

CRAFT BREW ALLIANCE, INC.
Form 10-Q
August 03, 2016

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, 2016
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 or a smaller reporting company (See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act). Check one:

Large Accelerated Filer	Accelerated Filer
Non-accelerated Filer (Do not check if a smaller reporting company)	Smaller Reporting Company

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 July 26, 2016 was 19,237,052.

CRAFT BREW ALLIANCE, INC.
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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, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 335	\$ 911
Accounts receivable, net	27,330	18,926
Inventory, net	22,982	18,300
Deferred income tax asset, net	2,414	1,905
Other current assets	2,766	2,439
Total current assets	55,827	42,481
Property, equipment and leasehold improvements, net	121,665	116,867
Goodwill	12,917	12,917
Intangible and other assets, net	18,649	18,069
Total assets	\$ 209,058	\$ 190,334
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 25,294	\$ 17,100
Accrued salaries, wages and payroll taxes	4,383	5,468
Refundable deposits	7,164	6,559
Other accrued expenses	2,082	2,009
Current portion of long-term debt and capital lease obligations	807	507
Total current liabilities	39,730	31,643
Long-term debt and capital lease obligations, net of current portion	30,250	18,991
Fair value of derivative financial instruments	1,011	569
Deferred income tax liability, net	19,347	19,669
Other liabilities	965	724
Total liabilities	91,303	71,596
Commitments and contingencies		
Common shareholders' equity:		
Common stock, \$0.005 par value. Authorized 50,000,000 shares; issued and outstanding 19,237,052 and 19,179,006	96	96
Additional paid-in capital	139,773	139,534
Accumulated other comprehensive loss	(626)	(352)
Accumulated deficit	(21,488)	(20,540)
Total common shareholders' equity	117,755	118,738
Total liabilities and common shareholders' equity	\$ 209,058	\$ 190,334

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

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

	Three Months		Six Months Ended	
	Ended		June 30,	
	2016	2015	2016	2015
Sales	\$66,294	\$62,638	\$108,087	\$107,257
Less excise taxes	4,016	4,107	6,587	7,017
Net sales	62,278	58,531	101,500	100,240
Cost of sales	41,780	39,841	72,285	70,388
Gross profit	20,498	18,690	29,215	29,852
Selling, general and administrative expenses	16,548	16,263	30,472	29,216
Operating income (loss)	3,950	2,427	(1,257)) 636
Interest expense	(187)) (150)) (334)) (271)
Other income, net	6	7	12	13
Income (loss) before income taxes	3,769	2,284	(1,579)) 378
Income tax expense (benefit)	1,508	894	(631)) 151
Net income (loss)	\$2,261	\$1,390	\$(948)) \$227
Basic and diluted net income (loss) per share	\$0.12	\$0.07	\$(0.05)) \$0.01
Shares used in basic per share calculations	19,216	19,145	19,198	19,130
Shares used in diluted per share calculations	19,232	19,177	19,198	19,164

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

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

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Net income (loss)	\$2,261	\$1,390	\$(948)	\$227
Unrealized gain (loss) on derivative hedge transactions, net of tax	(68)	111	(274)	32
Comprehensive income (loss)	\$2,193	\$1,501	\$(1,222)	\$259

