CRAFT BREWERS ALLIANCE, INC.
Form 10-Q
August 15, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended June 30, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______________ to ______________

Commission File Number 0-26542

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

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

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

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

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

The number of shares of the registrant's common stock outstanding as of August 2, 2011 was 18,844,817.

CRAFT BREWERS ALLIANCE, INC.
FORM 10-Q
For the Quarterly Period Ended June 30, 2011

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PART I.
ITEM 1. Financial Statements

CRAFT BREWERS ALLIANCE, INC.
CONSOLIDATED BALANCE SHEETS

	(unaudited) June 30, 2011	December 31, 2010
	(dollars in thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,474	$ 164
Accounts receivable, net	13,078	10,514
Inventories	9,855	8,729
Deferred income tax asset, net	596	932
Other current assets	3,305	3,233
Total current assets	33,308	23,572
Property, equipment and leasehold improvements, net	98,540	98,778
Equity method investment in Fulton Street Brewery, LLC	—	5,240
Goodwill	12,917	12,917
Intangible and other assets, net	18,233	17,759
Total assets	$ 162,998	$ 158,266
LIABILITIES AND COMMON STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 14,762	$ 13,825
Accrued salaries, wages, severance and payroll taxes	4,080	4,053
Refundable deposits	6,486	6,291
Other accrued expenses	1,479	1,378
Current portion of long-term debt and capital lease obligations	2,116	2,460
Total current liabilities	28,923	28,007
Long-term debt and capital lease obligations, net of current portion	16,213	24,675
Fair value of derivative financial instruments	737	849
Deferred income tax liability, net	13,991	10,118
Other liabilities	452	421
Commitments and Contingencies		
Common stockholders' equity:		
Common stock, $0.005 par value, authorized 50,000,000 shares; issued and outstanding 18,839,217 shares and 18,819,053 shares at June 30, 2011 and December 31, 2010, respectively	94	94
Additional paid-in capital	134,842	134,601
Accumulated other comprehensive loss	(459)	(528)

Retained deficit		(31,795)		(39,971)
Total common stockholders' equity		102,682		94,196
Total liabilities and common stockholders' equity	$	162,998	$	158,266

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

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CRAFT BREWERS ALLIANCE, INC.
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands, except per share amounts)			
Sales	$44,849	$39,645	$79,809	$68,967
Less excise taxes	3,353	2,406	6,016	4,276
Net sales	41,496	37,239	73,793	64,691
Cost of sales	28,038	26,841	51,107	47,446
Gross profit	13,458	10,398	22,686	17,245
Selling, general and administrative expenses	10,670	7,545	19,959	13,750
Operating income	2,788	2,853	2,727	3,495
Income from equity method investments	335	338	691	423
Gain on sale of Fulton Street Brewery, LLC	10,398	—	10,398	—
Interest expense	(260)	(409)	(542)	(808)
Interest and other income, net	7	75	20	128
Income before income taxes	13,268	2,857	13,294	3,238
Income tax provision	5,108	1,123	5,118	1,295
Net income	$8,160	$1,734	$8,176	$1,943
Basic and diluted earnings per share	$0.43	$0.10	$0.43	$0.11

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

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CRAFT BREWERS ALLIANCE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six Months Ended June 30,	
	2011	2010
	(in thousands)	
Operating Activities		
Net income	$8,176	$1,943
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,651	3,589
Income from equity method investments, net of distributions received	(691)	(404)
Gain on sale of Fulton Street Brewery, LLC	(10,398)	—
Deferred income taxes	4,166	1,109
Stock-based compensation	249	74
Loss on sale or disposal of property, equipment and leasehold improvements	—	34
Other	(49)	223
Changes in operating assets and liabilities:		
Accounts receivable	(1,727)	(4,397)
Inventories	(1,111)	(257)
Income tax receivable and other current assets	(72)	1,713
Other assets	(221)	39
Accounts payable and other accrued expenses	1,017	4,816
Accrued salaries, wages, severance and payroll taxes	27	(1,111)
Refundable deposits and other liabilities	606	(538)
Net cash provided by operating activities	3,623	6,833
Investing Activities		
Expenditures for property, equipment and leasehold improvements	(3,694)	(1,090)
Proceeds from sale of property, equipment and leasehold improvements	49	65
Proceeds from the sale of Fulton Street Brewery, LLC	15,075	—
Net cash provided by (used in) investing activities	11,430	(1,025)
Financing Activities		
Principal payments on debt and capital lease obligations	(1,256)	(731)
Net repayments under revolving line of credit	(7,500)	(5,100)
Issuance of common stock	13	23
Net cash used in financing activities	(8,743)	(5,808)
Increase in cash and cash equivalents	6,310	—
Cash and cash equivalents:		
Beginning of period	164	11
End of period	$6,474	$11
Supplemental Disclosures		

