
**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 September 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

(State or other jurisdiction of incorporation or organization)

91-1141254

(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 every Interactive Data File required to be submitted 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 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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 November 1, 2018 was 19,381,762.

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)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash, cash equivalents and restricted cash	\$ 12,156	\$ 579
Accounts receivable, net	28,460	27,784
Inventory, net	17,271	13,844
Assets held for sale	—	22,946
Other current assets	1,275	4,335
Total current assets	59,162	69,488
Property, equipment and leasehold improvements, net	104,225	106,283
Goodwill	12,917	12,917
Intangible, equity method investment and other assets, net	20,244	20,949
Total assets	\$ 196,548	\$ 209,637
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 18,899	\$ 14,338
Accrued salaries, wages and payroll taxes	4,749	5,877
Refundable deposits	4,029	4,816
Deferred revenue	5,335	3,385
Other accrued expenses	2,415	2,368
Current portion of long-term debt and capital lease obligations	816	699
Total current liabilities	36,243	31,483
Long-term debt and capital lease obligations, net of current portion	9,763	32,599
Deferred income tax liability, net	12,271	12,886
Other liabilities	1,639	1,878
Total liabilities	59,916	78,846
Commitments and contingencies (Note 12)		
Common shareholders' equity:		
Common stock, \$0.005 par value. Authorized 50,000,000 shares; issued and outstanding 19,381,762 and 19,309,829	97	96
Additional paid-in capital	143,589	142,196
Accumulated other comprehensive income (loss)	3	(164)
Accumulated deficit	(7,057)	(11,337)
Total common shareholders' equity	136,632	130,791
Total liabilities and common shareholders' equity	\$ 196,548	\$ 209,637

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Sales	\$ 55,639	\$ 60,040	\$ 170,977	\$ 171,010
Less excise taxes	2,750	3,402	8,778	9,520
Net sales	52,889	56,638	162,199	161,490
Cost of sales	36,190	37,254	108,302	111,108
Gross profit	16,699	19,384	53,897	50,382
Selling, general and administrative expenses	16,712	16,328	47,317	47,357
Operating income (loss)	(13)	3,056	6,580	3,025
Interest expense	(107)	(179)	(348)	(533)
Other income (expense), net	(13)	(59)	42	(46)
Income (loss) before income taxes	(133)	2,818	6,274	2,446
Income tax provision (benefit)	(194)	1,067	1,600	758
Net income	\$ 61	\$ 1,751	\$ 4,674	\$ 1,688
Basic and diluted net income per share	\$ —	\$ 0.09	\$ 0.24	\$ 0.09
Shares used in basic per share calculations	19,370	19,296	19,338	19,278
Shares used in diluted per share calculations	19,545	19,443	19,525	19,401

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$ 61	\$ 1,751	\$ 4,674	\$ 1,688
Unrealized gain on derivative hedge transactions, net of tax	38	15	167	63
Comprehensive income	<u>\$ 99</u>	<u>\$ 1,766</u>	<u>\$ 4,841</u>	<u>\$ 1,751</u>

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

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

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 4,674	\$ 1,688
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,985	7,904
(Gain) loss on sale or disposal of Property, equipment and leasehold improvements	(549)	164
Deferred income taxes	(673)	(168)
Stock-based compensation	1,058	945
Other	206	906
Changes in operating assets and liabilities:		
Accounts receivable, net	(676)	(4,886)
Inventories	(2,905)	1,371
Other current assets	2,360	1,124
Accounts payable and other accrued expenses	6,872	13,096
Accrued salaries, wages and payroll taxes	(1,128)	1,203
Refundable deposits	(560)	(884)
Net cash provided by operating activities	16,664	22,463
Cash flows from investing activities:		
Expenditures for Property, equipment and leasehold improvements	(6,216)	(16,170)
Proceeds from sale of Property, equipment and leasehold improvements	22,998	95
Investment in Wynwood	—	(2,101)
Restricted cash from sale of Property, equipment and leasehold improvements	515	—
Net cash provided by (used in) investing activities	17,297	(18,176)
Cash flows from financing activities:		
Principal payments on debt and capital lease obligations	(520)	(483)
Net repayments under revolving line of credit	(22,199)	(3,922)
Proceeds from issuances of common stock	427	98
Tax payments related to stock-based awards	(92)	(17)
Net cash used in financing activities	(22,384)	(4,324)
Increase (decrease) in Cash, cash equivalents and restricted cash	11,577	(37)
Cash, cash equivalents and restricted cash:		
Beginning of period	579	442
End of period	\$ 12,156	\$ 405
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 396	\$ 540
Cash paid for income taxes, net	450	216
Supplemental disclosure of non-cash information:		
Purchases of Property, equipment and leasehold improvements with capital leases	\$ —	\$ 400
Purchases of Property, equipment and leasehold improvements included in Accounts payable at end of period	205	285

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

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 (loss), Net income or Basic or diluted net income per share.

Note 2. Recent Accounting Pronouncements

ASU 2018-15

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-15, "Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract." ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. ASU 2018-15 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. We are still evaluating the effect of the adoption of ASU 2018-15.

ASU 2018-13

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." ASU 2018-13 removes, modifies and adds certain disclosure requirements on fair value measurements. ASU 2018-13 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. We are still evaluating the effect of the adoption of ASU 2018-13.

ASU 2018-02

In February 2018, the FASB issued 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 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, ASU 2018-10 and ASU 2018-11

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.

In July 2018, the FASB issued ASU 2018-10, "Codification Improvements to Topic 842, Leases." ASU 2018-10 provides narrow amendments that clarify how to apply certain aspects of the guidance in ASU 2016-02. ASU 2018-10 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We are still evaluating the effect of the adoption of ASU 2018-10.

In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842): Targeted Improvements." ASU 2018-11 provides an optional transition method, that allows entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. ASU 2018-11 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. We are still evaluating the effect of the adoption of ASU 2018-11.

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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.

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 September 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 September 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 September 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.

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Inventories consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Raw materials	\$ 7,801	\$ 4,290
Work in process	2,803	1,960
Finished goods	4,354	5,009
Packaging materials	960	956
Promotional merchandise	831	1,161
Brewpub food, beverages and supplies	522	468
	<u>\$ 17,271</u>	<u>\$ 13,844</u>

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

Note 5. Related Party Transactions

As of September 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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Gross sales to A-B and Ambev	\$ 41,737	\$ 46,147	\$ 129,588	\$ 127,932
International distribution fee earned from ABWI	850	850	2,550	2,550
International distribution fee from ABWI, recorded in Deferred revenue	650	400	1,950	1,200
Contract Brewing fee earned from ABC	821	—	1,679	—
Margin fee paid to A-B, classified as a reduction of Sales	601	649	1,806	1,806
Inventory management and other fees paid to A-B, classified in Cost of sales	97	97	287	289
Media and other reimbursement from A-B, classified as a reduction of Selling, general and administrative expenses	192	221	192	295