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

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

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net income (loss)	\$(948)	\$227
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,362	4,727
Loss on sale or disposal of Property, equipment and leasehold improvements	9	306
Deferred income taxes	(664)	67
Stock-based compensation	309	605
Excess tax benefit from employee stock plans	—	(51)
Other	(73)	62
Changes in operating assets and liabilities:		
Accounts receivable, net	(8,404)	(9,831)
Inventories	(5,034)	62
Other current assets	(327)	(97)
Accounts payable and other accrued expenses	8,051	5,330
Accrued salaries, wages and payroll taxes	(1,086)	(114)
Refundable deposits	625	(181)
Net cash provided by (used in) operating activities	(2,180)	1,112
Cash flows from investing activities:		
Expenditures for Property, equipment and leasehold improvements	(9,220)	(5,816)
Proceeds from sale of Property, equipment and leasehold improvements	8	387
Net cash used in investing activities	(9,212)	(5,429)
Cash flows from financing activities:		
Principal payments on debt and capital lease obligations	(350)	(245)
Net borrowings under revolving line of credit	11,237	4,900
Proceeds from issuances of common stock	—	58
Tax payments related to stock-based awards	(71)	(151)
Excess tax benefit from employee stock plans	—	51
Net cash provided by financing activities	10,816	4,613
Increase (decrease) in Cash and cash equivalents	(576)	296
Cash and cash equivalents:		
Beginning of period	911	981
End of period	\$335	\$1,277
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$300	\$329
Cash paid for income taxes, net	80	56
Supplemental disclosure of non-cash information:		
Purchases of Property, equipment and leasehold improvements with capital leases	\$673	\$—
Purchases of Property, equipment and leasehold improvements included in Accounts payable at end of period	1,550	667

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

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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, 2015 ("2015 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.

Note 2. Recent Accounting Pronouncements

ASU 2016-12

In May 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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 Topic 606 (ASU 2014-09). We are still evaluating any potential impact that adoption of ASU 2016-12 may have on our financial position, results of operations or cash flows.

ASU 2016-10

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 Topic 606 (ASU 2014-09). We are still evaluating any potential impact that adoption of ASU 2016-10 may have on our financial position, results of operations or cash flows.

ASU 2016-09

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation - Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies the accounting for several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The early adoption of ASU 2016-09 in the second quarter of 2016 did not 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 still evaluating any potential impact that adoption of

ASU 2016-02 may have on our financial position, results of operations or cash flows.

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. Except for the early application guidance specifically allowed in ASU 2016-01, early adoption is not permitted. We do not expect the adoption of ASU 2016-01 to have a material effect on our financial position, results of operations or cash flows.

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ASU 2015-17

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes." ASU 2015-17 simplifies the presentation of deferred income taxes, and requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments apply to all entities that present a classified statement of financial position and aligns the presentation of deferred income tax assets and liabilities with International Financial Reporting Standards. ASU 2015-17 is effective for public companies for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted. We do not expect the adoption of ASU 2015-17 to have a material effect on our financial position, results of operations or cash flows.

ASU 2015-15

In August 2015, the FASB issued ASU 2015-15, "Interest - Imputation of Interest (Subtopic 835-30)." ASU 2015-15 provides guidance as to the presentation and subsequent measurement of debt issuance costs associated with line of credit arrangements. The amendments are effective for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The amendments are to be applied on a retrospective basis, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effects of applying the new guidance. The adoption of ASU 2015-15 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2015-11

In July 2015, the FASB issued ASU No. 2015-11, "Simplifying the Measurement of Inventory (Topic 330)." ASU 2015-11 simplifies the accounting for the valuation of all inventory not accounted for using the last-in, first-out ("LIFO") method by prescribing that inventory be valued at the lower of cost and net realizable value. ASU 2015-11 is effective for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016 on a prospective basis. We do not expect the adoption of ASU 2015-11 to have a material effect on our financial position, results of operations or cash flows.

ASU 2015-05

In April 2015, the FASB issued ASU 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40)." ASU 2015-05 provides guidance regarding the accounting for a customer's fees paid in a cloud computing arrangement; specifically about whether a cloud computing arrangement includes a software license, and if so, how to account for the software license. ASU 2015-05 is effective for public companies' annual periods, including interim periods within those fiscal years, beginning after December 15, 2015 on either a prospective or retrospective basis. The adoption of ASU 2015-05 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2015-03

In April 2015, the FASB issued ASU No. 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments are effective for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The amendments are to be applied on a retrospective basis, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effects of applying the new guidance. The adoption of ASU 2015-03 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2015-02

In February 2015, the FASB issued ASU No. 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis," which is intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability companies, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The ASU focuses on the consolidation evaluation for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification and improves current U.S. GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity ("VIE"), and changing consolidation conclusions for companies in several industries that typically make use of limited partnerships or VIEs. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of ASU 2015-02 did not have a material effect on our financial position, results of operations or cash flows.

