

CRAFT BREW ALLIANCE, INC.
Form 10-Q
August 08, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period Ended June 30, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 0-26542

CRAFT BREW ALLIANCE, INC.
(Exact name of registrant as specified in its charter)

Washington 91-1141254
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

929 North Russell Street
Portland, Oregon 97227
(Address of principal executive offices)

(503) 331-7270
(Registrant's telephone number, including Area Code)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. (See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act).

Check one:

Large Accelerated Filer

Non-accelerated Filer (Do not check if a smaller reporting company)

Accelerated Filer
Smaller Reporting
Company
Emerging Growth
Company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of the registrant's common stock outstanding as of August 2, 2018 was 19,362,600.

CRAFT BREW ALLIANCE, INC.
INDEX TO FORM 10-Q

| | Page |
|---|-----------|
| PART I - FINANCIAL INFORMATION | |
| Item 1. Financial Statements | |
| <u>Consolidated Balance Sheets (unaudited) – June 30, 2018 and December 31, 2017</u> | <u>2</u> |
| <u>Consolidated Statements of Operations (unaudited) - Three and Six Months Ended June 30, 2018 and 2017</u> | <u>3</u> |
| <u>Consolidated Statements of Comprehensive Income (Loss) (unaudited) – Three and Six Months Ended June 30, 2018 and 2017</u> | <u>4</u> |
| <u>Consolidated Statements of Cash Flows (unaudited) - Six Months Ended June 30, 2018 and 2017</u> | <u>5</u> |
| <u>Notes to Consolidated Financial Statements (unaudited)</u> | <u>6</u> |
| Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>17</u> |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>28</u> |
| Item 4. <u>Controls and Procedures</u> | <u>29</u> |
| PART II OTHER INFORMATION | |
| Item 1. <u>Legal Proceedings</u> | <u>30</u> |
| Item 1A. <u>Risk Factors</u> | <u>30</u> |
| Item 6. <u>Exhibits</u> | <u>30</u> |
| <u>Signature</u> | <u>31</u> |

Index

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CRAFT BREW ALLIANCE, INC.
CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except per share amounts)

| | June 30, 2018 | December 31, 2017 |
|---|------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash, cash equivalents and restricted cash | \$5,778 | \$ 579 |
| Accounts receivable, net | 36,999 | 27,784 |
| Inventory, net | 14,522 | 13,844 |
| Assets held for sale | — | 22,946 |
| Other current assets | 1,874 | 4,335 |
| Total current assets | 59,173 | 69,488 |
| Property, equipment and leasehold improvements, net | 104,982 | 106,283 |
| Goodwill | 12,917 | 12,917 |
| Intangible, equity method investment and other assets, net | 20,469 | 20,949 |
| Total assets | \$197,541 | \$ 209,637 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$20,042 | \$ 14,338 |
| Accrued salaries, wages and payroll taxes | 4,673 | 5,877 |
| Refundable deposits | 4,282 | 4,816 |
| Deferred revenue | 4,685 | 3,385 |
| Other accrued expenses | 3,163 | 2,368 |
| Current portion of long-term debt and capital lease obligations | 807 | 699 |
| Total current liabilities | 37,652 | 31,483 |
| Long-term debt and capital lease obligations, net of current portion | 9,946 | 32,599 |
| Fair value of derivative financial instruments | 47 | 221 |
| Deferred income tax liability, net | 12,301 | 12,886 |
| Other liabilities | 1,647 | 1,657 |
| Total liabilities | 61,593 | 78,846 |
| Commitments and contingencies (Note 12) | | |
| Common shareholders' equity: | | |
| Common stock, \$0.005 par value. Authorized 50,000,000 shares; issued and outstanding 19,362,386 and 19,309,829 | 97 | 96 |
| Additional paid-in capital | 143,004 | 142,196 |
| Accumulated other comprehensive loss | (35 |) (164 |
| Accumulated deficit | (7,118 |) (11,337 |
| Total common shareholders' equity | 135,948 | 130,791 |
| Total liabilities and common shareholders' equity | \$197,541 | \$ 209,637 |

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

Index

CRAFT BREW ALLIANCE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

| | Three Months | | Six Months Ended | |
|---|--------------|----------|------------------|-----------|
| | Ended | | June 30, | |
| | June 30, | | | |
| | 2018 | 2017 | 2018 | 2017 |
| Sales | \$65,253 | \$64,204 | \$115,338 | \$110,970 |
| Less excise taxes | 3,430 | 3,654 | 6,028 | 6,118 |
| Net sales | 61,823 | 60,550 | 109,310 | 104,852 |
| Cost of sales | 39,696 | 42,221 | 72,112 | 73,854 |
| Gross profit | 22,127 | 18,329 | 37,198 | 30,998 |
| Selling, general and administrative expenses | 15,857 | 15,560 | 30,605 | 31,029 |
| Operating income (loss) | 6,270 | 2,769 | 6,593 | (31) |
| Interest expense | (107) | (173) | (241) | (354) |
| Other income, net | 21 | 10 | 55 | 13 |
| Income (loss) before income taxes | 6,184 | 2,606 | 6,407 | (372) |
| Income tax provision (benefit) | 1,732 | 882 | 1,794 | (309) |
| Net income (loss) | \$4,452 | \$1,724 | \$4,613 | \$(63) |
| Basic and diluted net income (loss) per share | \$0.23 | \$0.09 | \$0.24 | \$— |
| Shares used in basic per share calculations | 19,334 | 19,278 | 19,322 | 19,270 |
| Shares used in diluted per share calculations | 19,517 | 19,389 | 19,502 | 19,270 |

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

Index

CRAFT BREW ALLIANCE, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (Unaudited)
 (In thousands)

| | Three Months | | Six Months | |
|---|--------------|---------|------------|--------|
| | Ended | | Ended | |
| | June 30, | | June 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) | \$4,452 | \$1,724 | \$4,613 | \$(63) |
| Unrealized gain (loss) on derivative hedge transactions, net of tax | 46 | (3) | 129 | 48 |
| Comprehensive income (loss) | \$4,498 | \$1,721 | \$4,742 | \$(15) |

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

Index

CRAFT BREW ALLIANCE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$4,613 | \$(63) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,387 | 5,468 |
| (Gain) loss on sale or disposal of Property, equipment and leasehold improvements | (494) | 146 |
| Deferred income taxes | (629) | (378) |
| Stock-based compensation | 687 | 554 |
| Other | 188 | 875 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (9,215) | (3,334) |
| Inventories | (285) | 3,323 |
| Other current assets | 1,761 | (1,093) |
| Accounts payable and other accrued expenses | 7,889 | 7,299 |
| Accrued salaries, wages and payroll taxes | (1,204) | (49) |
| Refundable deposits | (241) | (397) |
| Net cash provided by operating activities | 8,457 | 12,351 |
| Cash flows from investing activities: | | |
| Expenditures for Property, equipment and leasehold improvements | (4,284) | (4,920) |
| Proceeds from sale of Property, equipment and leasehold improvements | 22,936 | 91 |
| Restricted cash from sale of Property, equipment and leasehold improvements | 515 | — |
| Net cash provided by (used in) investing activities | 19,167 | (4,829) |
| Cash flows from financing activities: | | |
| Principal payments on debt and capital lease obligations | (348) | (261) |
| Net repayments under revolving line of credit | (22,199) | (5,756) |
| Proceeds from issuances of common stock | 206 | 87 |
| Tax payments related to stock-based awards | (84) | — |
| Net cash used in financing activities | (22,425) | (5,930) |
| Increase in Cash, cash equivalents and restricted cash | 5,199 | 1,592 |
| Cash, cash equivalents and restricted cash: | | |
| Beginning of period | 579 | 442 |
| End of period | \$5,778 | \$2,034 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$285 | \$363 |
| Cash paid for income taxes, net | 126 | 176 |
| Supplemental disclosure of non-cash information: | | |
| Purchases of Property, equipment and leasehold improvements with capital leases | \$— | \$180 |
| Purchases of Property, equipment and leasehold improvements included in Accounts payable at end of period | 429 | 7,550 |
| The accompanying notes are an integral part of these financial statements. | | |

Index

CRAFT BREW ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

The accompanying consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017 ("2017 Annual Report"). These consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements are unaudited but, in the opinion of management, reflect all material adjustments necessary to present fairly our consolidated financial position, results of operations and cash flows for the periods presented. All such adjustments were of a normal, recurring nature. The results of operations for such interim periods are not necessarily indicative of the results of operations for the full year.

Reclassifications

Certain reclassifications have been made to the prior year's data to conform to the current year's presentation. None of the changes affect our previously reported consolidated Net sales, Gross profit, Operating income, Net income or Basic or diluted net income per share.

Note 2. Recent Accounting Pronouncements

ASU 2018-02

In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 allows entities to reclassify accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (the "Act"). This update is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. The update should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the income tax rate change resulting from the Act is recognized. The early adoption of ASU 2018-02 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2017-12

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." ASU 2017-12 refines and expands hedge accounting for both financial and commodity risks. Its provisions create more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes. It also makes certain targeted improvements to simplify the application of hedge accounting guidance. ASU 2017-12 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018, on a prospective basis. We do not expect the adoption of ASU 2017-12 to have a material effect on our financial position, results of operations or cash flows.