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

	September 30, 2018	December 31, 2017
Amounts due from A-B related to beer sales pursuant to the A-B distributor agreement	\$ 15,667	\$ 15,663
Amounts due from ABWI and A-B related to international distribution fee	4,500	5,000
Refundable deposits due to A-B	(2,483)	(1,619)
Amounts due to A-B for services rendered	(9,109)	(4,836)
Net amount due from A-B and ABWI	<u>\$ 8,575</u>	<u>\$ 14,208</u>

Transactions with Wynwood Brewing Co. ("Wynwood")

As of September 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 September 30, 2018.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Master distributor fee earned	\$ 3	\$ 3	\$ 22	\$ 3
Royalty fee paid	—	31	—	31
Brewery representative reimbursement, classified as a reduction of Selling, general and administrative expenses	—	42	—	42
Share of loss, classified as a component of Other income (expense), net	22	37	44	37
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):

	September 30, 2018	December 31, 2017
Amounts receivable related to raw materials and alternating proprietorship fees	\$ 277	\$ 148
Amounts receivable related to Brewery representative reimbursements	—	32
Amounts due related to purchases of beer pursuant to the distributor agreement	(206)	(116)
Amounts due related to Royalty fees	—	(4)
Net amount receivable	<u>\$ 71</u>	<u>\$ 60</u>

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 September 30,		Nine Months Ended September 30,	
2018	2017	2018	2017
\$ 41	\$ 26	\$ 123	\$ 87

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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 September 30,		Nine Months Ended September 30,	
2018	2017	2018	2017
\$ 145	\$ 143	\$ 435	\$ 431

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 September 30, 2023. The Term Loan contract had a total notional value of \$6.7 million as of September 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 2.18% at September 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 September 30, 2018, unrealized net gains of \$4,000 were recorded in Accumulated other comprehensive income (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 nine months of 2018 or 2017.

The fair value of our derivative instruments are recorded as a component of Other liabilities on our consolidated balance sheets was as follows (in thousands):

	September 30, 2018	December 31, 2017
Fair value of interest rate swaps - asset (liability)	\$ 4	\$ (221)

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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 September 30,			
2018	\$ 52	Interest expense	\$ 13
2017	\$ 24	Interest expense	\$ 30
Nine Months Ended September 30,			
2018	\$ 225	Interest expense	\$ 52
2017	\$ 101	Interest expense	\$ 123

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 assets and (liabilities) measured at fair value on a recurring basis (in thousands):

Fair Value at September 30, 2018	Level 1	Level 2	Level 3	Total
Interest rate swap	\$ —	\$ 4	\$ —	\$ 4
Fair Value at December 31, 2017				
Interest rate swaps	\$ —	\$ (221)	\$ —	\$ (221)

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 nine months ended September 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):

	September 30, 2018	December 31, 2017
Fixed-rate debt on Consolidated Balance Sheets	\$ 1,648	\$ 1,855
Estimated fair value of fixed-rate debt	1,671	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 nine-month periods ended September 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)

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):

	September 30, 2018		
	As Reported	Balance without Adoption of ASC 606	Effect of Change Higher (Lower)
Consolidated Balance Sheets			
Assets:			
Other current assets	\$ 1,275	\$ 1,492	\$ (217)
Intangible, equity method investment and other assets, net	20,244	20,244	—
Liabilities:			
Deferred income tax liability, net	12,271	12,316	(45)
Common shareholders' equity:			
Accumulated deficit	\$ (7,057)	\$ (7,319)	\$ (262)

	Three Months Ended September 30, 2018			Nine Months Ended September 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	\$ 16,712	\$ 16,771	\$ (59)	\$ 47,317	\$ 47,495	\$ (178)
Income tax provision (benefit)	(194)	(209)	15	1,600	1,555	45
Net income	61	19	42	4,674	4,546	128

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

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	Beer Related ¹	Brewpubs	Total	Beer Related ¹	Brewpubs	Total
Product sold through distributor agreements ²	\$ 45,326	\$ —	\$ 45,326	\$ 139,141	\$ —	\$ 139,141
Alternating proprietorship and contract brewing fees	2,863	—	2,863	8,748	—	8,748
International distribution fees	850	—	850	2,550	—	2,550
Brewpubs ³	—	6,166	6,166	—	18,278	18,278
Other ⁴	434	—	434	2,260	—	2,260
	<u>\$ 49,473</u>	<u>\$ 6,166</u>	<u>\$ 55,639</u>	<u>\$ 152,699</u>	<u>\$ 18,278</u>	<u>\$ 170,977</u>

- (1) Beer Related sales include sales to A-B subsidiaries including Ambev, ABWI and ABC. Sales to wholesalers through the A-B distributor agreement in the three and nine-month periods ended September 30, 2018 represented 76.9% and 77.2% 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, Deferred revenue on our Consolidated Balance Sheets included \$3.4 million related to the IDA. As of September 30, 2018, we earned the right to receive an additional \$4.5 million pursuant to the IDA, of which we have recognized \$2.6 million as Sales, resulting in Deferred revenue of \$5.3 million at September 30, 2018. We will earn the right to receive an additional \$1.5 million in the fourth quarter of 2018 and we expect to earn the right to receive an additional \$20.0 million in 2019. We expect to recognize an additional \$0.9 million of Deferred revenue as Sales in the remainder of 2018, \$3.2 million in 2019, and \$22.7 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.

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

	Three Months Ended September 30,		
	Beer Related	Brewpubs	Total
2018			
Net sales	\$ 46,723	\$ 6,166	\$ 52,889
Gross profit	\$ 16,261	\$ 438	\$ 16,699
Gross margin	34.8%	7.1%	31.6%
2017			
Net sales	\$ 49,073	\$ 7,565	\$ 56,638
Gross profit	\$ 18,679	\$ 705	\$ 19,384
Gross margin	38.1%	9.3%	34.2%
	Nine Months Ended September 30,		
	Beer Related	Brewpubs	Total
2018			
Net sales	\$ 143,921	\$ 18,278	\$ 162,199
Gross profit	\$ 52,913	\$ 984	\$ 53,897
Gross margin	36.8%	5.4%	33.2%
2017			
Net sales	\$ 140,359	\$ 21,131	\$ 161,490
Gross profit	\$ 48,569	\$ 1,813	\$ 50,382
Gross margin	34.6%	8.6%	31.2%

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 Ended September 30,		Nine Months Ended September 30,	
2018	2017	2018	2017
76.9%	77.2%	77.2%	75.2%

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

September 30, 2018	December 31, 2017
70.9%	74.4%

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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of sales	\$ 42	\$ 50	\$ 108	\$ 86
Selling, general and administrative expense	329	341	950	859
Total stock-based compensation expense	\$ 371	\$ 391	\$ 1,058	\$ 945

At September 30, 2018, we had total unrecognized stock-based compensation expense of \$2.0 million, which will be recognized over the weighted average remaining vesting period of 1.8 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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Weighted average common shares used for basic EPS	19,370	19,296	19,338	19,278
Dilutive effect of stock-based awards	175	147	187	123
Shares used for diluted EPS	19,545	19,443	19,525	19,401
Stock-based awards not included in diluted per share calculations as they would be antidilutive	—	—	—	—

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 lawsuit alleges that the defendants misled customers regarding the state in which Kona Brewing Company beers are manufactured. On April 28, 2017, we filed a motion to dismiss the complaint, which was granted in part and denied in part on September 1, 2017. On September 26, 2018, the court granted Plaintiffs' motion for class certification, forming a class of persons within the state of California who purchased certain Kona Brewing Company products within the relevant statute of limitations period. Our motion for reconsideration was denied on October 16, 2018. A trial date has been set for August of 2020. We have not recorded any liabilities with respect to the claims.

