably to A-B s ability to influence certain matters involving us, which could have a negative impact on the trading price of our common stock.

*We do not know what impact, if any, the acquisition of Anheuser-Busch by InBev (now Anheuser-Busch Inbev) will have on our business.* On November 18, 2008, InBev completed the acquisition of the parent company of A-B and changed the acquiring entity s name to Anheuser-Busch Inbev to reflect the combined operations. Anheuser-Busch Inbev is the leading global brewer, one of the world s top five consumer products companies, headquartered in Leuven, Belgium. Anheuser-Busch InBev manages a portfolio of over 200 brands that includes global flagship brands Stella Artois and Beck s, in addition to A-B s Budweiser. As mentioned previously, A-B has a significant ownership stake in the Company. We do not know what impact, if any, the acquisition of A-B by Anheuser-Busch InBev will have on our distribution or ownership relationships with A-B.

*We are dependent on our distributors for the sale of our products.* Although substantially all of our products are sold and distributed through A-B, we continue to rely heavily on distributors, most of which are independent wholesalers, for the sale of our products to retailers. Any disruption in the ability of the wholesalers, A-B, or us to distribute products efficiently due to any significant operational problems, such as wide-spread labor union strikes, the loss of a

major wholesaler as a customer or the termination of the distribution relationship with A-B, could hinder our ability to get our products to retailers and could have a material adverse impact on our sales and results of operations.

*Increased competition could adversely affect sales and results of operations.* We compete in the highly competitive craft brewing market as well as in the much larger specialty beer market, which encompasses producers of import beers, major national brewers that produce fuller-flavored products, and large spirit companies and national brewers that produce flavored alcohol beverages. Beyond the beer market, craft

brewers have also faced competition from producers of wines and spirits. Increasing competition could cause our future sales and results of operations to be adversely affected. Our rate of future growth in sales revenues is volatile and could be negative. We have historically operated with little or no backlog and, therefore, our ability to predict sales for future periods is limited.

*Future price promotions to generate demand for our products may be unsuccessful.* The prices that we charge in the future for our products may decrease from historical levels, depending on competitive factors in various markets. In order to stimulate demand for our products, we participate in price promotions with wholesalers and retail customers in most markets. The number of markets in which we choose to participate in price promotions and the frequency of such promotions may increase in the future. There can be no assurance, however, that these price promotions will be successful in increasing demand for our products.

*Operating breweries at production levels substantially below their current designed capacities could negatively impact our gross margins.* At December 31, 2008, the annual working capacity of our breweries totaled approximately 797,000 barrels. Due to many factors, including seasonality, production schedules of various draft products and bottled products and packages, and expected production losses, actual production capacity will always be less than working capacity. We believe that capacity utilization of the breweries will fluctuate throughout the year, and even though we expect that capacity of our breweries will be efficiently utilized during periods when our sales are strongest, there likely will be periods when the capacity utilization will be lower. If we are unable to achieve significant sales growth, the resulting excess capacity and unabsorbed overhead will have an adverse effect on our gross margins, operating cash flows and overall financial performance. We will periodically evaluate whether we expect to recover the costs of our production facilities over the course of their useful lives. If facts and circumstances indicate that the carrying value of these long-lived assets may be impaired, an evaluation of recoverability will be performed in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, by comparing the carrying value of the assets to projected future undiscounted cash flows along with other quantitative and qualitative analyses. If we determine that the carrying value of such assets does not appear to be recoverable, we will recognize an impairment loss by a charge against current operations.

*Due to our concentration of sales in the Pacific Northwest and California, our results of operations and financial condition may be subject to fluctuations in regional economic conditions.* A significant portion of our sales have been in the Pacific Northwest and California and, consequently, business may be adversely affected by changes in economic and business conditions nationally and specifically within these areas. In 2008, approximately one third of beer shipped by the Company was to wholesalers located in Oregon and Washington. Shipments to California wholesalers represented approximately another one quarter of the Company s total shipments, resulting in a total concentration approaching 60% in these three western states. We also believe these regions are among the most competitive craft beer markets in the United States, both in terms of number of market participants and consumer awareness. The Pacific Northwest and California offer significant competition to our products, not only from other craft brewers but also from the increasing wine market and from flavored alcohol beverages. This intense competition is magnified because certain of our brands are viewed as being relatively mature.

*The craft beer business is seasonal in nature, and we are likely to experience fluctuations in results of operations and financial condition.* Sales of craft beer products are somewhat seasonal, with the first and fourth quarters historically being the slowest and the rest of the year generating stronger sales. As well, our sales volume may also be affected by weather conditions. Therefore, the results for any quarter may not be indicative of the results that may be achieved for the full fiscal year. If an adverse event such as a regional economic downturn or poor weather conditions should occur during the second and third quarters, the adverse impact to our revenues would likely be greater as a result of the seasonal business.

*Changes in consumer preferences or public attitudes about our products could reduce demand.* If consumers were unwilling to accept our products or if general consumer trends caused a decrease in the demand for beer, including craft beer, it would adversely impact our sales and results of operations. If the flavored alcohol beverage market, the wine market, or the spirits market continues to grow, this could draw consumers away from our products and have an adverse effect on sales and results of operations. Further, the

alcoholic beverage industry has become the subject of considerable societal and political attention in recent years due to increasing public concern over alcohol-related social problems, including drunk driving, underage drinking and health consequences from the misuse of alcohol. If beer consumption in general were to fall out of favor among domestic consumers, or if the domestic beer industry were subjected to significant additional governmental regulation, our operations could be adversely affected.

*We are dependent upon the services of our key personnel.* If we lose the services of any members of senior management or key personnel for any reason, we may be unable to replace them with qualified personnel, which could have a material adverse effect on our operations. Additionally, the loss of Terry Michaelson as our chief executive officer, and the failure to find a replacement satisfactory to A-B, would be a default under the amended A-B Distribution Agreement. We do not carry key person life insurance on any of our executive officers.

*Our gross margin may fluctuate.* Future gross margin may fluctuate and even decline as a result of many factors, including the level of fixed and semi variable operating costs, level of production at our breweries in relation to current production capacity, availability and prices of raw materials and packaging materials, sales mix between draft and bottled product sales, sales mix of various bottled product packages, and rates charged for freight and federal or state excise taxes. Our high level of fixed and semi variable operating costs causes our gross margin to be especially sensitive to relatively small increases or decreases in sales volume.

*We are subject to governmental regulations affecting our breweries and pubs; the costs of complying with governmental regulations, or our failure to comply with such regulations, could affect our financial condition and results of operations.* Our breweries and pubs are subject to licensing and regulation by a number of governmental authorities, including the TTB, the U.S. Department of Agriculture, the U.S. Food and Drug Administration, state alcohol regulatory agencies in the states in which we sell our products, and state and local health, sanitation, safety, fire and environmental agencies. Failure to comply with applicable federal, state or local regulations could result in limitations on our ability to conduct business. TTB permits can be revoked for failure to pay taxes, to keep proper accounts, to pay fees, to bond premises, or to abide by federal alcoholic beverage production and distribution regulations, or if holders of 10% or more of our common stock are found to be of questionable character. TTB permits are also required in connection with establishing a commercial brewery, expanding or modifying existing brewing operations, entering into a contract brewing arrangement, and entering into an alternating proprietorship agreement, such as our arrangement with Kona. Other permits or licenses could be revoked if we fail to comply with the terms of such permits or licenses, and additional permits or licenses could be required in the future for existing or expanded operations. Because our sales objective and growth plans may rely on any one of these approaches, if licenses, permits or approvals necessary for our brewery or pub operations were unavailable or unduly delayed, or if any permits or licenses that we hold were to be revoked, our ability to conduct business could be substantially and adversely affected.

Management believes that the Company currently has all of the licenses, permits and approvals required for its current operations. However, the Company does business in almost every state with its products being distributed though the A-B distribution network, and for many of these states, relies on the licensing, permitting and approvals maintained by A-B. If a state or a number of states required the Company to obtain its own licensing, permitting or approvals to operate within the state s boundaries, a combination of events may occur, including a disruption of sales or significant increases in compliance costs. If licenses, permits or approvals not previously required for the sale of the Company s malt beverage products were to be suddenly required, the Company s ability to conduct its business could be substantially and adversely affected.

*An increase in excise taxes could adversely affect our financial condition or results of operations.* The U.S. federal government currently levies an excise tax of $18 per barrel on beer sold for consumption in the United States; however, brewers that produce less than two million barrels annually at taxed at $7 per barrel on the first 60,000 barrels shipped, with the remainder of the shipments taxed at the normal rate. While we are not aware of any

plans by the federal government to reduce or eliminate this benefit to small brewers, any such reduction in a material amount could have an adverse effect on our financial condition and results of operations. In addition, we would lose the benefit of this rate structure if our annual production exceeds the two million barrel threshold. Certain states also levy excise taxes on alcoholic beverages, which have also

been subject to change. It is possible that excise taxes will be increased in the future by either the federal government or any state government or both. In the past, increases in excise taxes on alcoholic beverages have been considered in connection with various governmental budget-balancing or funding proposals. Due in part to the economic recession and the follow-on effect on state budgets, a number of states are proposing legislation, including a key market in the state of Oregon, which would lead to significant increases in the excise tax rate on alcoholic beverages for their states. Any such increases in excise taxes, if enacted, would adversely affect our financial condition or results of operations.

*Changes in state laws regarding distribution arrangements may adversely impact our operations.* In 2006, the Washington state legislature enacted legislation removing the long-standing requirement that small producers of wine and beer distribute their products through wholesale distributors, thus permitting these small producers to distribute their products directly to retailers. The law further provides that any brewery that produces more than 2,500 barrels annually may distribute its products directly to retailers, if its distribution facilities are physically separate and distinct from its production facilities. The legislation stipulates that prices charged by a brewery must be uniform for all distributors and retailers, but does not mandate the price retailers may charge consumers. Our operations will continue to be substantially impacted by the Washington state regulatory environment, and while it is difficult to predict what impact, if any, this law will have, the beer and wine market is likely to experience an increase in competition that could cause future sales and results of operations to be adversely affected. This law may also impact the financial stability of Washington state wholesalers on which we rely.

Other states in which we have a significance sales presence may enact similar legislation, which is likely to have the same or similar effect on the competitive environment for those states. An increase in the competitive environment in those states could have an adverse effect on our future sales and results of operations.

*We may experience a shortage of kegs necessary to distribute draft beer.* We distribute our draft beer in kegs that are owned by us as well as leased from a third-party vendor. During periods when we experience stronger sales, we may need to rely on kegs leased from A-B and the third-party vendor to address the additional demand. If shipments of draft beer increase, we may experience a shortage of available kegs to fill sales orders. If we cannot meet our keg requirements through either lease or purchase, we may be required to delay some draft shipments. Such delays could have an adverse impact on sales and relationships with wholesalers and A-B. As well, we may decide to pursue other alternatives for leasing or purchasing kegs. There is no assurance, though, that we will be successful in securing additional kegs.

*Our key raw materials may continue to increase in cost and adequate supplies may become even more difficult to secure.* According to industry and media sources, the cost of barley, wheat and hops, all primary ingredients in our products, have increased significantly in the prior two years. Media sources explain that the cost of barley increased 48% from August 2006 through June 2007, largely driven by a lower supply of barley as farmers shifted their focus to growing corn, a key component of biofuels. The beer industry appears to also be experiencing a decline in the supply of hops, driven by a number of factors: excess supply in the 1990s led some growers to switch to more lucrative crops, resulting in an estimated 40% decrease in worldwide hop-growing acreage; poor weather in eastern Europe and Germany caused substantial hops crop losses in 2007; hops crop production in England has declined approximately 85% since the mid-1970s; and 2007 U.S., New Zealand, and Australia hops crop yields were only average. Wheat exports have increased by 30% because of the weak U.S. dollar and poor worldwide harvests, leading to U.S. supplies of wheat that are at the lowest levels in 60 years. While we have historically utilized fixed price contracts to secure adequate supplies of key raw materials, including barley, wheat and hops, recent fixed price contracts reflect current market pricing that is significantly higher than historical pricing. If we experience difficulty in securing our key raw materials or continue to experience increases in the cost of these materials, it would adversely affect our financial condition or results of operations.

*Loss of income tax benefits could negatively impact our results of operations.* As of December 31, 2008, our deferred tax assets were primarily comprised of federal net operating losses ( NOLs ) of $29.1 million, or $9.9 million tax-effected; state NOL carryforwards of $299,000 tax-effected; and federal and state alternative

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minimum tax credit carryforwards of $183,000 tax effected. The ultimate realization of deferred tax assets is dependent upon the existence of, or generation of, taxable income during the periods in which those temporary differences become deductible. As of December 31, 2008, we recorded a valuation allowance of $1.0 million against certain of our deferred tax assets based on our assessment that it was more likely than not that these deferred tax assets would not be realized. To the extent that we continue to generate NOLs in the future, or otherwise are unable to generate adequate taxable income in future periods, we may be unable to recognize additional tax benefits. In addition, we may be required to record an increase to the valuation allowance to provide for other deferred tax assets in the event that our assessment is that they are more likely than not to not be realized.

In conjunction with the Merger, we reviewed Section 382 of the Internal Revenue Code, which can limit the use of NOLs in instances where there has been a change in ownership of greater than 50% of the stock owned by one or more shareholders holding five percent or more of the outstanding stock, and do not believe that Section 382 impacts our ability to utilize the NOLs in the future. While we are not aware of any plans by the federal or state governments to amend the rules regarding utilization of NOLs, any such modification could have an adverse effect on our financial condition and results of operations.

*Our common stock could be de-listed from the NASDAQ Global Market if our stock price were to trade below $1.00 per share for an extended period of time.* Since the beginning of 2009, our stock price has been trading in a range from $0.86 to $1.27 per share. Under NASDAQ s Marketplace Rule 4450(a)(5), ( Rule ) any Company whose stock has a closing bid price less than $1.00 for 30 consecutive days may be subject to a de-listing proceeding instigated by the NASDAQ. On October 16, 2008, NASDAQ announced that it had suspended the enforcement of the Rule until January 19, 2009, and then on December 23, 2008, NASDAQ announced the suspension of enforcement of this rule until April 20, 2009. In the event that we receive notice that our common stock is being subjected to de-listing procedures from the NASDAQ Global Market, NASDAQ rules permit us to appeal any de-listing determination by the NASDAQ staff to a NASDAQ Listing Qualifications Panel. Alternatively, NASDAQ may permit us to transfer the listing of our common stock to the NASDAQ Capital Market if we satisfy the requirements for initial inclusion set forth in Marketplace Rule 4310(c), except for the bid price requirement. We will continue to monitor the bid price for our common stock and consider various options available to us if our common stock does not trade at a level that is likely to maintain compliance or the NASDAQ does not further extend the suspension of the Rule.

Delisting from the NASDAQ Global Market could have an adverse effect on our business and on the trading of our common stock. If a delisting of our common stock from the NASDAQ Stock Market were to occur, our common stock would trade on the OTC Bulletin Board or on the pink sheets maintained by the National Quotation Bureau, Inc. Such alternatives are generally considered to be less efficient markets, and our stock price, as well as the liquidity of our common stock, may be adversely impacted as a result.

*The expiration of lock-up agreements entered into with certain Widmer shareholders in connection with the Merger could cause the market price of our common stock to decline.* As a condition to the closing of the Merger, certain shareholders of Widmer executed lock-up agreements pursuant to which these holders generally agreed that, from the closing date of the Merger to the first anniversary of the closing, they will not directly or indirectly sell or otherwise transfer any shares of our common stock then held or thereafter acquired without the consent of our board of directors. These Widmer shareholders received 4,002,343 shares of our common stock pursuant to the Merger, which represents approximately 23.6% of the outstanding shares as of December 31, 2008. Upon the expiration of the lock-up agreements, all of these shares will be available for sale in the public market, subject to volume, manner of sale and other limitations under Rule 144 in the case of shares held by any of these shareholders who are affiliates of the Company. Such sales in the public market after the lock-up agreements expire, or the perception that such sales could occur, could cause the market price of our common stock to decline.

*Our relationships with Kona and FSB may not provide anticipated benefits.* As a result of the Merger, we have a 20% equity interest in Kona and a 42% equity interest in FSB; however as a result of the Merger, we recorded these investments as our percentage share of the associated fair value of the entities, resulting in an amount greater than our percentage share of the net book value of the corresponding entity. As a result of

declines deemed to be other than temporary in the estimated future profitability of these entities, we recorded charges to loss on impairment of $100,000 and $1.3 million associated with our corporate investment in Kona and FSB, respectively, for the year ended December 31, 2008. If the sales or operations of Kona or FSB experience further declines that are deemed to be other than temporary in nature and substantial in volume or quantity, our analyses of the fair values of these equity investments as compared with their carrying values may indicate that additional impairment losses have been incurred. Any such impairment losses would be charged against current operations.

*The fair value of our intangible Widmer trademark asset may decrease further.* One of the assets acquired in the Merger was the intangible Widmer trademark, which we recorded at its estimated fair value of $16.3 million as of the effective date of the Merger. As a result of a decrease in the estimated cash flows associated with this asset, our analysis concluded that a decrease in the fair value of this asset had occurred. This resulted in our recognizing a loss on impairment of this asset of $6.5 million during the fourth quarter of 2008. If the current recession causes a reduction in consumer demand, or we, for any other reason, experience a decrease in sales growth, a further decrease in the cash flows projected to be generated by this asset may occur. If this decrease is significant, our analysis of the fair value of this intangible asset as compared with its carrying value may indicate that an additional impairment loss has been incurred. Any such impairment loss would be charged against current operations.

*We do not intend to pay and are limited in our ability to declare or pay dividends, accordingly, shareholders must rely on stock appreciation for any return on their investment in us.* We do not anticipate paying cash dividends in the future. Further, due to our loan agreement with Bank of America, N.A. ( BofA ) as modified, we are not able to declare or pay a dividend without our lender s prior consent. As a result, only appreciation of the price of our common stock will provide a return to shareholders. Investors seeking cash dividends should not invest in our common stock.

*Our modified credit agreement limits our near-term capital expenditures.* Maintaining our facilities or entering into new product or packaging introduction may require incremental capital expenditures; however, per the terms of our borrowing arrangement with our lender, our capital expenditures will be limited in each of the first two quarters of 2009 to specified amounts. If the capital expenditures necessary to maintain our facilities or bring new products or packaging to market are greater than the amounts to which we are limited by this arrangement, our ability to maintain or increase sales growth could be impaired, which could materially adversely affect our business.

**Item 1B.** ***Unresolved Staff Comments***

None.

**Item 2.** ***Properties***

The Company currently owns and operates three highly automated small-batch breweries, the Washington Brewery, the Portland Brewery and the New Hampshire Brewery, as well as a small, manual brewpub-style brewing system at the Rose Quarter Brewery. The Company leases the sites upon which the New Hampshire Brewery and Rose Quarter Brewery are located, in addition to its office space and warehouse locations in Portland, Oregon for its corporate, administrative and sales functions. These operating leases expire at various times between 2011 and 2047. Certain of these leases are with entities that have members that include related parties to the Company. See Notes 16 and 17 to the Financial Statements included elsewhere herein for further discussion regarding these arrangements.

*The Washington Brewery.* The Washington Brewery, located on approximately 22 acres (17 of which are developable) in Woodinville, Washington, a suburb of Seattle, is across the street from the Chateau Ste. Michelle Winery and next to the Columbia Winery. The Washington Brewery is comprised of an approximately 88,000 square-foot building, a 40,000 square-foot building and an outdoor tank farm. The two buildings house a 100-barrel brewhouse, fermentation cellars, filter rooms, grain storage silos, a bottling line, a keg filling line, dry

storage, two coolers and loading docks. The brewery includes a retail merchandise outlet and the Forecasters Public House, a 4,000 square-foot family-oriented pub that seats 200 patrons and features

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an outdoor beer garden that seats an additional 200 people. Additional entertainment facilities include a 4,000 square-foot special events room accommodating up to 250 people. The brewery also houses office space, in a portion of which some of the Company s Operations staff are located. The remaining space is leased out to a third party through October 2009. The Company purchased the land in 1993 and believes that its value has appreciated. The brewery s annual production capacity as of year end 2008 was approximately 230,000 barrels, which is also the expected annual production capacity for 2009. The Company s annual production capacity is estimated assuming a total of two weeks shut down for maintenance and other interruptions, and also assumes a standard mix of brands and package changes.

*The Oregon Brewery.* The Oregon Brewery, located in Portland, Oregon, is comprised of an approximately 135,000 square-foot building housing the primary brewery equipment, a 40,000 square-foot building and a 10,000 square-foot addition. The three structures house a 230-barrel brewhouse, fermentation cellars, filter rooms, grain storage silos, a bottling line, a keg filling line, dry storage, two coolers and loading docks. The brewery includes a retail merchandise outlet and the Gasthaus Pub and Restaurant, a 3,100 square-foot family-oriented pub that seats 125 patrons. There are also two special events rooms that combined represent 3,700 square feet and can accommodate up to 125 people. The brewery also houses office space, where most of the Company s corporate and sales and marketing staff are located. The brewery s annual production capacity as of year end 2008 is approximately 377,000 barrels, which is also the expected annual production capacity for 2009.

*The New Hampshire Brewery.* The New Hampshire Brewery is located on approximately 23 acres in Portsmouth, New Hampshire. The Company leases the land under a contract that expires in 2047, with an option to renew for up to two seven-year extensions. The New Hampshire Brewery is modeled after the Washington Brewery and is similarly equipped, but is larger in design, covering 125,000 square feet to accommodate all phases of the Company s brewing operations under one roof. Also included is a retail merchandise outlet; the Cataqua Public House, a 4,000 square-foot family-oriented pub with an outdoor beer garden, and a special events room accommodating up to 250 people. Production began in October 1996, with an initial brewing capacity of approximately 100,000 barrels per year. In order to accommodate sales growth, the Company has steadily expanded the production capacity at this location. As of December 31, 2008, the brewery s annual production capacity is approximately 190,000 barrels, which is also the expected annual production capacity for 2009.

*The Rose Quarter Brewery.* The Company also operates a second location in Portland, Oregon, which is a pilot 10-barrel brewhouse at the Rose Quarter. The Rose Quarter is a sports and entertainment venue featuring two multi-purpose arenas, including the home arena for the National Basketball Association s Portland Trail Blazers professional basketball team.

Substantially all of the personal property and the real properties associated with the Oregon Brewery and the Washington Brewery secure the Company s loan agreement with BofA. See Notes 6 and 9 to the Financial Statements included elsewhere herein.

**Item 3.** ***Legal Proceedings***

The Company is involved from time to time in claims, proceedings and litigation arising in the normal course of business. The Company believes that, to the extent that any pending or threatened litigation involving the Company or its properties exists, such litigation will not likely have a material adverse effect on the Company s financial condition or results of operations.

**Item 4.** ***Submission of Matters to a Vote of Security Holders***

None.

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## Executive Officers of the Company

**Terry E. Michaelson (55)    Chief Executive Officer**

Mr. Michaelson has served as the Company s sole Chief Executive Officer since November 13, 2008 and was the Company s Co-Chief Executive Officer prior to that beginning with the effective date of the Merger, July 1, 2008. He served as President of Craft Brands from July 2004 to July 1, 2008. From March 1995 to June 2004, he served as Chief Operating Officer and Executive Vice President of Widmer Brothers Brewing Company (Widmer), and from August 1993 to June 2004, Mr. Michaelson served as a director of Widmer. From January 1994 to February 1995, he served as Director of Operations of Widmer.