ASU 2017-09

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718) - Scope of Modification Accounting." ASU 2017-09 provides clarity and is expected to reduce both diversity in practice and the cost and complexity when accounting for a change to the terms of a stock-based award. ASU 2017-09 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017, on a prospective

basis. The adoption of ASU 2017-09 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2017-04

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment." ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. An entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if applicable. The loss recognized should not exceed the total amount of goodwill allocated to the reporting unit. The same impairment test also applies to any reporting unit with a zero or negative carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASU 2017-04 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019, on a prospective

Index

basis. Early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. We do not expect the adoption of ASU 2017-04 to have a material effect on our financial position, results of operations or cash flows.

ASU 2016-18

In August 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230) - Restricted Cash." ASU 2016-18 reduces the diversity in practice in the classification and the presentation of restricted cash within an entity's statement of cash flows. ASU 2016-18 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods, with early adoption permitted. The adoption of ASU 2016-18 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2016-15

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 addresses eight specific cash flow issues and how they should be reported on the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods, with early adoption permitted. The adoption of ASU 2016-15 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2016-13

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326)." ASU 2016-13 addresses accounting for credit losses for assets that are not measured at fair value through net income on a recurring basis. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods, with early adoption permitted for fiscal years beginning after December 15, 2018. We do not expect the adoption of ASU 2016-13 to have a material effect on our financial position, results of operations or cash flows.

ASU 2016-02

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requires disclosing key information about leasing arrangements. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We are currently evaluating the potential impact of the adoption of ASU 2016-02 on our consolidated financial statements. We currently expect the adoption of this standard to result in a material increase to the assets and liabilities on our consolidated balance sheets.

ASU 2016-01

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10)." ASU 2016-01 enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information by addressing certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The amendments simplify certain requirements and also reduce diversity in current practice for other requirements. ASU 2016-01 is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of ASU 2016-01 on January 1, 2018 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2014-09, ASU 2016-10 and ASU 2016-12

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09, as amended, affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). ASU 2014-09, as amended, is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017.

In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing." ASU 2016-10 clarifies aspects of Topic 606 related to identifying performance obligations and the licensing implementation guidance, while retaining the related core principles for those areas. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements in ASU 2014-09.

In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606) - Narrow-Scope Improvements and Practical Expedients." ASU 2016-12 clarifies aspects of Topic 606 related to the guidance on assessing collectibility, presentation of sales taxes, non-cash consideration, and completed contracts and contract modifications. The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements in ASU 2014-09.

Index

The standards permit either the retrospective or the modified retrospective (cumulative effect) transition method. On January 1, 2018, we adopted the new accounting standard Accounting Standards Codification ("ASC") 606, "Revenue from Contracts with Customers" and all the related amendments to all contracts using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of accumulated deficit. We expect the impact of the adoption of the new standard to be immaterial to our net income on an ongoing basis.

See also Note 8.

Note 3. Cash, Cash Equivalents and Restricted Cash

We maintain cash balances with financial institutions that may exceed federally insured limits. We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. As of June 30, 2018 and December 31, 2017, we did not have any cash equivalents.

As part of our cash management system, we use a controlled disbursement account to fund cash distribution checks presented for payment by the holder. Checks issued but not yet presented to banks may result in overdraft balances for accounting purposes. As of June 30, 2018 and December 31, 2017, there were no bank overdrafts. Changes in bank overdrafts from period to period are reported in the Consolidated Statements of Cash Flows as a component of operating activities within Accounts payable and Other accrued expenses.

Cash and cash equivalents that are restricted as to withdrawal or use under terms of certain contractual agreements are recorded in Cash, cash equivalents and restricted cash on our Consolidated Balance Sheets. Restricted cash of \$0.5 million at June 30, 2018 represents funds held in an escrow account from the sale of our Woodinville brewery related to a lien; we expect that the lien will be resolved in our favor and the restriction will be removed. We did not have any restricted cash at December 31, 2017.

Note 4. Inventories

Inventories are stated at the lower of standard cost or net realizable value.

We regularly review our inventories for the presence of obsolete product attributed to age, seasonality and quality. If our review indicates a reduction in utility below the product's carrying value, we reduce the product to a new cost basis. We record the cost of inventory for which we estimate we have more than a twelve-month supply as a component of Intangible, equity method investment and other assets, net on our Consolidated Balance Sheets.

Inventories consisted of the following (in thousands):

| | June 30, December 31, | |
|--------------------------------------|-----------------------|-----------|
| | 2018 | 2017 |
| Raw materials | \$3,247 | \$ 4,290 |
| Work in process | 2,616 | 1,960 |
| Finished goods | 6,120 | 5,009 |
| Packaging materials | 1,322 | 956 |
| Promotional merchandise | 714 | 1,161 |
| Brewpub food, beverages and supplies | 503 | 468 |
| | \$14,522 | \$ 13,844 |

Work in process is beer held in fermentation tanks prior to the filtration and packaging process.

Index

Note 5. Related Party Transactions

As of June 30, 2018 and December 31, 2017, Anheuser-Busch, LLC ("A-B") owned approximately 31.3% and 31.4%, respectively, of our outstanding common stock.

Transactions with A-B, Ambev and Anheuser-Busch Worldwide Investments, LLC ("ABWI")

In December 2015, we partnered with Ambev, the Brazilian subsidiary of Anheuser-Busch InBev SA, to distribute Kona beers into Brazil. In August 2016, we also entered into an International Distribution Agreement with ABWI, an affiliate of A-B, pursuant to which ABWI distributes our malt beverage products in jurisdictions outside the United States, subject to the terms and conditions of our prior agreement with our other international distributor, CraftCan Travel LLC, and certain other limitations.

Contract Brewing Arrangement with Anheuser-Busch Companies, LLC ("ABC")

On January 30, 2018, we entered into a Contract Brewing Agreement (the "Brewing Agreement") with ABC, an affiliate of A-B, pursuant to which we brew, package, and palletize certain malt beverage products of A-B's craft breweries at our Portland, Oregon, and Portsmouth, New Hampshire, breweries as selected by ABC. Under the terms of the Brewing Agreement, ABC pays us a per barrel fee that varies based on the annual volume of the specified product brewed by us, plus (a) our actual incremental costs of brewing the product and (b) certain capital costs and costs of graphics and labeling that we incur in connection with the brewed products.

The Brewing Agreement will expire on December 31, 2018, unless the arrangement is extended at the mutual agreement of the parties. The Brewing Agreement contains specified termination rights, including, among other things, the right of either party to terminate the Brewing Agreement if (i) the other party fails to perform any material obligation under the Brewing Agreement or any other agreement between the parties, subject to certain cure rights, or (ii) the Master Distributor Agreement is terminated.

Transactions with A-B, Ambev, ABWI and ABC consisted of the following (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------------|----------|---------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Gross sales to A-B and Ambev | \$50,283 | \$49,144 | \$87,851 | \$81,785 |
| International distribution fee earned from ABWI | 850 | 850 | 1,700 | 1,700 |
| International distribution fee from ABWI, recorded in Deferred revenue | 650 | 400 | 1,300 | 800 |
| Contract Brewing fee earned from ABC | 395 | — | 858 | — |
| Margin fee paid to A-B, classified as a reduction of Sales | 687 | 669 | 1,205 | 1,157 |
| Inventory management and other fees paid to A-B, classified in Cost of sales | 100 | 101 | 190 | 192 |
| Media and other reimbursement from A-B, classified as a reduction of Selling, general and administrative expenses | — | 74 | — | 74 |

Amounts due to or from A-B and ABWI were as follows (in thousands):

| | June 30, 2018 | December 31, 2017 |
|--|------------------|----------------------|
| Amounts due from A-B related to beer sales pursuant to the A-B distributor agreement | \$23,593 | \$ 15,663 |
| Amounts due from ABWI and A-B related to international distribution fee | 3,000 | 5,000 |
| Refundable deposits due to A-B | (1,982) | (1,619) |
| Amounts due to A-B for services rendered | (9,002) | (4,836) |
| Net amount due from A-B and ABWI | \$15,609 | \$ 14,208 |

Index

Transactions with Wynwood Brewing Co. ("Wynwood")

As of June 30, 2018 and December 31, 2017, we owned a 24.5% interest in Wynwood. The carrying value of our investment was \$2.0 million as of June 30, 2018.