Cash paid for interest	$605	$870
Cash paid for income taxes	$211	$205

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

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CRAFT BREWERS ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The accompanying financial statements and related notes of the Company should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 ("2010 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 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 the consolidated financial position, results of operations and cash flows of the Company 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 amounts in the prior periods' Consolidated Financial Statements have been reclassified to conform to the current period's presentation.

Recent Accounting Pronouncements
In June 2011, the Financial Accounting Standards Board, or FASB, issued ASU No. 2011-05, "Comprehensive Income: Presentation of Comprehensive Income." This new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. The updated guidance is effective on a retrospective basis for financial statements issued for interim and annual periods beginning after December 15, 2011. This guidance affects presentation only and will have no effect on our financial condition, results of operations or cash flows.

In May 2011, the FASB amended ASC 820, "Fair Value Measurement." This amendment is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards ("IFRS") requirements for measurement of and disclosures about fair value. This guidance clarifies the application of existing fair value measurements and disclosures, and changes certain principles or requirements for fair value measurements and disclosures. The updated guidance is effective on a prospective basis for financial statements issued for interim and annual periods beginning after December 15, 2011. The adoption of this guidance will not have a material impact on our consolidated financial statements.

In December 2010, the FASB issued ASU No. 2010-29, "Supplementary Pro Forma Information for Business Combinations" ("ASU 2010-29"). ASU 2010-29 clarifies provisions of FASB ASC Topic 805, "Business Combinations" ("ASC 805") relating to the acquisition date that should be used for disclosing the pro forma financial information required by ASC 805 when comparative financial statements are presented. As of December 31, 2010, the Company adopted the provisions of ASU 2010-29, and implemented its provisions in preparing the pro forma information presented regarding the October 1, 2010 merger with Kona Brewing Co., Inc. ("KBC") and related entities ("KBC Merger"). See Note 9, Merger with KBC.

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CRAFT BREWERS ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(unaudited)

2. Inventories

Inventories consist of the following:

	June 30, 2011	December 31, 2010
	(in thousands)	
Raw materials	$ 2,179	$ 2,870
Work in process	3,370	2,244
Finished goods	2,760	1,933
Packaging materials	355	343
Promotional merchandise	1,021	1,184
Pub food, beverages and supplies	170	155
	$ 9,855	$ 8,729

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

3. Equity Method Investments

Fulton Street Brewery, LLC ("FSB")
On May 2, 2011 (the "Closing Date"), the Company, Anheuser-Busch, Incorporated ("A-B"), and Goose Holdings, Inc. ("GHI") completed the transaction contemplated by the equity purchase agreement (the "Purchase Agreement") dated as of February 18, 2011, pursuant to which the Company and GHI (collectively, the "Sellers") sold all of the equity in FSB to A-B. The aggregate consideration paid by A-B was approximately $38.9 million ("Purchase Consideration"), net of transaction fees paid by A-B on the Sellers' behalf, and was determined by arm's length negotiations among the parties. The Company became a party to the Purchase Agreement pursuant to the Joinder to Equity Purchase Agreement (the "Joinder Agreement") dated May 2, 2011, by and among A—-B, GHI and the Company. A copy of the Joinder Agreement was filed as exhibit 2.1 to the Company's Form 8-K filed with the SEC on May 4, 2011.