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 had been received from Pabst by the end of 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 \$0.6 million from the sale proceeds and recorded a gain of \$0.5 million 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.

Note 15. Subsequent Events

Amendment to Credit Agreement

On October 10, 2018, we executed a First Amendment (the "Amendment") to our Amended and Restated Credit Agreement with Bank of America, N.A. dated November 30, 2015 (as amended, the "Credit Agreement"). The Credit Agreement provides for a term loan and a revolving line of credit. The primary changes effected by the Amendment were to increase the maximum amount available under the line of credit from \$40.0 million to \$45.0 million and to extend the maturity date of the line of credit from November 30, 2020 to September 30, 2023, which is also the maturity date of the term loan. The maximum amount of the line of credit is subject to loan commitment reductions in the amount of \$750,000 each quarter beginning March 31, 2020. The Amendment also increased the limit on the total amount of investments that we may make in other craft brewers from \$5.0 million to \$10.0 million.

As amended, the Credit Agreement requires us to satisfy the following financial covenants: (i) a Consolidated Leverage Ratio of 3.50 to 1.00 and (ii) a Fixed Charge Coverage Ratio of 1.20 to 1.00. Failure to maintain compliance with these covenants is an event of default and would give BofA the right to declare the entire outstanding loan balance immediately due and payable.

Purchase of Intellectual Property of Cisco Brewers, Inc. ("Cisco")

On October 10, 2018, we purchased the intellectual property assets of Cisco, relating to its malt beverage products (the "Products"), including all trademarks, logos, and goodwill, as well as raw materials, finished goods, work in process, packaging materials, specified contract rights, and other assets relating to the manufacture and sale of those Products (the "Purchase Transaction"). We paid \$23.0 million in cash (the "Purchase Price"), assumed certain liabilities relating to the acquired assets, and agreed to pay an additional amount as a cash incentive payment based on Product shipments in 2023 in excess of a specified number of barrels. The Purchase Transaction excluded certain assets owned by Cisco, including intellectual property rights associated with its operation of its brewpub in Nantucket and a taproom in Boston, Massachusetts, as well as our brewpub in Portsmouth, New Hampshire, which Cisco began operating in June 2018. Of the Purchase Price, \$690,000 was placed in escrow to cover potential liabilities associated with certain third party and direct claims relating to the assets purchased and liabilities assumed in the Purchase Transaction.

We also entered into an agreement permitting Cisco to operate up to three initial brewpubs and any number of "pop-up" locations, royalty-free under a non-exclusive license arrangement, using the intellectual property rights associated with the Products acquired by us in the Purchase Transaction. The license agreement permits Cisco to operate additional brewpubs upon the payment of a \$50,000 annual royalty per brewpub.

As of the date of this report, the initial accounting for the Purchase Transaction was incomplete; therefore, we have not disclosed how we accounted for the transaction, including the amounts recognized for the transaction and the line item in the financial statements in which each amount is recognized, the amount of acquisition related costs, amounts recognized as expenses and the line item in the income statement in which each expense is recognized, and the issuance cost not recognized as expense.

Agreement to Acquire Appalachian Mountain Brewery ("AMB")

On October 10, 2018, we entered into an agreement to acquire substantially all the assets of AMB, subject to regulatory approval by the U.S. Alcohol and Tobacco Tax and Trade Bureau and the approval of holders of a majority of the outstanding shares of voting capital stock of AMB.

Increase in Ownership Interest of Wynwood

On October 10, 2018, we increased our ownership interest in Wynwood, which operates a brewery and taproom in Miami, Florida, from 24.5% to 100%. Wynwood is now a wholly owned subsidiary.

Primary Reasons Behind Transactions

We completed the acquisition of Cisco's intellectual property, increased our ownership interest in Wynwood and entered into an agreement to acquire substantially all the assets of AMB to unlock the full potential of each brand. Over the past several years, our partnerships with North Carolina-based AMB, Massachusetts-based Cisco, and Florida-based Wynwood have bolstered our brand portfolio with strong local brands and breweries in key markets, complementing Kona as the anchor of our portfolio strategy. Further, these partners have supported our strategic brewery evolution by leveraging the capability and location of the Portsmouth, New Hampshire brewery to increase production for partner brands as we rebalanced our brewing footprint. We plan to increase marketing spend and resources to fuel each brand's growth and help drive continued innovation and greater levels of support for their local communities.

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.

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 brands 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. 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, CBA has expanded its portfolio of brands and maximized its brewing footprint, initially through strategic partnerships with Appalachian Mountain Brewery ("AMB"), based in Boone, North Carolina; Cisco Brewers ("Cisco"), based in Nantucket, Massachusetts; and Wynwood Brewing Co. ("Wynwood"), based in Miami, Florida. Through these strategic partnerships, we gained local relevance in select beer geographies, while our partner breweries acquired 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% ownership interest in Wynwood and acquired the remaining ownership interest in Wynwood in October 2018. Also in October 2018, we purchased the intellectual property assets of Cisco and entered into an agreement to acquire substantially all the assets of AMB. See Note 15 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q for additional information regarding these transactions.

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 have been producing some CBA beers at ABCS's brewery in Fort Collins, Colorado since 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 our regional brands 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 Anheuser-Busch Companies, LLC ("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.

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Following is a summary of our financial results:

Nine Months Ended September 30,	Net sales	Net income	Number of barrels sold
2018	\$162.2 million	\$4.7 million	587,400
2017	\$161.5 million	\$1.7 million	586,300

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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Sales	105.2 %	106.0 %	105.4 %	105.9 %
Less excise taxes	(5.2)	(6.0)	(5.4)	(5.9)
Net sales	100.0	100.0	100.0	100.0
Cost of sales	68.4	65.8	66.8	68.8
Gross profit	31.6	34.2	33.2	31.2
Selling, general and administrative expenses	31.6	28.8	29.2	29.3
Operating income (loss)	—	5.4	4.1	1.9
Interest expense	(0.2)	(0.3)	(0.2)	(0.3)
Other income (expense), net	—	(0.1)	—	—
Income (loss) before income taxes	(0.3)	5.0	3.9	1.5
Income tax provision (benefit)	(0.4)	1.9	1.0	0.5
Net income	0.1 %	3.1 %	2.9 %	1.0 %

(1) Percentages may not add due to rounding.