Transactions with Wynwood consisted of the following (in thousands):

| | Three Months Ended June 30, 2018 | 2017 | Six Months Ended June 30, 2018 | 2017 |
|---|--|------|--|------|
| Master distributor fee earned | \$ 12 | \$ | -\$ 19 | \$ — |
| Share of (gain) loss, classified as a component of Other income (expense), net | (1) | — | 22 | — |
| Refund of investment, classified as a reduction in the carrying value of the equity method investment | — | — | 23 | — |

Amounts due to or from Wynwood were as follows (in thousands):

| | June 30, 2018 | December 31, 2017 |
|---|------------------|----------------------|
| Amounts receivable related to raw materials and alternating proprietorship fees | \$ 188 | \$ 148 |
| Amounts receivable related to Brewery representative reimbursements | — | 32 |
| Amounts due related to purchases of beer pursuant to the distributor agreement | (123) | (116) |
| Amounts due related to Royalty fees | — | (4) |
| Net amount receivable | \$ 65 | \$ 60 |

Operating Leases

We lease our headquarters office space, restaurant and storage facilities located in Portland, land and certain equipment from two limited liability companies, both of whose members include our former Board Chair, who is also a significant shareholder, and his brother, who continues to be employed by us. Lease payments to these lessors were as follows (in thousands) and are included in the Rent expense under all operating leases above:

| Three Months Ended June 30, 2018 | Six Months Ended June 30, 2017 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2017 |
|--|--|--|--|
| \$41 | \$31 | \$82 | \$61 |

We hold lease and sublease obligations for certain office space and the land underlying the brewery and pub location in Kona, Hawaii, with a company whose owners include a shareholder who owns more than 5% of our common stock. The sublease contracts expire on various dates through 2020, with an extension at our option for two five-year periods. Lease payments to this lessor were as follows (in thousands) and are included in the Rent expense under all operating leases above:

| Three Months Ended June 30, 2018 | Six Months Ended June 30, 2017 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2017 |
|--|---|--|---|
| \$147 | \$145 | \$290 | \$288 |

Note 6. Derivative Financial Instruments

Interest Rate Swap Contracts

Our risk management objectives are to ensure that business and financial exposures to risk that have been identified and measured are minimized using the most effective and efficient methods to reduce, transfer and, when possible, eliminate such exposures. Operating decisions contemplate associated risks and management strives to structure proposed transactions to avoid or reduce risk whenever possible.

We have assessed our vulnerability to certain business and financial risks, including interest rate risk associated with our variable-rate long-term debt. To mitigate this risk, effective January 23, 2014, we entered into an interest rate swap contract with Bank of America, N.A. (“BofA”) for 75% of the Term Loan balance, to hedge the variability of interest payments associated with our variable-rate borrowings under our Term Loan with BofA. The Term Loan contract and the interest rate swap terminate on

Index

September 30, 2023. The Term Loan contract had a total notional value of \$6.8 million as of June 30, 2018. Through this swap agreement, we pay interest at a fixed rate of 2.86% and receive interest at a floating-rate of the one-month LIBOR, which was 2.07% at June 30, 2018.

Effective January 4, 2016, we entered into a \$9.1 million notional amount interest rate swap contract with BofA, which was set to expire January 1, 2019, to hedge the variability of interest payments associated with our variable-rate borrowings on our line of credit. The notional amount fluctuated based on a predefined schedule based on our anticipated borrowings. This swap agreement was terminated effective January 18, 2018 as we paid off our line of credit, and we received interest of \$27,000.

Since the interest rate swaps hedge the variability of interest payments on variable rate debt with similar terms, they qualify for cash flow hedge accounting treatment.

As of June 30, 2018, unrealized net losses of \$0.05 million were recorded in Accumulated other comprehensive loss as a result of these hedges. The effective portion of the gain or loss on the derivatives is reclassified into Interest expense in the same period during which we record Interest expense associated with the related debt. There was no hedge ineffectiveness during the first six months of 2018 or 2017.

The fair value of our derivative instruments was as follows (in thousands):

| | June 30, 2018 | December 31, 2017 |
|-----------------------------------|---------------|-------------------|
| Fair value of interest rate swaps | \$ (47) | \$ (221) |

The effect of our interest rate swap contracts that were accounted for as a derivative instrument on our Consolidated Statements of Operations was as follows (in thousands):

| Derivatives in Cash Flow Hedging Relationships | Amount of Gain Recognized in Accumulated OCI (Effective Portion) | Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion) |
|--|--|--|--|
| Three Months Ended June 30, | | | |
| 2018 | \$ 61 | Interest expense | \$ 17 |
| 2017 | \$ (5) | Interest expense | \$ 40 |
| Six Months Ended June 30, | | | |
| 2018 | \$ 173 | Interest expense | \$ 39 |
| 2017 | \$ 77 | Interest expense | \$ 93 |

See also Note 7.

Note 7. Fair Value Measurements

Factors used in determining the fair value of our financial assets and liabilities are summarized into three broad categories:

- Level 1 – quoted prices in active markets for identical securities as of the reporting date;
- Level 2 – other significant directly or indirectly observable inputs, including quoted prices for similar securities, interest rates, prepayment speeds and credit risk; and
- Level 3 – significant inputs that are generally less observable than objective sources, including our own assumptions in determining fair value.

The factors or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

Index

The following table summarizes liabilities measured at fair value on a recurring basis (in thousands):

| Fair Value at June 30, 2018 | Level 1 | Level 2 | Level 3 | Total |
|-----------------------------|---------|----------|---------|----------|
| Interest rate swap | \$ | —\$(47) | \$ | —\$(47) |

Fair Value at December 31, 2017

| | | | | |
|---------------------|----|-----------|----|-----------|
| Interest rate swaps | \$ | —\$(221) | \$ | —\$(221) |
|---------------------|----|-----------|----|-----------|

We did not have any assets measured at fair value on a recurring basis at June 30, 2018 or December 31, 2017.

The fair value of our interest rate swaps was based on quarterly statements from the issuing bank. There were no changes to our valuation techniques during the six months ended June 30, 2018.

We believe the carrying amounts of Cash, cash equivalents and restricted cash, Accounts receivable, Other current assets, Accounts payable, Accrued salaries, wages and payroll taxes, and Other accrued expenses are a reasonable approximation of the fair value of those financial instruments because of the nature of the underlying transactions and the short-term maturities involved.

We had fixed-rate debt outstanding as follows (in thousands):

| | June 30, 2018 | December 31, 2017 |
|--|---------------|-------------------|
| Fixed-rate debt on Consolidated Balance Sheets | \$ 1,718 | \$ 1,855 |
| Estimated fair value of fixed-rate debt | 1,746 | 1,915 |

We calculate the estimated fair value of our fixed-rate debt using a discounted cash flow methodology. Using estimated current interest rates based on a similar risk profile and duration (Level 2), the fixed cash flows are discounted and summed to compute the fair value of the debt.

Note 8. Revenue Recognition

On January 1, 2018, we adopted the Accounting Standards Codification ("ASC") 606, "Revenue from Contracts with Customers" and all the related amendments (the "new revenue standard") for all of our revenue contracts, using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of Accumulated deficit. The adoption of ASC 606 did not have a material impact on our consolidated financial statements as of January 1, 2018 or for the three and six-month periods ended June 30, 2018.

The adjustments to our Consolidated Balance Sheets upon adoption of ASC 606, effective January 1, 2018 were as follows (in thousands):

| | Balance at December 31, 2017 | Adjustments due to ASC 606 | Balance at January 1, 2018 |
|--|------------------------------|----------------------------|----------------------------|
| Assets: | | | |
| Other current assets | \$4,335 | \$ (237) | \$4,098 |
| Intangible, equity method investment and other assets, net | 20,949 | (157) | 20,792 |
| Common shareholders' equity: | | | |
| Accumulated deficit | \$(11,337) | \$ (394) | \$(11,731) |

Index

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on our Consolidated Balance Sheets and Consolidated Statements of Operations was as follows (in thousands):

| | June 30, 2018 | | |
|--|---------------|-------------------------------------|---------------------------------|
| | As Reported | Balance without Adoption of ASC 606 | Effect of Change Higher (Lower) |
| Consolidated Balance Sheets | | | |
| Assets: | | | |
| Other current assets | \$1,874 | \$2,111 | \$(237) |
| Intangible, equity method investment and other assets, net | 20,469 | 20,508 | (39) |
| Liabilities: | | | |
| Deferred income tax liability, net | 12,301 | 12,334 | (33) |
| Common shareholders' equity: | | | |
| Accumulated deficit | \$(7,118) | \$(7,427) | \$(309) |

| | Three Months Ended June 30, 2018 | | | Six Months Ended June 30, 2018 | | |
|--|----------------------------------|-------------------------------------|---------------------------------|--------------------------------|-------------------------------------|---------------------------------|
| | As Reported | Balance without Adoption of ASC 606 | Effect of Change Higher (Lower) | As Reported | Balance without Adoption of ASC 606 | Effect of Change Higher (Lower) |
| Consolidated Statements of Operations | | | | | | |
| Selling, general and administrative expenses | \$15,857 | \$15,916 | \$(59) | \$30,605 | \$30,723 | \$(118) |
| Income tax provision | 1,732 | 1,715 | 17 | 1,794 | 1,761 | 33 |
| Net income | 4,452 | 4,410 | 42 | 4,613 | 4,528 | 85 |

The following table disaggregates our Sales by major source (in thousands):

| | Three Months Ended June 30, 2018 | | | Six Months Ended June 30, 2018 | | |
|--|----------------------------------|----------|----------|--------------------------------|-----------|-----------|
| | Beer Related ¹ | Brewpubs | Total | Beer Related ¹ | Brewpubs | Total |
| Product sold through distributor agreements ² | \$54,148 | \$ — | \$54,148 | \$93,815 | \$ — | \$93,815 |
| Alternating proprietorship and contract brewing fees | 3,175 | — | 3,175 | 5,886 | — | 5,886 |
| International distribution fees | 850 | — | 850 | 1,700 | — | 1,700 |
| Brewpubs ³ | — | 6,101 | 6,101 | — | 12,112 | 12,112 |
| Other ⁴ | 979 | — | 979 | 1,825 | — | 1,825 |
| | \$59,152 | \$ 6,101 | \$65,253 | \$103,226 | \$ 12,112 | \$115,338 |

Index

Beer Related sales include sales to A-B subsidiaries including Ambev, ABWI and ABC. Sales to wholesalers (1) through the A-B distributor agreement in the three and six-month periods ended June 30, 2018 represented 77.9% and 77.3% of our Sales, respectively.