**Mark D. Moreland (44)    Chief Financial Officer and Treasurer**

Mr. Moreland has served as the Company s Chief Financial Officer and Treasurer since August 19, 2008 and prior to that was the Company s Chief Accounting Officer, beginning with the effective date of the Merger. From April 1, 2008 to June 30, 2008, Mr. Moreland served as Chief Financial Officer of Widmer Brothers Brewing Company. He was Executive Vice President and Chief Financial Officer of Knowledge Learning Corporation from July 2006 to November 2007. From July 2005 to June 2006, Mr. Moreland held the positions of Interim CFO, Senior Vice President Finance and Treasurer with Movie Gallery, Inc., which operates the Movie Gallery and Hollywood Entertainment video rental chains. From August 2002 to July 2005, he was Senior Vice President, Finance and Treasurer of Hollywood Entertainment Corporation, which Movie Gallery, Inc. acquired in April 2005. Movie Gallery and each of its U.S. affiliates filed voluntary petitions under Chapter 11 of the U.S. Bankruptcy Code on October 16, 2007, and the plan of reorganization was subsequently confirmed by the U.S. Bankruptcy Court in 2008.

**V. Sebastian Pastore (42)    Vice President, Brewing Operations and Technology**

Mr. Pastore has served as Vice President, Brewing Operations and Technology for the Company since the Merger. Prior to that, Mr. Pastore has served as Vice President of Brewing of Widmer from March 2002 to the effective date of the Merger. From June 2000 to March 2002, he worked for Coca-Cola Enterprises. From December 1994 to June 2000, Mr. Pastore worked at Widmer serving as the Director of Brewing and from January 1990 to November 1994, he served as the Assistant Brewmaster.

**Martin J. Wall (37)    Vice President, Sales**

Mr. Wall has served as Vice President, Sales for the Company since the Merger. Prior to that, Mr. Wall served as Vice President of Sales of Craft Brands from July 2004 to the effective date of the Merger. From September 2000 to June 2004, he served as Vice President of Sales of Widmer. Prior to September 2000, Mr. Wall held various positions at Widmer, including Market Manager and Brewery Representative.

There is no family relationship between any of the directors or executive officers of the Company, except that Kurt R. Widmer, the Chairman of the Company s Board, is the brother of Robert Widmer, who serves as the Company s Vice President of Corporate Quality Assurance and Industry Relations, a non-executive position.

## PART II

**Item 5.** ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

The Company s Common Stock trades on the Nasdaq Stock Market under the trading symbol HOOK. The table below sets forth, for the fiscal quarters indicated, the reported high and low sale prices of the Company s Common Stock, as reported on the NASDAQ Stock Market:

| | High | Low |
|---|---|---|
| **2008** | | |
| First quarter | $ 6.63 | $ 4.00 |
| Second quarter | $ 4.90 | $ 3.85 |
| Third quarter | $ 4.89 | $ 2.78 |
| Fourth quarter | $ 3.80 | $ 1.11 |
| **2007** | | |
| First quarter | $ 7.80 | $ 5.00 |
| Second quarter | $ 8.08 | $ 6.17 |
| Third quarter | $ 8.21 | $ 5.68 |
| Fourth quarter | $ 7.11 | $ 5.84 |

As of March 16, 2009, there were 690 common stockholders of record, although the Company believes that the number of beneficial owners of its common stock is substantially greater.

The Company has not paid any dividends during the past 10 years, and has never declared or paid normal or ordinary dividends during its existence. Under the terms of the Company s loan agreement with Bank of America, N.A. ( BofA ) as modified, the Company may not declare or pay dividends without our lender s consent. The Company anticipates that for the foreseeable future, all earnings, if any, will be retained for the operation and expansion of its business and that it will not pay cash dividends. The payment of dividends, if any, in the future will be at the discretion of the board of directors and will depend upon, among other things, future earnings, capital requirements, restrictions in future financing agreements, the general financial condition of the Company and general business conditions.

**Item 6.** ***Selected Financial Data***

Not applicable.

**Item 7.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis should be read in conjunction with the Company s Financial Statements and Notes thereto included herein. The discussion and analysis includes period-to-period comparisons of the Company s financial results. Although period-to-period comparisons may be helpful in understanding the Company s financial results, the Company believes that they should not be relied upon as an accurate indicator of future performance.

**Merger with Widmer Brothers Brewing Company**

On November 13, 2007, the Company entered into an Agreement and Plan of Merger with Widmer Brothers Brewing Company, an Oregon corporation ( Widmer ). On July 1, 2008, the merger of Widmer with and into the Company was completed (the Merger ). In connection with the Merger, the name of the Company was changed from Redhook Ale Brewery, Incorporated to Craft Brewers Alliance, Inc. The common stock of the Company continues to trade on the Nasdaq Stock Market under the trading symbol HOOK.

The Company believes that the combined entity has the potential to secure efficiencies, beyond those that had already been achieved by its existing relationships with Widmer, in utilizing the two companies breweries

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and a national sales force, as well as by reducing duplicate functions. Utilizing the combined breweries offers a greater opportunity to rationalize production capacity in line with product demand. The national sales force of the combined entity will support further promotion of the products of its corporate investments, Kona Brewery LLC ( Kona ), which brews Kona malt beverage products, and to a lesser extent, the Fulton Street Brewery, LLC ( FSB ), which brews Goose Island malt beverage products. The Company also expects that the combined entity may have greater access to capital markets driven by its increased size and expected growth rates.

### Overview

Since its formation, the Company has focused its business activities on the brewing, marketing and selling of craft beers in the United States. The Company generated gross sales of $86.0 million and a net loss of $33.3 million for the year ended December 31, 2008, compared with gross sales of $46.5 million and a net loss $939,000 for the corresponding period in 2007. The Company generated a loss per share of $2.63 on 12.7 million shares for fiscal year 2008 compared with a loss per share of $0.11 on 8.3 million shares for fiscal year 2007. The results for the year ended December 31, 2008 reflect a non-cash charge of $30.6 million as a loss on impairment of assets recorded by the Company due to its analysis at year end of the estimated fair value of certain assets that were acquired by the Company in the Merger as compared to their respective carrying value in light of current economic circumstances. The comparability of the two fiscal periods is further impacted by the Merger.

The Company s sales volume (shipments) increased 34.1% to 424,900 barrels in 2008 as compared with 316,900 barrels in 2007, due primarily to shipments of Widmer- and Kona-branded products in the second half of 2008 as a result of the Merger. Sales in the craft beer industry generally reflect a degree of seasonality, with the first and fourth quarters historically being the slowest and the rest of the year typically demonstrating stronger sales. The Company has historically operated with little or no backlog, and its ability to predict sales for future periods is limited.

Since July 1, 2008, the Company has produced its specialty bottled and draft Redhook-branded and Widmer-branded products in its four Company-owned breweries, one in the Seattle suburb of Woodinville, Washington ( Washington Brewery ), another in Portsmouth, New Hampshire ( New Hampshire Brewery ), and two in Portland, Oregon. The two in Portland, Oregon are the Company s largest production facility ( Oregon Brewery ) and its smallest, a manual brewpub-style brewery at the Rose Quarter ( Rose Quarter Brewery ). The Company sells these products in addition to the Kona branded products predominantly to Anheuser-Busch, Incorporated ( A-B ) and its network of wholesalers pursuant to the July 1, 2004 Master Distributor Agreement (the A-B Distribution Agreement ), as amended. These products are available in 48 states.

In addition to the sale of Redhook-branded and Widmer-branded beer, the Company also earns revenue in connection with two operating agreements with Kona an alternating proprietorship agreement and a distribution agreement. Pursuant to the alternating proprietorship agreement, Kona produces a portion of its malt beverages at the Oregon Brewery. The Company sells raw materials to Kona prior to production beginning and receives from Kona a facility leasing fee based on the barrels brewed and packaged at the Company s brewery. These sales and fees are reflected as revenue in the Company s statements of operations. Under the distribution agreement, the Company purchases and distributes product manufactured by Kona and then markets, sells and distributes the Kona-branded products pursuant to the A-B Distribution Agreement. As Kona s distributor, the Company also markets, sells and distributes any Kona-branded products manufactured at the Company s Oregon Brewery.

The Company also derives other revenues from sources including the sale of retail beer, food, apparel and other retail items in its three brewery pubs. The Company added the third pub, located in Portland, Oregon and attached to the Oregon Brewery, in the Merger.

In conjunction with the Merger, the Company acquired from Widmer a 20% equity ownership in Kona and a 42% equity ownership in FSB, brewer of Goose Island-branded products. Both investments are

accounted for under the equity method, as outlined by Accounting Principles Board Opinion ( APB ) No. 18, *The Equity Method of Accounting for Investments in Common Stock* ( APB 18 ).

From July 1, 2004 through June 30, 2008, the Company produced its specialty bottled and draft Redhook-branded products at the Washington Brewery and the New Hampshire Brewery. The Company distributed these products in the Midwest and Eastern United States. pursuant to the A-B Distribution Agreement and in the western United States through Craft Brands Alliance LLC ( Craft Brands ). In addition to the sale of Redhook-branded beer, the Company also brewed, marketed and sold *Widmer Hefeweizen* in the Midwest and Eastern United States in conjunction with a 2003 licensing agreement with Widmer and brewed Widmer-branded products for Widmer in connection with contract brewing arrangements.

Craft Brands was a joint venture sales and marketing entity formed by the Company and Widmer in July 2004. The Company and Widmer manufactured and sold their product to Craft Brands at a price substantially below wholesale pricing levels; Craft Brands, in turn, advertised, marketed, sold and distributed the product to wholesale outlets in the western United States through a distribution agreement between Craft Brands and A-B. (Due to state liquor regulations, the Company sold its product in Washington state directly to third-party beer distributors and returned a portion of the revenue to Craft Brands based upon a contractually determined formula.) Profits and losses of Craft Brands were generally shared between the Company and Widmer based on the cash flow percentages of 42% and 58%, respectively. In connection with the Merger, Craft Brands was merged with and into the Company, effective July 1, 2008. All existing agreements between the Company and Craft Brands and between Craft Brands and Widmer terminated as a result of the merger of Craft Brands with and into the Company.

For additional information regarding the A-B Distribution Agreement and Craft Brands, see Part 1, Item 1, Business *Product Distribution,* *Relationship with Anheuser-Busch, Incorporated* and *Relationship with Craft Brands Alliance LLC.*

The Company s sales are affected by several factors, including consumer demand, price discounting and competitive considerations. The Company competes in the highly competitive craft brewing market as well as in the much larger beer, wine, spirits and flavored alcohol markets, which encompass producers of import beers, major national brewers that produce fuller-flavored products, large spirit companies, and national brewers that produce flavored alcohol beverages. The craft beer segment is highly competitive due to the proliferation of small craft brewers, including contract brewers, and the large number of products offered by such brewers. Certain national domestic brewers have also sought to appeal to this growing demand for craft beers by producing their own fuller-flavored products. These fuller-flavored products have been most successful within the wheat beer category, including *Shock Top Belgian White* and *Blue Moon Belgian White.* These beers are generally considered to be within the same category as the Company s *Hefeweizen* beer, putting them in direct competition. The wine and spirits market has also experienced significant growth in the past five years or so, attributable to competitive pricing, increased merchandising, and increased consumer interest in wine and spirits. In recent years, the specialty segment has seen the introduction of flavored alcohol beverages, the consumers of which, industry sources generally believe, correlate closely with the consumers of the import and craft beer products. Sales of these flavored alcohol beverages were initially very strong, but growth rates have slowed in recent years. While there appear to be fewer participants in the flavored alcohol category than at its peak, there is still significant volume associated with these beverages. Because the number of participants and number of different products offered in this segment have increased significantly in the past ten years, the competition for bottled and draft product placements has intensified.

While the craft beer market has seen a significant growth in the number of competitors, the national domestic and international brewers have undergone a second round of consolidation, reducing the number of market participants at the top of the beer market. A number of factors have driven this consolidation, including the desire to capture market share and positioning as either the largest brewer or second largest brewer in any given market. The U.S. beer market,

in which the Company competes, was once dominated by three companies, A-B, Miller Brewing Company and Adolph Coors Company. During the past decade, Miller Brewing Company and Adolph Coors Company were merged with international brewers, South African Brewers ( SAB ) and Molson of Canada, respectively, to increase the global market reach of their brands.

During the current year, the resulting companies, SABMiller and MolsonCoors, completed the terms of a joint venture to merge their U.S. operations, competing under the name MillerCoors. Likewise, A-B was acquired by Belgium-based InBev in a deal consummated in the fourth quarter of 2008. Shipments for the two entities, A-B and MillerCoors, represented nearly 80% of the total U.S. market, including imports, for 2008.

Another factor driving this is the desire on the part of these larger consolidated national brewers to control the rising cost of the majority of the inputs to the brewing process, primarily barley, wheat and hops, and packaging and shipping costs. While consolidation promises to alleviate these cost pressures for the national brewers, the Company faces these same pressures with limited resources available to achieve similar benefits.

Management monitors the annual working capacity of each brewery in connection with production and resource planning. Because an industry standard for defining brewery capacity does not exist, there are numerous variables that can be considered in arriving at an estimate of annual working capacity. Following the Merger, management reviewed each facility, scrutinized the factors important to the Company in arriving at a practical definition of capacity, and recomputed the annual working capacity of each brewery. Among the factors that management considered in estimating annual working capacity are:

- Brewhouse capacity, fermentation capacity, and packaging capacity;
- A normal production year;
- The product mix and product cycle times; and
- Brewing losses and packaging losses.

Because the conditions under which each brewery operates differs (such as age of equipment, local environment, product mix), the impact that these factors have on the estimate of capacity also vary by brewery. For example, while the New Hampshire Brewery and the Oregon Brewery are constrained by the volume of beer that each can ferment (each brewery can brew more beer than it can ferment), the Washington Brewery is constrained by the size of its brewhouse (the brewery has adequate capacity to ferment all product that it brews).

Management did not consider the impact that seasonality clearly has on the capacity calculation. Rather, management assumed that each brewery produces beer at 100% of working capacity throughout a 50 week year. But because seasonality is a notable factor affecting the Company s sales, the Company expects that the breweries capacity will be more efficiently utilized during periods when the Company s sales are strongest and there likely will be periods where the breweries capacity utilization will be lower.

Management estimates the annual working capacity after the Merger for its breweries as follows:

| | **Annual Working Capacity at December 31, 2008 (In barrels)** |
|---|---|
| Oregon Brewery(1) | 377,000 |
| Washington Brewery | 230,000 |
| New Hampshire Brewery | 190,000 |

797,000

Note 1 Excludes the annual working capacity for the Rose Quarter Brewery, which is less than 1,000 barrels.

In order to accommodate volume growth in the markets served by the New Hampshire Brewery, the Company has expanded the brewery s fermentation capacity several times during the past several years. During the year ended December 31, 2007, the Company completed the installation of four additional 400-barrel fermenters, one 70,000 pound grain silo and upgraded its process control automation at an estimated cost of $1.3 million. These improvements added approximately 21,700 barrels of capacity to the New Hampshire Brewery. During the year ended December 31, 2008, the Company added eight 400-barrel fermenters and four

bright tanks, and began an upgrade of its incoming water filtration and water treatment systems, which is expected to be completed during the first quarter of 2009. For the year ended December 31, 2008, the Company has expended $4.1 million associated with these projects and increased annual working capacity by 43,300 barrels, bringing the annual working capacity to 190,000 barrels. Further expansion of the New Hampshire Brewery s fermentation capacity and improvements to its refrigeration facility has been deferred from their scheduled completion in 2008 into the third quarter of 2009.

The Company s capacity utilization has a significant impact on gross profit. Generally, when facilities are operating at their working capacities, profitability is favorably affected because fixed and semi-variable operating costs, such as depreciation and production salaries, are spread over a larger sales base. Because current period production levels have been below the Company s working capacity, gross margins have been negatively impacted. If the Company is unable to achieve significant sales growth, the resulting excess capacity and unabsorbed overhead of the Company will have an adverse effect on the Company s gross margins, operating cash flows and overall financial performance.

In addition to capacity utilization, other factors that could affect cost of sales and gross margin include changes in freight charges, the availability and prices of raw materials and packaging materials, the mix between draft and bottled product sales, the sales mix of various bottled product packages, and fees related to the A-B Distribution Agreement. Prior to July 1, 2008, sales to Craft Brands at a price substantially below wholesale pricing levels and sales of contract beer at a pre-determined contract price also affected cost of sales, gross margins and the comparability of fiscal periods.

**Brand Trends**

*Redhook Beers.* The Redhook brand has lagged the trend in the growth of the craft segment for the last several years, due in part to the life cycle of the brand family s former flagship, *ESB*, which had matured in key markets even while the overall segment continued to grow. To offset this factor, the Company engaged in systematic initiatives, including rebranding *Redhook IPA* into *Long Hammer IPA* and relaunching this brand with new packaging and a concentrated focus as the new Redhook flagship in January 2007. Leveraging off of the growth of the IPA category, this rebranding effort resulted in an increase in shipments of *Long Hammer IPA* the Company estimates approximated 15% from 2007 to 2008. As part of these initiatives, the Company reexamined its pricing strategy and has increased the brand family to price points comparable to the market leaders in the last couple of years.

The Company will continue to look for niche areas of category growth for Redhook on which to capitalize. For example, in early 2009 the Company has launched *Slim Chance Light Ale* to fulfill consumer demand for full-flavored, low-calorie craft beer. In order to reconnect the Redhook brand with the craft community, a high-end line of Redhook beers was launched in late 2008. Each beer in this line is marketed toward the beer connoisseur, premium-priced, and only available for a limited time.

Since these efforts were initiated, the Redhook brand sales trends in the Western United States have shown a slowing in the rate of decline and modest growth during some periods, driven primarily by a reversal of the negative trend in Washington state. For 2008, overall shipments of Redhook-branded products declined approximately 2.6%.

*Widmer Brothers Beers.* The Widmer Brothers brand has experienced significant growth in recent years, led by the popular consumer response to the Hefeweizen category within the craft beer segment and the role that *Widmer Hefeweizen* has enjoyed as a leader in this category. This category continues to experience positive trends nationally, but has more recently seen a significant increase in competitive products from other craft brewers as well as offerings from large domestic brewers such as A-B s *Shock Top Belgian White* and MillerCoors *Blue Moon Belgian White* attempting to participate in the same category. *Widmer Hefeweizen* has also been particularly impacted by the downturn in the restaurant industry as a result of the U.S. economic recession worsening during the fourth quarter of

2008. This brand is significantly more dependent on on-premise sales than any of the Company s other brands.

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As a result of the Merger, the Company now has the ability to sell and market other Widmer-branded products in the Midwest and Eastern United States. This will round out the Widmer-brand offering in these regions, giving the consumers in these areas a true Widmer brand family to enjoy, including *Drop Top Amber Ale* and *Drifter Pale Ale*, which has been launched in 2009. In an effort to keep *Widmer Hefeweizen* top of mind with consumers and to shift the emphasis of this brand from the on-premise market, beginning in 2009, the Company will offer *Widmer Hefeweizen* in the Western U.S. markets in a 5-liter steel mini keg. This is expected to allow consumers the opportunity to enjoy the draft experience of this brand at home.

Except for Widmer-branded products brewed and shipped under the contract brewing arrangements and *Widmer Hefeweizen* shipped under the licensing agreement, sales and shipments for Widmer-branded product were not reflected in the Company s statements of operations prior to the Merger.

*Kona Brewing Beers.* Prior to its association with the Company, the Kona Brewing brand had experienced strong growth as a result of forming relationships with Widmer and Craft Brands beginning in 2004. However, Kona-branded product is relatively new outside of Hawaii and has been recently introduced into a number of new markets in the continental United States. Kona-branded products have experienced the rapid growth of a new brand that benefits from growing distribution and new trial from consumers. The brand family has a clear identity, the Company markets it as Liquid Aloha , which is easily grasped by consumers, and the beer is of high quality, making it easy to sell to wholesalers, retailers and consumers.

Despite lapping strong launch volumes in the Kona brand s biggest mainland market, California, the brand continues to see double-digit growth in this market, suggesting that consumers have formed a strong bond with the brand, purchasing it repeatedly. The Company identifies *Longboard Island Lager* as the brand family s flagship, creating a direct connection to Hawaii with consumers. The Company believes that the Kona brand s growth potential is significant not only from organic growth within its current markets, but also from geographic expansion into the Eastern United States.

Sales and shipments for Kona-branded product were not reflected in the Company s statements of operations prior to the Merger.

For additional information about risks and uncertainties facing the Company, see Part 1, Item 1A. Risk Factors.