Segment Information

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

	Three Months Ended September 30,		
	Beer Related	Brewpubs	Total
2018			
Net sales	\$ 46,723	\$ 6,166	\$ 52,889
Gross profit	\$ 16,261	\$ 438	\$ 16,699
Gross margin	34.8%	7.1%	31.6%
2017			
Net sales	\$ 49,073	\$ 7,565	\$ 56,638
Gross profit	\$ 18,679	\$ 705	\$ 19,384
Gross margin	38.1%	9.3%	34.2%
Nine Months Ended September 30,			
	Beer Related	Brewpubs	Total
2018			
Net sales	\$ 143,921	\$ 18,278	\$ 162,199
Gross profit	\$ 52,913	\$ 984	\$ 53,897
Gross margin	36.8%	5.4%	33.2%
2017			
Net sales	\$ 140,359	\$ 21,131	\$ 161,490
Gross profit	\$ 48,569	\$ 1,813	\$ 50,382
Gross margin	34.6%	8.6%	31.2%

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Sales by Category

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

Sales by Category	Three Months Ended September 30,		Dollar Change	% Change
	2018	2017		
A-B and A-B related ⁽¹⁾	\$ 42,807	\$ 46,348	\$ (3,541)	(7.6)%
Contract brewing and beer related ⁽²⁾	6,666	6,127	539	8.8 %
Excise taxes	(2,750)	(3,402)	652	(19.2)%
Net beer related sales	46,723	49,073	(2,350)	(4.8)%
Brewpubs ⁽³⁾	6,166	7,565	(1,399)	(18.5)%
Net sales	\$ 52,889	\$ 56,638	\$ (3,749)	(6.6)%

Sales by Category	Nine Months Ended September 30,		Dollar Change	% Change
	2018	2017		
A-B and A-B related ⁽¹⁾	\$ 132,011	\$ 128,676	\$ 3,335	2.6 %
Contract brewing and beer related ⁽²⁾	20,688	21,203	(515)	(2.4)%
Excise taxes	(8,778)	(9,520)	742	(7.8)%
Net beer related sales	143,921	140,359	3,562	2.5 %
Brewpubs ⁽³⁾	18,278	21,131	(2,853)	(13.5)%
Net sales	\$ 162,199	\$ 161,490	\$ 709	0.4 %

(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, fees earned pursuant to the 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 September 30,	2018 Shipments	2017 Shipments	Increase (Decrease)	% Change	Change in Depletions ⁽¹⁾
A-B and A-B related ⁽²⁾	170,000	182,700	(12,700)	(7.0)%	(1)%
Contract brewing and beer related ⁽³⁾	24,000	22,700	1,300	5.7 %	
Brewpubs	1,800	2,500	(700)	(28.0)%	
Total	195,800	207,900	(12,100)	(5.8)%	

Nine Months Ended September 30,	2018 Shipments	2017 Shipments	Increase (Decrease)	% Change	Change in Depletions ⁽¹⁾
A-B and A-B related ⁽²⁾	514,800	512,000	2,800	0.5 %	(2)%
Contract brewing and beer related ⁽³⁾	67,000	67,200	(200)	(0.3)%	
Brewpubs	5,600	7,100	(1,500)	(21.1)%	
Total	587,400	586,300	1,100	0.2 %	

(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 Brewing Agreement with ABC.

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

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The decrease in sales to A-B and A-B related in the three-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to a decrease in shipment volume due to timing of production runs in Fort Collins, partially offset by an increase in average unit pricing. International distribution fees earned were \$0.9 million in the three-month periods ended September 30, 2018 and 2017. The increase in sales to A-B and A-B related in the nine-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to increases in average unit pricing and shipment volume. International distribution fees earned were \$2.6 million in the nine-month periods ended September 30, 2018 and 2017.

The increase in Contract brewing and beer related sales in the three-month period ended September 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 nine-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to \$1.7 million of non-recurring fees earned in the 2017 period from Pabst Northwest Brewing Company ("Pabst") related to a contract brewing volume shortfall and a decrease in contract brewing volume, 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 nine-month periods ended September 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. Sales at our Kona brewpub were adversely affected by the lower tourism resulting from the eruption of the Kilauea volcano and hurricane Lane.

In December 2017, the Tax Cuts and Jobs Act was signed into law; it provides significant excise tax relief to small and regional brewers and small wineries 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 is \$0.056 for an effective rate of \$0.17 per gallon; and producers like us, who produce between 130,000 and 750,000 gallons, 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.

Shipments by Brand

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

Three Months Ended September 30,	2018 Shipments	2017 Shipments	Increase (Decrease)	% Change	Change in Depletions
Kona	120,100	122,500	(2,400)	(2.0)%	9 %
Widmer Brothers	24,600	32,900	(8,300)	(25.2)%	(22)%
Redhook	16,200	24,400	(8,200)	(33.6)%	(27)%
Omission	11,400	12,600	(1,200)	(9.5)%	(4)%
All other ⁽¹⁾	14,500	12,800	1,700	13.3 %	8 %
Total ⁽²⁾	<u>186,800</u>	<u>205,200</u>	<u>(18,400)</u>	(9.0)%	(1)%

Nine Months Ended September 30,	2018 Shipments	2017 Shipments	Increase (Decrease)	% Change	Change in Depletions
Kona	360,100	335,500	24,600	7.3 %	7 %
Widmer Brothers	76,800	96,100	(19,300)	(20.1)%	(20)%
Redhook	55,200	71,700	(16,500)	(23.0)%	(26)%
Omission	34,500	33,900	600	1.8 %	3 %
All other ⁽¹⁾	39,500	35,400	4,100	11.6 %	13 %
Total ⁽²⁾	<u>566,100</u>	<u>572,600</u>	<u>(6,500)</u>	(1.1)%	(2)%

(1) All other includes the shipments and depletions from our Square Mile brand family, as well as the previously non-owned Cisco Brewers, AMB and Wynwood 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 decrease in our Kona brand shipments in the three-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to a decrease in domestic shipments, primarily led by a decline in the Longboard Lager brand, partially offset by continued demand for Big Wave Golden Ale. In the third quarter of 2017, more Kona beer was produced and shipped out of A-B's Fort Collins brewery than in the third quarter of 2018, primarily due to timing of production runs.

The increase in our Kona brand shipments in the nine-month period ended September 30, 2018 compared to the same period of 2017 was 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, partially offset by declines in Longboard Lager.

The decreases in our Widmer Brothers brand shipments in the three and nine-month periods ended September 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 nine-month periods ended September 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 the Longhammer IPA brand, partially offset by increased demand for our Big Ballard IPA brand.

Omission brand shipments decreased in the three-month period ended September 30, 2018 compared to the same period of 2017, primarily led by declines in the Pale Ale and Lager brands, partially offset by increased demand for our newest brand, Omission Ultimate Light.

Omission brand shipments increased in the nine-month period ended September 30, 2018 compared to the same period of 2017, primarily led by increased demand for our newest brand, Omission Ultimate Light, partially offset by declines in the Pale Ale and Lager brands.

The increases in All other shipments in the three and nine-month periods ended September 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 and AMB.