(2) Product sold through distributor agreements included domestic and international sales of owned and non-owned brands pursuant to terms in our distributor agreements.

(3) Brewpub sales include sales of promotional merchandise and sales of beer directly to customers.

(4) Other sales include sales of beer related merchandise, hops, spent grain and an export manager fee.

Revenue is recognized when obligations under the terms of a contract with our customers are satisfied; generally this occurs when the product arrives at distribution centers or when the wholesaler takes possession. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods. We consider customer purchase orders, which in some cases are governed by a master agreement, to be the contracts with a customer. For each contract related to the production of beer, we consider the promise to transfer products, each of which is distinct, to be the identified performance obligation. The transaction price for each performance obligation is specifically identified within the contract with our customer and represents the fair standalone selling price. Discounts are recognized as a reduction to Sales at the time we recognize the revenue. We generally do not grant return privileges, except in limited and specific circumstances.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of accounting pursuant to ASC 606. In contracts with multiple performance obligations, we identify each performance obligation and evaluate whether the performance obligation is distinct within the context of the contract at contract inception. Performance obligations that are not distinct at contract inception are combined.

We entered into an International Distribution Agreement ("IDA") with A-B for the rights to serve as our exclusive distributor in international territories defined by the IDA for a 10-year period. The IDA represents a single international license to all territories defined in the IDA. Revenue is recognized on a straight-line basis over the 10-year term of the agreement. In accordance with ASC 606, we evaluate the factors used in our estimates of variable consideration to be received under contracts on a quarterly basis. We estimate variable consideration as the most likely amount to which we expect to be entitled. We have evaluated, on a quarterly basis, the qualitative factors, including current market conditions and our relationship with A-B, and we consider receiving \$34.0 million over the 10-year term of the IDA the most likely outcome under the IDA. We believe that the possibility of a significant reversal of cumulative revenue recognized from this agreement under this conclusion is remote. Under the IDA, A-B has the right to issue purchase orders to distribute product in international territories defined by the IDA. Each purchase order placed under the IDA is a distinct performance obligation. The transaction price for each performance obligation is a sales-based royalty, which is recognized as revenue in accordance with the sales-based royalty exception. Accordingly, royalty revenue is recognized as the variability associated with the royalty is resolved, which is upon A-B's subsequent sale of our product.

In cases where all conditions to a sale are not met at the time of sale, revenue recognition is deferred until all conditions are met. As of January 1, 2018, we had \$3.4 million of deferred revenue recorded in Deferred revenue on the Consolidated Balance Sheets related to the IDA. As of June 30, 2018, we earned the right to receive an additional \$3.0 million pursuant to the IDA, of which we have recognized \$1.7 million as Sales, resulting in deferred revenue of \$4.7 million at June 30, 2018. We will earn the right to receive an additional \$3.0 million over the remaining two quarters in 2018 and we will earn the right to receive an additional \$20.0 million in 2019. We expect to recognize an additional \$1.7 million of deferred revenue as Sales in the remainder of 2018, \$3.4 million in 2019, and \$22.6 million thereafter.

Note 9. Segment Results and Concentrations

Our chief operating decision maker monitors Net sales and gross margins of our Beer Related operations and our Brewpubs operations. Beer Related operations include the brewing operations and related domestic and international beer and cider sales of our Kona, Widmer Brothers, Redhook and Omission beer brands and Square Mile cider brand. Brewpubs operations primarily include our brewpubs, some of which are located adjacent to our Beer Related operations. We do not track operating results beyond the gross margin level or our assets on a segment level.

Index

Net sales, Gross profit and gross margin information by segment was as follows (dollars in thousands):

| Three Months Ended June 30, | | | | | |
|-----------------------------|-----------------|----------|----------|---|--|
| 2018 | Beer Related | Brewpubs | Total | | |
| Net sales | \$55,722 | \$6,101 | \$61,823 | | |
| Gross profit | \$21,942 | \$185 | \$22,127 | | |
| Gross margin | 39.4 | % 3.0 | % 35.8 | % | |

| 2017 | | | | | |
|--------------|----------|---------|----------|---|--|
| Net sales | \$53,435 | \$7,115 | \$60,550 | | |
| Gross profit | \$17,620 | \$709 | \$18,329 | | |
| Gross margin | 33.0 | % 10.0 | % 30.3 | % | |

| Six Months Ended June 30, | | | | | |
|---------------------------|-----------------|----------|-----------|---|--|
| 2018 | Beer Related | Brewpubs | Total | | |
| Net sales | \$97,198 | \$12,112 | \$109,310 | | |
| Gross profit | \$36,652 | \$546 | \$37,198 | | |
| Gross margin | 37.7 | % 4.5 | % 34.0 | % | |

| 2017 | | | | | |
|--------------|----------|----------|-----------|---|--|
| Net sales | \$91,286 | \$13,566 | \$104,852 | | |
| Gross profit | \$29,890 | \$1,108 | \$30,998 | | |
| Gross margin | 32.7 | % 8.2 | % 29.6 | % | |

The segments use many of the same assets. For internal reporting purposes, we do not allocate assets by segment and, therefore, no asset by segment information is provided to our chief operating decision maker.

In preparing this financial information, certain expenses were allocated between the segments based on management estimates, while others were based on specific factors such as headcount. These factors can have a significant impact on the amount of Gross profit for each segment. While we believe we have applied a reasonable methodology, assignment of other reasonable cost allocations to each segment could result in materially different segment Gross profit.

Sales to wholesalers through the A-B distributor agreement represented the following percentage of our Sales:

| Three Months | | Six Months | |
|--------------|-------|------------|-------|
| Ended June | | Ended June | |
| 30, | | 30, | |
| 2018 | 2017 | 2018 | 2017 |
| 77.9% | 76.8% | 77.3% | 74.2% |

Receivables from A-B and ABWI represented the following percentage of our Accounts receivable balance:

| June 30 | December 31, |
|---------|--------------|
| 2018 | 2017 |
| 71.9% | 74.4 % |

Index

Note 10. Significant Stock-Based Plan Activity and Stock-Based Compensation

Stock-Based Compensation

Stock-based compensation expense was recognized in our Consolidated Statements of Operations as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------------|-------|---------------------------------|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Cost of sales | \$14 | \$17 | \$66 | \$36 |
| Selling, general and administrative expense | 188 | 180 | 621 | 518 |
| Total stock-based compensation expense | \$202 | \$197 | \$687 | \$554 |

At June 30, 2018, we had total unrecognized stock-based compensation expense of \$2.4 million, which will be recognized over the weighted average remaining vesting period of 2.0 years.

Note 11. Earnings Per Share

The reconciliation between the number of shares used for the basic and diluted per share calculations, as well as other related information, is as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------------|--------|---------------------------------|--------|
| | 2018 | 2017 | 2018 | 2017 |
| Weighted average common shares used for basic EPS | 19,334 | 19,278 | 19,322 | 19,270 |
| Dilutive effect of stock-based awards | 183 | 111 | 180 | — |
| Shares used for diluted EPS | 19,517 | 19,389 | 19,502 | 19,270 |
| Stock-based awards not included in diluted per share calculations as they would be antidilutive | — | 2 | — | 125 |

Note 12. Commitments and Contingencies

General

We are subject to various claims and pending or threatened lawsuits in the normal course of business. Although we do not anticipate that the resolution of legal proceedings arising in the normal course of business or the proceeding described below will have a material adverse effect on our financial position, results of operations or cash flows, we cannot predict this with certainty.

Legal

On February 28, 2017 and March 6, 2017, respectively, two lawsuits, Sara Cilloni and Simone Zimmer v. Craft Brew Alliance, Inc., and Theodore Broomfield v. Kona Brewing Co. LLC, Kona Brew Enterprises, LLP, Kona Brewery LLC, and Craft Brew Alliance, Inc., were filed in the United States District Court for the Northern Division of California. On April 7, 2017, the two lawsuits were consolidated into a single complaint under the Broomfield case. The consolidated lawsuit purports to be a class action brought on behalf of all persons who purchased Kona Brewing Company beer within the relevant statute of limitations period. The lawsuit alleges that the defendants misled customers regarding the state in which Kona Brewing Company beers are manufactured and in describing Kona Brewing Company beer as “craft beer.” We intend to vigorously defend against the foregoing action and, on April 28,

2017, we filed a motion to dismiss the complaint. The motion to dismiss was granted in part and denied in part on September 1, 2017. A hearing on class certification is scheduled for September 6, 2018. We have not recorded any liabilities with respect to the claims.

Index

Note 13. Termination of Pabst Agreements

Termination of Agreements with Pabst

Effective May 1, 2017, we reached an agreement with Pabst Brewing Company, LLC, and Pabst Northwest Brewing Company, LLC (collectively, "Pabst") to terminate the brewing agreements that provided for brewing selected brands owned by Pabst at our brewery in Woodinville, Washington, through December 31, 2018. In conjunction with the termination of the brewing arrangements, Pabst's option to purchase the Woodinville brewery and adjacent pub pursuant to the Option and Agreement of Purchase and Sale dated as of January 8, 2016 (the "Option Agreement") was also terminated. Pabst agreed to pay us \$2.7 million in connection with the termination of the brewing agreements and Option Agreement. This payment is in addition to the \$1.6 million of contract brewing volume shortfall fees for the 2016 calendar year recognized in the fourth quarter of 2016 and \$1.7 million related to remaining volume shortfalls for the 2016 - 2017 contract year ended March 31, 2017, recognized in the first quarter of 2017. All payments were received from Pabst in the second quarter of 2017.