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ASU 2014-09

In May 2014, the FASB issued ASU No. 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. We are still evaluating the effect of the adoption of ASU 2014-09.

Note 3. Cash and Cash Equivalents

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, 2016 and December 31, 2015, 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, 2016 and December 31, 2015, bank overdrafts of \$0.6 million and \$2.2 million, respectively, were included in Accounts payable on our Consolidated Balance Sheets. 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.

Note 4. Inventories

Inventories, except for pub food, beverages and supplies, are stated at the lower of standard cost or market. Pub food, beverages and supplies are stated at the lower of cost or market.

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 and other assets, net on our Consolidated Balance Sheets.

Inventories consisted of the following (in thousands):

	June 30, December 31,	
	2016	2015
Raw materials	\$8,179	\$ 5,468
Work in process	3,231	3,822
Finished goods	8,007	6,109
Packaging materials	1,247	727
Promotional merchandise	1,634	1,477
Pub food, beverages and supplies	684	697
	\$22,982	\$ 18,300

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

Note 5. Related Party Transactions

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

In December 2015, we partnered with Ambev, the Brazilian subsidiary of Anheuser-Busch InBev SA, to distribute Kona beers into Brazil. Transactions with A-B and Ambev consisted of the following (in thousands):

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	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Gross sales to A-B and Ambev	\$53,638	\$52,279	\$85,894	\$87,946
Margin fee paid to A-B, classified as a reduction of Sales	456	746	814	1,284
Inventory management and other fees paid to A-B, classified in Cost of sales	105	103	191	193

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

	June 30, 2016	December 31, 2015
Amounts due from A-B related to beer sales pursuant to the A-B distributor agreement	\$19,130	\$ 12,576
Refundable deposits due to A-B	(2,774)	(2,291)
Amounts due to A-B for services rendered	(1,647)	(1,645)
Net amount due from A-B	\$14,709	\$ 8,640

Operating Leases

We lease our headquarters office space, restaurant and storage facilities located in Portland, Oregon, as well as the 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 is a current employee. Lease payments to these lessors were as follows (in thousands):

Three Months Ended June 30, 2016	Six Months Ended June 30, 2015
\$30	\$60

We lease or sublease certain office space and the land underlying the brewery and pub location in Kona, Hawaii, from 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):

Three Months Ended June 30, 2016	Six Months Ended June 30, 2015
\$128	\$257

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 current swap contract terminates on September 29, 2023, and had a total notional value of \$7.4 million as of June 30, 2016. 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 0.45% at June 30, 2016.

Effective January 4, 2016, we entered into an interest rate swap contract with BofA to hedge the variability of interest payments associated with our variable-rate borrowings on our Line of Credit. The notional amount fluctuates based on

a predefined schedule based on our anticipated borrowings. The current swap contract terminates on January 1, 2019, and had a total notional value of \$11.7 million as of June 30, 2016. Through this swap agreement, we pay interest at a fixed rate of 1.28% and receive interest at a floating-rate of the one-month LIBOR, which was 0.45% at June 30, 2016.

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, 2016, unrealized net losses of \$1.0 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 Term Loan and Line of Credit. There was no hedge ineffectiveness during the first six months of 2016 or 2015.

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

Fair Value of Derivative Instruments	June 30, 2016	December 31, 2015
Fair value of interest rate swaps	\$(1,011)	\$ (569)

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 (Loss) 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,			
2016	\$ (109)	Interest expense	\$ 71
2015	\$ 179	Interest expense	\$ 52
Six Months Ended			
June 30,			
2016	\$ (442)	Interest expense	\$ 134
2015	\$ 51	Interest expense	\$ 104

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.

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

Fair Value at June 30, 2016	Level 1	Level 2	Level 3	Total
Interest rate swaps	\$	—\$(1,011)	\$	—\$(1,011)

Fair Value at December 31, 2015

Interest rate swaps \$ —\$(569) \$ —\$(569)

We did not have any assets measured at fair value on a recurring basis at June 30, 2016 or December 31, 2015.