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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 September 30,			
	2018		2017	
	Shipments	% of Total	Shipments	% of Total
Draft	43,500	23.3%	46,700	22.8%
Packaged	143,300	76.7%	158,500	77.2%
Total	<u>186,800</u>	<u>100.0%</u>	<u>205,200</u>	<u>100.0%</u>

	Nine Months Ended September 30,			
	2018		2017	
	Shipments	% of Total	Shipments	% of Total
Draft	132,500	23.4%	130,900	22.9%
Packaged	433,600	76.6%	441,700	77.1%
Total	<u>566,100</u>	<u>100.0%</u>	<u>572,600</u>	<u>100.0%</u>

The package mix was relatively consistent in the three and nine-month periods ended September 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 September 30,		Dollar Change	% Change
	2018	2017		
	Beer Related	\$ 30,462		
Brewpubs	5,728	6,860	(1,132)	(16.5)%
Total	<u>\$ 36,190</u>	<u>\$ 37,254</u>	<u>\$ (1,064)</u>	<u>(2.9)%</u>

	Nine Months Ended September 30,		Dollar Change	% Change
	2018	2017		
	Beer Related	\$ 91,008		
Brewpubs	17,294	19,318	(2,024)	(10.5)%
Total	<u>\$ 108,302</u>	<u>\$ 111,108</u>	<u>\$ (2,806)</u>	<u>(2.5)%</u>

The slight increase in Beer Related Cost of sales in the three-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to an increase in brewery costs on a per barrel basis as a result of lower overall utilization and an increase in alternating proprietorship volume, partially offset by a decrease in shipment volume.

The decrease in Beer Related Cost of sales in the nine-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to a decrease in Beer Related Cost of sales on a per barrel basis. The decrease in our Beer Related Cost of sales on a per barrel basis was primarily due to the lower cost of having a portion of our beer produced by A-B in its Fort 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 due to higher fixed overhead and distribution rates on a per barrel basis and an increase in shipment volume.

The decreases in Brewpubs Cost of sales in the three and nine-month periods ended September 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 in the nine-month period.

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Capacity Utilization

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Capacity Utilization	59%	63%	59%	62%

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-month period ended September 30, 2018 compared to the same period of 2017 due to a decrease in shipment volume. Our capacity utilization declined in the nine-month period ended September 30, 2018 compared to the same period of 2017 due to 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 September 30,		Dollar Change	% Change
	2018	2017		
Beer Related	\$ 16,261	\$ 18,679	\$ (2,418)	(12.9)%
Brewpubs	438	705	(267)	(37.9)%
Total	\$ 16,699	\$ 19,384	\$ (2,685)	(13.9)%

	Nine Months Ended September 30,		Dollar Change	% Change
	2018	2017		
Beer Related	\$ 52,913	\$ 48,569	\$ 4,344	8.9 %
Brewpubs	984	1,813	(829)	(45.7)%
Total	\$ 53,897	\$ 50,382	\$ 3,515	7.0 %

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Beer Related	34.8%	38.1%	36.8%	34.6%
Brewpubs	7.1%	9.3%	5.4%	8.6%
Overall	31.6%	34.2%	33.2%	31.2%

The decrease in Beer Related Gross profit and gross margin in the three-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to a decrease in shipment volume and an increase in brewery costs on a per barrel basis, partially offset by increased unit pricing. Beer Related Gross profit and gross margin were also negatively affected by a change in mix of our shipments from our more profitable owned brands to less profitable alternating proprietorship and contract brewing volume, as well as decreased cross-brewing volume from A-B's Fort Collins brewery.

The increase in Beer Related Gross profit and gross margin in the nine-month period ended September 30, 2018 compared to the same period of 2017 was 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 Fort Collins, partially offset by \$1.7 million of non-recurring fees earned from Pabst related to a contract

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brewing volume shortfall in the 2017 nine-month period, and increases in brewery costs and distribution rates on a per barrel basis and an increase in alternating proprietorship volume.

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

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 September 30,		Dollar Change	% Change
	2018	2017		
Selling, general and administrative expenses	\$ 16,712	\$ 16,328	\$ 384	2.4%
As a % of Net sales	31.6%	28.8%		

	Nine Months Ended September 30,		Dollar Change	% Change
	2018	2017		
Selling, general and administrative expenses	\$ 47,317	\$ 47,357	\$ (40)	(0.1)%
As a % of Net sales	29.2%	29.3%		

The increase in SG&A for the three-month period ended September 30, 2018 compared to the same period of 2017 was primarily due to increased professional fees and in-market promotional spend, partially offset by a decrease in general and administrative costs.

The slight decrease in SG&A for the nine-month period ended September 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 general and administrative costs, partially offset by increases in in-market promotional spend and professional fees. For the remainder of 2018, promotional, creative and media spend are expected to increase.

Interest Expense

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

	Three Months Ended September 30,		Dollar Change	% Change
	2018	2017		
	\$ 107	\$ 179	\$ (72)	(40.2)%

	Nine Months Ended September 30,		Dollar Change	% Change
	2018	2017		
	\$ 348	\$ 533	\$ (185)	(34.7)%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Average debt outstanding	\$10,665	\$25,299	\$13,056	\$26,238
Average interest rate	3.52%	2.34%	3.02%	2.08%

The decreases in Interest expense in the three and nine-month periods ended September 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.

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The decreases in our average debt outstanding were due to principal payments made on our term loan and the payoff of our revolving credit balance following the sale of our Woodinville, Washington brewery in January 2018.

Income Tax Provision (Benefit)

Our effective income tax rate was 25.5% for the first nine months of 2018 and 31.0% in the first nine 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.

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 25.5% 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 October 1, 2018 primarily from cash on hand, cash flows generated from operations and borrowing under our line of credit as the need arises. Capital resources available to us at September 30, 2018 included \$11.6 million of Cash and cash equivalents and \$38.1 million available under our revolving credit facility.

At September 30, 2018 and December 31, 2017, we had \$22.9 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 7.2% and 20.3%, respectively.

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

	Nine Months Ended September 30,	
	2018	2017
Net cash provided by operating activities	\$ 16,664	\$ 22,463
Net cash provided by (used in) investing activities	17,297	(18,176)
Net cash used in financing activities	(22,384)	(4,324)
Increase (decrease) in Cash, cash equivalents and restricted cash	<u>\$ 11,577</u>	<u>\$ (37)</u>

Cash provided by operating activities of \$16.7 million in the first nine months of 2018 resulted from our Net income of \$4.7 million, net non-cash expenses of \$8.0 million and changes in our operating assets and liabilities as discussed in more detail below.

Accounts receivable, net, increased \$0.7 million to \$28.5 million at September 30, 2018 compared to \$27.8 million at December 31, 2017. This increase was primarily due to a \$1.3 million increase in our receivable from our non-A-B customers, including our international distributor and partner breweries, partially offset by a net decrease of \$0.5 million for amounts due from ABWI related to the international distribution fee. The receivable from A-B and ABWI totaled \$20.2 million at September 30, 2018. Historically, we have not had collection problems related to our accounts receivable.

Inventories increased \$3.5 million to \$17.3 million at September 30, 2018 compared to \$13.8 million at December 31, 2017. The increase was primarily due to an increase in raw materials as we purchased hops under raw material contracts.

Accounts payable increased \$4.6 million to \$18.9 million at September 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.

Capital expenditures of \$6.2 million in the first nine months of 2018 were primarily directed to beer production capacity and efficiency improvements. As of September 30, 2018, we had an additional \$0.2 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 Kona brewery. We anticipate total capital expenditures of approximately \$16.0 million to \$17.0 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.