The Company's share of the Purchase Consideration in exchange for its 42 percent interest in FSB was $16.3 million, net of the Company's share of transaction fees paid by A-B on the Sellers' behalf, and consisted of $15.1 million received in cash and $1.3 million placed in escrow. The escrow balance is to satisfy valid claims, if any, that may be asserted by A-B in connection with breaches of representations and warranties made by the Sellers in the Purchase Agreement. The escrow balance will be released to the Company in three payments ratably, every six months, beginning six months following the Closing Date, subject to indemnification claims, as applicable. The Company also received reimbursement from A-B for legal and professional fees the Company separately incurred in evaluation of the transaction. In the second quarter of 2011, the Company recorded a gain of approximately $10.4 million associated with the sale of its equity interest in FSB.

The Company recognized $691,000 in 2011 for its share of FSB's earnings through the Closing Date, of which $335,000 was recognized in the second quarter of 2011. For the three and six month periods ended June 30, 2010, the Company's share of FSB's net income totaled $332,000 and $378,000, respectively. The book value of the Company's equity investment in FSB was $5.9 million as of the Closing Date and $5.2 million at December 31, 2010.

The consolidated statements of income for the six month periods ended June 30 include the results of FSB for the six month periods ended May 31. Due to the timing of receipt of FSB's financial statements, the Company accounted for its share of net earnings of FSB on a one-month lag. If the Company had instead recorded the equity in FSB's earnings for the six months ended June 30, the Company would have recorded a decrease of $248,000 and an increase of $50,000 to its consolidated statements of income for the six months ended June 30, 2011 and 2010, respectively. There is no lag impact related to the month of June 2011 as the sale of FSB was effective May 2, 2011 and all earnings were captured as of that date.

CRAFT BREWERS ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(unaudited)

At June 30, 2011, the Company had net outstanding receivables due from FSB of $381,000. At December 31, 2010, the Company had recorded a payable to FSB of $3.3 million, primarily for amounts owing for purchases of Goose Island-branded product.

Kona Brewery, LLC ("Kona")
For the three and six month periods ended June 30, 2010, the Company's share of Kona's net income was $6,000 and $45,000, respectively. As a result of the closing of the KBC Merger on October 1, 2010, Kona became a wholly owned subsidiary of the Company. As such, the operations of KBC are included in our consolidated financial statements for the three and six month periods ended June 30, 2011. See Note 9, Merger with KBC for a discussion of the KBC Merger.

4. Derivative Financial Instruments and Fair Value Measurement

Interest Rate Swap Contracts
The Company's 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.

The Company has assessed its vulnerability to certain business and financial risks, including interest rate risk associated with its variable-rate long-term debt. To mitigate this risk, the Company entered into a five-year interest rate swap contract with Bank of America, N.A. ("BofA") with a total notional value of $9.3 million (as of June 30, 2011) to hedge the variability of interest payments associated with its variable-rate borrowings under its term loan with BofA ("Term Loan"). Through this swap agreement, the Company pays interest at a fixed rate of 4.48% and receives interest at a floating-rate of the one-month LIBOR. Since the interest rate swap hedges the variability of interest payments on variable rate debt with similar terms, it qualifies for cash flow hedge accounting treatment under ASC Topic 815, Derivatives and Hedging ("ASC 815"). As of June 30, 2011, unrealized net losses of $737,000 were recorded in accumulated other comprehensive loss as a result of this hedge. The effective portion of the gain or loss on the derivative is reclassified into interest expense in the same period during which the Company records interest expense associated with the Term Loan. There was no hedge ineffectiveness recognized for the three and six month periods ended June 30, 2011, respectively.

	Balance Sheet Location	June 30, 2011	December 31, 2010
		(in thousands)	
Derivative instruments in liability positions:			
Derivatives designated as hedging instruments under ASC 815			
Interest rate swap contract	Non-current liabilities - derivative financial instruments	$737	$849

Total derivatives	$737	$849

The interest rate swap contract is secured by substantially all of the Company's personal property and by the real properties located at 924 North Russell Street, Portland, Oregon and 14300 NE 145th Street, Woodinville, Washington ("collateral") under the loan agreement with BofA. The Company's subsidiaries, Kona and Kona Brewing Co., LLC, have unconditionally guaranteed the Company's obligations to BofA arising under the interest rate swap agreement.