The fair value of our interest rate swaps were based on quarterly statements from the issuing bank. There were no changes to our valuation techniques during the six months ended June 30, 2016.

We believe the carrying amounts of Cash and cash equivalents, 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.

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

	June 30, December 31,	
	2016	2015
Fixed-rate debt on balance sheet	\$ 993	\$ 676
Estimated fair value of fixed-rate debt	\$ 1,025	\$ 706

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. Segment Results and Concentrations

Our chief operating decision maker monitors Net sales and gross margins of our Beer Related operations and our Pubs operations. Beer Related operations include the brewing operations and related beer sales of our Widmer Brothers, Redhook, Kona and Omission beer brands, as well as our Square Mile cider brand. Pubs operations primarily include our pubs, 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.

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

	Three Months Ended June 30,			
2016	Beer Related	Pubs	Total	
Net sales	\$54,832	\$7,446	\$62,278	
Gross profit	\$19,369	\$1,129	\$20,498	
Gross margin	35.3	% 15.2	% 32.9	%

2015				
Net sales	\$51,229	\$7,302	\$58,531	
Gross profit	\$17,715	\$975	\$18,690	
Gross margin	34.6	% 13.4	% 31.9	%

	Six Months Ended June 30,			
2016	Beer Related	Pubs	Total	
Net sales	\$87,311	\$14,189	\$101,500	
Gross profit	\$27,223	\$1,992	\$29,215	
Gross margin	31.2	% 14.0	% 28.8	%

2015				
Net sales	\$86,787	\$13,453	\$100,240	
Gross profit	\$28,281	\$1,571	\$29,852	
Gross margin	32.6	% 11.7	% 29.8	%

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.

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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,	
2016	2015	2016	2015
80.2%	82.3%	78.7%	80.8%

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

June 30		December 31,	
2016		2015	
70.0%	66.4	%	

Note 9. Significant Stock-Based Plan Activity and Stock-Based Compensation

Stock-Based Compensation Expense

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

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Cost of sales	\$20	\$20	\$34	\$49
Selling, general and administrative expense	269	305	275	556
Total stock-based compensation expense	\$289	\$325	\$309	\$605

At June 30, 2016, we had total unrecognized stock-based compensation expense of \$2.4 million, which will be recognized over the weighted average remaining vesting period of 2.9 years.

Note 10. 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		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Weighted average common shares used for basic EPS	19,216	19,145	19,198	19,130
Dilutive effect of stock-based awards	16	32	—	34
Shares used for diluted EPS	19,232	19,177	19,198	19,164
Stock-based awards not included in diluted per share calculations as they would be antidilutive	312	248	282	200

Because we were in a loss position for the six months ended June 30, 2016, there is no difference between the number of shares used for the basic and diluted per share calculations.

Note 11. Brewing Arrangement with Pabst Northwest Brewing Company

On January 8, 2016, we entered into brewing agreements ("the brewing agreements") with Pabst Northwest Brewing Company ("Pabst"), a subsidiary of Pabst Brewing Company, under which Pabst began brewing selected Rainier Brewing Company and other brands at our brewery in Woodinville, Washington in the second quarter of 2016 under a license agreement. We will continue to operate the Woodinville brewery and the adjacent Redhook Forecaster's Pub under the agreements, which expire on December 31, 2018.

In conjunction with the brewing agreements, we granted Pabst an option to purchase the Woodinville brewery and adjacent pub, as well as related assets (together, the "Property"), at any time prior to termination of the brewing agreements. The purchase price of the Property will be \$25.0 million if Pabst exercises the option during the first year of the agreement, \$26.0 million if exercise

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occurs during the second year of the agreement, and \$28.0 million if Pabst exercises the option during the third year of the agreement and on or before the close of business on December 31, 2018. Under the option agreement, Pabst conducted an additional diligence review of environmental and title issues relating to the Property, and, upon completion, did not exercise its right to terminate either the brewery agreements or the option agreement. If Pabst does not exercise its option to purchase the Property, it may be required to pay us a termination fee.