Credit Agreement

On October 10, 2018, we executed a First Amendment (the "Amendment") to our Amended and Restated Credit Agreement with Bank of America, N.A. ("BofA") dated November 30, 2015 (as amended, the "Credit Agreement"). The Credit Agreement provides for a term loan (the "Term Loan") with an original principal balance of \$10.8 million and a \$45.0 million reducing revolving line of credit (the "Line of Credit"), including provisions for cash borrowings and up to \$2.5 million notional amount of standby letters of credit. We may draw upon the Line of Credit for working capital and general corporate purposes until expiration on September 30, 2023. The maximum amount of the Line of Credit is subject to loan commitment reductions in the amount of \$750,000 each quarter beginning March 31, 2020. As of September 30, 2018, we had \$38.1 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 also September 30, 2023. At September 30, 2018, \$8.9 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 September 30, 2018, our marginal rate was 0.75%, resulting in an annual interest rate of 2.86%.

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 Credit Agreement, with any unpaid principal balance and unpaid accrued interest due and payable on September 30, 2023.

The Credit Agreement requires us to satisfy the following financial covenants: (i) a Consolidated Leverage Ratio of 3.50 to 1.00 and (ii) a Fixed Charge Coverage Ratio of 1.20 to 1.00. Failure to maintain compliance with these covenants is an event of default and would give BofA the right to declare the entire outstanding loan balance immediately due and payable. As of September 30, 2018, we were in compliance with all financial covenants.

The Credit Agreement authorizes acquisitions within the same line of business as long as we remain in compliance with the financial covenants of the Credit Agreement and there is at least \$5.0 million of availability remaining on the Line of Credit following the acquisition. The Credit Agreement also limits the total amount of investments that we may make in other craft brewers to \$10.0 million; provided that such limit does not apply to the acquisition of all or substantially all the assets of, or a controlling ownership interest in, such business or business unit.

See Note 15 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q for additional information regarding the Amendment.

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.

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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.

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 third 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.

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 November 7, 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

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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.

November 7, 2018

By: /s/ Edwin A. Smith

Edwin A. Smith
*Corporate Controller and
Principal Accounting Officer*

CERTIFICATION

I, Andrew J. Thomas, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Craft Brew Alliance, Inc. (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and we have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: November 7, 2018

By: /s/ Andrew J. Thomas

Andrew J. Thomas

Chief Executive Officer

CERTIFICATION

I, Edwin A. Smith, certify that, in the course of performing the functions of Chief Financial Officer:

1. I have reviewed this quarterly report on Form 10-Q of Craft Brew Alliance, Inc. (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and we have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: November 7, 2018

By: /s/ Edwin A. Smith
Edwin A. Smith
*Corporate Controller and
Principal Accounting Officer*

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002**

In connection with the Quarterly Report of Craft Brew Alliance, Inc. (the “Registrant”) on Form 10-Q for the quarter ended September 30, 2018, as filed with the Securities and Exchange Commission on November 7, 2018 (the “Report”), Andrew J. Thomas, the Chief Executive Officer of the Registrant, and Edwin A. Smith, the Corporate Controller and Principal Accounting Officer of the Registrant, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to his knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: November 7, 2018

BY: /s/ Andrew J. Thomas

Andrew J. Thomas
Chief Executive Officer
(Principal Executive Officer)

BY: /s/ Edwin A. Smith

Edwin A. Smith
*Corporate Controller and
Principal Accounting Officer*
(Principal Accounting Officer)



FOR IMMEDIATE RELEASE

CRAFT BREW ALLIANCE ANNOUNCES ACCELERATED 9% DEPLETIONS GROWTH FOR KONA IN THE THIRD QUARTER AND HIGHLIGHTS SUCCESSFUL EXPANSION OF PORTFOLIO WITH ACQUISITION OF THREE REGIONAL CRAFT BRANDS

Building on strong year-to-date financial performance, CBA tightens guidance and updates SG&A spend

Portland, Ore. (Nov. 7, 2018) - Craft Brew Alliance, Inc. ("CBA") (Nasdaq: BREW), a leading craft brewing company, today announced financial results for the third quarter and year-to-date ended September 30, 2018. Third quarter results include 9% depletions growth for Kona, as well as continued progress leveraging our improved business fundamentals to develop a strong portfolio for tomorrow as evidenced by the recently announced acquisitions of our three regional partner brands, Appalachian Mountain Brewery, Cisco Brewers, and Wynwood Brewing Co.

As a result of strong year-to-date financial performance in line with management's expectations, including accelerated depletions growth for Kona, a 200-basis-point expansion in gross margin, and a \$0.15 increase in EPS, we are tightening full-year guidance and updating our selling, general & administrative (SG&A) expense and income tax rate. We now anticipate higher SG&A spend to reflect incremental marketing programs to fuel Kona's momentum and ongoing innovation initiatives, as well as costs related to our partner acquisitions.

Accelerating Kona's Growth in the Third Quarter

Kona delivered robust 9% depletions growth in the third quarter, after growing 7% in the second quarter and 3% in the first quarter, improving the year-to-date trend to a 7% increase in depletions. Kona's momentum was driven by flagship Big Wave Golden Ale, which grew total depletions by 30% in the third quarter, and is particularly remarkable amidst increased headwinds in today's fast-changing market. Successful testing of incremental marketing programming in key mainland markets, including Florida, also drove Kona's accelerated performance in the third quarter.

Reshaping our Portfolio for Tomorrow

As part of our Kona Plus strategy to support Kona with strong regional brands in key markets, we took steps to round out our portfolio, culminating with the October 10, 2018 announcement that we are acquiring our three partner brands, Appalachian Mountain Brewery, Cisco Brewers, and Wynwood Brewing Co. Year-to-date, these brands have achieved a combined 18% increase in depletions over the same period last year. Looking forward, we plan to increase investment behind these brands to further bolster their contribution and overall value to CBA.

Unlocking Kona's Potential in Brazil with Local Production and Marketing

Building on a successful 18-month ecommerce pilot with Ambev in Brazil, we committed to a comprehensive business plan to grow Kona in the world's third largest beer market with an initial focus in Rio de Janeiro. The plan includes dedicated local commercial resources and increased marketing, as well as local production of Kona to ensure reliability of supply, freshness of beer, and improved sustainability throughout the value chain. With this plan, Rio will become the lead market in Brazil, serving as a template for future international markets.

Investing in the Future through Innovation

In the third quarter, we continued to invest in exploring new opportunities for future topline growth through our ongoing consumer research projects with the Yale Center for Consumer Insights and global consultancy Prophet, as well as our test-and-learn beverage initiative called the pH Experiment. While the research projects are ongoing, our initial learnings continue to broaden our view of today's changing consumer landscape and inform potential evolution of our business model and portfolio in 2019 and beyond.