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## Results of Operations

The following table sets forth, for the periods indicated, certain items from the Company s Statements of Operations expressed as a percentage of net sales:

| | Year Ended December 31, | |
|---|---|---|
| | 2008 | 2007 |
| Sales | 107.8% | 112.2% |
| Less excise taxes | 7.8 | 12.2 |
| Net sales | 100.0 | 100.0 |
| Cost of sales | 82.3 | 88.7 |
| Gross profit | 17.7 | 11.3 |
| Selling, general and administrative expenses | 24.9 | 19.9 |
| Loss on impairment of assets | 38.4 | |
| Merger-related expenses | 2.2 | 1.4 |
| Income from equity investment in Craft Brands | 1.7 | 6.8 |
| Operating loss | (46.1) | (3.2) |
| Loss from equity investments in Kona & FSB | | |
| Interest expense | (1.2) | (0.7) |
| Interest and other income, net | 0.1 | 1.2 |
| Loss before income taxes | (47.2) | (2.7) |
| Income tax benefit | (5.5) | (0.4) |
| Net loss | (41.7)% | (2.3)% |

***Non-GAAP Financial Measures***

The Company s loan agreement as modified subjects the Company to a financial covenant based on earnings before interest, taxes, depreciation and amortization ( EBITDA ). See *Liquidity and Capital Resources*. EBITDA is defined per the modified loan agreement and requires additional adjustments, among other items, to (a) exclude defined costs associated with restructuring, (b) adjust losses (gains) on sale or disposal of assets, and (c) exclude certain other non-cash income and expense items. Per the covenant in the modified loan agreement, EBITDA is to be measured on a one-quarter basis until September 30, 2009 when the measurement will be on a trailing four-quarter basis. EBITDA as defined under the modified loan agreement was $1.7 million for the quarter ended December 31, 2008. The following table reconciles net income to EBITDA per the modified loan agreement for the quarter ended December 31, 2008:

| | For the Quarter Ended December 31, 2008 (In thousands) |
|---|---|

| | | |
|---|---|---|
| Net loss | $ | (30,101) |
| Interest expense | | 541 |
| Income tax benefit | | (2,719) |
| Depreciation expense | | 1,645 |
| Amortization expense | | 367 |
| Loss on impairment of assets | | 30,589 |
| Merger-related expenses | | 140 |
| Restructuring costs, as defined | | 1,044 |
| Loss on sale or disposal of assets | | 18 |
| Allowable indirect merger-related costs | | 150 |
| EBITDA per the modified loan agreement | $ | 1,674 |

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***Year Ended December 31, 2008 Compared with Year Ended December 31, 2007***

The following table sets forth, for the periods indicated, a comparison of certain items from the Company s Statements of Operations:

| | Year Ended December 31, 2008 | Year Ended December 31, 2007 | Increase/ (Decrease) | % Change |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Sales | $ 86,013 | $ 46,544 | $ 39,469 | 84.8% |
| Less excise taxes | 6,252 | 5,074 | 1,178 | 23.2 |
| Net sales | 79,761 | 41,470 | 38,291 | 92.3 |
| Cost of sales | 65,646 | 36,785 | 28,861 | 78.5 |
| Gross profit | 14,115 | 4,685 | 9,430 | 201.3 |
| Selling, general and administrative expenses | 19,894 | 8,257 | 11,637 | 140.9 |
| Loss on impairment of asset | 30,589 | | 30,589 | |
| Merger-related expenses | 1,783 | 584 | 1,199 | 205.3 |
| Income from equity investment in Craft Brands | 1,390 | 2,826 | (1,436) | (50.8) |
| Operating loss | (36,761) | (1,330) | (35,431) | N/M |
| Loss from equity investments in Kona and FSB | (11) | | (11) | |
| Interest expense | (993) | (302) | (691) | 228.8 |
| Interest and other income, net | 110 | 517 | (407) | (78.7) |
| Loss before income taxes | (37,655) | (1,115) | (36,540) | N/M |
| Income tax benefit | (4,377) | (176) | (4,201) | N/M |
| Net loss | $ (33,278) | $ (939) | $ (32,339) | N/M |

**Note**: N/M Not Meaningful

*Sales.* Total sales increased $39.5 million in 2008 compared with 2007, due to the factors discussed below:

| Sales Revenues by Category | Year Ended December 31, 2008 | Year Ended December 31, 2007 | Increase/ (Decrease) | % Change |
|---|---|---|---|---|
| | (In thousands) | | | |
| A-B | $ 62,364 | $ 18,879 | $ 43,485 | 230.3% |
| Craft Brands | 6,914 | 13,885 | (6,971) | (50.2) |

| | | | | |
|---|---|---|---|---|
| Contract brewing | 2,956 | 7,363 | (4,407) | (59.9) |
| Alternating proprietorship | 5,761 | | 5,761 | |
| Pubs and other(1) | 8,018 | 6,417 | 1,601 | 24.9 |
| Total Sales | $ 86,013 | $ 46,544 | $ 39,469 | 84.8% |

(1) Other includes international, non-wholesalers and other

An increase in shipments of 220,700 barrels or 204.5% to A-B from shipments of 107,900 barrels in 2007 to 328,600 barrels in 2008 due in part to the effects of the Merger, including shipments in the West for the second half of the year being made via A-B at wholesale price levels instead of Craft Brands at below wholesale price levels. Additionally, both draft and bottled products experienced a pricing increase at the wholesale level from a year ago;

With the Merger and the related merger of Craft Brands into the Company, the termination of several sales and contract agreements effective July 1, 2008, including the distribution agreement with Craft

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Brands and the contract brewing agreement with Widmer, which led to a $7.0 million and $4.4 million, respectively, reduction in sales revenues from fiscal year 2007 to fiscal year 2008;

The inclusion of alternating proprietorship fees of $5.8 million earned from Kona for leasing the Oregon Brewery and sales of raw materials during the last six months of 2008 (no such activity occurred prior to the Merger); and

An increase of $1.6 million in pub and other sales in 2008 primarily due to the half year of sales generated by the pub in Portland, Oregon, which was acquired as a result of the Merger.

*Shipments Brand.* The following table sets forth a comparison of shipments by brand for the periods indicated:

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 Shipments | | | 2007 Shipments | | | Increase / | % |
| | Draft | Bottle | Total | Draft | Bottle | Total | (Decrease) | Change |
| | (In barrels) | | | | | | | |
| Redhook brand | 61,000 | 139,800 | 200,800 | 66,400 | 139,800 | 206,200 | (5,400) | (2.6)% |
| Widmer brand(1) | 100,700 | 76,800 | 177,500 | 67,200 | 43,500 | 110,700 | 66,800 | 60.3 |
| Kona brand | 18,800 | 27,800 | 46,600 | | | | 46,600 | |
| Total shipped | 180,500 | 244,400 | 424,900 | 133,600 | 183,300 | 316,900 | 108,000 | 34.1% |

(1) Shipments of Widmer-branded product in 2007 and for the first six months of 2008 are only those products brewed and shipped by the Company and do not include Widmer-branded products shipped by Widmer or Craft Brands. The Company s shipments were made pursuant to a licensing agreement and contract brewing arrangements with Widmer, all of which were terminated in connection with the Merger.

Total Company shipments increased 34.1% to 424,900 barrels in 2008 as compared with 316,900 barrels in 2007, primarily driven by shipments of Widmer-branded products acquired in the Merger and shipments of Kona-branded products pursuant to a distribution arrangement with Kona.

Although the Company has brewed and distributed Redhook-branded beer for the Company s entire existence, the Company first began to expand its brand portfolio in 2003 by entering into a licensing arrangement with Widmer. Under the licensing agreement, the Company brewed *Widmer Hefeweizen* in the New Hampshire Brewery and sold it in the Midwest and in Eastern markets. In 2004 following the formation of Craft Brands, the Company further expanded its production of Widmer-branded products by entering into two contract brewing arrangements with Widmer. In 2007, the Company brewed and shipped approximately 28,800 barrels of *Widmer Hefeweizen* in the Midwest and Eastern United States pursuant to the licensing agreement and another 81,900 barrels of Widmer-branded products in conjunction with the contract brewing arrangements. Although the licensing agreement and the contract brewing arrangements were terminated when the Merger was consummated, those brewing activities still continue and are only a portion of total Widmer-branded shipments. Although the Company plans to expand the distribution of other Widmer- and Kona-branded products in the Midwest and Eastern United States, shipments in these states in the last six months of 2008 were limited to *Widmer Hefeweizen* and totaled approximately 9,900 barrels.

During the year ended December 31, 2008, 69.6% of Redhook-branded shipments were shipments of bottled beer versus 67.8% in the same period for 2007. The sales mix of Kona-branded beer is also weighted toward bottled product, although somewhat less than Redhook-branded beer with 59.7% of Kona-branded shipments being bottled beer. The sales mix of Widmer-branded products contrasts significantly from that of the Redhook and Kona brands with only 43.3% of Widmer-branded products being bottled beer in 2008. Although the average revenue per barrel for sales of bottled beer is generally 40% to 50% higher than that of draft beer, the cost per barrel is also higher, resulting in a gross margin that is approximately 10% less than that of draft beer sales.

*Shipments Customer.* The following table sets forth a comparison of shipments by customer for the periods indicated:

| | Year Ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 Shipments | | | 2007 Shipments | | | Increase/ | % |
| | Draft | Bottle | Total | Draft | Bottle | Total | (Decrease) | Change |
| | (In barrels) | | | | | | | |
| A-B | 142,400 | 186,200 | 328,600 | 46,100 | 61,800 | 107,900 | 220,700 | 204.5% |
| Craft Brands | 16,300 | 41,800 | 58,100 | 35,300 | 86,600 | 121,900 | (63,800) | (52.3) |
| Contract brewing | 16,500 | 14,500 | 31,000 | 48,300 | 33,600 | 81,900 | (50,900) | (62.1) |
| Pubs and other(1) | 5,300 | 1,900 | 7,200 | 3,900 | 1,300 | 5,200 | 2,000 | 38.5 |
| Total shipped | 180,500 | 244,400 | 424,900 | 133,600 | 183,300 | 316,900 | 108,000 | 34.1% |

(1) International, non-wholesalers, pubs and other

Prior to July 1, 2008, the Company s products were shipped through A-B in the Midwest and Eastern United States and through Craft Brands in the west, ultimately being shipped to either a consumer or retailer through wholesalers in the A-B distribution network. In connection with the Merger, Craft Brands was merged with and into the Company and all shipments in the United States began to be sold through A-B through wholesalers in the A-B distribution network.

*Pricing and Fees.* Average revenue per barrel on shipments of beer for 2008 was 34.3% higher than average revenue per barrel for 2007. Comparison between the two years has been significantly impacted by the Merger. During the last six months of 2008, the Company sold 98.4% of its beer through A-B at wholesale pricing levels throughout the United States. During the corresponding period in 2007, the Company sold 34.0% of its product at wholesale pricing levels in the Midwest and Eastern United States, another 38.8% at lower than wholesale pricing levels to Craft Brands in the Western United States, and 25.4% at agreed-upon pricing levels for beer brewed on a contract basis.

Management believes that most, if not all, craft brewers are reviewing their pricing strategies in response to recent increases in the costs of raw materials. Pricing changes implemented by the Company have generally followed pricing changes initiated by large domestic or import brewing companies. While the Company has implemented modest price increases during the past few years, some of the benefit has been offset by competitive promotions and discounting. The Company may experience a decline in sales in certain regions following a price increase.

In connection with all sales through the A-B Distribution Agreement, as amended, the Company pays a Margin fee to A-B. The Margin does not apply to sales from the Company s retail operations or to dock sales. The Margin also did not apply to the Company s sales to Craft Brands during all of 2007 and the first six months of 2008 because Craft Brands paid a comparable fee to A-B on its resale of the product. The A-B Distribution Agreement also provides that the Company shall pay the Additional Margin on shipments of Redhook-, Widmer-, and Kona-branded product that exceed shipments in the same territory during the same periods in fiscal 2003. During the year ended December 31, 2008, the Margin was paid to A-B on shipments totaling 328,600 barrels. During the year ended December 31, 2007, the Margin was paid to A-B on shipments totaling 107,900 barrels. As 2008 shipments in the United States and 2007 shipments in the Midwest and Eastern United States exceeded 2003 shipments in the corresponding territories, the Company paid A-B the Additional Margin. For the year ended December 31, 2008 and 2007, the Company paid a total of $3.1 million and $1.0 million, respectively, to A-B related to the total of Margin and Additional Margin. These fees are reflected as a reduction of sales in the Company s statements of operations.

As of December 31, 2008, the net amount due to A-B under all Company agreements with A-B totaled $2.3 million. In connection with the sale of beer pursuant to the A-B Distribution Agreement, the Company s accounts receivable reflect significant balances due from A-B, and the refundable deposits and accrued expenses reflect significant balances due to A-B. Although the Company considers these balances to be due to or from A-B, the final destination of the Company s products is an A-B wholesaler and payments by the

wholesaler are settled through A-B. The Company purchases packaging, other materials and services under separate arrangements; balances due to A-B under these arrangements are reflected in accounts payable and accrued expenses. These amounts are also included in the net amount presented above.

*Alternating Proprietorship.* In conjunction with an alternating proprietorship agreement, Kona produces a portion of its malt beverages at the Oregon Brewery under a brewery leasing arrangement. The Company receives a leasing fee based on the barrels Kona brews and packages at the Company s brewery and also sells raw materials to Kona prior to production occurring. Revenues associated with these activities for the year ended December 31, 2008 were $5.8 million.

*Retail Operations and Other Sales.* Sales through the Company s retail operations and other sales increased $1.6 million to $8.0 million in 2008 from $6.4 million in 2007, primarily as the result of the addition of a third pub pursuant to the Merger.

*Excise Taxes.* Excise taxes for the year ended December 31, 2008 increased $1.2 million, or 23.2%, primarily due to the increase in shipments of Widmer-branded products and the effect of the marginal excise tax rate on these shipments of $18 per barrel. Excise taxes for 2008 decreased as a percentage of net sales and on a per barrel basis when compared with the same 2007 period because Kona was responsible for the excise tax on the Kona-branded shipments.

*Cost of Sales.* Cost of sales increased 78.5% to $65.6 million for the year ended December 31, 2008 from $36.8 million in the same 2007 period and increased $38.42 or 33.1% on a per barrel basis from $116.08 per barrel for 2007 to $154.50 per barrel for 2008. In contrast, cost of sales decreased as a percentage of net sales to 82.3% from 88.7% because of the significant change in product mix and pricing caused by the Merger. Comparability of the periods was significantly affected by the Merger and the change in operations for the resulting remaining six months of 2008, including a 93.9% increase in shipments for the last six months compared with the first half of the 2008 year, the addition of another production brewery, a change in the mix of products shipped, the addition of the alternating proprietorship relationship, a third pub and the elimination of the licensing agreement and contract brewing arrangements.

Cost of sales for 2008 includes third and fourth quarters of 2008 costs to produce Widmer-branded products that were brewed by Widmer prior to the Merger. These Widmer-branded products are in addition to those produced by the Company prior to the Merger pursuant to the licensing agreement and the contract brewing arrangements. The increase in direct costs to produce these Widmer-branded products was slightly offset by the elimination of licensing fees paid to Widmer in connection with the licensing agreement that terminated upon consummation of the Merger. The years ended December 31, 2008 and 2007 include $165,000 and $432,000 for licensing fees paid to Widmer in connection with the Company s shipment of 12,500 barrels and 28,800 barrels, respectively, of *Widmer Hefeweizen* in the Midwest and Eastern United States.

The annual working capacity of the Oregon Brewery acquired in the Merger is approximately 377,000 barrels, nearly equal to the combined annual working capacity of the Company s Washington and New Hampshire Breweries before the Merger. Cost of sales increased significantly as a result the Oregon Brewery s fixed and semi-variable costs, including depreciation, utilities, labor, rent, and property taxes. For example, depreciation and amortization expense charged to cost of sales for the year ended December 31, 2008 increased approximately 83.4%, or $2.3 million more than depreciation and amortization expense charged to cost of sales for the year ended December 31, 2007. While the fixed and semi-variable costs other than depreciation may not have increased to the same degree as depreciation, the increases in these costs were substantial.

Based upon the Company s total average working capacity of 572,400 barrels and 365,900 barrels for 2008 and 2007, respectively, the utilization rate was 74.2% and 86.6%, respectively. Capacity utilization rates are calculated by dividing the Company s total shipments by the average working capacity. See Overview for discussion of the Company s methodology in calculating annual working capacity.

Cost of sales for 2008 includes third and fourth quarters of 2008 costs associated with two distinct Kona revenue streams: (i) direct and indirect costs related to the alternating proprietorship arrangement with Kona

and (ii) the cost paid to Kona for the Kona-branded finished goods that are marketed and sold by the Company to wholesalers through the A-B Distribution Agreement.

Inventories acquired pursuant to the Merger were recorded at their estimated fair values as of July 1, 2008, resulting in an increase (the Step Up Adjustment ) over the cost at which these inventories were stated on the June 30, 2008 Widmer balance sheet. The July 1, 2008 Step Up Adjustment totaled approximately $1.0 million for raw materials acquired and $118,000 for work in process and finished goods acquired. During the year ended December 31, 2008, approximately $430,000 of the Step Up Adjustment was expensed to cost of sales in connection with normal production and sales.

Cost of sales and gross margin for 2008 were negatively impacted by an increase in the cost of some raw materials, malt and hops in particular, certain packaging materials and shipping costs due to relatively high fuel costs for a majority of the year.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses for 2008 increased $11.6 million to $19.9 million from expenses of $8.3 million for 2007. Comparability of the two periods is difficult because the Merger resulted in a significant increase in sales, marketing and administrative functions, particularly in the third and fourth quarters of 2008:

Prior to July 1, 2008, selling, general and administrative expense in the Company s statements of operations reflected the sales and marketing efforts only for the Midwest and Eastern United States because Craft Brands performed these functions for the Western United States. In the third and fourth quarters of 2008, all promotion, marketing and sales efforts for the entire United States for all malt beverage products are reflected in the Company s statements of operations.

Finance, accounting and information technology functions performed in Woodinville, Washington prior to the Merger were transferred to staff in the Portland, Oregon office following the Merger. Because the transition of these functions was not complete until the end of the third quarter of 2008, selling, general and administrative expenses for 2008 include salaries and related administrative costs associated with both locations for an entire quarter.

The Company experienced a work-force reduction during the fourth quarter of 2008 as a result of the execution of its cost-containment strategies. This action was intended to reduce duplicative functions, but also represented a redeployment of certain functions to more profitable opportunities. During the fourth quarter of 2008, the Company recorded costs of $1.0 million for severance and benefit accruals related to this action. The Company does not expect there will be significant costs recognized in succeeding years associated with this action.

*Loss on Impairment of Assets.* During the year ended December 31, 2008, the Company recorded a non-cash charge of $30.6 million associated with a loss on the impairment of assets that were acquired as a result of the Merger. Due to a combination of factors, including the U.S. economic environment, particularly during the fourth quarter of 2008, the Company s expectations of a follow-on impact on consumer demand, the increase in competition from both other craft and specialty brewers and the fuller-flavored offerings from the national domestic brewers, and the Company s plans for the near and medium term, the Company believed that impairments may have occurred to certain of its assets acquired in the Merger. Based on its analyses of its tangible and intangible assets, the Company determined that its goodwill asset was fully impaired, and the Company s intangible Widmer trademark and its corporate investments were partially impaired. See further discussion below at *Critical Accounting Policies and Estimates.* No loss on impairment of assets was recognized during the year ended December 31, 2007.

*Merger-related Expenses.* In connection with the Merger, the Company incurred merger-related expenditures, including legal, consulting, meeting, filing, printing and severance costs. During 2008 and 2007, merger-related expenses totaling $1.8 million and $584,000, respectively, were recorded as expenses in the Company s statements of operations. During the year ended December 31, 2008, other merger-related costs totaling $663,000 were capitalized as a component of goodwill on the balance sheet; however, these costs were charged to earnings when the Company recognized the loss on impairment of assets. Capitalized merger costs of $154,000 were presented as other current assets during the corresponding period in 2007.

Merger-related expenses include severance payments to employees and officers whose employment were or will be terminated as a result of the Merger. The Company estimates that merger-related severance benefits totaling approximately $214,000 will be paid in 2009 to all affected former Redhook employees and officers and affected former Widmer employees. Merger-related severance costs totaling approximately $430,000 will be paid out to this employee group after 2009. Of the total severance, $1.5 million was recognized as a merger-related expense in the Company s statements of operations during the year ended December 31, 2008.

*Income from Equity Investment in Craft Brands.* Because Craft Brands was merged with and into the Company in connection with the Merger, the Company did not recognize income from its investment in Craft Brands after June 30, 2008. For the year ended December 31, 2008, the Company s share of Craft Brands net income totaled $1.4 million compared with $2.8 million for the same period in 2007.

*Loss from Equity Investments in Kona and FSB.* In conjunction with the Merger, the Company acquired from Widmer a 20% equity ownership in Kona and a 42% equity ownership in Fulton Street Brewery, LLC. Both investments are accounted for under the equity method, consistent with APB 18. For the year ended December 31, 2008, the Company s share of Kona s net loss totaled $14,000 and the Company s share of FSB s net income totaled $3,000.

*Interest Expense.* Interest expense increased approximately $691,000 to $993,000 in 2008 from $302,000 in 2007, due to a higher level of debt outstanding during the current period. In connection with the Merger, the Company increased its leverage, such that average outstanding debt for 2008 was $14.4 million as compared with average outstanding debt of $4.2 million for 2007.

*Interest and Other Income, net.* Interest and other income, net decreased by $407,000 to $110,000 for 2008 from $517,000 for the same period of 2007, primarily attributable to a $270,000 decrease in interest income earned on interest-bearing deposits. The Company s interest-bearing deposits were significantly lower than 2007 deposits as a result of the repayment of the $4.3 million term loan in December 2007 and the acquisition of additional debt in connection with the Merger.

*Income Taxes.* The Company s provision for income taxes was a benefit of $4.4 million for 2008 as compared with $176,000 for 2007. The tax provision is driven by pre-tax results relative to other components of the tax provision calculation, such as the exclusion of the loss from impairment for assets, primarily the impairment of the goodwill asset, from the taxable loss, the effect of other non-deductible expenses and the increase of the valuation allowance to provide for Company s NOLs and other deferred tax assets.

At December 31, 2008, based upon the available evidence and due to the Company s taxable loss for the current year exceeding its preliminary projections, the Company believes that it is more likely than not that certain deferred tax assets will not be realized. As a result, the Company recorded a valuation allowance of $1.0 million recorded as a reduction of the tax benefit for the year ended December 31, 2008. To the extent that the Company continues to be unable to generate adequate taxable income in future periods, the Company may not be able to recognize additional tax benefits and may be required to increase the valuation allowance to provide for NOLs and other deferred tax assets for which a valuation allowance had not been previously recorded. At December 31, 2007, the Company s balance sheet included a valuation allowance of $1.1 million to provide for certain federal and state NOLs. In connection with the Merger, the Company determined that the previously established valuation allowance was no longer required and recorded the release against goodwill.

**Liquidity and Capital Resources**

The Company has required capital principally for the construction and development of its production facilities. Historically, the Company has financed its capital requirements through cash flow from operations, bank borrowings

and the sale of common and preferred stock. The Company expects to meet its future financing needs and working capital and capital expenditure requirements through cash on hand, operating cash flow and borrowings under its loan agreement.

The Company is in compliance with all applicable contractual financial covenants at December 31, 2008. However, the Company and BofA executed a loan modification to its loan agreement effective November 14,

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2008, as a result of the Company s inability to meet its covenants as of September 30, 2008. BofA permanently waived the noncompliance effective September 30, 2008, restoring the Company s borrowing capacity pursuant to the loan agreement. The terms of the modification to the loan agreement are discussed in more detail below. The Company refinanced borrowings assumed as a result of the Merger by concurrently entering into a loan agreement (the Loan Agreement ) with BofA. The Loan Agreement is comprised of a $15.0 million revolving line of credit ( Line of Credit ), including provisions for cash borrowings and up to $2.5 million notional amount of letters of credit, and a $13.5 million term loan ( Term Loan ). The Company may draw upon the Line of Credit for working capital and general corporate purposes. The Line of Credit matures on January 1, 2013 at which time the outstanding principal balance and any accrued but unpaid interest will be due. At December 31, 2008, the Company had $12.0 million outstanding under the Line of Credit with $3.0 million of availability for further cash borrowing.

The Company had $11,000 and $5.5 million of cash and cash equivalents at December 31, 2008 and 2007, respectively. At December 31, 2008, the Company had a working capital deficit of $927,000. The Company s debt as a percentage of total capitalization (total debt and common stockholders equity) was 29.5% and 0.1% at December 31, 2008 and 2007, respectively. Cash used by operating activities totaled $4.9 million for the year ended December 31, 2008 as compared with cash provided by operating activities of $1.6 million for the year ended December 31, 2007.

As of December 31, 2008 and February 28, 2009, the Company s available liquidity was $4.0 million and $3.6 million, respectively, comprised of accessible cash and cash equivalents and further borrowing capacity.

Capital expenditures for 2008 were $6.7 million for the year ended December 31, 2008. Major 2008 projects included, at the New Hampshire Brewery, an expansion of brewing and fermentation capacity and improvements to the water treatment system costing $2.6 million and $1.5 million, respectively; and for all of the production breweries, purchases of additional kegs costing $2.2 million. Future capital expenditures are expected to be funded with operating cash flows and borrowings under the Company s loan agreement. Although the Company is subject to limits on its capital expenditures due to the modification of its loan agreement, the Company expects that all projects in progress will be able to be completed within the revised covenants.