Fair Value Measurements

The recorded values of the Company's financial instruments, with the exception of its debt obligations, are considered to approximate the fair values of the financial instruments, in all material respects, as the Company's receivables and payables are recorded at amounts expected to be realized and paid and the Company's derivative financial instruments are carried at fair value. At June 30, 2011 the total carrying value and fair value of the Company's debt obligations, including the current portion, was $18.3 million and $18.6 million, respectively. At December 31, 2010, the total carrying value and fair value of the Company's debt obligations, including the current portion, was $27.1 million and $27.7 million, respectively.

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CRAFT BREWERS ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(unaudited)

Under the three-tier fair value hierarchy established in ASC 820, Fair Value Measurements and Disclosures, the inputs used in measuring fair value are prioritized as follows:

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

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

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

The Company has assessed its assets and liabilities that are measured and recorded at fair value within the above hierarchy and that assessment is as follows:

	Fair Value Hierarchy Assessment			
	Level 1	Level 2	Level 3	Total
		(in thousands)		
June 30, 2011				
Derivative financial instruments - interest rate swap contracts	$ -	$ 737	$ -	$ 737
December 31, 2010				
Derivative financial instruments - interest rate swap contracts	$ -	$ 849	$ -	$ 849

5. Debt and Capital Lease Obligations

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

	June 30, 2011	December 31, 2010
	(in thousands)	
Term loan payable to bank, due July 1, 2018	$ 12,442	$ 12,639
Line of credit payable to bank, due September 30, 2015	—	7,500
Promissory notes payable to individual lenders, all due July 1, 2015	600	600
Premium on promissory notes	455	504
Note with affiliated party	928	1,403
Capital lease obligations on equipment	3,904	4,489
	18,329	27,135
Less current portion of long-term debt	2,116	2,460

	$ 16,213	$ 24,675

Since June 2008, the Company has maintained a loan agreement (as amended, the “Loan Agreement”) with BofA, which is presently comprised of a $22.0 million revolving line of credit (“Line of Credit”), including provisions for cash borrowings and up to $2.5 million notional amount of letters of credit, and a Term Loan with an original balance of $13.5 million. The Company may draw upon the Line of Credit for working capital and general corporate purposes.

CRAFT BREWERS ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(unaudited)

With the May 2, 2011 receipt of $15.3 million in cash, including reimbursements, the Company repaid the outstanding borrowings under the Line of Credit and had no borrowings outstanding under the Line of Credit at June 30, 2011.

Under the Loan Agreement, the Company may select either the London Inter-Bank Offered Rate (“LIBOR”) or the Inter-Bank Offered Rate (“IBOR”) (each, a “Benchmark Rate”) as the basis for calculating interest on the outstanding principal balance of the Line of Credit. Interest accrues at an annual rate equal to the Benchmark Rate plus a marginal rate. The Company may select different Benchmark Rates for different tranches of its borrowings under the Line of Credit. The marginal rate varies from 1.00% to 2.25% based on the ratio of the Company’s funded debt to earnings before interest, taxes, depreciation and amortization (“EBITDA”), as defined (“funded debt ratio”). LIBOR rates may be selected for one, two, three, or six month periods, and IBOR rates may be selected for no shorter than 14 days and no longer than six months. Accrued interest for the Line of Credit is due and payable monthly.

Under the Loan Agreement a quarterly fee on the unused portion of the Line of Credit, including the undrawn amount of the related standby letter of credit, varies from 0.15% to 0.30% based upon the Company’s funded debt ratio. At June 30, 2011, the quarterly fee was 0.15%. An annual fee is payable in advance on the notional amount of each standby letter of credit issued and outstanding multiplied by an applicable rate ranging from 1.00% to 2.00%.

Interest on the Term Loan will accrue on the outstanding principal balance in the same manner as provided for under the Line of Credit, as established under the LIBOR one-month Benchmark Rate. At June 30, 2011 and December 31, 2010, the principal balance outstanding under the Term Loan was $12.4 million and $12.6 million, respectively. The interest rate on the Term Loan was 1.44% as of June 30, 2011. Accrued interest for the Term Loan is due and payable monthly. Principal payments are due monthly in accordance with an agreed-upon schedule set forth in the Loan Agreement, with any unpaid principal balance and unpaid accrued interest due and payable on July 1, 2018.