See Note 14 for a discussion of the classification of the assets related to our Woodinville brewery as assets held for sale.

Note 14. Assets Held for Sale and Sale of Woodinville, Washington Brewery

Assets held for sale at December 31, 2017 represented the assets related to our Woodinville, Washington Brewery, which was designated as held for sale on May 1, 2017. At the end of 2017, a \$493,000 impairment charge was recorded, as a component of Selling, general and administrative expenses in our Consolidated Statements of Operations, related to the sale of our Woodinville brewery, which was sold on January 12, 2018 to assignees of Sound Commercial Investment Holdings, LLC, for a total purchase price of \$24.5 million (the "Sale Transaction").

The assets that were sold included the real property, equipment, fixtures, mechanical systems, and certain personal property used in our operation of the brewery and adjacent brewpub. We paid real estate brokerage commissions totaling \$560,000 from the sale proceeds and recorded a gain of \$500,000 during the quarter ended March 31, 2018 related to the Sale Transaction, which was recorded as a component of Selling, general and administrative expenses in our Consolidated Statements of Operations.

In contemplation of the sale of certain brewing and bottling equipment included in the Sale Transaction, \$0.5 million of the total purchase price was placed in escrow following the closing. If the purchaser of the equipment had sold it for less than \$3.5 million, the shortfall would have been paid to the purchaser up to the amount held in escrow, with the balance, if any, paid to us. The Woodinville brewing and bottling equipment was sold for more than \$3.5 million in the first quarter of 2018 and, accordingly, the \$0.5 million in escrow was remitted to us.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This quarterly report on Form 10-Q includes forward-looking statements. Generally, the words "believe," "expect," "intend," "estimate," "anticipate," "project," "will," "may," "plan" and similar expressions or their negatives identify forward-looking statements, which generally are not historical in nature. These statements are based upon assumptions and projections that we believe are reasonable, but are by their nature inherently uncertain. Many possible events or factors could affect our future financial results and performance, and could cause actual results or performance to differ materially from those expressed, including those risks and uncertainties described in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 ("2017 Annual Report"), and those described from time to time in our future reports filed with the Securities and Exchange Commission (the "SEC"). Caution should be taken not to place undue reliance on these forward-looking statements, which speak only as of the date of this quarterly report.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto included herein, as well as the audited Consolidated Financial Statements and Notes and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our 2017 Annual Report. The discussion and analysis includes period-to-period comparisons of our financial results. Although period-to-period comparisons may be helpful in understanding our financial results, we believe that they should not be relied upon as an accurate indicator of future performance.

Index

Overview

Craft Brew Alliance, Inc. ("CBA") is the seventh largest craft brewing company in the U.S. and a leader in brewing, branding, and bringing to market world-class American craft beers.

CBA's distinctive portfolio combines the power of dynamic national lifestyle brands with strong regional craft breweries rooted in community. Our national portfolio is led by Kona Brewing Co., one of the largest craft breweries in the U.S., and also includes Omission Brewing Co., which is the leader in the gluten-removed beer segment. Our regional portfolio spans some of the country's largest beer states, with Appalachian Mountain Brewery, Cisco Brewers, Redhook Brewery, Square Mile Cider Co., Widmer Brothers Brewing, and Wynwood Brewing Co. We nurture the growth and development of our brands in today's increasingly competitive beer market through our state-of-the-art brewing and distribution capability, integrated sales and marketing infrastructure, and strong focus on partnerships, local community and sustainability.

CBA was formed in 2008 through the merger of Redhook Brewery and Widmer Brothers Brewing, the two largest craft brewing pioneers in the Northwest at the time. Following a successful strategic brewing and distribution partnership, Kona Brewing Co. joined CBA in 2010 and has become one of the largest craft brands in the U.S. As part of CBA, Kona has expanded its reach across all 50 U.S. states and approximately 30 international markets, while remaining deeply rooted in its home of Hawaii.

As competition in the craft beer market continues to grow and consumers increasingly demand local offerings, Craft Brew Alliance has expanded its portfolio of brands and maximized its brewing footprint through strategic partnerships with Appalachian Mountain Brewery, based in Boone, North Carolina; Cisco Brewers, based in Nantucket, Massachusetts; and Wynwood Brewing Co., based in Miami, Florida. Through these strategic partnerships, we gain local relevance in select beer geographies, while our partner breweries gain access to our world-class leadership and national brewing and sales infrastructure to grow their brands. In the third quarter of 2017, we acquired a 24.5% interest in Wynwood Brewing Co.

Publicly traded on NASDAQ under the ticker symbol BREW, Craft Brew Alliance is headquartered in Portland, Oregon and operates breweries and brewpubs across the U.S.

We proudly brew our craft beers in three company-owned breweries located in Portland, Oregon; Portsmouth, New Hampshire; and Kailua-Kona, Hawaii. In 2016, we entered into a contract brewing agreement with A-B Commercial Strategies, LLC ("ABCS"), an affiliate of Anheuser-Busch, LLC ("A-B"), and began producing some CBA beers at ABCS's brewery in Fort Collins, Colorado in 2017. Additionally, we own and operate three small innovation breweries, which are primarily used for small batch production and experimental, limited-release beers that could potentially scale for larger production; these innovation breweries are located in Portland, Oregon, Seattle, Washington and Portsmouth, New Hampshire.

We distribute our beers to retailers through wholesalers that are aligned with the A-B network. These sales are made pursuant to a Master Distributor Agreement (the "A-B Distributor Agreement") with A-B, which extends through 2028. As a result of this distribution arrangement, we believe that, under alcohol beverage laws in a majority of states, these wholesalers would own the exclusive right to distribute our beers in their respective markets if the A-B Distributor Agreement expires or is terminated. Our Kona and Omission brands are distributed nationally and internationally, while we focus distribution of Appalachian Mountain Brewery, Cisco Brewers, Redhook Brewery, Square Mile Cider, Widmer Brothers and Wynwood Brewing in their respective home markets. Separate from our A-B wholesalers, we maintain an internal independent sales and marketing organization with resources across the key functions of brand management, field marketing, field sales, and national retail sales.

On January 30, 2018, we entered into a Contract Brewing Agreement (the “Brewing Agreement”) with ABC, an affiliate of A-B, pursuant to which we brew, package, and palletize certain malt beverage products of A-B's craft breweries at our Portland, Oregon, and Portsmouth, New Hampshire, breweries as selected by ABC. Under the terms of the Brewing Agreement, ABC pays us a per barrel fee that varies based on the annual volume of the specified product brewed by us, plus (a) our actual incremental costs of brewing the product and (b) certain capital costs and costs of graphics and labeling that we incur in connection with the brewed products. This Brewing Agreement will expire on December 31, 2018, unless the arrangement is extended at the mutual agreement of the parties.

We operate in two segments: Beer Related operations and Brewpubs operations. Beer Related operations include the brewing, and domestic and international sales, of craft beers and ciders from our breweries. Brewpubs operations primarily include our five brewpubs, three of which are located adjacent to our Beer Related operations, as well as other merchandise sales, and sales of our beers directly to customers.

Index

Following is a summary of our financial results:

| Six Months Ended June 30, | Net sales | Net income (loss) | Number of barrels sold |
|---------------------------|-----------------|-------------------|------------------------|
| 2018 | \$109.3 million | \$4.6 million | 391,600 |
| 2017 | \$104.9 million | \$(0.1) million | 378,400 |

Results of Operations

The following table sets forth, for the periods indicated, certain information from our Consolidated Statements of Operations expressed as a percentage of Net sales⁽¹⁾:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|---------|---------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Sales | 105.5 % | 106.0 % | 105.5 % | 105.8 % |
| Less excise taxes | (5.5) | (6.0) | (5.5) | (5.8) |
| Net sales | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of sales | 64.2 | 69.7 | 66.0 | 70.4 |
| Gross profit | 35.8 | 30.3 | 34.0 | 29.6 |
| Selling, general and administrative expenses | 25.6 | 25.7 | 28.0 | 29.6 |
| Operating income (loss) | 10.1 | 4.6 | 6.0 | — |
| Interest expense | (0.2) | (0.3) | (0.2) | (0.3) |
| Other income, net | — | — | 0.1 | — |
| Income (loss) before income taxes | 10.0 | 4.3 | 5.9 | (0.4) |
| Income tax provision (benefit) | 2.8 | 1.5 | 1.6 | (0.3) |
| Net income (loss) | 7.2 % | 2.8 % | 4.2 % | (0.1)% |

(1) Percentages may not add due to rounding.