As discussed above, at September 30, 2008, the Company was not in compliance with the covenants for the Loan Agreement as it was unable to meet either of the two required financial covenants, the funded debt to bank EBITDA ratio or the fixed charge coverage ratio, for the trailing twelve months ended September 30, 2008. Bank EBITDA is defined as Earnings before interest, taxes, depreciation, amortization and certain other adjustments as defined in the Loan Agreement. The Company and BofA executed a modification to the loan agreement effective November 14, 2008 ( Modification Agreement ) that permanently waived the noncompliance as an event of default at September 30, 2008. The Modification Agreement subjects the Company to certain terms and conditions different than under the original Loan Agreement. Those terms and conditions as modified are summarized below.

Under the Modification Agreement, the Company may select from one of the following two interest rate benchmarks as the basis for calculating interest on the outstanding principal balance of the Line of Credit: the London Inter-Bank Offered Rate ( LIBOR ) or the Inter-Bank Offered Rate ( IBOR ) (each, a Benchmark Rate ). Interest accrues at an annua rate equal to the Benchmark Rate plus a marginal rate. The Company may select different Benchmark Rates for different tranches of its borrowings under the Line of Credit. The marginal rate is fixed at 3.50% until September 30, 2009 at which time it will vary from 1.75% to 3.50% based on the ratio of the Company s funded debt to EBITDA, as defined. LIBOR rates may be selected for one, two, three, or six month periods, and IBOR rates may be selected for no shorter than 14 days and no longer than six months. Under the Modification Agreement, the Company may not draw upon the Line of Credit in increments of less than $1 million. Accrued interest for the Line of Credit is due and payable monthly. At December 31, 2008, the weighted-average interest rate for the borrowings outstanding under the Line of Credit was 3.90%.

An annual fee will be payable in advance on the notional amount of each standby letter of credit issued and outstanding multiplied by an applicable rate ranging from 1.13% to 1.50%.

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Interest on the Term Loan will accrue on the outstanding principal balance in the same manner as provided for under the Line of Credit, as established under the LIBOR one-month Benchmark Rate. The interest rate on the Term Loan was 3.95% as of December 31, 2008. Accrued interest for the Term Loan is due and payable monthly. At December 31, 2008, principal payments are due monthly in accordance with an agreed-upon schedule set forth in the Loan Agreement. Any unpaid principal balance and unpaid accrued interest will be due on July 1, 2018.

Under the Modification Agreement, a quarterly fee on the unused portion of the Line of Credit, including the undrawn amount of the Standby Letter of Credit, will accrue at a rate of 0.50% payable quarterly. A loan fee associated with the Term Loan for $25,000 was paid during the three months ended September 30, 2008, and a loan fee associated with the Modification Agreement for $30,000 was paid during the three months ended December 31, 2008. These amounts were fully charged to interest expense during the year ended December 31, 2008.

The Modification Agreement also revised the types of financial covenants that the Company is required to meet for each quarter through June 30, 2009. The Company generated EBITDA under the Modified Agreement of $1.7 million for the quarter ended December 31, 2008, and as of December 31, 2008 was in compliance with the loan covenants under the Modification Agreement. EBITDA under the Modified Agreement is defined similar to Bank EBITDA but includes certain adjustments specific to the Modification Agreement.

The following table summarizes the financial covenant ratios required pursuant to the Modification Agreement:

**Financial Covenants Required by Modification Agreement**

| | | |
|---|---|---|
| Minimum EBITDA, as defined (in thousands) | | |
| For the quarter ending March 31, 2009 | $ | 850 |
| For the quarter ending June 30, 2009 | $ | 2,300 |
| For the quarter ending September 30, 2009 and thereafter | | Does not apply |
| | | |
| Asset Coverage Ratio | | |
| For the quarter ending March 31, 2009 and thereafter | | 1.50 to 1 |
| | | |
| Capital Expenditures (in thousands) | | |
| To spend or incur obligations less than the following: | | |
| For the quarter ending March 31, 2009(1) | $ | 1,350 |
| For the quarter ending June 30, 2009(1) | $ | 550 |
| For the quarter ending September 30, 2009 and thereafter | | Does not apply |

(1) - Provides for carryover spending of any amount not used in the prior quarter

The Loan Agreement is secured by substantially all of the Company s personal property and by the real properties located at 924 North Russell Street, Portland, Oregon and 14300 NE 145th Street, Woodinville, Washington ( Collateral ), which comprise its larger-scale automated Portland, Oregon brewery and its Woodinville, Washington brewery, respectively. The Company was requested by BofA to obtain a deed of trust on the real property at the New Hampshire Brewery; however, this was subject to consent by the lessor of the land upon which the brewery is located. The Company made commercially reasonable efforts to obtain this from the lessor but was unable to obtain the consent. BofA subsequently rescinded this requirement in February 2009.

In addition, the Company is restricted in its ability to declare or pay dividends, repurchase any outstanding common stock, acquire additional debt or enter into any agreement that would result in a change in control of the Company. Effective September 30, 2009, the Company will be required to meet the financial covenant ratios of funded debt to EBITDA, as defined, and fixed charge coverage in the manner established pursuant to the original Loan Agreement, but at levels specified by the Modification Agreement.

If the Company is unable to generate sufficient EBITDA to meet the associated covenants either under the Modified Agreement or its Loan Agreement, as applicable, this would result in a violation. Failure to meet the covenants is an event of default and, at its option, BofA could deny a request for another waiver and declare the entire outstanding loan balance immediately due and payable. In such a case, the Company would seek to refinance the loan with one or more lenders, potentially at less desirable terms. However, there can be no guarantee that additional financing would be available at commercially reasonable terms, if at all.

As a result of the Merger, the Company assumed Widmer s promissory notes signed in connection with the acquisition of commercial real estate related to the Portland, Oregon brewery. These notes were separately executed by Widmer with three individuals, but under substantially the same terms and conditions. Each promissory note is secured by a deed of trust on the commercial real estate. The outstanding note balance to each lender as of December 31, 2008 was $200,000, with each note bearing a fixed interest rate of 24% per annum, subject to a one-time adjustment on July 1, 2010 to reflect the change in the consumer price index from the date of issue, July 1, 2005, to the date of adjustment. The promissory notes are carried at the total of stated value plus a premium reflecting the difference between the Company s incremental borrowing rate and the stated note rate. The effective interest rate for each note is 6.31%. Each note matures on the earlier of the individual lender s death or July 1, 2015, but in no event prior to July 1, 2010, with prepayment of principal not allowed under the notes terms. Interest payments are due and payable monthly.

As a result of the Merger, the Company assumed Widmer s capital equipment lease obligation to BofA, which is secured by substantially all of the brewery equipment and restaurant furniture and fixtures located in Portland, Oregon. The outstanding balance for the capital lease as of December 31, 2008 was $6.6 million, with monthly loan payments of $119,020 required through the maturity date of June 30, 2014. The capital lease carries an effective interest rate of 6.56%. The capital lease is subject to a prepayment penalty of the product of a specified percentage and the amount prepaid. This specified percentage began at 4% and, except in the event of acceleration due to an event of default, ratably declines 1% for every year the lease is outstanding until July 31, 2011, at which time the capital lease is not subject to a prepayment penalty. The specified percentage is 3% as of December 31, 2008. In the event of acceleration due to an event of default, the prepayment penalty is restored to 4%.

A minimal balance remains outstanding of other capital lease obligations consisting of agreements executed by the Company in prior years for the use of small production equipment and machinery.

***Trend***

Since July 1, 2008, the Company has experienced a $3.6 million decline in working capital. The decline for this period was partially attributable to $4.0 million in capital expenditures, $1.5 million in debt and interest payments, and $945,000 in merger-related costs, net of the working capital position assumed from Widmer. These declines in working capital have impacted the Company s financial position, including the Company s ability to comply with the financial covenants required by its loan agreement.

The Company recognizes the need to evaluate and improve its operating cost structure. Management has focused aggressively on identifying areas within the Company that can yield significant cost savings, whether driven by the synergies of the Merger and integration or generated by general cost-reduction programs, and executing appropriate measures to secure these savings. The Company has been implementing these cost savings initiatives since the Merger and will continue to do so into 2009. Management believes that the Company can meet its normal cash flow requirements and comply with the terms of its loan agreement, but there is no assurance that it can do so. The failure to meet the working capital requirements could have a material adverse effect on the Company s future operations and growth.

**Certain Considerations: Issues and Uncertainties**

The Company does not provide forecasts of future financial performance or sales volumes, although this Annual Report contains certain other types of forward-looking statements that involve risks and uncertainties. The Company may, in discussions of its future plans, objectives and expected performance in periodic reports filed by the Company with the Securities and Exchange Commission (or documents incorporated by reference

therein) and in written and oral presentations made by the Company, include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements are based on assumptions that the Company believes are reasonable, but are by their nature inherently uncertain. In all cases, there can be no assurance that such assumptions will prove correct or that projected events will occur. Actual results could differ materially from those projected depending on a variety of factors, including, but not limited to, the successful execution of market development and other plans, the availability of financing and the issues discussed in Part I, Item 1A. Risk Factors above. In the event of a negative outcome of any one these factors, the trading price of the Company s common stock could decline and an investment in the Company s common stock could be impaired.

**Critical Accounting Policies and Estimates**

The Company s financial statements are based upon the selection and application of significant accounting policies that require management to make significant estimates and assumptions. Management believes that the following are some of the more critical judgment areas in the application of the Company s accounting policies that currently affect its financial condition and results of operations. Judgments and uncertainties affecting the application of these policies may result in materially different amounts being reported under different conditions or using different assumptions.

*Goodwill, other intangible assets and long-lived assets.* In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ), goodwill and other intangible assets with indefinite useful lives are not amortized but are reviewed periodically for impairment.

The provisions of SFAS 142 require that an intangible asset that is not subject to amortization, including goodwill, be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The provisions also require that a two-step test be performed to assess goodwill for impairment. First, the fair value of each reporting unit is compared with its carrying value, including goodwill. If the fair value exceeds the carrying value then goodwill is not impaired and no further testing is performed. If the carrying value of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step compares the fair value of the reporting unit s goodwill with the carrying amount of the goodwill. An impairment loss would be recognized in an amount equal to the excess of the carrying amount of goodwill over the fair value of the goodwill.

Due to a combination of factors, including the U.S. economic environment, particularly during the fourth quarter of 2008, the Company s expectations of a follow-on impact on consumer demand, the increase in competition from both other craft and specialty brewers and the fuller-flavored offerings from the national domestic brewers, and the Company s plans for the near and medium term, the Company believed that impairments may have occurred to certain of its assets acquired in the Merger.

In performing its analysis of the fair value of its intangible trademark asset in accordance with SFAS 142, the Company based its estimates of fair value on an income methodology using a discounted cash flow valuation model under a relief from royalty methodology. The relief from royalty model incorporates the Company s estimates of the royalty rate that a market participant would assume, projections of future revenues and the Company s judgment regarding the applicable discount rates used to discount those estimated cash flows. The analysis resulted in a partial impairment of the Company s Widmer brand trademark. Given that certain of these inputs are unobservable, management assessed this to be a level 3 measurement within the hierarchy established by SFAS No. 157 *Fair Value Measurements* ( SFAS 157 ).

In performing the second step of the Company s analysis of the fair value of its goodwill asset in accordance with SFAS 142, the Company based its estimates on the income methodology, a market methodology and a transactional

methodology, weighting each on a probability assessment. The income methodology employed a discounted cash flow valuation model, using the Company s projections of future revenue growth and operating profitability. The discounted cash flow model incorporates the Company s estimates of future cash flows, future growth rates and management s judgment regarding the applicable

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discount rates used to discount those estimated cash flows. The market methodology compared the market capitalization of other publicly traded regional and national brewing companies against their revenues and EBITDA to derive a market capitalization multiple. This multiple was applied against the Company s forecasted EBITDA. The transactional methodology compared revenues and specified earnings multiples on recent merger transactions involving a similarly situated specialty brewer to derive an estimated revenue multiple to apply against the Company s revenue projections. The analysis resulted in a complete impairment of the Company s goodwill balance. Given that certain of these inputs are unobservable, management assessed this to be a level 3 measurement within the hierarchy established by SFAS 157.

In performing its analysis of the fair values of its equity investments in accordance with APB 18, the Company based its estimates on an income methodology using a discounted cash flow valuation model. The discounted cash flow model incorporates the Company s estimates of 1) the future cash flows associated with the investments, 2) future growth rates for those entities and 3) the applicable discount rates used to discount those estimated cash flows. The analysis resulted in a partial impairment of the Company s equity investment in FSB of $1.3 million and its equity investment in Kona of $100,000. Given that certain of these inputs are unobservable, management assessed this to be a level 3 measurement within the hierarchy established by SFAS 157.

The Company will evaluate potential impairment of long-lived assets in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ). SFAS 144 establishes procedures for review of recoverability and measurement of impairment, if necessary, of long-lived assets and certain identifiable intangibles. When facts and circumstances indicate that the carrying values of long-lived assets may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the assets to projected future undiscounted cash flows in addition to other quantitative and qualitative analyses. Upon indication that the carrying value of such assets may not be recoverable, the Company recognizes an impairment loss by a charge against current operations.

*Refundable Deposits on Kegs.* The Company distributes its draft beer in kegs that are owned by the Company as well as in kegs that have been leased from third parties. Kegs that are owned by the Company are reflected in the Company s balance sheets at cost and are depreciated over the estimated useful life of the keg. When draft beer is shipped to the wholesaler, regardless of whether the keg is owned or leased, the Company collects a refundable deposit, reflected as a current liability in the Company s balance sheets. Upon return of the keg to the Company, the deposit is refunded to the wholesaler. When a wholesaler cannot account for some of the Company s kegs for which it is responsible, the wholesaler pays the Company, for each keg determined to be lost, a fixed fee and also forfeits the deposit. For the years ended December 31, 2008 and 2007, the Company reduced its brewery equipment by $770,000 and $716,000, respectively, comprised of lost keg fees and forfeited deposits.

The Company has experienced some loss of kegs and anticipates that some loss will occur in future periods due to the significant volume of kegs handled by each wholesaler and retailer, the similarities between kegs owned by most brewers, and the relatively low deposit collected on each keg when compared with the market value of the keg. The Company believes that this is an industry-wide problem and the Company s loss experience is typical of the industry. In order to estimate forfeited deposits attributable to lost kegs, the Company periodically uses internal records, A-B records, other third party records, and historical information to estimate the physical count of kegs held by wholesalers and A-B. These estimates affect the amount recorded as brewery equipment and refundable deposits as of the date of the financial statements. The actual liability for refundable deposits could differ from estimates. For the years ended December 31, 2008 and 2007, the Company decreased its refundable deposits and brewery equipment related to these adjustments by $596,000 and $48,000, respectively. As of December 31, 2008 and 2007, the Company s balance sheets include $5.7 million and $3.1 million, respectively, in refundable deposits on kegs and $5.0 million and $655,000 in keg equipment, net of accumulated depreciation.

*Revenue Recognition.* Effective with the Merger, the Company recognizes revenue from product sales, net of excise taxes, discounts and certain fees the Company must pay in connection with sales to A-B, when the products are delivered to A-B or the wholesaler. In prior periods, it had recognized revenues from these

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activities when the associated products were shipped to the customers as the time between shipment and delivery is short, product damage claims and returns are insignificant and the volume of shipments involved was relatively low. The Company assessed the cumulative impact of this change in accounting policy and determined that the change is not material to the consolidated financial statements as of and for the year ended December 31, 2008 or any prior period.

The Company also earns revenue in connection with two operating agreements with Kona an alternating proprietorship agreement and a distribution agreement. Pursuant to the alternating proprietorship agreement, Kona produces a portion of its malt beverages at the Oregon Brewery. The Company receives a facility fee from Kona based on the barrels brewed and packaged at the Company s brewery. Fees are recognized as revenue upon completion of the brewing process and packaging of the product. In connection with the alternating proprietorship agreement, the Company also sells certain raw materials to Kona for use in brewing. Revenue is recognized when the raw materials are removed from the Company s stock. Under the distribution agreement, the Company purchases Kona-branded product from Kona, whether manufactured at Kona s Hawaii brewery or the Company s brewery, then sells and distributes the product, recognizing revenue when the product is delivered to A-B or the wholesaler.

The Company recognizes revenue on retail sales at the time of sale. The Company recognizes revenue from events at the time of the event.

*Income Taxes.* The Company records federal and state income taxes in accordance with FASB SFAS No. 109, *Accounting for Income Taxes*. Deferred income taxes or tax benefits reflect the tax effect of temporary differences between the amounts of assets and liabilities for financial reporting purposes and amounts as measured for tax purposes as well as for tax net operating loss ( NOLs ) and credit carryforwards.

As of December 31, 2008, the Company s deferred tax assets were primarily comprised of federal NOL carryforwards of $29.1 million, or $9.9 million tax-effected; state NOL carryforwards of $299,000 tax-effected; and federal and state alternative minimum tax credit carryforwards of $183,000 tax-effected. In assessing the realizability of its deferred tax assets, the Company considered both positive and negative evidence when measuring the need for a valuation allowance. The ultimate realization of deferred tax assets is dependent upon the existence of, or generation of, taxable income during the periods in which those temporary differences become deductible. Among other factors, the Company considered future taxable income generated by projected differences between financial statement depreciation and tax depreciation, including the depreciation on the assets acquired in the Merger. Based upon this, the Company determined that its previously established valuation allowance of approximately $1.1 million was no longer required, and recorded the release of the valuation allowance against goodwill as of the date of the Merger.

At December 31, 2008, based upon the available evidence and due to the Company s taxable loss for the current year exceeding its preliminary projections, the Company believes that it is more likely than not that certain deferred tax assets will not be realized. As a result, the Company recorded a valuation allowance of $1.0 million recorded as a reduction of the tax benefit for the year ended December 31, 2008. To the extent that the Company continues to be unable to generate adequate taxable income in future periods, the Company may not be able to recognize additional tax benefits and may be required to increase the valuation allowance to provide for potentially expiring NOLs for which a valuation allowance had not been previously recorded.

There were no unrecognized tax benefits as of December 31, 2008 or December 31, 2007. The Company does not anticipate significant changes to its unrecognized tax benefits within the next twelve months.

Tax years that remain open for examination by the Internal Revenue Service include the years from 2005 through 2008. In addition, tax years from 1997 to 2004 may be subject to examination by the Internal Revenue Service and state tax jurisdiction to the extent that the Company utilizes the NOLs from those years in its current year or future

year tax returns.

*Fair value of financial instruments.* The recorded value of the Company s financial instruments is considered to approximate the fair value of the instruments, in all material respects, because the Company s receivables and payables are recorded at amounts expected to be realized and paid, the Company s derivative

financial instruments are carried at fair value, and the carrying value of the Company s debt obligations that were assumed in the Merger were adjusted to their respective fair values as of the effective date of the Merger.

The Company has adopted the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which requires that all derivatives be recognized at fair value in the balance sheet, and that the corresponding gains or losses be reported either in the statement of operations or as a component of comprehensive income, depending on whether the instrument meets the criteria to apply hedge accounting. Derivative financial instruments are utilized by the Company to reduce interest rate risk. The counterparties to derivative transactions are major financial institutions. The Company does not hold or issue derivative financial instruments for trading purposes.

**Recent Accounting Pronouncements**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 was effective for fiscal years beginning after November 15, 2007, with early adoption permitted. Although the Company adopted SFAS 159 as of January 1, 2008, the Company did not elect the fair value option for any items permitted under SFAS 159.

In December 2007, the Emerging Issues Task Force ( EITF ) of the FASB reached a consensus on Issue No. 07-1, *Accounting for Collaborative Arrangements* ( EITF 07-1 ). The EITF defines a collaborative arrangement and concludes that revenues and costs incurred with third parties in connection with collaborative arrangements would be presented gross or net based on the criteria in EITF No. 99-19 and other accounting literature. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and is to be applied retrospectively to all periods presented for all collaborative arrangements existing as of the effective date. The Company does not anticipate the adoption of EITF 07-1 will have a material effect on the Company s financial position, results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133* ( SFAS 161 ). SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities in order to improve the transparency of financial reporting. SFAS 161 amends and expands the disclosure requirements of SFAS 133 to provide users of financial statements with an enhanced understanding of (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. SFAS 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently evaluating the impact that SFAS No. 161 will have on its financial statement disclosures, but does not anticipate the adoption of SFAS 161 to have a material effect on the Company s financial position, results of operations or cash flows.

In April 2008, the FASB issued FASB Staff Position ( FSP ) No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP FAS 142-3 ). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142. FSP FAS 142-3 requires a company estimating the useful life of a recognized intangible asset to consider its historical experience in renewing or extending similar arrangements or, in the absence of historical experience, to consider assumptions that market participants would use about renewal or extension as adjusted for entity-specific factors. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim

periods within those fiscal years. Early adoption is prohibited. The Company anticipates that expanded disclosure may be required, but does not anticipate the

adoption of FSP FAS 142-3 will have a material effect on the Company s financial position, results of operations or cash flows.

In October 2008, the FASB issued FAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* ( FSP FAS 157-3 ), which clarifies the application of SFAS 157, in an inactive market. FSP FAS 157-3 addresses application issues such as how management s internal assumptions should be considered when measuring fair value when relevant observable data do not exist; how observable market information in a market that is not active should be considered when measuring fair value and how the use of market quotes should be considered when assessing the relevance of observable and unobservable data available to measure fair value. FSP FAS 157-3 was effective upon issuance. Our adoption of FSP FAS 157-3 did not have a material effect on our financial condition, results of operations or cash flows.

In November 2008, the EITF reached a consensus on issue No. 08-6, *Equity Method Investment Accounting Considerations* ( EITF 08-6 ). EITF 08-6 requires a company to measure its equity method investment initially at cost in accordance with SFAS No. 141(R) *Business Combinations*. EITF 08-6 also outlines the factors that a company should take into consideration when an impairment is recognized under the provisions of APB 18. EITF 08-6 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and is to be applied retrospectively. The Company does not anticipate the adoption of EITF 08-6 will have a material effect on the Company s financial position, results of operations or cash flows.

**Item 7A.** ***Quantitative and Qualitative Disclosures about Market Risk***

The Company has assessed its vulnerability to certain market risks, including interest rate risk associated with financial instruments included in cash and cash equivalents and long-term debt. To mitigate this risk, the Company entered into a five-year interest rate swap agreement to hedge the variability of interest payments associated with its variable-rate borrowings. Through this swap agreement, the Company pays interest at a fixed rate of 4.48% and receives interest at a floating-rate of the one-month LIBOR. Since the interest rate swap hedges the variability of interest payments on variable rate debt with similar terms, it qualifies for cash flow hedge accounting treatment under SFAS 133.

This interest rate swap reduces the Company s overall interest rate risk. However, due to the remaining outstanding borrowings that continue to have variable interest rates, management believes that interest rate risk to the Company could be material if prevailing interest rates increase materially.