Third quarter and year-to-date 2018 financial highlights:

- Third quarter net sales decreased by 6.6% to \$52.9 million, primarily driven by lower shipment volume compared to the third quarter in 2017.
 - Year-to-date net sales increased slightly to \$162.2 million due to improvements in pricing, alternating proprietorship fees, and lower excise tax rates. The increase was partially offset by lower mainland brewpub sales and the absence of a one-time \$1.7 million contract brewing shortfall fee that occurred in the first part of 2017.
- Third quarter total CBA depletions decreased by 1%, improving the year-to-date trend to a decrease of 2% compared to the same period a year ago. The decrease in total depletions for the third quarter and year-to-date primarily reflects declines in Widmer Brothers and Redhook, offset by continued accelerated growth for Kona.
 - Third quarter depletions for portfolio cornerstone Kona grew 9% compared to the third quarter in 2017, driving an improved 7% depletions increase year-to-date, over the same period a year ago.
- Third quarter shipments decreased by 5.8% and increased slightly by 0.2% year-to-date.
 - The evolution in year-to-date shipments was anticipated and reflects our supply chain team's continued work to better align shipments with depletions while maintaining optimal inventory levels.
- Third quarter gross profit decreased by 14% to \$16.7 million, while year-to-date gross profit increased by 7%, to \$53.9 million, over the comparable periods last year. The year-to-date increase was primarily driven by improved revenue rates and cost of goods sold per barrel, partially offset by decreases in brewpub performance.
 - Beer gross margin was 34.8% in the third quarter, a decrease of 330 basis points compared to the third quarter in 2017, primarily due to lower fixed cost absorption as a result of lower shipment volumes. Gross margin for the quarter was also negatively impacted by a change in mix of shipments from more profitable owned brands to less profitable alternating proprietorship and contract brewing volume. These factors were partially offset by a reduction in beer loss and the removal of fixed costs associated with the closure of our Woodinville facility.
 - Year-to-date beer gross margin was 36.8%, an expansion of 220 basis points over the comparable 2017 period, primarily reflecting an increase in net sales and a reduction in cost of goods sold due to increased shipments out of Fort Collins and improved brewery operations, including the elimination of Woodinville as a fixed cost, partially off-set by an increase in contract shipments and higher fuel costs.
 - Total CBA gross margin was 31.6% in the third quarter, a decrease of 260 basis points, compared to the third quarter in 2017. The third quarter gross margin decrease reflects higher cost of goods sold due to lower fixed cost absorption from lower shipment volumes, and lower brewpub gross margins as a result of lower sales in our mainland brewpubs.
 - Year-to-date gross margin was 33.2%, an increase of 200 basis points over the comparable nine-month period in 2017, reflecting improved beer gross margins, offset by lower brewpub gross margins.
- Third quarter SG&A was \$16.7 million, a slight increase over the third quarter of 2017, primarily reflecting increased creative and media investments and initial legal and transaction costs related to our partner acquisitions, partially offset by a decrease in administrative costs.
 - Year-to-date SG&A was \$47.3 million, essentially flat compared to the same period last year, as we actively reallocated funds away from general and administrative towards market-facing initiatives.
- Diluted net income per share was \$0.00 for the third quarter, a decrease of \$0.09 compared to the third quarter in 2017.
 - Year to date, diluted net income per share was \$0.24, an increase of \$0.15 over the same period last year.

“We accomplished a lot in the third quarter - from continuing to accelerate Kona, to bringing our partner acquisitions to the finish line, to maintaining close control of our operations - and I'm proud of our team for their continued focus on achieving these milestones,” said Andy Thomas, chief executive officer, CBA. “While our third quarter results were largely in line with our expectations, they nevertheless reflect the increasing costs and challenges of competing in today's crowded market.”

Tightened Year-End Financial Guidance

Based on our solid year-to-date performance, we are updating and tightening our guidance as follows:

- Total depletions and shipments ranging between a decline of 1% and an increase of 1%, reflecting continued progress in harmonizing our supply chain.
- Average price increases of 2% to 3%, reflecting improvements in revenue management and lower federal excise taxes.
- Total gross margin rate of 33.0% to 34.0%, reflecting increases in net revenue per barrel, continued improvements in brewery operations, lower fixed overhead, and ongoing efforts to stabilize pub operations.
- SG&A expense ranging from \$62 million to \$63 million, as we continue to reinvest cost savings into our brands and expand our consumer and trade marketing programming.
- Capital expenditures of \$16 million to \$17 million. Due to variability in the timing of certain significant progress payments related to construction of the new 100,000-barrel Kona brewery, there could be a shift of up to \$6 million from this year into 2019.
- Effective tax rate of 25.5%, a decrease of 250 basis points from the previously communicated tax rate guidance, primarily as a result of the IRS's clarification that certain business expenses continue to qualify for a 50% deduction for income tax purposes.

Forward-Looking Statements

Statements made in this press release that state the Company's or management's intentions, hopes, beliefs, expectations or predictions for the future, including depletions, shipments and sales growth, price increases, and gross margin rate improvement, the level and effect of SG&A expense and business development, anticipated capital spending, our effective income tax rate, and the benefits or improvements to be realized from strategic initiatives and capital projects, are forward-looking statements. It is important to note that the Company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained from time to time in the Company's SEC filings, including, but not limited to, the Company's report on Form 10-K for the year ended December 31, 2017. Copies of these documents may be found on the Company's website, www.craftbrew.com, or obtained by contacting the Company or the SEC.

About Craft Brew Alliance

CBA is an independent craft brewing company that brews, brands, and brings to market world-class American craft beers.

Our distinctive portfolio combines the power of Kona Brewing Company, a dynamic, fast-growing national craft beer brand, with strong regional breweries and innovative lifestyle brands Appalachian Mountain Brewery, Cisco Brewers, Omission Brewing Co., Redhook Brewery, Square Mile Cider Co., Widmer Brothers Brewing, and Wynwood Brewing Co. CBA nurtures the growth and development of its 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.

Formed in 2008, CBA is headquartered in Portland, Oregon and operates breweries and brewpubs across the U.S. CBA beers are available in all 50 U.S. states and 30 different countries around the world. For more information about CBA and our brands, please visit www.craftbrew.com.

Contact:

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Director of Communications
Craft Brew Alliance, Inc.
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Craft Brew Alliance, Inc.
Condensed Consolidated Statements of Operations
(Dollars and shares in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Sales	\$ 55,639	\$ 60,040	\$ 170,977	\$ 171,010
Less excise taxes	2,750	3,402	8,778	9,520
Net sales	52,889	56,638	162,199	161,490
Cost of sales	36,190	37,254	108,302	111,108
Gross profit	16,699	19,384	53,897	50,382
As percentage of net sales	31.6 %	34.2 %	33.2 %	31.2 %
Selling, general and administrative expenses	16,712	16,328	47,317	47,357
Operating income (loss)	(13)	3,056	6,580	3,025
Interest expense	(107)	(179)	(348)	(533)
Other income (expense), net	(13)	(59)	42	(46)
Income (loss) before income taxes	(133)	2,818	6,274	2,446
Income tax provision (benefit)	(194)	1,067	1,600	758
Net income	\$ 61	\$ 1,751	\$ 4,674	\$ 1,688
Basic and diluted net income per share	\$ —	\$ 0.09	\$ 0.24	\$ 0.09
Weighted average shares outstanding:				
Basic	19,370	19,296	19,338	19,278
Diluted	19,545	19,443	19,525	19,401
Total shipments (in barrels):				
Core Brands	186,800	205,200	566,100	572,600
Contract Brewing	9,000	2,700	21,300	13,700
Total shipments	195,800	207,900	587,400	586,300
Change in depletions ⁽¹⁾	(1)%	(2)%	(2)%	(1)%