Index

Segment Information

Net sales, Gross profit and Gross margin information by segment was as follows (dollars in thousands):

Three Months Ended June 30,

| 2018 | Beer Related | Brewpubs | Total |
|--------------|-----------------|----------|----------|
| Net sales | \$55,722 | \$6,101 | \$61,823 |
| Gross profit | \$21,942 | \$185 | \$22,127 |
| Gross margin | 39.4 % | 3.0 % | 35.8 % |

2017

| | | | |
|--------------|----------|---------|----------|
| Net sales | \$53,435 | \$7,115 | \$60,550 |
| Gross profit | \$17,620 | \$709 | \$18,329 |
| Gross margin | 33.0 % | 10.0 % | 30.3 % |

Six Months Ended June 30,

| 2018 | Beer Related | Brewpubs | Total |
|--------------|-----------------|----------|-----------|
| Net sales | \$97,198 | \$12,112 | \$109,310 |
| Gross profit | \$36,652 | \$546 | \$37,198 |
| Gross margin | 37.7 % | 4.5 % | 34.0 % |

2017

| | | | |
|--------------|----------|----------|-----------|
| Net sales | \$91,286 | \$13,566 | \$104,852 |
| Gross profit | \$29,890 | \$1,108 | \$30,998 |
| Gross margin | 32.7 % | 8.2 % | 29.6 % |

Index

Sales by Category

Sales by category were as follows (dollars in thousands):

| Sales by Category | Three Months Ended June 30, | | Dollar | |
|--|--------------------------------|----------|----------|-------------|
| | 2018 | 2017 | Change | % Change |
| A-B and A-B related ⁽¹⁾ | \$50,841 | \$49,325 | \$1,516 | 3.1 % |
| Contract brewing and beer related ⁽²⁾ | 8,311 | 7,764 | 547 | 7.0 % |
| Excise taxes | (3,430) | (3,654) | 224 | (6.1)% |
| Net beer related sales | 55,722 | 53,435 | 2,287 | 4.3 % |
| Brewpubs ⁽³⁾ | 6,101 | 7,115 | (1,014) | (14.3)% |
| Net sales | \$61,823 | \$60,550 | \$1,273 | 2.1 % |

| Sales by Category | Six Months Ended June 30, | | Dollar | |
|--|------------------------------|-----------|----------|-------------|
| | 2018 | 2017 | Change | % Change |
| A-B and A-B related ⁽¹⁾ | \$89,204 | \$82,328 | \$6,876 | 8.4 % |
| Contract brewing and beer related ⁽²⁾ | 14,022 | 15,076 | (1,054) | (7.0)% |
| Excise taxes | (6,028) | (6,118) | 90 | (1.5)% |
| Net beer related sales | 97,198 | 91,286 | 5,912 | 6.5 % |
| Brewpubs ⁽³⁾ | 12,112 | 13,566 | (1,454) | (10.7)% |
| Net sales | \$109,310 | \$104,852 | \$4,458 | 4.3 % |

A-B and A-B related includes domestic and international sales of our owned brands sold through A-B and Ambev, (1) as well as non-owned brands sold pursuant to master distribution agreements, fees earned pursuant to the contract brewing agreement with ABC and the international distribution fees earned from ABWI.

(2) Beer related includes international sales of our beers, and non-owned brands, not sold through A-B or Ambev, as well as fees earned through alternating proprietorship agreements and from contract brewing shortfall fees.

(3) Brewpubs sales include sales of promotional merchandise and sales of beer directly to customers.

Shipments by Category

Shipments by category were as follows (in barrels):

| Three Months Ended June 30, | 2018 | 2017 | Increase | % | Change in Depletions ⁽¹⁾ |
|--|-----------|-----------|------------|---------|--|
| | Shipments | Shipments | (Decrease) | Change | |
| A-B and A-B related ⁽²⁾ | 198,300 | 195,900 | 2,400 | 1.2 % | (2)% |
| Contract brewing and beer related ⁽³⁾ | 24,300 | 27,100 | (2,800) | (10.3)% | |
| Brewpubs | 2,000 | 2,600 | (600) | (23.1)% | |
| Total | 224,600 | 225,600 | (1,000) | (0.4)% | |

| Six Months Ended June 30, | 2018 | 2017 | Increase | % | Change in Depletions ⁽¹⁾ |
|--|-----------|-----------|------------|---------|--|
| | Shipments | Shipments | (Decrease) | Change | |
| A-B and A-B related ⁽²⁾ | 344,800 | 329,300 | 15,500 | 4.7 % | (3)% |
| Contract brewing and beer related ⁽³⁾ | 43,000 | 44,500 | (1,500) | (3.4)% | |
| Brewpubs | 3,800 | 4,600 | (800) | (17.4)% | |
| Total | 391,600 | 378,400 | 13,200 | 3.5 % | |

(1) Change in depletions reflects the year-over-year change in barrel volume sales of beer by wholesalers to retailers.

(2)

A-B and A-B related includes domestic and international shipments of our owned brands distributed through A-B and Ambev, as well as non-owned brands distributed pursuant to master distribution agreements and shipments pursuant to the contract brewing agreement with ABC.

- (3) Beer related includes international shipments of our beers, and non-owned brands, not distributed through A-B or Ambev.

Index

The increases in sales to A-B and A-B related in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to increases in average unit pricing and shipment volume. Shipment volume increased in the second quarter of 2018 primarily as a result of lower than usual shipment volumes in the second quarter of 2017, as we reduced our inventory levels at our wholesale partners as part of our ongoing efforts to address slowing craft segment growth and the inventory pressures facing distributors in the complex craft beer market. International distribution fees earned were \$0.9 million in the three-month periods ended June 30, 2018 and 2017 and \$1.7 million in the six-month periods ended June 30, 2018 and 2017.

The increase in Contract brewing and beer related sales in the three-month period ended June 30, 2018 compared to the same period of 2017 was primarily due to an increase in international shipments of our beer and an increase in our alternating proprietorship fees, partially offset by a decrease in contract brewing volume. The decrease in Contract brewing and beer related sales in the six-month period ended June 30, 2018 compared to the same period of 2017 was primarily due to \$1.7 million of fees earned in the 2017 period from Pabst Northwest Brewing Company ("Pabst") related to a contract brewing volume shortfall, partially offset by an increase in international shipments of our beer and an increase in our alternating proprietorship fees.

Brewpubs sales decreased in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, primarily as a result of the closure of our Woodinville brewpub, as well as the conversion of our Portland brewpub into a beer-focused taproom, both at the end of 2017, partially offset by the opening of our newest brewpub, Redhook Brewlab, in Seattle, Washington, in the third quarter of 2017, and an increase in sales at our Kona brewpub. Sales at our Kona brewpub may be adversely affected by the lower tourism resulting from the ongoing eruption of the Kilauea volcano.

In December 2017, the Tax Cuts and Jobs Act was signed into law and will provide small and regional brewers and small wineries significant excise tax relief effective January 1, 2018. The new law affects our Excise taxes in the following ways:

• Beer: Reduced the federal excise tax to \$3.50 per barrel on the first 60,000 barrels for domestic brewers producing fewer than 2 million barrels annually, down from \$7.00 per barrel;

• Beer: Reduced the federal excise tax to \$16.00 per barrel on the first 6 million barrels for all other brewers and all beer importers, down from \$18.00 per barrel; and

• Cider: While the existing excise tax on hard cider did not change from \$0.226 per gallon, the new laws expanded the small producer tax credit for hard cider to \$0.062 on the first 30,000 gallons for an effective rate of \$0.164 per gallon; the tax credit on the next 100,000 gallons produced will be \$0.056 for an effective rate of \$0.17 per gallon; and producers like us, who produce between 130,000 and 750,000 gallons, will receive a \$0.033 credit for an effective tax rate of \$0.193 per gallon.

Currently, the changes in the Tax Cuts and Jobs Act are set to expire at the end of 2019. However, the Beer Institute, of which we are a member, and other industry groups support extending the relief embodied in the Tax Cuts and Jobs Act and making federal excise tax relief for all brewers and beer importers permanent. 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.

Index

Shipments by Brand

The following table sets forth a comparison of shipments by brand (in barrels):

| Three Months Ended June 30, | 2018 Shipments | 2017 Shipments | Increase (Decrease) | % Change | Change in Depletions |
|-----------------------------|-------------------|-------------------|------------------------|-------------|-------------------------|
| Kona | 141,000 | 130,900 | 10,100 | 7.7 % | 7 % |
| Widmer Brothers | 28,900 | 35,400 | (6,500) | (18.4)% | (19)% |
| Redhook | 20,400 | 26,600 | (6,200) | (23.3)% | (27)% |
| Omission | 12,800 | 12,100 | 700 | 5.8 % | 5 % |
| All other ⁽¹⁾ | 15,600 | 14,200 | 1,400 | 9.9 % | 12 % |
| Total ⁽²⁾ | 218,700 | 219,200 | (500) | (0.2)% | (2)% |

| Six Months Ended June 30, | 2018 Shipments | 2017 Shipments | Increase (Decrease) | % Change | Change in Depletions |
|---------------------------|-------------------|-------------------|------------------------|-------------|-------------------------|
| Kona | 240,000 | 213,000 | 27,000 | 12.7 % | 5 % |
| Widmer Brothers | 52,200 | 63,200 | (11,000) | (17.4)% | (19)% |
| Redhook | 39,000 | 47,300 | (8,300) | (17.5)% | (25)% |
| Omission | 23,100 | 21,300 | 1,800 | 8.5 % | 7 % |
| All other ⁽¹⁾ | 25,000 | 22,600 | 2,400 | 10.6 % | 17 % |
| Total ⁽²⁾ | 379,300 | 367,400 | 11,900 | 3.2 % | (3)% |

All other includes the shipments and depletions from our Square Mile brand family, as well as the non-owned (1)Cisco Brewers, Appalachian Mountain Brewing and Wynwood Brewing Co. brand families, shipped by us pursuant to distribution agreements.