**Item 8.** ***Financial Statements and Supplementary Data***

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of
Craft Brewers Alliance, Inc.
(formerly Redhook Ale Brewery, Incorporated)

We have audited the accompanying balance sheets of Craft Brewers Alliance, Inc. (formerly Redhook Ale Brewery, Incorporated) ( the Company ) as of December 31, 2008 and 2007 and the related statements of operations, common stockholders equity and cash flows for each of the years in the two year period ended December 31, 2008. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Craft Brewers Alliance, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

Seattle, Washington
March 25, 2009

**CRAFT BREWERS ALLIANCE, INC.**

**BALANCE SHEETS**

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (Dollars in thousands except per share amounts) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 11 | $ 5,527 |
| Accounts receivable, net of allowance for doubtful accounts of $64 and $95 in 2008 and 2007, respectively | 12,499 | 3,893 |
| Trade receivable from Craft Brands | | 670 |
| Inventories, net | 9,729 | 2,928 |
| Income tax receivable | 724 | |
| Deferred income tax asset, net | 767 | 944 |
| Other | 3,951 | 1,043 |
| Total current assets | 27,681 | 15,005 |
| Property, equipment and leasehold improvements, net | 101,389 | 55,862 |
| Equity investments | 5,189 | 416 |
| Intangible and other assets, net | 13,546 | 107 |
| Total assets | $ 147,805 | $ 71,390 |
| **LIABILITIES AND COMMON STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 15,000 | $ 3,149 |
| Trade payable to Craft Brands | | 416 |
| Accrued salaries, wages, severance and payroll taxes | 3,630 | 1,524 |
| Refundable deposits | 6,191 | 3,500 |
| Other accrued expenses | 2,393 | 687 |
| Current portion of long-term debt and capital lease obligations | 1,394 | 15 |
| Total current liabilities | 28,608 | 9,291 |
| Long-term debt and capital lease obligations, net of current portion | 31,834 | 31 |
| Fair value of derivative financial instruments | 1,252 | |
| Deferred income tax liability, net | 6,552 | 1,762 |
| Other liabilities | 278 | 226 |

| | | | | |
|---|---|---|---|---|
| Common Stockholders Equity: | | | | |
| Common stock, par value $0.005 per share, 50,000,000 shares authorized; 16,948,063 shares in 2008 and 8,354,239 shares in 2007 issued and outstanding | | 85 | | 42 |
| Additional paid-in capital | | 122,433 | | 69,304 |
| Accumulated other comprehensive income | | (693) | | |
| Retained deficit | | (42,544) | | (9,266) |
| Total common stockholders equity | | 79,281 | | 60,080 |
| Total liabilities and common stockholders equity | $ | 147,805 | $ | 71,390 |

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

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**CRAFT BREWERS ALLIANCE, INC.**

**STATEMENTS OF OPERATIONS**

| | Year Ended December 31, | |
|---|---|---|
| | **2008** | **2007** |
| | (In thousands, except per share amounts) | |
| Sales | $ 86,013 | $ 46,544 |
| Less excise taxes | 6,252 | 5,074 |
| Net sales | 79,761 | 41,470 |
| Cost of sales | 65,646 | 36,785 |
| Gross profit | 14,115 | 4,685 |
| Selling, general and administrative expenses | 19,894 | 8,257 |
| Loss on impairments of assets | 30,589 | |
| Merger-related expenses | 1,783 | 584 |
| Income from equity investment in Craft Brands | 1,390 | 2,826 |
| Operating loss | (36,761) | (1,330) |
| Loss from equity investments in Kona and FSB | (11) | |
| Interest expense | (993) | (302) |
| Interest and other income, net | 110 | 517 |
| Loss before income taxes | (37,655) | (1,115) |
| Income tax benefit | (4,377) | (176) |
| Net loss | $ (33,278) | $ (939) |
| Basic and diluted loss per share | $ (2.63) | $ (0.11) |

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

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**CRAFT BREWERS ALLIANCE, INC.**

**STATEMENTS OF COMMON STOCKHOLDERS EQUITY**

| | Common Stock | | Additional | Accumulated Other | | Total Common |
|---|---|---|---|---|---|---|
| | Shares | Par Value | Paid-In Capital | Comprehensive Income | Retained Deficit | Stockholders Equity |
| | (In thousands) | | | | | |
| Balance as of December 31, 2006 | 8,281 | $ 41 | $ 68,978 | $ | $ (8,327) | $ 60,692 |
| Issuance of shares under stock plans | 49 | 1 | 157 | | | 158 |
| Stock-based compensation | 24 | | 169 | | | 169 |
| Net loss | | | | | (939) | (939) |
| Balance as of December 31, 2007 | 8,354 | 42 | 69,304 | | (9,266) | 60,080 |
| Issuance of shares under stock plans | 228 | 1 | 474 | | | 475 |
| Stock-based compensation | 4 | | 20 | | | 20 |
| Issuance of shares pursuant to merger with Widmer Brothers Brewing Company | 8,362 | 42 | 52,635 | | | 52,677 |
| Comprehensive income: | | | | | | |
| Unrealized losses on derivative financial instruments, net of taxes of $407 | | | | (693) | | (693) |
| Net loss | | | | | (33,278) | (33,278) |
| Total comprehensive loss | | | | | | (33,971) |
| Balance as of December 31, 2008 | 16,948 | $ 85 | $ 122,433 | $ (693) | $ (42,544) | $ 79,281 |

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

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**CRAFT BREWERS ALLIANCE, INC.**

**STATEMENTS OF CASH FLOWS**

| | Year Ended December 31, 2008 | 2007 |
|---|---|---|
| | (In thousands) | |
| **Operating Activities** | | |
| Net loss | $ (33,278) | $ (939) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 5,474 | 2,863 |
| Income from equity investments less than (in excess of) cash distributions | 88 | (288) |
| Deferred income taxes | (4,400) | (224) |
| Loss on impairment of assets | 30,589 | |
| Reserve for obsolete inventory | 155 | 205 |
| (Gain) loss on disposition of property, equipment and leasehold improvements | 42 | (3) |
| Stock compensation | 20 | 169 |
| Other | (45) | 79 |
| Changes in operating assets and liabilities, net of effects of acquisition of Widmer Brothers Brewing Company: | | |
| Accounts receivable | 1,416 | (2,077) |
| Trade receivables from Craft Brands | 120 | 184 |
| Inventories | (1,844) | (561) |
| Other current assets | (3,431) | (839) |
| Income taxes receivable | 722 | |
| Other assets | (295) | 113 |
| Accounts payable and other accrued expenses | (1,134) | 1,221 |
| Trade payable to Craft Brands | 60 | 91 |
| Accrued salaries, wages and payroll taxes | 734 | (23) |
| Refundable deposits | 134 | 1,626 |
| Net cash provided by (used in) operating activities | (4,873) | 1,597 |
| **Investing Activities** | | |
| Expenditures for fixed assets | (6,667) | (1,410) |
| Proceeds from disposition of fixed assets | 442 | 487 |
| Cash acquired in acquisition of Widmer Brothers Brewing Company, net | 2,274 | |
| Net cash used in investing activities | (3,951) | (923) |
| **Financing Activities** | | |
| Principal payments on debt and capital lease obligations | (642) | (4,740) |
| Net borrowings under revolving line of credit | 3,500 | |
| Issuance of common stock | 475 | 158 |
| Amounts paid for debt issue costs | (25) | |

| | | | | |
|---|---|---|---|---|
| Net cash provided by (used in) financing activities | | 3,308 | | (4,582) |
| Decrease in cash and cash equivalents | | (5,516) | | (3,908) |
| Cash and cash equivalents: | | | | |
| Beginning of period | | 5,527 | | 9,435 |
| End of period | $ | 11 | $ | 5,527 |
| **Supplemental Disclosures** | | | | |
| Cash paid for interest | $ | 837 | $ | 332 |
| Cash paid for income taxes | $ | 47 | $ | 53 |
| Non-cash Transaction | | | | |
| Net assets of Widmer Brothers Brewing Company acquired in exchange for issuance of common stock and assumption of debt (see Note 2) | $ | 80,072 | $ | |

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

**CRAFT BREWERS ALLIANCE, INC.**

**NOTES TO FINANCIAL STATEMENTS**

## 1. Nature of Operations

Craft Brewers Alliance, Inc. (the Company or CBA ) was formed in 1981 to brew and sell craft beer. The Company produces specialty bottled and draft products at its Company-owned breweries and on the premises of each of its production breweries, operates a pub or restaurant that promotes the Company s products, offers dining and entertainment facilities, and sells retail merchandise.

For more than ten years, the Company s products have been distributed in the United States in 48 states. This was accomplished primarily through a series of distribution agreements with Anheuser-Busch, Incorporated ( A-B ) and with, until its merger, Craft Brands Alliance, LLC ( Craft Brands ), a joint venture that the Company participated in with Widmer Brothers Brewing Company ( Widmer ). In 2004, the Company executed three agreements, an exchange and recapitalization agreement ( Exchange Agreement ), a distribution agreement ( A-B Distribution Agreement ) and a registration rights agreement that collectively constitute the framework of its existing relationship with A-B. The terms of the Exchange Agreement, as amended, provided that the Company issue 1,808,243 shares of common stock to A-B in exchange for 1,289,872 shares of convertible redeemable Series B Preferred Stock held by A-B. The Series B Preferred Stock, then reflected on the Company s balance sheet at approximately $16.3 million, was cancelled. In connection with the Exchange Agreement, the Company also paid $2.0 million to A-B in November 2004. The terms of the A-B Distribution Agreement provided for the Company to continue to distribute its product in the Midwest and Eastern United States through A-B s national distribution network by selling its product to A-B. The A-B Distribution Agreement is subject to early termination, by either party, upon the occurrence of certain events.

The Company executed an agreement to which A-B is a party effective July 1, 2008, modifying and amending the A-B Distribution Agreement, Exchange Agreement and registration rights agreement to reflect A-B s consent to and effect of the merger transaction discussed below ( Consent and Amendment Agreement ). The Consent and Amendment Agreement extended the expiration date of the A-B Distribution Agreement to December 31, 2018 and modified, in part, the scope of the distribution area to include those regions that were previously covered under agreement between the Company and Craft Brands. The amended A-B Distribution Agreement provides for an automatic renewal for an additional ten-year period absent A-B providing written notice to the contrary on or prior to June 30, 2018.

The financial statements as of and for the year ended December 31, 2008 reflect the July 1, 2008 merger of Widmer with and into the Company, as more fully described in Note 2 below. The financial statements as of December 31, 2008 also reflect the effect of the July 1, 2008 merger on the termination of the agreements between the Company and Craft Brands, and the resulting merger of Craft Brands with and into the Company. See Note 7 for further discussion of Craft Brands.

## 2. Merger with Widmer

On November 13, 2007, the Company entered into an Agreement and Plan of Merger with Widmer, which was subsequently amended on April 30, 2008 ( Merger Agreement ). The Merger Agreement provided, subject to customary conditions to closing, for a merger (the Merger ) of Widmer with and into the Company. A copy of the Merger Agreement was included as an exhibit to the Company s current report on Form 8-K filed with the Securities and Exchange Commission ( SEC ) on November 13, 2007. A copy of Amendment No. 1 to the Merger Agreement was included as an exhibit to the Company s registration statement on Form S-4/A filed with the SEC on May 2, 2008.

The Company believes that the combined entity has the potential to secure efficiencies beyond those that had already been achieved by its existing relationships with Widmer in utilizing the two companies breweries and a national sales force, as well as by reducing duplicate functions. Utilizing the combined breweries offers a greater opportunity to rationalize production capacity in line with product demand. The national sales force of the combined entity will support further promotion of the products of its corporate investments, Kona

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**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

Brewery LLC ( Kona ), which brews Kona malt beverage products, and, to a lesser extent, Fulton Street Brewery, LLC ( FSB ), which brews Goose Island malt beverage products. The Company also expects that the combined entity may have greater access to capital markets driven by its increased size and expected growth rates.

On July 1, 2008, the Merger was consummated. Pursuant to the Merger Agreement and by operation of law, upon the merger of Widmer with and into the Company, the Company acquired all of the assets, rights, privileges, properties, franchises, liabilities and obligations of Widmer. Each outstanding share of capital stock of Widmer was converted into the right to receive 2.1551 shares of Company common stock, or 8,361,514 shares. The Merger resulted in Widmer shareholders and existing Company shareholders each holding approximately 50% of the outstanding shares of the Company. No Widmer shareholder exercised statutory appraisal rights in connection with the Merger.

In connection with the Merger, the name of the Company was changed from Redhook Ale Brewery, Incorporated to Craft Brewers Alliance, Inc. The common stock of the Company continues to trade on the Nasdaq Stock Market under the trading symbol HOOK.

***Merger-Related Costs***

In connection with the Merger, the Company incurred merger-related expenditures, including legal, consulting, meeting, filing, printing and severance costs. Certain of the merger-related expenses have been reflected in the statements of operations as selling, general and administrative expenses. Certain of the other merger-related costs have been capitalized in accordance with Financial Accounting Standards Board s ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 141, *Business Combinations* ( SFAS 141 ) as discussed below. The summary of merger-related expenditures incurred during the periods indicated is as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 2008 | 2007 |
| | (In thousands) | |
| Merger-related costs and expenses: | | |
| Reflected in Statements of Operations | $ 1,783 | $ 584 |
| Reflected in Balance Sheets | | 154 |
| Total Merger-related costs & expenses | $ 1,783 | $ 738 |

As discussed further in Note 12, as of December 31, 2008, the Company recorded a full impairment of its goodwill asset. All costs capitalized to goodwill, including any capitalized merger costs, were charged to earnings for the year ended December 31, 2008 as a result. As of December 31, 2007, capitalized merger costs of $154,000 were presented in other current assets on the Company s balance sheet.

Merger-related expenses include severance payments to employees and officers whose employment was or will be terminated as a result of the Merger. The Company estimates that merger-related severance benefits totaling

approximately $644,000 will be paid from 2009 to 2011 to all affected former Redhook employees and officers, and affected former Widmer employees. The Company recognized $1.5 million as a merger-related expense in the statement of operations during the year ended December 31, 2008 in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The Company estimates that the remaining severance cost related to the affected employee group will be recognized as a merger-related expense of approximately $112,000 and $113,000 in the first and second quarters of 2009, respectively.

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**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

***Accounting for the Acquisition of Widmer***

The acquisition of Widmer has been accounted for in accordance with SFAS 141 and SFAS No. 142, *Goodwill and Intangible Assets* ( SFAS 142 ). Accordingly, the Company s balance sheet as of December 31, 2008 reflects the acquisition of Widmer tangible and intangible assets and assumption of Widmer liabilities. The results of operations of Widmer from July 1, 2008 to December 31, 2008 are included in the Company s statement of operations for the year ended December 31, 2008.

Under the purchase method of accounting, the aggregate purchase price of Widmer, including direct merger costs, was allocated to the Company s estimate of the fair value of Widmer assets acquired and liabilities assumed on July 1, 2008, the date of acquisition, based upon estimates of their fair value as indicated below. The excess of the purchase price over the net assets acquired was recorded as goodwill.

The Company has estimated the aggregate purchase price of Widmer as follows:

| | (In thousands) |
|---|---|
| Fair value of Common Stock issued | $ 52,677 |
| Interest-bearing debt assumed | 29,669 |
| Total purchase price | $ 82,346 |

The fair value of the common stock issued was the product of the number of shares of common stock issued to Widmer security holders pursuant to the Merger and $6.30, the average closing price of the common stock as reported by Nasdaq for the five trading days before and after November 13, 2007, the date of the Merger Agreement.

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**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

The Company has allocated the purchase price as follows:

| | | (In thousands) |
|---|---|---|
| Widmer assets acquired and liabilities assumed: | | |
| Current assets | $ | 18,887 |
| Income tax receivable | | 1,491 |
| Property, equipment and leasehold improvements | | 44,929 |
| Equity investments | | 6,600 |
| Trade name and trademarks | | 16,300 |
| Intangible assets recipes, distributor agreements, and non-compete agreements | | 3,000 |
| Favorable contracts | | 643 |
| Total assets acquired | | 91,850 |
| Current liabilities | | (19,821) |
| Fair value of derivative financial instrument | | (186) |
| Premium on promissory notes payable | | (686) |
| Deferred income tax liability, net and other noncurrent liabilities | | (10,718) |
| Total liabilities assumed | | (31,411) |
| Net assets acquired | | 60,439 |
| Excess of purchase price over net assets acquired | | 21,907 |
| Incremental direct merger costs incurred by the Company | | 879 |
| Elimination of valuation allowance for deferred tax assets | | (1,059) |
| Elimination of receivables and payables due to/from Widmer and Craft Brands | | 623 |
| Elimination of investment in Craft Brands | | 339 |
| | | 782 |
| Goodwill recorded | $ | 22,689 |

***Unaudited Pro Forma Results of Operations***

The unaudited pro forma combined condensed results of operations are presented below for:

the year ended December 31, 2008 as if the Merger had been completed on January 1, 2008; and

the year ended December 31, 2007 as if the Merger had been completed on January 1, 2007.

| | **Proforma Results Year Ended December 31, 2008** | **2007** |
|---|---|---|
| | **(In thousands, except per share data)** | |
| Net sales | $ 117,654 | $ 100,656 |
| Loss before income taxes | $ (39,287) | $ (1,109) |
| Net loss | $ (34,357) | $ (729) |
| Basic and diluted loss per share | $ (2.03) | $ (0.04) |

The unaudited pro forma results of operations are not necessarily indicative of the operating results that would have been achieved had the Merger been consummated as of the dates indicated, or that may be achieved in the future. Rather, the unaudited pro forma combined condensed results of operations presented

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

above are based on estimates and assumptions that have been made solely for the purpose of developing such pro forma results. Historical results of operations were adjusted to give effect to pro forma events that are (1) directly attributable to the acquisition, (2) factually supportable, and (3) expected to have a continuing impact on the combined results. These pro forma results of operations do not give effect to any cost savings, revenue synergies or restructuring costs which may result from the integration of Widmer s operations.

## 3. Significant Accounting Policies

### *Cash and Cash Equivalents*

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company maintains cash and cash equivalent balances with financial institutions that may exceed federally insured limits. The carrying amount of cash equivalents approximates fair value because of the short-term maturity of these instruments.

### *Accounts Receivable*

Accounts receivable is comprised of trade receivables due from wholesalers and A-B for beer and promotional product sales. Because of state liquor laws and each wholesaler s agreement with A-B, the Company does not have collectability issues related to the sale of its beer products. Accordingly, the Company does not regularly provide an allowance for doubtful accounts for beer sales. The Company has provided an allowance for promotional merchandise that has been invoiced to the wholesaler, which reflects the Company s best estimate of probable losses inherent in the accounts. The Company determines the allowance based on historical customer experience and other currently available evidence. When a specific account is deemed uncollectible, the account is written off against the allowance.

### *Inventories*

Inventories, except for pub food, beverages and supplies, are stated at the lower of standard cost, which approximates the first-in, first-out method, or market. Pub food, beverages and supplies are stated at the lower of cost or market.

In coordinating the operations of the merged entity, the Company has identified specific classes of inventory items that were previously expensed by the Company, but were carried as inventory by Widmer. Specific classes of inventory items include certain packaging items, promotional merchandise and pub food, beverages and supplies. Generally this was due to the significance of the item relative to the operations of the individual entities, reflecting minor differences in the two businesses. The Company revised its policies with regard to these items as of the beginning of the third quarter of 2008, such that, on a prospective basis, purchases of these items are now inventoried. The Company assessed the cumulative impact of this change in accounting policy and determined that the change is not material to the financial statements as of and for the year ended December 31, 2008 or any prior period.

The Company regularly reviews its inventories for the presence of obsolete product attributed to age, seasonality and quality. Inventories that are considered obsolete are written off or adjusted to carrying value. The Company records as a non-current asset the cost of inventory for which it estimates it has more than a twelve-month supply.

### *Investment in Subsidiaries*

As a result of the merger of Craft Brands with and into the Company, the Company terminated its agreements with Craft Brands effective July 1, 2008. Prior to this date, the Company had assessed its investment in Craft Brands pursuant to the provisions of FASB Interpretation No. 46 Revised, *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51* ( FIN 46R ). In applying FIN 46R, the Company

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

did not consolidate the financial statements of Craft Brands with the financial statements of the Company, but instead accounted for its investment in Craft Brands under the equity method, as outlined by Accounting Principles Board ( APB ) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* ( APB 18 ). The Company recognized its share of the net earnings of Craft Brands by an increase to its investment in Craft Brands on the Company s balance sheet and recognized income from equity investment in the Company s statement of operations. Any cash distributions received or the Company s share of losses reported by Craft Brands were reflected as a decrease in investment in Craft Brands on the Company s balance sheet. Prior to the merger, the Company did not control the amount or timing of cash distributions by Craft Brands.

As a result of the Merger, the Company acquired a 42% equity ownership interest in FSB and a 20% equity ownership interest in Kona. The Company accounts for these investments under the equity method in accordance with APB 18. For these investments, upon acquisition in the Merger, the Company recorded the fair value of the respective investment as its carrying value. The difference between the carrying value of the equity investment and the Company s amount of underlying equity in the net assets of the investee is considered equity method goodwill, which is not amortized. The carrying value of the equity investment is reviewed for impairment. At December 31, 2008, the Company recorded a loss on impairment of assets associated with these investments. See Note 12 for further details.

***Property, Equipment and Leasehold Improvements***

Property, equipment and leasehold improvements are stated at cost less accumulated depreciation and accumulated amortization. Expenditures for repairs and maintenance are expensed as incurred; renewals and betterments are capitalized. Upon disposal of equipment and leasehold improvements, the accounts are relieved of the costs and related accumulated depreciation or amortization, and resulting gains or losses are reflected in operations.

Depreciation and amortization of property, equipment and leasehold improvements is provided on the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Buildings | 31 - 50 years |
| Brewery equipment | 10 - 25 years |
| Furniture, fixtures and other equipment | 2 - 10 years |
| Vehicles | 5 years |
| Leasehold improvements | Useful life or term of lease, whichever less |

***Goodwill and Other Intangible Assets***

In accordance with SFAS 142, goodwill and other intangible assets with indefinite useful lives are not amortized but are reviewed periodically for impairment.

The provisions of SFAS 142 require that an intangible asset that is not subject to amortization, including goodwill, be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The provisions also require that a two-step test be performed to assess goodwill for impairment. First, the fair value of each reporting unit is compared with its carrying value, including goodwill. If the fair value exceeds the

carrying value then goodwill is not impaired and no further testing is performed. If the carrying value of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step compares the fair value of the reporting unit s goodwill with the carrying amount of the goodwill. An impairment loss would be recognized in an amount equal to the excess of the carrying amount of goodwill over the fair value of the goodwill.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

The significant estimates and assumptions used by management in assessing the recoverability of goodwill and other intangible assets are estimated future cash flows, present value discount rate, and other factors. Any changes in these estimates or assumptions could result in an impairment charge. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management s subjective judgment.

The Company will amortize intangible assets with finite lives over their respective finite lives up to their estimated residual values. The Company will evaluate potential impairment of long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ). SFAS 144 establishes procedures for review of recoverability and measurement of impairment, if necessary, of long-lived assets and certain identifiable intangibles. When facts and circumstances indicate that the carrying values of long-lived assets may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the assets to projected future undiscounted cash flows in addition to other quantitative and qualitative analyses. Upon indication that the carrying value of such assets may not be recoverable, the Company recognizes an impairment loss by a charge against current operations.