The Company is in compliance with all applicable contractual financial covenants at June 30, 2011. These financial covenants under the Loan Agreement are measured on a trailing four-quarter basis. For all periods ending June 30, 2011 and thereafter, the Company is required to maintain a funded debt ratio of up to 3.0 to 1 and a fixed charge coverage ratio above 1.25 to 1.

Pursuant to the KBC Merger, the Company assumed an obligation for a promissory note payable (“related party note”) to a counterparty that was a significant Kona shareholder. The related party note is secured by the equipment comprising a photovoltaic cell generation system (“photovoltaic system”) installed at the Company’s brewery located in Kailua-Kona, Hawaii. The balance of the related party note payable as of June 30, 2011 and December 31, 2010 was $928,000 and $1.4 million, respectively. Accrued interest on the related party note is due and payable monthly at a fixed interest rate of 4.75%, with monthly loan payments of $16,129. Any unpaid principal balance and unpaid accrued interest under the related party note will be due and payable on November 15, 2014. The photovoltaic system was eligible for certain federal grants and state tax credits, which were applied for and collected by the Company and remitted to the creditor as a reduction of principal.

The Company was obligated under a capital equipment lease to BofA secured by substantially all of the brewery equipment and restaurant furniture and fixtures located in Portland, Oregon. The outstanding balance for the capital lease as of June 30, 2011 and December 31, 2010 was $3.9 million and $4.5 million, respectively, with monthly loan payments of $119,020 required through the maturity date of June 30, 2014. The capital lease carried an effective interest rate of 6.56% and was subject to a prepayment penalty equal to a specified percentage multiplied by the amount prepaid which terminated in July 2011. The specified percentage was 1% as of June 30, 2011. On July 20, 2011, the Company paid off the remaining balance on the capital lease without penalty.

6. Common Stockholders' Equity

Stock Plans

The Company maintains several stock incentive plans, including those described below, under which non-qualified stock options, incentive stock options and restricted stock are granted to employees and non-employee directors. The Company issues new shares of common stock upon exercise of stock options. Under the terms of the Company's stock incentive plans, subject to certain limitations, employees and directors may be granted options to purchase the Company's common stock at an exercise price equal to the market price on the date the option is granted.

CRAFT BREWERS ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(unaudited)

On May 26, 2010, the shareholders approved the 2010 Stock Incentive Plan (the “2010 Plan”), as recommended by the Company’s board of directors. The 2010 Plan provides for grants of stock options, restricted stock, restricted stock units, performance awards and stock appreciation rights. While incentive stock options may only be granted to employees, awards other than incentive stock options may be granted to employees and directors. The 2010 Plan is administered by the compensation committee of the board of directors (“Compensation Committee”), which determines the grantees, the number of shares of common stock for which options are exercisable and the exercise prices of such options, and the terms and conditions of other equity-based awards under the 2010 Plan. Options granted to the Company’s employees generally vest over a five-year period and remain exercisable until ten years from the date of grant. Up to 750,000 shares of common stock may be issued under the 2010 Plan. As of June 30, 2011, the 2010 Plan had 645,400 shares available for future stock-based awards.

The Company maintains the 2002 Stock Option Plan (the “2002 Plan”) under which non-qualified stock options and incentive stock options were granted to employees and non-qualified stock options were granted to non-employee directors and independent consultants or advisors. Options granted to the Company’s employees generally vest over four or five years while options granted to the Company’s directors generally became exercisable within three months following the grant date. Vested options generally remain exercisable until ten years from the date of grant. The Compensation Committee administers the 2002 Plan.

The Company also maintains the 2007 Stock Incentive Plan (the “2007 Plan”) under which grants of stock options and restricted stock were made to the Company’s employees and restricted stock grants were made to the Company’s directors. Options granted to the Company’s employees generally vest over a five-year period and remain exercisable until ten years from the date of grant. The 2007 Plan is administered by the Compensation Committee.

With the approval of the 2010 Plan, no further grants of stock options or similar stock awards may be made under either the 2007 Plan or the 2002 Plan, but the provisions of these plans will remain in effect until all outstanding options are terminated or exercised.