(2) Total shipments by brand include international shipments and exclude shipments produced under our contract brewing arrangements.

The increases in our Kona brand shipments in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to increases in domestic and international shipments, primarily led by continued demand for Big Wave Golden Ale and our newest brand, Kanaha Blonde Ale.

The decreases in our Widmer Brothers brand shipments in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were led by decreases in Hefeweizen brand shipments, primarily due to increased competition in the home market of Oregon.

Redhook brand shipments decreased in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, primarily due to a continued strategic focus on the home market of Washington, led by declines in Longhammer IPA brand, partially offset by increased demand for our Big Ballard IPA brand.

Omission brand shipments increased in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017, primarily led by increased demand for our newest brand, Omission Ultimate Light.

The increases in All other shipments in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to increases in the shipment volumes related to our distribution agreements with Wynwood Brewing Co. and Appalachian Mountain Brewing, partially offset by decreases in Cisco Brewers brand shipments.

Index

Shipments by Package

The following table sets forth a comparison of our shipments by package, excluding shipments produced under our contract brewing arrangements (in barrels):

| | Three Months Ended June 30, | | 2017 | |
|----------|-----------------------------|------------|-----------|------------|
| | 2018 | | 2017 | |
| | Shipments | % of Total | Shipments | % of Total |
| Draft | 49,800 | 22.8 % | 48,200 | 22.0 % |
| Packaged | 168,900 | 77.2 % | 171,000 | 78.0 % |
| Total | 218,700 | 100.0 % | 219,200 | 100.0 % |

| | Six Months Ended June 30, | | 2017 | |
|----------|---------------------------|------------|-----------|------------|
| | 2018 | | 2017 | |
| | Shipments | % of Total | Shipments | % of Total |
| Draft | 89,000 | 23.5 % | 84,200 | 22.9 % |
| Packaged | 290,300 | 76.5 % | 283,200 | 77.1 % |
| Total | 379,300 | 100.0 % | 367,400 | 100.0 % |

The package mix was relatively consistent in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017.

Cost of Sales

Cost of sales includes purchased raw and component materials, direct labor, overhead and shipping costs.

Information regarding Cost of sales was as follows (dollars in thousands):

| | Three Months Ended June 30, | | Dollar | |
|--------------|-----------------------------|----------|-----------|----------|
| | 2018 | 2017 | Change | % Change |
| Beer Related | \$33,780 | \$35,815 | \$(2,035) | (5.7)% |
| Brewpubs | 5,916 | 6,406 | (490) | (7.6)% |
| Total | \$39,696 | \$42,221 | \$(2,525) | (6.0)% |

| | Six Months Ended June 30, | | Dollar | |
|--------------|---------------------------|----------|-----------|----------|
| | 2018 | 2017 | Change | % Change |
| Beer Related | \$60,546 | \$61,396 | \$(850) | (1.4)% |
| Brewpubs | 11,566 | 12,458 | (892) | (7.2)% |
| Total | \$72,112 | \$73,854 | \$(1,742) | (2.4)% |

The decreases in Beer Related Cost of sales in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to decreases in our Beer Related Cost of sales on a per barrel basis, partially offset by an increase in shipment volume in the six-month period. The decreases in our Beer Related Cost of sales on a per barrel basis were primarily due to the lower cost of having a portion of our beer produced by A-B in its Ft. Collins, Colorado brewery, as well as cost savings associated with removing the Woodinville facility from our brewing footprint and the termination of our contract brewing agreement in Memphis, which had higher costs on a per barrel basis, partially offset by increases in brewery costs and distribution rates on per barrel bases.

The decreases in Brewpubs Cost of sales in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to closure of the Woodinville brewpub and conversion of the Portland brewpub into a taproom, partially offset by the costs of opening our new brewpub in Seattle, as well as increased sales at our Kona brewpub.

Index

Capacity Utilization

Capacity utilization is calculated by dividing total shipments by approximate working capacity and was as follows:

| | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2017 | 2018 | 2017 |
|----------------------|--|--|------|------|
| Capacity Utilization | 67% | 68% | 59% | 61% |

In June 2014, we initiated full-scale brewing with our brewing partner in Memphis, Tennessee. This partnership provided us scalable capacity and we had the ability to produce up to 100,000 barrels at this location annually. Production ceased with this brewing partner during the second quarter of 2017. In 2016, we entered into a contract brewing agreement with ABCS with the ability to have up to 300,000 barrels produced annually and, during the second quarter of 2017, production began in their facilities. Our capacity utilization declined in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 due to reductions in wholesaler inventories, as well as a larger percentage of our beer being brewed by ABCS as part of our contract brewing relationship and evolving brewery footprint.

As discussed in Notes 13 and 14 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this report, we ceased production at our Woodinville, Washington brewery during the second quarter of 2017, which reduced the capacity of our owned breweries beginning in the third quarter of 2017. As a result, beginning with the third quarter of 2017, our capacity utilization calculation was revised to exclude, from the denominator, the production capacity of our Woodinville, Washington brewery, which we have estimated to be approximately 220,000 barrels per year.

Gross Profit

Information regarding Gross profit was as follows (dollars in thousands):

| | Three Months Ended June 30, | | Dollar | |
|--------------|--------------------------------|----------|---------|-------------|
| | 2018 | 2017 | Change | % Change |
| Beer Related | \$21,942 | \$17,620 | \$4,322 | 24.5 % |
| Brewpubs | 185 | 709 | (524) | (73.9)% |
| Total | \$22,127 | \$18,329 | \$3,798 | 20.7 % |

| | Six Months Ended June 30, | | Dollar | |
|--------------|------------------------------|----------|---------|-------------|
| | 2018 | 2017 | Change | % Change |
| Beer Related | \$36,652 | \$29,890 | \$6,762 | 22.6 % |
| Brewpubs | 546 | 1,108 | (562) | (50.7)% |
| Total | \$37,198 | \$30,998 | \$6,200 | 20.0 % |

Gross profit as a percentage of Net sales, or gross margin, was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------|-----------------------------------|-------|---------------------------------|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Beer Related | 39.4% | 33.0% | 37.7% | 32.7% |

| | | | | |
|----------|-------|-------|-------|-------|
| Brewpubs | 3.0 % | 10.0% | 4.5 % | 8.2 % |
| Overall | 35.8% | 30.3% | 34.0% | 29.6% |

The increases in Beer Related Gross profit and gross margin in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to increased unit pricing, as well as the lower costs related to having a portion of our beer produced by A-B in Ft. Collins, partially offset by increases in brewery costs and distribution rates on per barrel bases. The six-month period ended June 30, 2018 also benefited from an increase in shipment volume partially offset by \$1.7 million of fees earned from Pabst related to a contract brewing volume shortfall in the 2017 six-month period.

The decreases in the Brewpubs Gross profit and gross margin in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to the net costs associated with our new brewpub in Seattle, partially offset by the increased sales at our Kona brewpub.

Index

Selling, General and Administrative Expenses

Selling, general and administrative expenses (“SG&A”) include compensation and related expenses for our sales and marketing activities, management, legal and other professional and administrative support functions.

Information regarding SG&A was as follows (dollars in thousands):

| | Three Months Ended June 30, | | Dollar | | % Change | |
|--|--------------------------------|----------|--------|-------------|-------------|--|
| | 2018 | 2017 | Change | % Change | | |
| Selling, general and administrative expenses | \$15,857 | \$15,560 | \$297 | 1.9 | % | |
| As a % of Net sales | 25.6 | % 25.7 | % | | | |

| | Six Months Ended June 30, | | Dollar | | % Change | |
|--|------------------------------|----------|---------|-------------|-------------|--|
| | 2018 | 2017 | Change | % Change | | |
| Selling, general and administrative expenses | \$30,605 | \$31,029 | \$(424) | (1.4) | % | |
| As a % of Net sales | 28.0 | % 29.6 | % | | | |

The increase in SG&A for the three-month period ended June 30, 2018 compared to the same period of 2017 was primarily due to increased creative and media spend.

The decrease in SG&A for the six-month period ended June 30, 2018 compared to the same period of 2017 was primarily due to a gain of \$0.5 million in the first quarter of 2018 related to the sale of the Woodinville brewing and bottling equipment and a decrease in professional fees, partially offset by increases in creative and media spend and rent expense. To strengthen sales volume, additional increases in creative and media spend are expected for the balance of the year.