Acquired intangibles and their estimated remaining useful lives include:

| | |
|---|---|
| Trade name and trademarks | Indefinite |
| Recipes | Indefinite |
| Distributor agreements | 15 years |
| Non-compete agreements | 3 years |

***Refundable Deposits on Kegs***

The Company distributes its draft beer in kegs that are owned by the Company as well as in kegs that have been leased from third parties. Kegs that are owned by the Company are reflected in the Company s balance sheets at cost and are depreciated over the estimated useful life of the keg. When draft beer is shipped to the wholesaler, regardless of whether the keg is owned or leased, the Company collects a refundable deposit, presented as a current liability refundable deposits in the Company s balance sheets. Upon return of the keg to the Company, the deposit is refunded to the wholesaler. See discussion at Note 17, Related-Party Transactions for impact of lost kegs on the Company s brewery equipment.

The Company has experienced some loss of kegs and anticipates that some loss will occur in future periods due to the significant volume of kegs handled by each wholesaler and retailer, the homogeneous nature of kegs owned by most brewers, and the relatively small deposit collected for each keg when compared with its market value. The Company believes that this is an industry-wide problem and that the Company s loss experience is not atypical. In order to estimate forfeited deposits attributable to lost kegs, the Company periodically uses internal records, records maintained by A-B, records maintained by other third party vendors, and historical information to estimate the physical count of kegs held by wholesalers and A-B. These estimates affect the amount recorded as equipment and refundable deposits as of the date of the financial statements. The actual liability for refundable deposits could differ from estimates. For the years ended December 31, 2008 and 2007, the Company decreased its refundable deposits and brewery equipment by $596,000 and $48,000, respectively. As of December 31, 2008 and 2007, the Company s balance sheets include $5.7 million and $3.1 million, respectively, in refundable deposits on kegs and $5.0 million and

$655,000 in keg equipment, net of accumulated depreciation.

***Fair Value of Financial Instruments***

The recorded value of the Company s financial instruments is considered to approximate the fair value of the instruments, in all material respects, because the Company s receivables and payables are recorded at amounts expected to be realized and paid, the Company s derivative financial instruments are carried at fair

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

value, and the carrying value of the Company s debt obligations that were assumed in the Merger were adjusted to their respective fair values as of the effective date of the Merger.

Financial instruments that potentially subject the Company to credit risk consist principally of trade accounts receivable. While wholesale distributors and A-B account for substantially all trade accounts receivable, this concentration risk is limited due to the number of distributors, their geographic dispersion, and state laws regulating the financial affairs of distributors of alcoholic beverages.

The Company has adopted the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ), which requires that all derivatives be recognized at fair value in the balance sheet, and that the corresponding gains or losses be reported either in the statement of operations or as a component of comprehensive income, depending on whether the instrument meets the criteria to apply hedge accounting. Derivative financial instruments are utilized by the Company to reduce interest rate risk. The Company does not hold or issue derivative financial instruments for trading purposes.

***Comprehensive Income***

The Company accounts for comprehensive income under SFAS No. 130, *Reporting Comprehensive Income,* which establishes standards for the reporting and presentation of elements of comprehensive income, including deferred gains and losses on unrealized derivative hedge transactions.

***Revenue Recognition***

Effective with the Merger, the Company recognizes revenue from product sales when the products are delivered to A-B or the wholesaler. These are recorded net of excise taxes, discounts and certain fees the Company must pay in connection with sales to A-B. In prior periods, it had recognized revenues from these activities when the associated products were shipped to the customers as the time between shipment and delivery was short, product damage claims and returns were insignificant and the volume of shipments involved was relatively low. The Company assessed the cumulative impact of this change in accounting policy and determined that the change is not material to the financial statements as of and for the year ended December 31, 2008 or any prior period.

The Company also earns revenue in connection with two operating agreements with Kona an alternating proprietorship agreement and a distribution agreement. Pursuant to the alternating proprietorship agreement, Kona produces a portion of its malt beverages at the Company s brewery in Portland, Oregon. The Company receives a facility fee from Kona based on the barrels brewed and packaged at the Company s brewery. Fees are recognized as revenue upon completion of the brewing process and packaging of the product. In connection with the alternating proprietorship agreement, the Company also sells certain raw materials to Kona for use in brewing. Revenue is recognized when the raw materials are removed from the Company s stock. Under the distribution agreement, the Company purchases Kona-branded product from Kona, whether manufactured at Kona s Hawaii brewery or the Company s brewery, then sells and distributes the product. The Company recognizes revenue when the product is delivered to A-B or the wholesaler.

The Company recognizes revenue on retail sales at the time of sale. The Company recognizes revenue from events at the time of the event.

***Excise Taxes***

The federal government levies excise taxes on the sale of alcoholic beverages, including beer. For brewers producing less than two million barrels of beer per calendar year, the federal excise tax is $7 per barrel on the first 60,000 barrels of beer removed for consumption or sale during the calendar year, and $18 per barrel for each barrel in excess of 60,000 barrels. Individual states also impose excise taxes on alcoholic beverages in varying amounts. As presented in the Company s statements of operations, sales reflect the amount invoiced to

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

A-B, wholesalers and other customers. Excise taxes due to federal and state agencies are not collected from the Company s customers, but rather are the responsibility of the Company. Net sales, as presented in the Company s statements of operations, are reduced by applicable federal and state excise taxes.

***Shipping and Handling Costs***

Costs incurred to ship the Company s product are included in cost of sales in the Company s statements of operations.

***Income Taxes***

The Company records federal and state income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* ( SFAS 109 ). Deferred income taxes or tax benefits reflect the tax effect of temporary differences between the amounts of assets and liabilities for financial reporting purposes and amounts as measured for tax purposes as well as for tax net operating loss and credit carryforwards. These deferred tax assets and liabilities are measured under the provisions of the currently enacted tax laws. Deferred tax assets are recognized for deductible temporary differences, net operating loss carryforwards and tax credit carryforwards if it is more likely than not that the tax benefits will be realized. For deferred tax assets that cannot be recognized under the more likely than not standard, the Company has established a valuation allowance. The effect on deferred taxes upon a change in valuation allowance is recognized in the period that the change occurs.

Penalties incurred in connection with tax matters are classified as general and administrative expenses, and interest assessments incurred in connection with tax matters are classified as interest expense.

***Advertising Expenses***

Advertising costs, comprised of television, radio, print and outdoor advertising, sponsorships and printed product information, as well as costs to produce these media, are expensed as incurred. For the years ended December 31, 2008 and 2007, advertising expenses totaling $1.8 million and $443,000, respectively, are reflected as selling, general and administrative expenses in the Company s statements of operations.

The Company incurs costs for the promotion of its products through a variety of advertising programs with its wholesalers and downstream retailers. These costs are included in selling, general and administrative expenses and frequently involve the local wholesaler sharing in the cost of the program. Reimbursements from wholesalers for advertising and promotion activities are recorded as a reduction to selling, general and administrative expenses in the Company s statements of operations. Reimbursements for pricing discounts to wholesalers are recorded as a reduction to sales in the Company s statements of operations.

***Segment Information***

The Company operates in one principal business segment as a manufacturer of beer and ales across domestic markets. The Company believes that its pub operations and brewery operations, whether considered individually or in combination, do not constitute a separate segment under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company believes that its three production brewery operations are functionally and financially similar. The Company operates its three pubs as an extension of the marketing of its products and views

their primary function to be promotion of these products.

***Stock-Based Compensation***

The Company maintains several stock incentive plans under which non-qualified stock options, incentive stock options and restricted stock have been granted to employees and non-employee directors and accounts for these grants consistent with SFAS No. 123R, *Share-Based Payment* ( SFAS 123R ), which revises

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**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

SFAS No. 123 and supersedes APB No. 25. SFAS 123R requires that all share-based payments to employees and directors be recognized as expense in the statement of operations based on their fair values and vesting periods. The Company is required to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company s statements of operations.

***Earnings (Loss) per Share***

The Company follows SFAS No. 128, *Earnings per Share*. Basic earnings (loss) per share is calculated using the weighted average number of shares of common stock outstanding. The calculation of adjusted weighted average shares outstanding for purposes of computing diluted earnings (loss) per share includes the dilutive effect of all outstanding stock options for the periods when the Company reports net income. The calculation uses the treasury stock method and the as if converted method in determining the resulting incremental average equivalent shares outstanding as applicable.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances at the time. Actual results could differ from those estimates under different assumptions or conditions.

***Reclassifications***

Certain reclassifications have been made to the prior year s data to conform to the current year s presentation.

***Recent Accounting Pronouncements***

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 was effective for fiscal years beginning after November 15, 2007, with early adoption permitted. Although the Company adopted SFAS 159 as of January 1, 2008, the Company did not elect the fair value option for any items permitted under SFAS 159.

In December 2007, the Emerging Issues Task Force ( EITF ) of the FASB reached a consensus on Issue No. 07-1, *Accounting for Collaborative Arrangements* ( EITF 07-1 ). The EITF defines a collaborative arrangement and concludes that revenues and costs incurred with third parties in connection with collaborative arrangements would be presented gross or net based on the criteria in EITF No. 99-19 and other accounting literature. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and is to be applied retrospectively to all periods presented for all collaborative arrangements existing as

of the effective date. The Company does not anticipate the adoption of EITF 07-1 will have a material effect on the Company s results of operations, financial condition or cash flows.



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**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133* ( SFAS 161 ). SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities in order to improve the transparency of financial reporting. SFAS 161 amends and expands the disclosure requirements of SFAS 133 to provide users of financial statements with an enhanced understanding of (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. SFAS 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently evaluating the impact that SFAS No. 161 will have on its financial statement disclosures, but does not anticipate the adoption of SFAS 161 will have a material effect on the Company s financial position, results of operations or cash flows.

In April 2008, the FASB issued FASB Staff Position ( FSP ) No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP FAS 142-3 ). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142. FSP FAS 142-3 requires a company estimating the useful life of a recognized intangible asset to consider its historical experience in renewing or extending similar arrangements or, in the absence of such experience, to consider assumptions that market participants would use about renewal or extension as adjusted for entity-specific factors. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company anticipates that expanded disclosure may be required, but does not anticipate the adoption of FSP FAS 142-3 will have a material effect on the Company s financial position, results of operations or cash flows.

In October 2008, the FASB issued FSP FAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* ( FSP FAS 157-3 ), which clarifies the application of SFAS No. 157, *Fair Value Measurements* in an inactive market. FSP FAS 157-3 addresses application issues such as how management s internal assumptions should be considered when measuring fair value when relevant observable data do not exist; how observable market information in a market that is not active should be considered when measuring fair value and how the use of market quotes should be considered when assessing the relevance of observable and unobservable data available to measure fair value. FSP FAS 157-3 was effective upon issuance. The Company s adoption of FSP FAS 157-3 did not have a material effect on the Company s financial condition, results of operations or cash flows.

In November 2008, the EITF reached a consensus on issue No. 08-6, *Equity Method Investment Accounting Considerations* ( EITF 08-6 ). EITF 08-6 requires a company to measure its equity method investment initially at cost in accordance with SFAS No. 141(R) *Business Combinations*. EITF 08-6 also outlines the factors that a company should take into consideration when an impairment is recognized under the provisions of APB 18. EITF 08-6 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and is to be applied retrospectively. The Company does not anticipate the adoption of EITF 08-6 will have a material effect on the Company s financial position, results of operations or cash flows.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

### 4. Inventories

Inventories consist of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Raw materials | $ 4,258 | $ 538 |
| Work in process | 1,921 | 922 |
| Finished goods | 1,624 | 511 |
| Packaging materials, net | 950 | 487 |
| Promotional merchandise, net | 907 | 470 |
| Pub food, beverages and supplies | 69 | |
| | $ 9,729 | $ 2,928 |

Work in process is beer held in fermentation tanks prior to the filtration and packaging process. The Company has established reserves for obsolescence and market valuation totaling $581,000 and $208,000 for its packaging materials and promotional merchandise inventories as of December 31, 2008 and 2007, respectively.

### 5. Other Current Assets

Other current assets consist of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Deposits paid to keg lessor | $ 3,182 | $ 656 |
| Merger-related costs (see Note 2) | | 154 |
| Prepaid property taxes | 177 | |
| Prepaid insurance | 201 | 201 |
| Other | 391 | 32 |
| | $ 3,951 | $ 1,043 |

### 6. Property, Equipment and Leasehold Improvements

Property, equipment and leasehold improvements consist of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Brewery equipment | $ 74,224 | $ 47,082 |
| Buildings | 50,927 | 35,846 |
| Land and improvements | 7,573 | 4,604 |
| Furniture, fixtures and other equipment | 3,931 | 2,337 |
| Leasehold improvements | 2,731 | 2 |
| Vehicles | 84 | 82 |
| Construction in progress | 675 | 314 |
| | 140,145 | 90,267 |
| Less accumulated depreciation and amortization | 38,756 | 34,405 |
| | $ 101,389 | $ 55,862 |

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

As of December 31, 2008 and 2007, brewery equipment included property acquired under a capital lease with a cost of $13.1 million and $77,000, respectively, and accumulated amortization of $869,000 and $34,000, respectively. The Company s statements of operations for the years ended December 31, 2008 and 2007 includes $870,000 and $15,000, respectively, in amortization expense related to this leased property.

## 7. Equity Investments

Equity investments consist of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Fulton Street Brewery, LLC ( FSB ) | $ 4,103 | $ |
| Kona Brewery LLC ( Kona ) | 1,086 | |
| Craft Brands Alliance LLC ( Craft Brands ) | | 416 |
| | $ 5,189 | $ 416 |

During the year ended December 31, 2008, the Company recognized impairment losses deemed to be other than temporary for its investments in FSB and Kona; see discussion at Note 12 for further details.

***FSB***

For the year ended December 31, 2008, the Company s share of FSB s net income totaled $3,000. The Company s investment in FSB was $4.1 million at December 31, 2008, and the Company s portion of equity as reported on FSB s financial statement was $1.9 million as of that date. The Company did not have an investment in FSB at December 31, 2007 as it acquired its interest in FSB as a result of the Merger. The Company has not received any cash capital distributions associated with FSB during its ownership period. At December 31, 2008, the Company has recorded a payable to FSB of $1.1 million primarily for amounts owing for purchases of Goose Island-branded product. The Company has recorded a receivable from FSB of $36,000 primarily for marketing fees associated with sales of Goose Island-branded product in the Company s distribution area.

***Kona***

For the year ended December 31, 2008, the Company s share of Kona s net loss totaled $14,000. The Company s investment in Kona was $1.1 million at December 31, 2008, and the Company s portion of equity as reported on Kona s financial statement was $347,000 as of that date. The Company did not have an investment in Kona at December 31, 2007 as it acquired its interest in Kona as a result of the Merger. The Company has not received any cash capital distributions associated with Kona during its ownership period. At December 31, 2008, the Company has recorded a receivable from Kona of $3.0 million primarily related to amounts owing under its alternative proprietorship and distribution agreements. Also at that date, the Company has recorded a payable to Kona of $1.9 million primarily for

amounts owing for purchases of Kona-branded product.

***Craft Brands***

On July 1, 2004, the Company entered into agreements with Widmer with respect to the operation of a joint venture sales and marketing entity, Craft Brands. Pursuant to these agreements, and through June 30, 2008, the Company manufactured and sold its product to Craft Brands at prices substantially below wholesale pricing levels; Craft Brands, in turn, advertised, marketed, sold and distributed the product to wholesale outlets in the western United States pursuant to a distribution agreement between Craft Brands and A-B.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

In connection with the Merger, Craft Brands was also merged with and into the Company, effective July 1, 2008. All existing agreements, including all associated future commitments and obligations, between the Company and Craft Brands and between Craft Brands and Widmer terminated as a result of the merger of Craft Brands.

The Operating Agreement addressed the allocation of profits and losses of Craft Brands up to July 1, 2008. During the first six months of 2008 and all of 2007, the Company was allocated 42% of Craft Brands profits and losses. Net cash flow, if any, was generally distributed monthly to the Company based upon that percentage. The Company did not receive a distribution in any event that caused the liabilities of Craft Brands, adjusted for the liabilities to its members, to be in excess of its assets, or Craft Brands to be unable to pay its debts as those debts became due in the ordinary course of business.

As a result of the merger with Craft Brands, the Company adjusted its residual investment in and wrote off its net receivable from Craft Brands to the total purchase consideration that resulted in increases to goodwill of $339,000 and $21,000, respectively.

For the years ended December 31, 2008 and 2007, the Company s share of Craft Brands net income totaled $1.4 million and $2.8 million, respectively. During the years ended December 31, 2008 and 2007, the Company received cash distributions of $1.5 million and $2.5 million, respectively, representing its share of the net cash flow of Craft Brands.

The selected financial information presented for Craft Brands for the year ended December 31, 2008 represents the activities for the entity from January 1, 2008 through June 30, 2008. The selected financial information is as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 2008 | 2007 |
| | (Dollars in thousands) | |
| Net sales | $ 38,463 | $ 65,358 |
| Gross profit | $ 12,089 | $ 21,271 |
| Operating income | $ 3,311 | $ 6,711 |
| Income before income taxes | $ 3,310 | $ 6,728 |
| Net income | $ 3,310 | $ 6,728 |
| Shipments (in barrels) | 180,300 | 425,500 |

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

## 8. Intangible and Other Assets

Intangible and other assets consist of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Trademarks and other | $ 10,027 | $ 378 |
| Distributor agreements | 2,200 | |
| Recipes | 700 | |
| Non-compete agreements | 100 | |
| Favorable contracts | 643 | |
| Promotional merchandise | 393 | 98 |
| | 14,063 | 476 |
| Less accumulated amortization | 517 | 369 |
| | $ 13,546 | $ 107 |

During the year ended December 31, 2008, the Company recognized impairment charges associated with a decrease in the estimated fair value of its Widmer brand trademark; see discussion at Note 12 for further details.

Accumulated amortization by class consists of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Trademarks and other | $ 201 | $ 369 |
| Distributor agreements | 73 | |
| Non-compete agreements | 17 | |
| Favorable contracts | 226 | |
| | $ 517 | $ 369 |

Estimated amortization expenses to be recorded by class for the next five fiscal years are as follows:

**Year Ended December 31,**

| **Estimated Amortization Expense** | **2009** | **2010** | **2011** | **2012** | **2013** |
|---|---|---|---|---|---|
| | | | **(In thousands)** | | |
| Trademarks and other | $ 3 | $ 3 | $ 3 | $ 2 | $ 3 |
| Distributor agreements | 147 | 146 | 147 | 146 | 147 |
| Non-compete agreements | 33 | 33 | 17 | | |
| Favorable contracts | 278 | 104 | 29 | 5 | 1 |
| | $ 461 | $ 286 | $ 196 | $ 153 | $ 151 |

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

## 9. Debt and Capital Lease Obligations

Long-term debt and capital lease obligations consist of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Term loan payable to bank, due July 1, 2018 | $ 13,363 | $ |
| Line of credit payable to bank, due January 1, 2013 | 12,000 | |
| Promissory notes payable to individual lenders, all due July 1, 2015 | 600 | |
| Premium on promissory notes | 654 | |
| Capital lease obligations on equipment | 6,611 | 46 |
| | 33,228 | 46 |
| Less current portion of long-term debt | 1,394 | 15 |
| | $ 31,834 | $ 31 |

As a result of the Merger, the Company assumed borrowings under Widmer s outstanding credit arrangement; however, the Company refinanced these amounts by concurrently entering into a new loan agreement (the Loan Agreement ) with Bank of America, N.A. ( BofA ). The Loan Agreement is comprised of a $15.0 million revolving line of credit ( Line of Credit ), including provisions for cash borrowings and up to $2.5 million notional amount of letters of credit, and a $13.5 million term loan ( Term Loan ). The Company may draw upon the Line of Credit for working capital and general corporate purposes. The Line of Credit matures on January 1, 2013 at which time the outstanding principal balance and any accrued but unpaid interest will be due. At December 31, 2008, the Company had $12.0 million outstanding under the Line of Credit with $3.0 million of availability for further cash borrowing.

At September 30, 2008, the Company was not in compliance with the covenants for the Loan Agreement as it was unable to meet either of the two required financial covenants, the funded debt to bank EBITDA ratio or the fixed charge coverage ratio, for the trailing twelve months ended September 30, 2008. Bank EBITDA is defined as Earnings before interest, taxes, depreciation, amortization and certain other adjustments as defined in the Loan Agreement. The Company and BofA executed a modification to the loan agreement effective November 14, 2008 ( Modification Agreement ) that permanently waived the noncompliance as an event of default at September 30, 2008. The Modification Agreement subjects the Company to certain terms and conditions different than under the original Loan Agreement. Those terms and conditions as modified are summarized below. As discussed in further detail below, the Company was in compliance with its covenants as of December 31, 2008.

Under the Modification Agreement, the Company may select from one of the following two interest rate benchmarks as the basis for calculating interest on the outstanding principal balance of the Line of Credit: the London Inter-Bank Offered Rate ( LIBOR ) or the Inter-Bank Offered Rate ( IBOR ) (each, a Benchmark Rate ). Interest accrues at an annua rate equal to the Benchmark Rate plus a marginal rate. The Company may select different Benchmark Rates for

different tranches of its borrowings under the Line of Credit. The marginal rate is fixed at 3.50% until September 30, 2009 at which time it will vary from 1.75% to 3.50% based on the ratio of the Company s funded debt to EBITDA, as defined. LIBOR rates may be selected for one, two, three, or six month periods, and IBOR rates may be selected for no shorter than 14 days and no longer than six months. Under the Modification Agreement, the Company may not draw upon the Line of Credit in increments of less than $1 million. Accrued interest for the Line of Credit is due and payable monthly. At December 31, 2008, the weighted-average interest rate for the borrowings outstanding under the Line of Credit was 3.90%.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

An annual fee will be payable in advance on the notional amount of each standby letter of credit issued and outstanding multiplied by an applicable rate ranging from 1.13% to 1.50%.

Interest on the Term Loan will accrue on the outstanding principal balance in the same manner as provided for under the Line of Credit, as established under the LIBOR one-month Benchmark Rate. The interest rate on the Term Loan was 3.95% as of December 31, 2008. Accrued interest for the Term Loan is due and payable monthly. At December 31, 2008, principal payments are due monthly in accordance with an agreed-upon schedule set forth in the Loan Agreement. Any unpaid principal balance and unpaid accrued interest will be due on July 1, 2018.

Under the Modification Agreement, a quarterly fee on the unused portion of the Line of Credit, including the undrawn amount of the Standby Letter of Credit, will accrue at a rate of 0.50% payable quarterly. A loan fee associated with the Term Loan for $25,000 was paid during the three months ended September 30, 2008, and a loan fee associated with the Modification Agreement for $30,000 was paid during the three months ended December 31, 2008. These amounts were fully charged to interest expense during the year ended December 31, 2008.

The Modification Agreement also revised the types of financial covenants that the Company is required to meet for each quarter through June 30, 2009. As of December 31, 2008, the Company was in compliance with the loan covenants under the Modification Agreement. A covenant under the Modification Agreement requires the Company to generate a specified EBITDA amount measured on a quarterly basis. EBITDA under the Modified Agreement is defined similar to Bank EBITDA but includes certain adjustments specific to the Modification Agreement.