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, 2015 (“2015 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 2015 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.

Overview

Craft Brew Alliance, Inc. ("CBA") is the fifth largest craft brewing company in the U.S. and a leader in brewing, branding, and bringing to market some of the world’s best-loved American craft beers.

Craft Brew Alliance 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. Since then, the Alliance has continued to grow, welcoming Kona Brewing Co. in 2008, and expanding with innovative category leaders and strategic partners. Today, we are home to three of the earliest trail blazers in craft beer: Redhook Ale Brewery, Washington’s largest craft brewery, founded in 1981; Widmer Brothers Brewing, Oregon’s largest craft brewery, founded in 1984; and Kona Brewing Company, Hawaii’s oldest and largest craft brewery, founded in 1994. As part of Craft Brew Alliance, these craft brewing legends have expanded their reach across the U.S. and approximately 30 international markets, while remaining deeply rooted to their local communities.

In addition to growing and nurturing distinctive brands steeped in local heritage, Craft Brew Alliance is committed to developing innovative new category leaders, such as Omission Beer, which is the #1 beer in the gluten-free beer segment, Square Mile Cider, the #1 local hard cider in the Pacific Northwest, and Resignation Brewery’s line of KCCO beers in partnership with theChive.com, which represents the first-ever virtual brewery conceived by an online media platform.

As 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 emerging craft beer brands in targeted markets. In 2015, we announced strategic partnerships with Appalachian Mountain

Brewery, based in Boone, North Carolina; and Cisco Brewers, based in Nantucket, Massachusetts. Through this strategic partnership model, we gain local relevance in select beer geographies, while the partner breweries gain access to our world-class leadership and national infrastructure to grow their brands.

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

We proudly brew our craft beers in four company-owned breweries located in Portland, Oregon; the Seattle suburb of Woodinville, Washington; Portsmouth, New Hampshire; and Kailua-Kona, Hawaii; and one brewery in Memphis, Tennessee owned by our brewing partner. Additionally, we own and operate two small innovation breweries, primarily used for small batch production and innovative brews, in Portland, Oregon and Portsmouth, New Hampshire.

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We distribute our beers to retailers through wholesalers that are aligned with the Anheuser-Busch, LLC (“A-B”) network. These sales are made pursuant to a Master Distributor Agreement (the “A-B Distributor Agreement”) with A-B. 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. Kona, Redhook and Widmer Brothers beers are distributed in all 50 states. Omission Beer continues to expand into new markets in the U.S. and internationally, while Square Mile Cider is currently available in 12 states in the West. In December 2015 we partnered with Ambev, the Brazilian subsidiary of Anheuser-Busch InBev SA, to distribute Kona beers into Brazil. 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.

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

Following is a summary of our financial results:

Six Months Ended June 30,	Net sales	Net income (loss)	Number of Barrels Sold
2016	\$101.5 million	\$(0.9) million	395,600
2015	\$100.2 million	\$0.2 million	406,600

Brewing Arrangement with Pabst Northwest Brewing Company

On January 8, 2016, we entered into brewing agreements with Pabst Northwest Brewing Company ("Pabst"), a subsidiary of Pabst Brewing Company, under which Pabst began brewing selected Rainier Brewing Company and other brands at our brewery in Woodinville, Washington, in the second quarter of 2016 under a licensing agreement. We will continue to operate the Woodinville brewery and the adjacent Redhook Forecaster's Pub under the agreements, which expire on December 31, 2018. For additional information, see Note 11 of Notes to Consolidated Financial Statements.

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,	
	2016	2015	2016	2015
Sales	106.4 %	107.0 %	106.5 %	107.0 %
Less excise taxes	(6.4)	(7.0)	(6.5)	(7.0)
Net sales	100.0	100.0	100.00	100.0
Cost of sales	67.1	68.1	71.2	70.2
Gross profit	32.9	31.9	28.8	29.8
Selling, general and administrative expenses	26.6	27.8	30.0	29.1
Operating income (loss)	6.3	4.1	(1.2)	0.6
Interest expense	(0.3)	(0.3)	(0.3)	(0.3)
Other income, net	—	—	—	—
Income (loss) before income taxes	6.1	3.9	(1.6)	0.4

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Income tax expense (benefit)	2.4	1.5	(0.6)	0.2
Net income (loss)	3.6	% 2.4	% (0.9)%	0.2 %

(1) Percentages may not add due to rounding.