Restricted Stock Grant
Beginning with the 2011 Annual Meeting of Shareholders, each non-employee director will receive an annual grant of shares of the Company’s common stock with a fair value equivalent to $25,000 upon election at the Annual Meeting of Shareholders. On May 25, 2011, the board of directors approved, under the 2010 Plan, an annual grant of 2,700 shares of fully-vested Common Stock to each non-employee director. On May 26, 2010, the board of directors approved, under the 2007 Plan, an annual grant of 3,000 shares of fully-vested Common Stock to each non-employee director. In conjunction with these stock grants, the Company issued 16,200 and 18,000 shares of Common Stock in 2011 and 2010, respectively. The Company recognized stock-based compensation of $164,000 and $61,000 during the three months ended June 30, 2011 and 2010, respectively, related to these awards.

Stock Option Activity
The Company recognized stock-based compensation associated with its stock option grants of $29,000 and $11,000 for the three months ended June 30, 2011 and 2010, respectively, and $68,000 and $13,000 for the six month periods ended June 30, 2011 and 2010, respectively. At June 30, 2011, the total unrecognized stock-based compensation associated with unvested option grants was approximately $525,000, which is expected to be recognized over a period of approximately 4.0 years.

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

	Options (in thousands)	Weighted Average Exercise Price (per share)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2010	219	$ 3.14	$ 931
Granted	45	9.29	
Exercised	(4)	3.15	
Outstanding at June 30, 2011	260	$ 4.20	$ 1,177
Exercisable at June 30, 2011	72	$ 2.13	$ 467

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CRAFT BREWERS ALLIANCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (continued)
(unaudited)

A total of 21,100 and 28,600 stock options vested in the three and six month periods ended June 30, 2011, respectively. No stock options vested during the three month period ended June 30, 2010, and 7,500 stock options vested during the six month period ended June 30, 2010. The total intrinsic value of stock options exercised during the six month periods ended June 30, 2011 and 2010 was $25,000 and $31,000, respectively.

In conjunction with the exercise of stock options under the Company's stock option plans during the six months ended June 30, 2011 and 2010, the Company issued 4,000 shares and 13,000 shares, respectively, of common stock and received proceeds on exercise totaling $13,000 and $23,000, respectively.

The following table summarizes information for options outstanding and exercisable at June 30, 2011:

Range of Exercise Prices	Outstanding Options (in thousands)	Outstanding Weighted Average Exercise Price (per share)	Outstanding Weighted Average Remaining Contractual Life (in years)	Exercisable Options (in thousands)	Exercisable Weighted Average Exercise Price (per share)	Exercisable Weighted Average Remaining Contractual Life (in years)
$ 1.25 to $ 2.00	37	$ 1.37	6.1	22	$ 1.46	5.1
$ 2.01 to $ 3.00	126	2.36	7.7	42	2.36	5.4
$ 3.01 to $ 3.15	8	3.15	3.9	8	3.15	3.9
$ 6.88 to $ 6.88	44	6.88	9.4	—	N/A	N/A
$ 9.28 to $ 9.35	45	9.29	9.9	—	N/A	N/A
$ 1.25 to $ 9.35	260	$ 4.20	8.0	72	$ 2.13	5.2

N/A - Not applicable

Performance Share Activity

During the second quarter of 2011, the Compensation Committee approved, under the 2010 Plan, the grant of performance shares to selected executives with vesting contingent upon meeting various Company-wide performance goals. The performance goals are tied to target amounts of the Company's adjusted EBITDA and net sales for the three fiscal years ending December 31, 2013. The awards earned will range from zero to one hundred percent of the targeted number of performance shares for the performance period ending March 31, 2014. Awards, if earned, will be paid in shares of common stock. Compensation expense for performance based shares is estimated based on an assessment of the probability that performance goals will be met during the vesting period. We will re-measure the probability of achieving the performance goals during each reporting period. In future reporting periods, if we determine that performance goals are not probable of occurrence, no compensation expense will be recognized and any previously recognized compensation cost would be reversed.