The following table summarizes the financial covenant ratios required pursuant to the Modification Agreement:

**Financial Covenants Required by Modification Agreement**

| | | |
|---|---|---|
| Minimum EBITDA, as defined (in thousands) | | |
| For the quarter ending March 31, 2009 | $ | 850 |
| For the quarter ending June 30, 2009 | $ | 2,300 |
| For the quarter ending September 30, 2009 and thereafter | | Does not apply |
| | | |
| Asset Coverage Ratio | | |
| For the quarter ending March 31, 2009 and thereafter | | 1.50 to 1 |
| | | |
| Capital Expenditures (in thousands) | | |
| To spend or incur obligations less than the following: | | |
| For the quarter ending March 31, 2009(1) | $ | 1,350 |
| For the quarter ending June 30, 2009(1) | $ | 550 |
| For the quarter ending September 30, 2009 and thereafter | | Does not apply |

(1) - Provides for carryover spending of any amount not used in the prior quarter

The Loan Agreement is secured by substantially all of the Company s personal property and by the real properties located at 924 North Russell Street, Portland, Oregon and 14300 NE 145th Street, Woodinville, Washington ( Collateral ), which comprise its larger-scale automated Portland, Oregon brewery and its Woodinville, Washington brewery, respectively.

In addition, the Company is restricted in its ability to declare or pay dividends, repurchase any outstanding common stock, acquire additional debt or enter into any agreement that would result in a change



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**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

in control of the Company. Effective September 30, 2009, the Company will be required to meet the financial covenant ratios of funded debt to EBITDA, as defined, and fixed charge coverage in the manner established pursuant to the original Loan Agreement, but at levels specified by the Modification Agreement.

If the Company is unable to generate sufficient EBITDA to meet the associated covenants either under the Modified Agreement or its Loan Agreement, as applicable, this would result in a violation. Failure to meet the covenants is an event of default and, at its option, BofA could deny a request for another waiver and declare the entire outstanding loan balance immediately due and payable. In such a case, the Company would seek to refinance the loan with one or more lenders, potentially at less desirable terms. However, there can be no guarantee that additional financing would be available at commercially reasonable terms, if at all.

As a result of the Merger, the Company assumed Widmer s promissory notes signed in connection with the acquisition of commercial real estate related to the Portland, Oregon brewery. These notes were separately executed by Widmer with three individuals, but under substantially the same terms and conditions. Each promissory note is secured by a deed of trust on the commercial real estate. The outstanding note balance to each lender as of December 31, 2008 was $200,000, with each note bearing a fixed interest rate of 24% per annum, subject to a one-time adjustment on July 1, 2010 to reflect the change in the consumer price index from the date of issue, July 1, 2005, to the date of adjustment. The promissory notes are carried at the total of stated value plus a premium reflecting the difference between the Company s incremental borrowing rate and the stated note rate. The effective interest rate for each note is 6.31%. Each note matures on the earlier of the individual lender s death or July 1, 2015, but in no event prior to July 1, 2010, with prepayment of principal not allowed under the notes terms. Interest payments are due and payable monthly.

As a result of the Merger, the Company assumed Widmer s capital equipment lease obligation to BofA, which is secured by substantially all of the brewery equipment and restaurant furniture and fixtures located in Portland, Oregon. The outstanding balance for the capital lease as of December 31, 2008 was $6.6 million, with monthly loan payments of $119,020 required through the maturity date of June 30, 2014. The capital lease carries an effective interest rate of 6.56%. The capital lease is subject to a prepayment penalty of the product of a specified percentage and the amount prepaid. This specified percentage began at 4% and, except in the event of acceleration due to an event of default, ratably declines 1% for every year the lease is outstanding until July 31, 2011, at which time the capital lease is not subject to a prepayment penalty. The specified percentage is 3% as of December 31, 2008. In the event of acceleration due to an event of default, the prepayment penalty is restored to 4%.

A minimal balance remains outstanding of other capital lease obligations consisting of agreements executed by the Company in prior years for the use of small production equipment and machinery.

On February 15, 2008, the Company had entered into a credit arrangement with BofA pursuant to which a $5 million revolving line of credit was provided. Effective June 30, 2008, the Company terminated this revolving line without drawing upon the line of credit at any time.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

For the Company s outstanding debt obligations as of December 31, 2008, long-term debt and future minimum capital lease payments for the next five fiscal years are as follows:

| | Long-term Debt | | | |
|---|---|---|---|---|
| | Line of Credit | Term Loan | Promissory Notes | Capital Lease Obligations |
| | (In thousands) | | | |
| Succeeding periods: | | | | |
| 2009 | $ | $ 351 | $ | $ 1,446 |
| 2010 | | 374 | | 1,440 |
| 2011 | | 396 | | 1,432 |
| 2012 | | 421 | | 1,428 |
| 2013 | 12,000 | 451 | | 1,428 |
| Thereafter | | 11,370 | 600 | 715 |
| | $ 12,000 | $ 13,363 | $ 600 | 7,889 |
| Amount representing interest | | | | (1,278) |
| | $ 12,000 | $ 13,363 | $ 605 | $ 6,611 |

**10. Derivative Financial Instruments and Fair Value Measurements**

In connection with the Loan Agreement, the Company entered into a five-year interest rate swap agreement with a total notional value of $10.1 million to hedge the variability of interest payments associated with its variable-rate borrowings under the Term Loan. Through this swap agreement, the Company pays interest at a fixed rate of 4.48% and receives interest at a floating-rate of the one-month LIBOR. Since the interest rate swap hedges the variability of interest payments on variable rate debt with similar terms, it qualifies for cash flow hedge accounting treatment under SFAS 133. As of December 31, 2008, an unrealized net loss of $1.1 million was recorded in accumulated other comprehensive loss as a result of this hedge. There was no hedge ineffectiveness recognized for the year ended December 31, 2008 associated with this contract.

As a result of the Merger, the Company assumed Widmer s contract with BofA for a $7.0 million notional interest rate swap agreement. On the effective date of the Merger, the Company entered into with BofA an equal and offsetting interest rate swap contract. Neither swap contract qualifies for hedge accounting under SFAS 133. The assumed contract requires the Company to pay interest at a fixed rate of 4.60% and receive interest at a floating rate of the one-month LIBOR, while the offsetting contract requires the Company to pay interest at a floating rate of the one-month LIBOR and receive interest at a fixed rate of 3.47%. Both contracts expire on November 1, 2010. The Company recorded a net gain on the contracts of $34,000 for the year ended December 31, 2008, which was recorded to other income. The Company did not have any similar contracts outstanding during 2007, therefore there were no

amounts recorded to earnings for the year ended December 31, 2007.

All swap obligations with BofA are secured by the Collateral under the Loan Agreement.

***Fair Value Measurements***

SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

is a market-based measurement that should be determined based upon assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

*Level 1:* Observable inputs (unadjusted) in active markets for identical assets and liabilities;

*Level 2:* Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets and inputs other than quoted prices that are observable for the asset or liability;

*Level 3:* Unobservable inputs for the asset or liability, including situations where there is little, if any, market activity or data for the asset or liability.

The Company has assessed its assets and liabilities that are measured and recorded at fair value on a recurring or non-recurring basis, within the above hierarchy and that assessment is as follows:

| | Fair Value Hierarchy Assessment | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (In thousands) | | | |
| Recurring | | | | |
| Derivative financial instruments interest rate swaps | $ | $ 1,252 | $ | $ 1,252 |
| Non-recurring | | | | |
| Goodwill | | | | |
| Trademarks | | | 10,002 | 10,002 |
| Equity investments | | | 5,189 | 5,189 |

**11. Common Stockholders Equity**

***Issuance of Common Stock***

In conjunction with the exercise of stock options granted under the Company s stock option plans during the years ended December 31, 2008 and 2007, the Company issued 227,750 and 48,550 shares, respectively, of common stock and received proceeds on exercise totaling $475,000 and $158,000, respectively. See *Stock-Based Compensation Expense* for a discussion of the impact on the Company s statements of operations.

On June 24, 2008, the board of directors approved under the 2007 Stock Incentive Plan (the 2007 Plan ) a grant of 1,140 shares of fully-vested common stock to each independent, non-employee director except for the A-B designated directors. In conjunction with these stock grants, the Company issued 4,560 shares of common stock. See *Stock-Based Compensation Expense* for a discussion of the impact on the Company s statements of operations.

On May 22, 2007, the board of directors approved under the 2007 Plan a grant of 2,300 shares of common stock to each independent, non-employee director (except for the A-B designated directors), 10,000 shares and 5,000 shares of common stock to its then Chief Executive Officer and its then President, respectively. Each grantee was fully vested in the corresponding grant. In conjunction with these stock grants, the Company issued 24,200 shares of common stock.

On July 1, 2008, the Company issued 8,361,514 common shares to the then shareholders of Widmer in exchange for cancellation of the Widmer shares. See Note 2 for further discussion.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

***Stock Plans***

The Company maintains several stock incentive plans under which non-qualified stock options, incentive stock options and restricted stock are granted to employees and non-employee directors. The Company issues new shares of common stock upon exercise of stock options. Under the terms of the Company s stock option plans, employees and directors may be granted options to purchase the Company s common stock at the market price on the date the option is granted. Under these stock option plans, stock options granted at less than the fair value on the date of grant and stock options granted to non-employee directors are deemed to be non-qualified stock options rather than incentive stock options.

The Company maintains the 1992 Stock Incentive Plan, as amended ( 1992 Plan ) and the Amended and Restated Directors Stock Option Plan (the Directors Plan ) under which non-qualified stock options and incentive stock options were granted to employees and non-employee directors through October 2002. Employee options were generally designated to vest over a five-year period while director options became exercisable nine months after the grant date. Vested options are generally exercisable for ten years from the date of grant. Although the 1992 Plan and the Directors Plan both expired in October 2002, preventing further option grants, the provisions of these plans remain in effect until all options are terminated or exercised.

The Company s shareholders approved the 2002 Stock Option Plan ( 2002 Plan ) in May 2002. The 2002 Plan provides for granting of non-qualified stock options and incentive stock options to employees, non-employee directors and independent consultants or advisors. The compensation committee of the board of directors administers the 2002 Plan, determining the grantees, the number of shares of common stock for which the options are exercisable, and the exercise prices of such shares, among other terms and conditions. Under the 2002 Plan, options granted to employees of the Company through December 31, 2008 were designated to vest over a five-year period, while options granted to the Company s directors in each year from 2002 through 2005 became exercisable six months following the grant date. Options were granted at an exercise price equal to fair market value of the underlying common stock on the grant date and terminate on the tenth anniversary of the grant date. Options granted in 2006 to the Company s directors (excluding the A-B designated directors) were at an exercise price less than the fair market value of the underlying common stock on the grant date. These options were immediately exercisable and each grantee exercised the option on the day of the grant. The maximum number of shares of common stock for which options may be granted during the term of the 2002 Plan is 346,000. As of December 31, 2008, the 2002 Plan had 100,259 shares available for future grants of options.

The 2007 Plan was adopted by the board of directors and approved by the shareholders in May 2007. The 2007 Plan provides for stock options, restricted stock, restricted stock units, performance awards and stock appreciation rights. While incentive stock options may only be granted to employees, awards other than incentive stock options may be granted to employees and directors. The 2007 Plan is administered by the compensation committee of the board of directors. A maximum of 100,000 shares of common stock are authorized for issuance under the 2007 Plan. As of December 31, 2008, the 2007 Plan had 71,240 shares available for future grants of stock-based awards.

***Stock-Based Compensation Expense***

As discussed above, the Company granted common shares to its independent, non-employee directors during the second quarters of 2008 and 2007, respectively, and common shares to certain of its executive officers during the

second quarter of 2007. As the grants were fully vested, the Company recognized stock-based compensation of $20,000 and $169,000 in its statements of operations during the years ended December 31, 2008 and 2007, respectively. See *Issuance of Common Stock* above for further details.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

***Stock Option Plan Activity***

Presented below is a summary of the Company s stock option plan activity:

| | Options (In thousands) | Weighted Average Exercise Price (Per share) | Weighted Average Remaining Contractual Life (In years) | Aggregate Intrinsic Value (In thousands) |
|---|---|---|---|---|
| Outstanding at January 1, 2008 | 689 | $ 2.57 | 3.33 | $ 2,809 |
| Granted | | | | |
| Exercised | (228) | | | |
| Canceled | (30) | | | |
| Outstanding at December 31, 2008 | 431 | $ 2.61 | 2.36 | $ |
| Exercisable at December 31, 2008 | 431 | $ 2.61 | 2.36 | $ |

The aggregate intrinsic value of the outstanding stock options is calculated as the difference between the stock closing price as reported by Nasdaq as of the last day of the period and the exercise price of the shares. The applicable stock closing prices as of December 31, 2008 and 2007 were $1.20 and $6.65 per share, respectively. For December 31, 2008 and 2007, there was no unrecognized stock-based compensation expense related to unvested stock options. The total intrinsic value of stock options exercised in 2008 and 2007 was $380,000 and $168,000, respectively. No options vested in 2008 or 2007.

The following table summarizes information for options outstanding and exercisable at December 31, 2008:

| | Outstanding and Exercisable | | |
|---|---|---|---|
| Range of Exercise Prices | Options (In thousands) | Weighted Average Remaining Contractual Life (In years) | Weighted Average Exercise Price (Per share) |
| $1.49 to $2.00 | 178 | 2.56 | $ 1.86 |
| $2.01 to $3.00 | 106 | 3.89 | $ 2.11 |

| | | | |
|---|---|---|---|
| $3.01 to $3.97 | 147 | 1.04 | $ 3.88 |
| $1.49 to $3.97 | 431 | 2.36 | $ 2.61 |

## 12. Loss on Impairment of Assets

The components of the loss on impairment of assets for the year ended December 31, 2008 are as follows:

| **Asset Category** | **Year Ended December 31, 2008 (In thousands)** |
|---|---|
| Goodwill | $ 22,689 |
| Trademark | 6,500 |
| Equity investments | 1,400 |
| Loss on impairment of assets | $ 30,589 |

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

Due to a combination of factors, including the U.S. economic environment, particularly during the fourth quarter of 2008, the Company s expectations of a follow-on impact on consumer demand, the increase in competition from both other craft and specialty brewers and the fuller-flavored offerings from the national domestic brewers, and the Company s plans for the near and medium term, the Company believed that impairments may have occurred to certain of its assets acquired in the Merger.

In performing the second step of the Company s analysis of the fair value of its goodwill asset in accordance with SFAS 142, the Company based its estimates on the income methodology, a market methodology and a transactional methodology, weighting each on a probability assessment. The income methodology employed a discounted cash flow valuation model, using the Company s projections of future revenue growth and operating profitability. The discounted cash flow model incorporates the Company s estimates of future cash flows, future growth rates and management s judgment regarding the applicable discount rates used to discount those estimated cash flows. The market methodology compared the market capitalization of other publicly traded regional and national brewing companies against their revenues and EBITDA to derive a market capitalization multiple. This multiple was applied against the Company s forecasted EBITDA. The transactional methodology compared revenues and specified earnings multiples on recent merger transactions involving a similarly situated specialty brewer to derive an estimated revenue multiple to apply against the Company s revenue projections. The analysis resulted in a complete impairment of the Company s goodwill balance. Given that certain of these inputs are unobservable, management assessed this to be a level 3 measurement within the hierarchy established by SFAS 157.

In performing its analysis of the fair value of its intangible trademark asset in accordance with SFAS 142, the Company based its estimates of fair value on an income methodology using a discounted cash flow valuation model under a relief from royalty methodology. The relief from royalty model incorporates the Company s estimates of the royalty rate that a market participant would assume, projections of future revenues and the Company s judgment regarding the applicable discount rates used to discount those estimated cash flows. The analysis resulted in a partial impairment of the Company s Widmer brand trademark. Given that certain of these inputs are unobservable, management assessed this to be a level 3 measurement within the hierarchy established by SFAS 157.

In performing its analysis of the fair values of its equity investments in accordance with APB 18, the Company based its estimates on an income methodology using a discounted cash flow valuation model. The discounted cash flow model incorporates the Company s estimates of 1) the future cash flows associated with the investments, 2) future growth rates for those entities and 3) the applicable discount rates used to discount those estimated cash flows. The analysis resulted in a partial impairment of the Company s equity investment in FSB of $1.3 million and its equity investment in Kona of $100,000. Given that certain of these inputs are unobservable, management assessed this to be a level 3 measurement within the hierarchy established by SFAS 157.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

## 13. Loss per Share

The following table sets forth the computation of basic and diluted loss per common share:

| | Year Ended December 31, 2008 | Year Ended December 31, 2007 |
|---|---|---|
| | (In thousands, except per share amounts) | |
| Numerator for basic and diluted net loss per share: | | |
| Net loss | $ (33,278) | $ (939) |
| Denominator for basic and diluted net loss per share: | | |
| Weighted average common shares outstanding | 12,660 | 8,331 |
| Basic and diluted net loss per share | $ (2.63) | $ (0.11) |

Certain Company stock options were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of the common shares, or the impact of their inclusion would be antidilutive. Such stock options, with prices ranging from $1.49 to $3.97 per share at December 31, 2008 and from $1.49 to $5.73 per share at December 31, 2007, averaged 569,000 and 720,000 for the years ended December 31, 2008 and 2007, respectively.

## 14. Income Taxes

The components of income tax expense (benefit) are as follows:

| | Year Ended December 31, 2008 | Year Ended December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Current | $ 23 | $ 48 |
| Deferred | (4,400) | (224) |
| Income tax benefit | $ (4,377) | $ (176) |

Current tax expense is attributable to state taxes and the federal alternative minimum tax ( AMT ). The Company paid income, equity and franchise taxes totaling $47,000 and $53,000 for the years ended December 31, 2008 and 2007,

respectively.

The income tax benefit differs from the amount computed by applying the statutory federal income tax rate to the loss before income taxes. The sources and tax effects of the differences are as follows:

| | Year Ended December 31, 2008 | Year Ended December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Benefit at U.S. statutory rate | $ (12,803) | $ (379) |
| State taxes, net of federal benefit | (418) | (25) |
| Permanent differences, primarily meals and entertainment | 130 | 80 |
| Loss on impairment of assets | 7,714 | |
| Merger expenses | | 148 |
| Valuation allowance | 1,000 | |
| Income tax benefit | $ (4,377) | $ (176) |

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

The income tax benefit for the year ended December 31, 2008 was affected by the loss on impairment of assets but the taxable loss for the year was not as the goodwill asset was recognized for financial statement purposes only and did not have a tax basis.

Significant components of the Company s deferred tax liabilities and assets are as follows:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (In thousands) | |
| Deferred tax liabilities: | | |
| Property, equipment and leasehold improvements | $ 10,815 | $ 9,059 |
| Intangible assets | 4,789 | |
| Equity investments | 1,133 | |
| Other | 269 | |
| Total deferred tax liabilities | 17,006 | 9,059 |
| Deferred tax assets: | | |
| Net operating losses and AMT credit carryforwards | 10,372 | 8,781 |
| Accrued salaries and severance | 834 | 335 |
| Other | 1,015 | 184 |
| Valuation allowance | (1,000) | (1,059) |
| Total deferred tax assets | 11,221 | 8,241 |
| Net deferred tax liability | $ 5,785 | $ 818 |
| As Presented on the Balance Sheet: | | |
| Long-term deferred income tax liability, net | $ 6,552 | $ 1,762 |
| Current deferred income tax asset, net | 767 | 944 |
| | $ 5,785 | $ 818 |

As of December 31, 2008, the Company s deferred tax assets were primarily comprised of federal net operating loss carryforwards ( NOLs ) of $29.1 million, or $9.9 million tax-effected; state NOL carryforwards of $299,000 tax-effected; and federal and state AMT credit carryforwards of $183,000 tax-effected. In assessing the realizability of its deferred tax assets, the Company considered both positive and negative evidence when measuring the need for a valuation allowance. The ultimate realization of deferred tax assets is dependent upon the existence of, or generation of, taxable income during the periods in which those temporary differences become deductible. Among other factors, the Company considered future taxable income generated by the projected differences between financial statement depreciation and tax depreciation, including the depreciation of the assets acquired in the Merger. Based upon this, the

Company determined that its previously established valuation allowance of approximately $1.1 million was no longer required, and recorded the release of the valuation allowance against goodwill as of the date of the Merger.

At December 31, 2008, based upon the available evidence and due to the Company s taxable loss for the current year exceeding its preliminary projections, the Company believes that it is more likely than not that certain deferred tax assets will not be realized. As a result, the Company recorded a valuation allowance of $1.0 million recorded as a reduction of the tax benefit for the year ended December 31, 2008. To the extent that the Company continues to be unable to generate adequate taxable income in future periods, the Company may not be able to recognize additional tax benefits and may be required to increase the valuation allowance to provide for potentially expiring NOLs for which a valuation allowance has not been previously recorded.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

There were no unrecognized tax benefits as of December 31, 2008 or 2007. The Company does not anticipate significant changes to its unrecognized tax benefits within the next twelve months.

Tax years that remain open for examination by the Internal Revenue Service ( IRS ) include the years from 2005 through 2008. In addition, tax years from 1997 to 2004 may be subject to examination by the IRS and state tax jurisdictions to the extent that the Company utilizes the NOLs from those years in its current or future tax returns.

## 15. Employee Benefit Plan

The Company sponsors a defined contribution or 401(K) plan for all employees 18 years or older. Employee contributions may be made on a before-tax basis, limited by IRS regulations. The Company matches the employee s contribution up to 4% of eligible compensation; however the Company s match is on a discretionary basis. Eligibility for the matching contribution begins after the participant has worked a minimum of three months. The Company s matching contributions to the plan vest ratably over five years of service by the employee. The Company s matching contributions to the plan for participants totaled $445,000 and $216,000 for the years ended December 31, 2008 and 2007, respectively.

## 16. Commitments

The Company leases office space, restaurant and production facilities, warehouse and storage facilities, land and equipment under operating leases that expire at various dates through the year ending December 31, 2047. Certain leases contain renewal options for varying periods and escalation clauses for adjusting rent to reflect changes in price indices. Certain leases require the Company to pay for insurance, taxes and maintenance applicable to the leased property. Under the terms of the land lease for the New Hampshire Brewery, the Company holds a first right of refusal to purchase the property should the lessor decide to sell the property.

Included in the lease obligations described above are contracts with lessors whose members include related parties to the Company. These contracts were assumed by the Company as a result of the Merger. The Company leases its headquarters office space, restaurant and storage facilities located in Portland, land and certain equipment from two limited liability companies, both of whose members include the Company s current Board Chair and a nonexecutive officer of the Company. Lease payments to these lessors totaled $55,000 for the year ended December 31, 2008. No amounts were paid by the Company to these lessors during the year ended December 31, 2007. The Company is responsible for taxes, insurance and maintenance associated with these leases. The lease for the headquarters office space and restaurant facility expires in 2034, with an extension at the Company s option for two 10-year periods, while the lease for the other facilities, land and equipment expires in 2017 with an extension at the Company s option for two five-year periods. Rental payments under the leases are adjusted each year to reflect increases in the Consumer Price Index. The rent during an extension period, if applicable, will be established at fair market levels at the beginning of each period. The Company holds a right to purchase the headquarters office space and restaurant facility at the greater of $2.0 million or the fair market value of the property as determined by a contractually established appraisal method. The right to purchase is not valid in the final year of the lease term or in each of the final years of the renewal terms, as applicable.