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Segment Information

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

Three Months Ended June 30,

2016	Beer Related	Pubs	Total
Net sales	\$54,832	\$7,446	\$62,278
Gross profit	\$19,369	\$1,129	\$20,498
Gross margin	35.3 %	15.2 %	32.9 %

2015

Net sales	\$51,229	\$7,302	\$58,531
Gross profit	\$17,715	\$975	\$18,690
Gross margin	34.6 %	13.4 %	31.9 %

Six Months Ended June 30,

2016	Beer Related	Pubs	Total
Net sales	\$87,311	\$14,189	\$101,500
Gross profit	\$27,223	\$1,992	\$29,215
Gross margin	31.2 %	14.0 %	28.8 %

2015

Net sales	\$86,787	\$13,453	\$100,240
Gross profit	\$28,281	\$1,571	\$29,852
Gross margin	32.6 %	11.7 %	29.8 %

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Sales by Category

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

Sales by Category	Three Months Ended June 30,		Dollar		% Change
	2016	2015	Change	%	
A-B and A-B related ⁽¹⁾	\$53,182	\$51,533	\$1,649	3.2	%
Contract brewing and beer related ⁽²⁾	5,666	3,803	1,863	49.0	%
Excise taxes	(4,016)	(4,107)	91	(2.2)	%
Net beer related sales	54,832	51,229	3,603	7.0	%
Pubs ⁽³⁾	7,446	7,302	144	2.0	%
Net sales	\$62,278	\$58,531	\$3,747	6.4	%

Sales by Category	Six Months Ended June 30,		Dollar		% Change
	2016	2015	Change	%	
A-B and A-B related ⁽¹⁾	\$85,080	\$86,662	\$(1,582)	(1.8)	%
Contract brewing and beer related ⁽²⁾	8,818	7,142	1,676	23.5	%
Excise taxes	(6,587)	(7,017)	430	(6.1)	%
Net beer related sales	87,311	86,787	524	0.6	%
Pubs ⁽³⁾	14,189	13,453	736	5.5	%
Net sales	\$101,500	\$100,240	\$1,260	1.3	%

(1) A-B and A-B related includes domestic and international sales of our owned brands sold through A-B and Ambev, as well as non-owned brands sold pursuant to master distribution agreements.

(2) Beer related includes international beer sales not sold through A-B or Ambev, as well as fees earned through an alternating proprietorship agreement.

(3) Pubs 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,	2016	2015	Increase	% Change	Change in Depletions ⁽¹⁾
	Shipments	Shipments			
A-B and A-B related ⁽²⁾	220,000	218,800	1,200	0.5 %	3 %
Contract brewing and beer related ⁽³⁾	23,100	17,300	5,800	33.5 %	
Pubs	2,900	2,800	100	3.6 %	
Total	246,000	238,900	7,100	3.0 %	

Six Months Ended June 30,	2016	2015	Increase (Decrease)	% Change	Change in Depletions ⁽¹⁾
	Shipments	Shipments			
A-B and A-B related ⁽²⁾	355,100	370,200	(15,100)	(4.1)%	0 %
Contract brewing and beer related ⁽³⁾	35,500	31,500	4,000	12.7 %	
Pubs	5,000	4,900	100	2.0 %	
Total	395,600	406,600	(11,000)	(2.7)%	

(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.