A summary of the activity for performance share awards as of June 30, 2011 and changes during the six month period then ended is presented below:

	Shares (in thousands)	Weighted Average Grant-Date Fair Value (per share)
Nonvested performance shares at December 31, 2010	-	$ -
Granted	68	$ 9.29
Nonvested performance shares at June 30, 2011	68	$ 9.29

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The compensation expense for the Company's performance share awards totaled $17,000 for the three and six month periods ended June 30, 2011. The value of the performance shares granted in 2011 is being amortized as compensation expense over the service period.

At June 30, 2011, the Company had $551,000 of total unrecognized compensation expense related to performance shares that will be recognized over a period of 2.8 years.

7. Earnings per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands, except per share amounts)			
Numerator for basic and diluted earnings per share:				
Net income	$8,160	$1,734	$8,176	$1,943
Denominator for basic earnings per share:				
Weighted average common shares outstanding	18,829	17,084	18,824	17,079
Dilutive effect of stock options on weighted average common shares	116	47	112	34
Denominator for diluted earnings per share	18,945	17,131	18,936	17,113
Basic and diluted earnings per share	$0.43	$0.10	$0.43	$0.11

The potential common shares excluded from the calculation of diluted earnings per share totaled 61,000 and 105,000 for the three month periods ended June 30, 2011 and 2010, respectively, and 52,000 and 69,000 for the six month periods ended June 30, 2011 and 2010, respectively, because their effect would be anti-dilutive.

8. Comprehensive Income

The following table sets forth the Company's comprehensive income for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Net income	$8,160	$1,734	$8,176	$1,943
Other comprehensive income (loss):				
Unrealized gains (losses) on derivative financial instruments, net of tax	7	(66)	69	(108)
Comprehensive income	$8,167	$1,668	$8,245	$1,835

9. Merger with KBC

On October 1, 2010, the Company completed its acquisition of KBC and related entities pursuant to an agreement and plan of merger dated July 31, 2010. The Company acquired all outstanding shares of KBC common stock in exchange for $6.2 million in cash and also issued to the former KBC shareholders 1,667,000 shares of the Company's common stock.

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The Company believes that the combined entity is able to secure advantages beyond those that had already been achieved in its long-term strategic relationship with KBC in supporting its brand family of beers. This acquisition increases the breadth and variety of the Company’s brand offerings, creating favorable selling opportunities in a greater number of lucrative markets.

Merger-Related Costs
In connection with the business combination, the Company incurred merger-related expenses, including legal, consulting, accounting and other professional fees, and severance costs. The Company recognized expenses associated with the KBC Merger during the latter half of 2010, but did not recognize any merger-related expenses in the first six months of 2010. The Company did not recognize significant merger-related costs during the six months ended June 30, 2011.

The Company estimates that merger-related severance benefits associated with the KBC Merger totaling $92,000 will be paid during the second half of 2011 to affected Kona employees.

Unaudited Pro Forma Results of Operations
The unaudited pro forma results of operations data are being furnished solely for informational purposes and are not intended to represent or be indicative of the consolidated results of operations that the Company would have reported had the KBC Merger and related transactions been completed as of the dates and for the periods presented, nor are they necessarily indicative of future results.

The unaudited pro forma results of operations data are derived from the consolidated financial statements of the Company and KBC and reflect pro forma adjustments relating to the KBC Merger and associated borrowing that are of a recurring nature consisting of pro forma amortization of intangible assets, primarily non-compete agreements, and pro forma effects of increased excise taxes associated with the loss of the lower rate benefit to KBC as a separate company, and of interest expense on the associated borrowing. Certain nonrecurring expenses assessed by the Company to be directly related to the KBC Merger have been included in the pro forma results presented for the six months ended June 30, 2010. These nonrecurring expenses are the merger-related expenses of $559,000 and certain incentive compensation costs that were triggered as a result of the KBC Merger totaling $449,000. These pro forma results of operations do not give effect to any cost savings, revenue synergies or restructuring costs which may result from the integration of KBC’s or Kona’s operations.

Consistent with ASU 2010-29, the unaudited pro forma combined condensed results of operations are presented below as if the KBC Merger had occurred on January 1, 2010.

Three Months Ended June 30,		Six Months Ended June 30,
2011	2010	2011