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

Craft Brew Alliance, Inc.
Condensed Consolidated Balance Sheets
(In thousands)
(Unaudited)

	September 30,	
	2018	2017
Current assets:		
Cash, cash equivalents and restricted cash	\$ 12,156	\$ 405
Accounts receivable, net	28,460	28,894
Inventory, net	17,271	17,659
Assets held for sale	—	23,462
Other current assets	1,275	1,372
Total current assets	59,162	71,792
Property, equipment and leasehold improvements, net	104,225	106,380
Goodwill	12,917	12,917
Intangible, equity method investment and other assets, net	20,244	20,925
Total assets	<u>\$ 196,548</u>	<u>\$ 212,014</u>
Current liabilities:		
Accounts payable	\$ 18,899	\$ 25,088
Accrued salaries, wages and payroll taxes	4,749	6,170
Refundable deposits	4,029	5,477
Deferred revenue	5,335	2,985
Other accrued expenses	2,415	4,602
Current portion of long-term debt and capital lease obligations	816	1,731
Total current liabilities	36,243	46,053
Long-term debt and capital lease obligations, net of current portion	9,763	23,527
Other long-term liabilities	13,910	19,996
Total common shareholders' equity	136,632	122,438
Total liabilities and common shareholders' equity	<u>\$ 196,548</u>	<u>\$ 212,014</u>

Craft Brew Alliance, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 4,674	\$ 1,688
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,985	7,904
(Gain) loss on sale or disposal of Property, equipment and leasehold improvements	(549)	164
Deferred income taxes	(673)	(168)
Other, including stock-based compensation	1,264	1,851
Changes in operating assets and liabilities:		
Accounts receivable, net	(676)	(4,886)
Inventories	(2,905)	1,371
Other current assets	2,360	1,124
Accounts payable and other accrued expenses	6,872	13,096
Accrued salaries, wages and payroll taxes	(1,128)	1,203
Refundable deposits	(560)	(884)
Net cash provided by operating activities	<u>16,664</u>	<u>22,463</u>
Cash flows from investing activities:		
Expenditures for Property, equipment and leasehold improvements	(6,216)	(16,170)
Proceeds from sale of Property, equipment and leasehold improvements	22,998	95
Investment in Wynwood	—	(2,101)
Restricted cash from sale of Property, equipment and leasehold improvements	515	—
Net cash provided by (used in) investing activities	<u>17,297</u>	<u>(18,176)</u>
Cash flows from financing activities:		
Principal payments on debt and capital lease obligations	(520)	(483)
Net repayments under revolving line of credit	(22,199)	(3,922)
Proceeds from issuances of common stock	427	98
Tax payments related to stock-based awards	(92)	(17)
Net cash used in financing activities	<u>(22,384)</u>	<u>(4,324)</u>
Increase (decrease) in Cash, cash equivalents and restricted cash	11,577	(37)
Cash, cash equivalents and restricted cash, beginning of period	579	442
Cash, cash equivalents and restricted cash, end of period	\$ <u>12,156</u>	\$ <u>405</u>

Craft Brew Alliance, Inc.
Select Financial Information on a Trailing Twelve-Month Basis
(Dollars in thousands, except per share amounts)
(Unaudited)

	Twelve Months Ended		Change	% Change
	September 30,			
	2018	2017		
Net sales	\$ 208,165	\$ 207,294	\$ 871	0.4 %
Gross profit	\$ 68,773	\$ 63,792	\$ 4,981	7.8 %
As percentage of net sales	33.0 %	30.8 %	220 bps	
Selling, general and administrative expenses	60,423	60,233	190	0.3 %
Operating income	<u>\$ 8,350</u>	<u>\$ 3,559</u>	<u>\$ 4,791</u>	134.6 %
Net income	<u>\$ 12,509</u>	<u>\$ 1,764</u>	<u>\$ 10,745</u>	609.1 %
Income per share:				
Basic	<u>\$ 0.65</u>	<u>\$ 0.09</u>	<u>\$ 0.56</u>	622.2 %
Diluted	<u>\$ 0.64</u>	<u>\$ 0.09</u>	<u>\$ 0.55</u>	611.1 %
Total shipments (in barrels):				
Core Brands	724,100	738,000	(13,900)	(1.9)%
Contract Brewing	25,300	19,900	5,400	27.1 %
Total shipments	<u>749,400</u>	<u>757,900</u>	<u>(8,500)</u>	(1.1)%
Change in depletions ⁽¹⁾	<u>(2)%</u>	<u>(2)%</u>		

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

Supplemental Disclosures Regarding Non-GAAP Financial Information

Craft Brew Alliance, Inc.
Reconciliation of Adjusted EBITDA to Net income
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$ 61	\$ 1,751	\$ 4,674	\$ 1,688
Interest expense	107	179	348	533
Income tax provision (benefit)	(194)	1,067	1,600	758
Depreciation expense	2,521	2,371	7,713	7,709
Amortization expense	77	65	272	195
Stock-based compensation	371	391	1,058	945
Loss on disposal of assets	(55)	18	(549)	164
Adjusted EBITDA	<u>\$ 2,888</u>	<u>\$ 5,842</u>	<u>\$ 15,116</u>	<u>\$ 11,992</u>

CBA has presented Adjusted Earnings before Interest, Taxes, Depreciation and Amortization (“Adjusted EBITDA”) in these tables to provide investors with additional information to evaluate our operating performance on an ongoing basis using criteria that are used by management. We define Adjusted EBITDA as net income (loss) before interest, income taxes, depreciation and amortization, stock-based compensation and other non-cash charges, including net gain or loss on disposal of property, equipment and leasehold improvements. We use Adjusted EBITDA, among other measures, to evaluate operating performance, to plan and forecast future periods’ operating performance, and as an incentive compensation target for certain management personnel.

As Adjusted EBITDA is not a measure of operating performance or liquidity calculated in accordance with generally accepted accounting principles in the United States of America (“GAAP”), this measure should not be considered in isolation of, or as a substitute for, net income (loss) as an indicator of operating performance, or net cash provided by (used in) operating activities as an indicator of liquidity. The use of Adjusted EBITDA instead of net income (loss) has limitations as an analytical tool, including the inability to determine profitability; the exclusion of interest expense and associated cash requirements, given the level of our indebtedness; and the exclusion of depreciation and amortization which represent significant and unavoidable operating costs, given the capital expenditures needed to maintain our operations. We compensate for these limitations by relying on GAAP results. Our computation of Adjusted EBITDA may differ from similarly titled measures used by other companies. As Adjusted EBITDA excludes certain financial information compared with net income (loss) and net cash provided by (used in) operating activities, the most directly comparable GAAP financial measures, users of this financial information should consider the types of events and transactions which are excluded. The table above shows a reconciliation of Adjusted EBITDA to net income (loss).