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

The increase in sales to A-B and A-B related in the three-month period ended June 30, 2016 compared to the same period of 2015 was primarily due to an increase in domestic and international shipments, and an increase in unit pricing. International shipments of our beers reflected in A-B and A-B related were to Ambev. The decrease in sales to A-B and A-B related in the six-month period ended June 30, 2016 compared to the same period of 2015 was primarily due to a decrease in domestic shipments, partially offset

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by an increase in unit pricing and international shipments to Ambev. The sales to A-B and A-B related in the three and six-month periods ended June 30, 2016 were also impacted by decreases in domestic shipments of the Redhook and Widmer Brothers brands as we concentrate on their home markets of Washington and Oregon, respectively, as well as our Omission brand. The decreases were partially offset by the continued successful focus on national distribution of Kona. During the first quarter of 2016, we closed our largest and most efficient brewery, located in Portland, for approximately two weeks as we installed new equipment to further increase capacity and efficiency. This closure resulted in a temporary decrease of shipments across our brands in the six-month period of 2016 compared to the same period of 2015.

The increases in Contract brewing and beer related sales in the three and six-month periods ended June 30, 2016 compared to the same periods of 2015 were primarily due to contract brewing volume for Cisco Brewers beers, as well as alternating proprietorship fees earned from Appalachian Mountain Brewing Company for leasing the Portsmouth Brewery, which began during the first quarter of 2016, and an increase in international shipments of our beers, which sell at a higher rate per barrel than contract brewing sales, as we expanded into additional countries. These increases were partially offset by decreases in our other contract brewing volume.

Pubs sales increased in the three and six-month periods ended June 30, 2016 compared to the same periods of 2015, primarily as a result of higher guest counts at our Kona Pub on the island of Oahu in Hawaii, partially offset by decreases in guest counts at our Redhook Pub in Woodinville, Washington. The Hawaii pubs also have higher revenue per guest than the Redhook and Widmer Brothers pubs. The increase in Pubs sales at our Kona Pub on Oahu in the first six months of 2016 compared to the same period of 2015 was primarily due to the closure of the pub in the first quarter of 2015 for three weeks for a full remodel.

Excise taxes vary directly with the volume of beer shipped domestically.

Shipments by Brand

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

Three Months Ended June 30,	2016 Shipments	2015 Shipments	Increase (Decrease)	% Change	Change in Depletions
Kona	130,100	105,000	25,100	23.9 %	18 %
Widmer Brothers	44,900	53,200	(8,300)	(15.6)%	(17)%
Redhook	38,200	48,700	(10,500)	(21.6)%	(19)%
Omission	13,700	14,900	(1,200)	(8.1)%	(6)%
All other ⁽¹⁾	12,100	6,500	5,600	86.2 %	86 %
Total ⁽²⁾	239,000	228,300	10,700	4.7 %	3 %

Six Months Ended June 30,	2016 Shipments	2015 Shipments	Increase (Decrease)	% Change	Change in Depletions
Kona	200,700	168,200	32,500	19.3 %	19 %
Widmer Brothers	78,300	93,600	(15,300)	(16.3)%	(16)%
Redhook	64,400	88,400	(24,000)	(27.1)%	(20)%
Omission	22,400	25,700	(3,300)	(12.8)%	(8)%
All other ⁽¹⁾	15,600	10,900	4,700	43.1 %	44 %
Total ⁽²⁾	381,400	386,800	(5,400)	(1.4)%	0 %

All other includes the shipments and depletions from our Square Mile and Resignation brand families, as well as (1) the non-owned Cisco Brewers and Appalachian Mountain Brewing 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, 2016 compared to the same periods of 2015 were primarily due to increases in domestic and international shipments, primarily led by demand for Big Wave Golden Ale.

The decreases in our Widmer Brothers brand shipments in the three and six-month periods ended June 30, 2016 compared to the same periods of 2015 were primarily due to a concentration on its home market of Oregon, led by decreases in Hefeweizen brand shipments.

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The decreases in our Redhook brand shipments in the three and six-month periods ended June 30, 2016 compared to the same periods of 2015 were primarily due to a concentration on its home market of Washington, led by decreased shipments of Longhammer IPA and ESB.

The decreases in our Omission brand shipments in the three and six-month periods ended June 30, 2016 compared to the same periods of 2015 were primarily due to lower demand for the Pale Ale style.