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

Minimum aggregate future lease payments under non-cancelable operating leases as of December 31, 2008 are as follows:

| | (In thousands) |
|---|---|
| 2009 | $ 580 |
| 2010 | 574 |
| 2011 | 516 |
| 2012 | 423 |
| 2013 | 422 |
| Thereafter | 12,490 |
| | $ 15,005 |

Rent expense under all operating leases, including short-term rentals as well as cancelable and noncancelable operating leases, totaled $1.9 million and $686,000 for the years ended December 31, 2008 and 2007, respectively.

The Company leases corporate office space to an unrelated party. The lease agreement expires in 2009. The Company recognized rental income of $193,000 for the years ended December 31, 2008 and 2007. Total future minimum lease rentals under the agreement are $193,000.

The Company periodically enters into commitments to purchase certain raw materials in the normal course of business. Furthermore, the Company has entered into purchase commitments and commodity contracts to ensure it has the necessary supply of malt and hops to meet future production requirements. Certain of the malt and hop commitments are for crop years through 2013. The Company believes that malt and hop commitments in excess of future requirements, if any, will not have a material impact on its financial condition or results of operations. The Company may take delivery of the commodities in excess of or make payments against the purchase commitments earlier than contractually obligated, which means the Company s cash outlays in any particular year may exceed the commitment amount disclosed.

The Company has entered into several multi-year sponsorship and promotional commitments with certain professional sports teams and entertainment companies, including certain contracts that were assumed as a result of the merger with Craft Brands. Generally, in exchange for its sponsorship consideration, the Company posts signage and provides other promotional materials at the site or the event. In certain instances, the Company is granted an exclusive right to provide the craft beer products at the site or event. The terms of these sponsorship commitments expire at various dates through the year ending December 31, 2011.

Aggregate payments under unrecorded, unconditional purchase and sponsorship commitments as of December 31, 2008 are as follows:

**Total Noncancelable Commitments**

| | Purchase Obligations | Sponsorship Obligations (In thousands) | Total |
|---|---|---|---|
| 2009 | $ 9,038 | $ 293 | $ 9,331 |
| 2010 | 10,732 | 247 | 10,979 |
| 2011 | 1,834 | 94 | 1,928 |
| 2012 | 1,522 | | 1,522 |
| 2013 | 1,356 | | 1,356 |
| | $ 24,482 | $ 634 | $ 25,116 |

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

## 17. Related-Party Transactions

For the years ended December 31, 2008 and 2007, sales to A-B through the amended A-B Distribution Agreement totaled $62.4 million and $18.9 million, respectively, which represented 72.5% and 40.6%, respectively, of the Company s sales for the corresponding period.

For all sales made pursuant to the amended A-B Distribution Agreement, the Company pays A-B certain fees, described in further detail below. A Margin fee applies to all product sales, except for sales to the Company s retail operations, pubs and restaurants, dock sales and for sales prior to the Merger, the Company s sales made to Craft Brands, which paid a comparable fee on its resale of the product. The Company also pays an additional fee for any shipments that exceed shipment levels as established in the amended A-B Distribution Agreement ( Additional Margin ). For the years ended December 31, 2008 and 2007, the Company paid a total of $3.1 million and $1.0 million, respectively, related to the Margin and Additional Margin. These fees are reflected as a reduction of sales in the Company s statements of operations.

Also included in the amended A-B Distribution Agreement are fees associated with administration and handling, including invoicing costs, staging costs, cooperage handling charges and inventory manager fees. These fees totaled approximately $205,000 and $150,000 for the years ended December 31, 2008 and 2007, respectively, and are reflected in cost of sales in the Company s statements of operations.

In certain instances, the Company may ship its product to A-B wholesaler support centers rather than directly to the wholesaler. Wholesaler support centers consolidate small wholesaler orders for the Company s products with orders of other A-B products prior to shipping to the wholesaler. A wholesaler support center fee for these shipments totaled $179,000 and $171,000 for the years ended December 31, 2008 and 2007, respectively, and is charged to cost of sales in the Company s statements of operations.

Under a separate agreement, the Company purchased certain materials, primarily bottles and other packaging materials, through A-B totaling $17.1 million and $9.6 million in 2008 and 2007, respectively. During 2008, the Company paid A-B amounts totaling $989,000 for media purchases and advertising services.

The Company entered into a purchase and sale agreement with A-B for the purchase of the *Pacific Ridge* brand, trademark and related intellectual property. In consideration, the Company agreed to pay A-B an annual royalty based upon the Company s shipments of this brand, expiring in 2023. Royalties of $71,000 are reflected in cost of sales in the Company s statements of operations for each of the years ended December 31, 2008 and 2007.

In connection with the shipment of its draft products per the amended A-B Distribution Agreement, the Company collects refundable deposits on its kegs from A-B s wholesalers. As these wholesalers generally hold an inventory of the Company s kegs at their warehouse and in retail establishments, A-B assists in monitoring the inventory of kegs received by its wholesalers. The wholesaler pays a flat fee to the Company for each keg determined to be lost and also forfeits the deposit. For the years ended December 31, 2008 and 2007, the Company reduced its brewery equipment by $770,000 and $716,000, respectively, for amounts received in lost keg fees and forfeited deposits.

During 2007 and up to the date of the Merger, the Company periodically leased kegs from A-B pursuant to a separate agreement. Lease and handling fees of $40,000 and $88,000 are reflected in cost of sales for the years ended

December 31, 2008 and 2007, respectively.

As of December 31, 2008 and 2007, net amounts due to A-B of $2.3 million and from A-B of $1.1 million, respectively, were outstanding.

The Company sold and shipped *Widmer Hefeweizen* under several contracts with Widmer prior to the Merger. One of these contracts was a licensing arrangement under which the Company sold this product in the Midwest and Eastern United States. The licensed product was brewed at the New Hampshire Brewery under

**Craft Brewers Alliance, Inc.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

the supervision and direction of Widmer s brewing staff to insure their brand quality and matching taste profile. The Company shipped 12,500 barrels and 28,800 barrels of *Widmer Hefeweizen* during the years ended December 31, 2008 and 2007, respectively. A licensing fee of $165,000 and $432,000 paid to Widmer is reflected in the Company s statements of operations for the years ended December 31, 2008 and 2007, respectively. The Company also brewed and shipped 31,000 barrels and 81,900 barrels of Widmer draft and bottled product under a contract brewing arrangement with Widmer during the years ended December 31, 2008 and 2007, respectively. The Company recognized contract brewing revenues of $3.0 million and $7.4 million received from Widmer, which are reflected in the Company s statements of operations for the years ended December 31, 2008 and 2007, respectively. These arrangements, along with all other agreements between Widmer and the Company, terminated on the effective date of the Merger.

As of December 31, 2007, the net amount due from Widmer was $93,000.

The Company has entered into several lease arrangements with lessors whose members include related parties to the Company. See discussion at Note 16, Commitments for further details regarding these lease arrangements.

For the year ended December 31, 2008, the Company earned alternative proprietorship fees of $2.4 million by leasing the Oregon Brewery to Kona and $3.4 million by selling raw materials and packaging products to Kona. These fees are recorded as sales revenues in the Company s statement of operations for the period.

At December 31, 2008 the net amount due from Kona was $1.1 million and net amount due to FSB was $1.0 million. No amounts were due to either entity at December 31, 2007. See discussion at Note 7 for further details.

At December 31, 2008, the Company had outstanding receivables due from Kona Brewing Co. ( KBC ) of $107,000. KBC and the Company are the only members of Kona.

## Item 9. *Changes In and Disagreements With Accountants on Accounting and Financial Disclosure*

None.

## Item 9A(T). *Controls and Procedures*

### Disclosure Controls and Procedures

The Company s management, including the Chief Executive Officer and the Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) or 15d-15(e)) as of the end of the period covered by this Report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective at the reasonable assurance level.

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms promulgated by the Securities and Exchange Commission ( SEC ) and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management believes that key controls are in place and the disclosure controls are functioning effectively at the reasonable assurance level as of December 31, 2008.

While reasonable assurance is a high level of assurance, it does not mean absolute assurance. Disclosure controls and internal control over financial reporting cannot prevent or detect all errors, misstatements or fraud. In addition, the design of a control system must recognize that there are resource constraints, and the costs associated with controls must be proportionate to their costs. Notwithstanding these limitations, the Company s management believes that its disclosure controls and procedures provide reasonable assurance that the objectives of its control system are being met.

### Changes in Internal Control Over Financial Reporting

During the fourth quarter of 2008, no changes in the Company s internal control over financial reporting were identified in connection with the evaluation required by Exchange Act Rule 13a-15 or 15d-15 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

### Report of Management on Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting in accordance with Exchange Act Rule 13a-15(f). The Company s internal control system was designed to provide reasonable assurance to the Company s management and Board of Directors regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of the Company s financial statements would be prevented or detected.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting based on the framework and criteria established in *Internal Control Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company s internal control over financial reporting was effective as of December 31, 2008, at the reasonable assurance level.

This annual report does not include an attestation report of the Company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to temporary rules of the SEC that permit the Company to provide only management s report in this annual report.

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**Item 9B.** ***Other Information***

None.

## PART III

**Item 10.** ***Directors, Executive Officers and Corporate Governance***

The response to this Item is contained in part in the Company s definitive proxy statement for its 2009 Annual Meeting of Stockholders to be held on May 29, 2009 (the 2009 Proxy Statement ) under the captions Board of Directors, Audit Committee, and Section 16(a) Beneficial Ownership Reporting Compliance, and the information contained therein is incorporated herein by reference.

Information regarding executive officers is set forth herein in Part I, under the caption Executive Officers of the Company.

**Code of Conduct**

The Company has adopted a Code of Conduct (code of ethics) applicable to all employees, including the principal executive officer, principal financial officer, principal accounting officer and directors. This, as well as the charters of each of the Board committees, are posted on the Company s website at www.Craftbrewers.com (select Investor Relations Governance Highlights). Copies of these documents are available to any shareholder who requests them. Such requests should be directed to Investor Relations, Craft Brewers Alliance, Inc., 929 N. Russell Street, Portland, OR 97227. Any waivers of the code of ethics for the Company s directors or executive officers are required to be approved by the Board of Directors. The Company will disclose any such waivers on a current report on Form 8-K within four business days after the waiver is approved.

**Item 11.** ***Executive Compensation***

The response to this Item is contained in the 2009 Proxy Statement under the captions Executive Compensation, Director Compensation and Compensation Committee and the information contained therein is incorporated herein by reference.

**Item 12.** ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following is a summary as of December 31, 2008 of all of the Company s plans that provide for the issuance of equity securities as compensation. See Note 11 to the Financial Statements Common Stockholders Equity for additional discussion.

| | Number to be Issued Upon Exercise of Outstanding | Weighted Average Exercise Price of Outstanding | Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities |
|---|---|---|---|

| Plan Category | Options and Rights (a) | | Options and Rights (b) | Reflected in Column (a))(c) |
|---|---|---|---|---|
| Equity compensation plans approved by security holders | 430,790 | $ | 2.61 | 171,499 |
| Equity compensation plans not approved by security holders | | | | |
| Total | 430,790 | $ | 2.61 | 171,499 |

The remaining response to this Item is contained in part in the 2009 Proxy Statement under the caption Security Ownership of Certain Beneficial Owners and Management, and the information contained therein is incorporated herein by reference.

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**Item 13.** ***Certain Relationships and Related Transactions, and Director Independence***

The response to this Item is contained in the 2009 Proxy Statement under the caption Related Person Transactions and Board of Directors Director Independence and the information contained therein is incorporated herein by reference.

**Item 14.** ***Principal Accountant Fees and Services***

The response to this Item is contained in the 2009 Proxy Statement under the caption Proposal No. 2 Ratification of Appointment of Independent Registered Public Accounting Firm and the information contained therein is incorporated herein by reference.

**PART IV**

**Item 15.** ***Exhibits and Financial Statement Schedules***

**(a) The following documents are filed as part of this report:**

**1. Audited Financial Statements**


| | **Page** |
|---|---|
| Report of Moss Adams LLP, Independent Registered Public Accountants | 49 |
| Balance Sheets as of December 31, 2008 and 2007 | 50 |
| Statements of Operations for the Years Ended December 31, 2008 and 2007 | 51 |
| Statements of Common Stockholders Equity for the Years Ended December 31, 2008 and 2007 | 52 |
| Statements of Cash Flows for the Years Ended December 31, 2008 and 2007 | 53 |
| Notes to Financial Statements | 54 |


**2. Exhibits**

Exhibits are listed in the Exhibit Index that appears immediately following the signature page of this report and is incorporated herein by reference, and are filed or incorporated by reference as part of this Annual Report on Form 10-K.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in Portland, Oregon, on March 25, 2009.

**Craft Brewers Alliance, Inc.**

By: /s/ JOSEPH K. O BRIEN

Joseph K. O Brien
*Controller and Chief Accounting Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ Terry E. Michaelson<br>Terry E. Michaelson | Chief Executive Officer<br>(Principal Executive Officer) | March 25, 2009 |
| /s/ Mark D. Moreland<br>Mark D. Moreland | Chief Financial Officer and Treasurer<br>(Principal Financial Officer) | March 25, 2009 |
| /s/ Joseph K. O Brien<br>Joseph K. O Brien | Controller<br>(Principal Accounting Officer) | March 25, 2009 |
| /s/ Kurt R. Widmer<br>Kurt R. Widmer | Chairman of the Board and Director | March 25, 2009 |
| /s/ Timothy P. Boyle<br>Timothy P. Boyle | Director | March 25, 2009 |
| /s/ Andrew R. Goeler<br>Andrew R. Goeler | Director | March 25, 2009 |
| /s/ Kevin R. Kelly<br>Kevin R. Kelly | Director | March 25, 2009 |

| | | |
|---|---|---|
| /s/ David R. Lord | Director | March 25, 2009 |
| David R. Lord | | |
| /s/ John D. Rogers, Jr. | Director | March 25, 2009 |
| John D. Rogers, Jr. | | |
| | Director | |
| Anthony J. Short | | |

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## Exhibit Index

| Exhibit Number | Description |
| --- | --- |
| 2.1 | Agreement and Plan of Merger between the Registrant and Widmer Brothers Brewing Company, dated November 13, 2007, as amended by Amendment No. 1 dated April 30, 2008 and Amendment No. 2 dated May 13, 2008 (incorporated by reference from Annex A to the Registrant s Registration Statement on Form S-4, No. 333-149908) |
| 3.1 | Restated Articles of Incorporation of the Registrant, dated July 1, 2008 (incorporated by reference from Exhibit 3.1 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |
| 3.2 | Amended and Restated Bylaws of the Registrant, dated July 1, 2008 (incorporated by reference from Exhibit 3.2 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |
| 10.1* | Amended and Restated Directors Stock Option Plan (incorporated by reference from Exhibit 10.14 to the Registrant s Registration Statement on Form S-1, No. 33-94166) |
| 10.2* | Amendment dated as of February 27, 1996 to Amended and Restated Directors Stock Option Plan (incorporated by reference from Exhibit 10.32 to the Registrant s Form 10-Q for the quarter ended June 30, 1996 (File No. 0-26542) ( 1996 Form 10-Q )) |
| 10.3* | Form of Stock Option Agreement for the Directors Stock Option Plan (incorporated by reference from Exhibit 10.4 to the Registrant s Form 10-K for the year ended December 31, 2004) |
| 10.4* | 1992 Stock Incentive Plan, approved October 20, 1992, as amended October 11, 1994 and May 25, 1995 (incorporated by reference from Exhibit 10.16 to the Registrant s Registration Statement on Form S-1, No. 33-94166) |
| 10.5* | Amendment dated as of February 27, 1996 to the 1992 Stock Incentive Plan, as amended (incorporated by reference from Exhibit 10.31 to the 1996 Form 10-Q) |
| 10.6* | Amendment dated as of July 25, 1996 to 1992 Stock Incentive Plan, as amended (incorporated by reference from Exhibit 10.33 to the 1996 Form 10-Q) |
| 10.7* | Form of Incentive Stock Option Agreement for the 1992 Stock Incentive Plan, as amended (incorporated by reference from Exhibit 10.8 to the Registrant s Form 10-K for the year ended December 31, 2004) |
| 10.8* | 2002 Stock Option Plan (incorporated by reference from Exhibit A to the Registrant s Proxy Statement for its 2002 Annual Meeting of Shareholders (File No. 0-26542) |
| 10.9* | Form of Stock Option Agreement (Directors Grants) for the 2002 Stock Option Plan (incorporated by reference from Exhibit 10.10 to the Registrant s Form 10-K for the year ended December 31, 2004) |
| 10.10* | Form of Nonqualified Stock Option Agreement (Executive Officer Grants) for the 2002 Stock Option Plan |
| 10.11* | 2007 Stock Incentive Plan (incorporated by reference from Appendix B to the Registrant s Proxy Statement for its 2007 Annual Meeting of Shareholders) |
| 10.12* | Amended and Restated Employment Agreement between the Registrant and Paul S. Shipman, dated February 13, 2008 (incorporated by reference from Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on February 19, 2008) |
| 10.13* | Letter of agreement between the Registrant and David Mickelson dated June 30, 2008 (incorporated by reference from Exhibit 10.4 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |
| 10.14* | Amended and Restated Letter of Agreement between the Registrant and Terry E. Michaelson dated March 12, 2009 (incorporated by reference from Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on March 25, 2009) |
| 10.15* | Amended and Restated Letter of Agreement between the Registrant and Mark D. Moreland dated March 12, 2009 (incorporated by reference from Exhibit 10.2 to the Registrant s Current Report on |

| | |
|---|---|
| | Form 8-K filed on March 25, 2009) |
| 10.16* | Letter of agreement between the Registrant and Timothy G. McFall dated June 30, 2008 (incorporated by reference from Exhibit 10.6 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |

| Exhibit Number | Description |
|---|---|
| 10.17* | Amended and Restated Letter of Agreement between the Registrant and V. Sebastian Pastore dated March 12, 2009 (incorporated by reference from Exhibit 10.3 to the Registrant s Current Report on Form 8-K filed on March 25, 2009) |
| 10.18* | Amended and Restated Letter of Agreement between the Registrant and Martin J. Wall, IV dated March 12, 2009 (incorporated by reference from Exhibit 10.4 to the Registrant s Current Report on Form 8-K filed on March 25, 2009) |
| 10.19* | Employment Agreement between the Registrant and Kurt Widmer dated June 30, 2008 (incorporated by reference from Exhibit 10.2 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |
| 10.20* | Employment Agreement between the Registrant and Robert Widmer dated June 30, 2008 (incorporated by reference from Exhibit 10.9 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |
| 10.21* | Non-Competition and Non-Solicitation Agreement dated June 30, 2008 between the Registrant and Kurt Widmer (incorporated by reference from Exhibit 10.10 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |
| 10.22* | Non-Competition and Non-Solicitation Agreement dated June 30, 2008 between the Registrant and Robert Widmer (incorporated by reference from Exhibit 10.11 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |
| 10.23* | Summary of Compensation Arrangements for Non-Employee Directors |
| 10.24* | Form of Lock-Up Agreement with Kurt Widmer, Robert Widmer and Terry Michaelson (incorporated by reference from Exhibit B to the Agreement and Plan of Merger dated November 13, 2007, between the Registrant and Widmer Brothers Brewing Company, which was filed as Exhibit 2.1 to the Registrant s Current Report on Form 8-K filed on November 13, 2007) |
| 10.25 | Services Agreement dated January 1, 2009 between the Registrant and Kona Brewery LLC |
| 10.26 | Sublease between Pease Development Authority as Sublessor and the Registrant as Sublessee, dated May 30, 1995 (incorporated by reference from Exhibit 10.11 to the Registrant s Registration Statement on Form S-1, No. 33-94166) |
| 10.27 | Assignment of Sublease and Assumption Agreement dated as of July 1, 1995, between the Registrant and CBA of New Hampshire, Inc. (incorporated by reference from Exhibit 10.24 to the Registrant s Registration Statement on Form S-1, No. 33-94166) |
| 10.28 | Loan Agreement dated as of July 1, 2008 between Registrant and Bank of America, N.A. (incorporated by reference from Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on July 7, 2008) |
| 10.29 | Loan Modification Agreement dated November 14, 2008 to Loan Agreement dated July 1, 2008 between Registrant and Bank of America, N.A. (incorporated by reference from Exhibit 10.1 to the Registrant s Form 10-Q for the quarter ended September 30, 2008) |
| 10.30 | Exchange and Recapitalization Agreement dated as of June 30, 2004 between the Registrant and Anheuser-Busch, Incorporated (incorporated by reference from Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on July 2, 2004) |
| 10.31 | Master Distributor Agreement dated as of July 1, 2004 between the Registrant and Anheuser-Busch, Incorporated (incorporated by reference from Exhibit 10.2 to the Registrant s Current Report on Form 8-K filed on July 2, 2004) |
| 10.32 | Registration Rights Agreement dated as of July 1, 2004 between the Registrant and Anheuser-Busch, Incorporated (incorporated by reference from Exhibit 10.3 to the Registrant s Current Report on Form 8-K filed on July 2, 2004) |
| 10.33 | Consent and Amendment dated as of July 1, 2008 among the Registrant, Widmer Brothers Brewing Company, Craft Brands Alliance LLC, and Anheuser-Busch, Incorporated (incorporated by reference from Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on July 2, 2008) |

10.34 Master Lease Agreement dated as of June 6, 2007 between Banc of America Leasing & Capital, LLC and Widmer Brothers Brewing Company (incorporated by reference to Exhibit 10.2 from Amendment No. 1 to the Registrant s Registration Statement on Form S-4, No. 333-149908 filed on May 1, 2008 ( S-4 Amendment No. 1 ))

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| Exhibit Number | Description |
|---|---|
| 10.35 | Amended and Restated License Agreement dated as of February 28, 1997 between Widmer Brothers Brewing Company and Widmer s Wine Cellars, Inc. and Canandaigua Wine Company, Inc. (incorporated by reference to Exhibit 10.3 from the S-4 Amendment No. 1) |
| 10.36 | Restated Lease dated as of January 1, 1994 between Smithson & McKay Limited Liability Company and Widmer Brothers Brewing Company (incorporated by reference to Exhibit 10.4 from the S-4 Amendment No. 1) |
| 10.37 | Commercial Lease (Restated) dated as of December 18, 2007 between Widmer Brothers LLC and Widmer Brothers Brewing Company (incorporated by reference to Exhibit 10.5 from the S-4 Amendment No. 1) |
| 10.38 | Amended and Restated Continental Distribution and Licensing Agreement between the Registrant and Kona Brewing LLC dated March 26, 2009 |
| 23.1 | Consent of Moss Adams LLP, Independent Registered Public Accounting Firm |
| 31.1 | Certification of Chief Executive Officer of Craft Brewers Alliance, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer of Craft Brewers Alliance, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer of Craft Brewers Alliance, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer of Craft Brewers Alliance, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

* Denotes a management contract or a compensatory plan or arrangement.

Confidential treatment has been requested with respect to portions of this exhibit. A complete copy of the agreement, including the redacted terms, has been separately filed with the Securities and Exchange Commission

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