Interest Expense

Information regarding Interest expense was as follows (dollars in thousands):

| Three Months Ended June 30, | | Dollar | | % Change | |
|--------------------------------------|-------|--------|-------------|-------------|--|
| 2018 | 2017 | Change | % Change | | |
| \$107 | \$173 | \$(66) | (38.2) | % | |

| Six Months Ended June 30, | | Dollar | | % Change | |
|---------------------------------|-------|---------|-------------|-------------|--|
| 2018 | 2017 | Change | % Change | | |
| \$241 | \$354 | \$(113) | (31.9) | % | |

| Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------------|------|---------------------------------|------|
| 2018 | 2017 | 2018 | 2017 |

| | | | | |
|--------------------------|----------|----------|----------|----------|
| Average debt outstanding | \$10,839 | \$25,862 | \$14,092 | \$26,372 |
| Average interest rate | 3.37% | 2.06% | 2.86% | 1.98% |

The decreases in Interest expense in the three and six-month periods ended June 30, 2018 compared to the same periods of 2017 were primarily due to decreases in our average debt outstanding, partially offset by increases in our average interest rate. The decreases in our average debt outstanding were due to principal payments made on our term loan and the payoff of our line of credit following the sale of our Woodinville, Washington Brewery in January 2018.

Income Tax Provision

Our effective income tax rate was 28.0% for the first six months of 2018 and 83.1% in the first six months of 2017. The effective income tax rates reflect the impact of non-deductible expenses (primarily meals and entertainment expenses), state and local taxes, tax credits, and income excluded from taxation under the domestic production activities exclusion.

Index

The decrease in our effective income tax rate was primarily due to tax legislation, which reduced our federal tax rate from 34% to 21% effective January 1, 2018. We expect our effective income tax rate to be 28% for all of 2018.

Liquidity and Capital Resources

We have required capital primarily for the construction and development of our production breweries, to support our brewery footprint evolution, and to fund our working capital needs. Historically, we have financed our capital requirements through cash flows from operations, bank borrowings and the sale of common and preferred stock. We anticipate meeting our obligations for the twelve months beginning July 1, 2018 primarily from cash flows generated from operations and borrowing under our line of credit facility as the need arises. Capital resources available to us at June 30, 2018 included \$5.3 million of Cash and cash equivalents and \$38.8 million available under our line of credit facility.

At June 30, 2018 and December 31, 2017, we had \$21.5 million and \$38.0 million of working capital, respectively, and our debt as a percentage of total capitalization (total debt and common shareholders' equity) was 7.3% and 20.3%, respectively.

A summary of our cash flow information was as follows (in thousands):

| | Six Months Ended | |
|--|------------------|----------|
| | June 30, | |
| | 2018 | 2017 |
| Net cash provided by operating activities | \$8,457 | \$12,351 |
| Net cash provided by (used in) investing activities | 19,167 | (4,829) |
| Net cash used in financing activities | (22,425) | (5,930) |
| Increase in Cash, cash equivalents and restricted cash | \$5,199 | \$1,592 |

Cash provided by operating activities of \$8.5 million in the first six months of 2018 resulted from our Net income of \$4.6 million, net non-cash expenses of \$5.1 million and changes in our operating assets and liabilities as discussed in more detail below.

Accounts receivable, net, increased \$9.2 million to \$37.0 million at June 30, 2018 compared to \$27.8 million at December 31, 2017. This increase was primarily due to increased shipment volume and a \$7.9 million increase in our receivable from A-B attributable to the timing of shipments, partially offset by a net decrease of \$2.0 million for amounts due from ABWI related to the international distribution fee. The receivable from A-B and ABWI totaled \$26.6 million at June 30, 2018. Historically, we have not had collection problems related to our accounts receivable.

Inventories increased \$0.7 million to \$14.5 million at June 30, 2018 compared to \$13.8 million at December 31, 2017. The increase was primarily due to increases in work in process and finished goods as a result of timing of shipments in the fourth quarter of 2017 and the second quarter of 2018, seasonality and the forecasted demand for our beer.

Accounts payable increased \$5.7 million to \$20.0 million at June 30, 2018 compared to \$14.3 million at December 31, 2017, primarily due to the timing of payments related to our contract brewing relationship with ABCS.

As of June 30, 2018, we had a state net operating loss carryforward ("NOL") of \$9,426, tax-effected, available to offset payment of future income taxes. We anticipate that we will utilize this NOL in the near future and, accordingly, once utilized, we will be required to satisfy all of our income tax obligations with cash.

Capital expenditures of \$4.3 million in the first six months of 2018 were primarily directed to beer production capacity and efficiency improvements. As of June 30, 2018, we had an additional \$0.4 million of expenditures recorded in Accounts payable on our Consolidated Balance Sheets, compared to \$0.5 million at December 31, 2017.

Beginning in 2015 through expected completion in 2019, we are investing approximately \$20 million in a new Hawaiian brewery. We anticipate total capital expenditures of approximately \$16.0 million to \$19.0 million in 2018 primarily for our new Kona brewery and the addition of a new can line in our Portland brewery to address consumer demand.

Index

Loan Agreement

We have a loan agreement (as amended, the “Loan Agreement”) with Bank of America, N.A., which currently consists of a 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 term loan (“Term Loan”) with an original principal balance of \$10.8 million. We may draw upon the Line of Credit for working capital and general corporate purposes until expiration on November 30, 2020. In accordance with the Loan Agreement, starting with the first quarter of 2018, availability under the Line of Credit is reduced by \$625,000 each quarter. As of June 30, 2018, we had \$38.8 million in funds available to be drawn upon from our Line of Credit and zero borrowings outstanding. The maturity date of the Term Loan is September 30, 2023. At June 30, 2018, \$9.0 million was outstanding under the Term Loan.

Under the Loan Agreement, interest accrues at an annual rate based on the London Inter-Bank Offered Rate (“LIBOR”) Daily Floating Rate plus a marginal rate. The marginal rate varies from 0.75% to 1.75% for the Line of Credit and Term Loan based on our funded debt ratio. At June 30, 2018, our marginal rate was 0.75%, resulting in an annual interest rate of 2.73%.

Accrued interest for the Term Loan is due and payable monthly. Principal payments on the Term Loan are due monthly in accordance with an agreed-upon schedule set forth in the Loan Agreement, with any unpaid principal balance and unpaid accrued interest due and payable on September 30, 2023.

The Loan Agreement authorizes acquisitions within the same line of business as long as we remain in compliance with the financial covenants of the Loan Agreement and there is at least \$5.0 million of availability remaining on the Line of Credit following the acquisition. As of June 30, 2018, we were in compliance with all financial covenants.

Critical Accounting Policies and Estimates

Our financial statements are based upon the selection and application of significant accounting policies that require management to make significant estimates and assumptions. Judgments and uncertainties affecting the application of these policies may result in materially different amounts being reported under different conditions or using different assumptions. Our estimates are based upon historical experience, market trends and financial forecasts and projections, and upon various other assumptions that management believes to be reasonable under the circumstances at various points in time. Actual results may differ, potentially significantly, from these estimates.

Our critical accounting policies, as described in our 2017 Annual Report on Form 10-K, relate to goodwill, indefinite-lived intangible assets, long-lived assets, refundable deposits on kegs, revenue recognition and deferred taxes. Other than as described in Notes 2 and 8 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q regarding revenue recognition, there have been no changes to our critical accounting policies since December 31, 2017.

Seasonality

Our sales generally reflect a degree of seasonality, with the first and fourth quarters historically exhibiting low sales levels compared to the second and third quarters. Accordingly, our results for any particular quarter are not likely to be indicative of the results to be achieved for the full year.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations,

liquidity, capital expenditures or capital resources.

Recent Accounting Pronouncements

See Notes 2 and 8 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in our reported market risks and risk management policies since the filing of our 2017 Annual Report on Form 10-K, which was filed with the SEC on March 7, 2018.

Index

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management, including our Chief Executive Officer and our Principal Accounting Officer, who has been performing the functions of the Chief Financial Officer since July 16, 2018, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) under the Securities Exchange Act of 1934 (“Exchange Act”) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Principal Accounting Officer concluded that, as of the end of the period covered by this report, disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Principal Accounting Officer, as appropriate, to allow timely decisions regarding required disclosures. 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 benefits associated with controls must be proportionate to their costs.

Changes in Internal Control Over Financial Reporting

During the second quarter of 2018, there were no changes in our internal control over financial reporting identified in connection with the above evaluation required by Exchange Act Rule 13a-15 or 15d-15, except those disclosed below, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Beginning January 1, 2018, we implemented ASC 606, Revenue from Contracts with Customers. Although the new revenue standard is not expected to have a material impact on our ongoing net income, we did implement changes to our processes related to revenue recognition and the control activities within them. These included the development of new policies based on the five-step model provided in the new revenue standard, ongoing assessment of any variable consideration, new training, ongoing contract review requirements, and gathering of information provided for disclosures.

Index

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See Note 12 of Notes to Consolidated Financial Statements included in Part 1, Item 1 of this report.

Item 1A. Risk Factors

There have been no changes in our reported risk factors since the filing of our 2017 Annual Report on Form 10-K, which was filed with the SEC on March 7, 2018.

Item 6. Exhibits

The following exhibits are filed herewith and this list is intended to constitute the exhibit index:

- 31.1 Certification of Chief Executive Officer of Craft Brew Alliance, Inc. pursuant to Exchange Act Rule 13a-14(a)
- 31.2 Certification of Principal Accounting Officer of Craft Brew Alliance, Inc. pursuant to Exchange Act Rule 13a-14(a)
- 32.1 Certification pursuant to Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350
- 99.1 Press Release dated August 8, 2018
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Index

SIGNATURE

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

CRAFT BREW ALLIANCE,
INC.

August 8, 2018 By: /s/ Edwin A. Smith
Edwin A. Smith
Corporate Controller and
Principal Accounting Officer