The increases in our All other shipments in the three and six-month periods ended June 30, 2016 compared to the same periods of 2015 were primarily due to increases in the shipment volumes related to our new distribution agreements with Cisco Brewers and Appalachian Mountain Brewing, partially offset by decreases in our Resignation and Square Mile brand families.

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):

	2016		2015	
Three Months Ended June 30,	Shipments	% of Total	Shipments	% of Total
Draft	53,200	22.3 %	50,400	22.1 %
Packaged	185,800	77.7 %	177,900	77.9 %
Total	239,000	100.0%	228,300	100.0%

	2016		2015	
Six Months Ended June 30,	Shipments	% of Total	Shipments	% of Total
Draft	90,700	23.8 %	89,900	23.2 %
Packaged	290,700	76.2 %	296,900	76.8 %
Total	381,400	100.0%	386,800	100.0%

The package mix was relatively consistent in the three-month period ended June 30, 2016 compared to the same period of 2015. In the six-month period ended June 30, 2016, the shift in package mix was also affected by a greater reduction in our packaged shipments compared to our draft shipments due to the temporary closure of our Oregon brewery discussed above.

Cost of Sales

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

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

	Three Months Ended June 30,		Dollar	
	2016	2015	Change	% Change
Beer Related	\$35,463	\$33,514	\$1,949	5.8 %
Pubs	6,317	6,327	(10)	(0.2)%
Total	\$41,780	\$39,841	\$1,939	4.9 %

	Six Months Ended June 30,		Dollar	
	2016	2015	Change	

				%	
				Change	
Beer Related	\$60,088	\$58,506	\$1,582	2.7	%
Pubs	12,197	11,882	315	2.7	%
Total	\$72,285	\$70,388	\$1,897	2.7	%

The increase in Beer Related Cost of sales in the three-month period ended June 30, 2016 compared to the same period of 2015 was primarily due to an increase in our shipment volume, and increases in brewery costs and distribution rates per barrel, partially offset by a decrease in component material costs on a per barrel basis. The increase in Beer Related Cost of sales in the six-month period ended June 30, 2016 compared to the same period of 2015 was primarily due to increases in brewery costs and distribution rates per barrel, partially offset by decreases in component material costs on a per barrel basis and shipment volume. The brewery costs per barrel for the three-month period ended June 30, 2016 increased as we began to absorb several key strategic operational enhancements completed during the first quarter of 2016. Our cost of goods for the six-month period were also negatively impacted

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by the operational enhancements, which required the temporary closure of our largest-volume brewery in Portland and led to a decrease in brewing volume in the first quarter of 2016.

Pubs Cost of sales in the three-month period ended June 30, 2016 compared to the same period of 2015, was relatively flat. The increase in Pubs Cost of sales in the six-month period ended June 30, 2016 compared to the same period of 2015 was primarily due to an increase in Sales at our Kona Pub on the island of Oahu.

Capacity utilization is calculated by dividing total shipments from our owned breweries by the approximate working capacity of these breweries and was as follows:

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2015	Three Months Ended June 30, 2016	Six Months Ended June 30, 2015
Capacity utilization	86%	82%	69%	70%

Capacity utilization in the six-month period ended June 30, 2016 was impacted by the closure of our largest and most efficient brewery, located in Portland, for approximately two weeks during the first quarter of 2016 as we installed new equipment to further increase capacity and efficiency. In June 2014, we initiated full-scale brewing with our brewing partner in Memphis, Tennessee. This partnership provides us scalable capacity and we anticipate producing up to 100,000 barrels at this location in 2016.

Gross Profit

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

	Three Months Ended June 30,		Dollar	
	2016	2015	Change	% Change
Beer Related	\$ 19,369	\$ 17,715	\$ 1,654	9.3 %
Pubs	1,129	975	154	15.8 %
Total	\$ 20,498	\$ 18,690	\$ 1,808	9.7 %

	Six Months Ended June 30,		Dollar	
	2016	2015	Change	% Change
Beer Related	\$ 27,223			