

REDHOOK ALE BREWERY INC

Form 10-Q/A

March 31, 2006

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q/A**

(MARK ONE)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2005
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**

REDHOOK ALE BREWERY, INCORPORATED
(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.)

14300 NE 145th Street, Suite 210
Woodinville, Washington
(Address of principal executive offices)

98072-9045
(Zip Code)

Registrant's telephone number, including area code: **(425) 483-3232**

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the registrant's Common Stock outstanding as of August 8, 2005 was 8,215,159.

Page 1 of 31 sequentially numbered pages

Explanatory Note

On March 23, 2006, Redhook Ale Brewery, Incorporated (the Company) filed a Current Report on Form 8-K with the Securities and Exchange Commission (SEC), announcing that it would be restating previously reported financial statements to correct an error as of and for the year ended December 31, 2004. As more fully described in Note 2 to the Financial Statements included in this Amendment No. 1 to Quarterly Report on Form 10-Q/A, the Company inadvertently overstated its net operating loss carryforwards (NOLs) with the state of New Hampshire by recording NOLs in excess of limits prescribed by state law, leading to an understatement of the Company's income tax provision and an overstatement of the Company's deferred tax asset, which was netted against the Company's deferred income tax liability on the Company's balance sheet. This Amendment No. 1 to Form 10-Q/A (Amendment) amends the Quarterly Report on Form 10-Q for the quarter end June 30, 2005, as filed on August 15, 2005 (Original Filing), to reflect the impact of the restatement on retained earnings and deferred income taxes on the balance sheet dated June 30, 2005.

Except as required to reflect the effects of the restatement for the item above, no additional modifications or updates in this Amendment have been made to the Original Filing on Form 10-Q. Information not affected by the restatement remains unchanged and reflects the disclosures made at the time of the Original Filing. This Amendment does not describe other events occurring after the original filing, including exhibits, or modify or update those disclosures affected by subsequent events. This Amendment should be read in conjunction with the Company's filings made with the SEC subsequent to the filing of the Original Filing, as information in such reports and documents may update or supersede certain information contained in this Amendment. Accordingly, this Amendment only amends and restates Items 1, 2 and 4 of Part I of the Original Filing, in each case, solely as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby. Additionally, pursuant to the rules of the SEC, Item 6 of Part II of the Original Filing has been amended to contain currently dated certifications of the Chief Executive Officer and Chief Financial Officer. As required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, the certifications of the Company's Chief Executive Officer and Chief Financial Officer are attached to this Amendment as Exhibits 31.1, 31.2, 32.1 and 32.2.

REDHOOK ALE BREWERY, INCORPORATED
FORM 10-Q/A
For The Quarterly Period Ended June 30, 2005
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REDHOOK ALE BREWERY, INCORPORATED
BALANCE SHEETS
(Unaudited)

	June 30, 2005	December 31, 2004
	(Restated; See Note 2)	(Restated; See Note 2)
ASSETS		
Current Assets:		
Cash and Cash Equivalents	\$ 4,364,278	\$ 5,589,621
Accounts Receivable	2,564,037	1,123,475
Trade Receivable from Craft Brands	1,068,124	398,707
Inventories	3,257,116	3,000,309
Other	466,964	506,328
Total Current Assets	11,720,519	10,618,440
Fixed Assets, Net	61,725,163	63,018,806
Receivable from Craft Brands		277,144
Investment in Craft Brands	283,490	192,857
Other Assets	15,553	20,977
Total Assets	\$ 73,744,725	\$ 74,128,224
LIABILITIES AND COMMON STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts Payable	\$ 2,589,701	\$ 1,815,380
Trade Payable to Craft Brands	513,121	431,089
Accrued Salaries, Wages and Payroll Taxes	1,226,002	1,220,248
Refundable Deposits	2,037,806	2,526,088
Other Accrued Expenses	417,245	515,123
Current Portion of Long-Term Debt	450,000	450,000
Total Current Liabilities	7,233,875	6,957,928
Long-Term Debt, Net of Current Portion	4,950,000	5,175,000
Deferred Income Taxes, Net	699,798	769,798
Other Liabilities	97,354	64,903
Commitments		
Common Stockholders Equity:		
Common Stock, Par Value \$0.005 per Share, Authorized, 50,000,000 Shares; Issued and Outstanding, 8,215,159 Shares in 2005 and 8,188,199 Shares in 2004	41,076	40,941

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Additional Paid-In Capital	68,813,651	68,761,766
Retained Earnings (Deficit)	(8,091,029)	(7,642,112)
Total Common Stockholders Equity	60,763,698	61,160,595
Total Liabilities and Common Stockholders Equity	\$ 73,744,725	\$ 74,128,224

See Accompanying Notes to Financial Statements

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STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Sales	\$9,741,216	\$11,443,406	\$17,066,190	\$20,833,885
Less Excise Taxes	982,424	952,566	1,734,851	1,723,211
Net Sales	8,758,792	10,490,840	15,331,339	19,110,674
Cost of Sales	7,277,051	7,479,198	13,325,340	14,053,411
Gross Profit	1,481,741	3,011,642	2,005,999	5,057,263
Selling, General and Administrative Expenses	1,851,815	2,545,796	3,394,338	5,074,364
Income from Equity Investment in Craft Brands	691,304		950,998	
Craft Brands Shared Formation Expenses		130,808		537,575
Operating Income (Loss)	321,230	335,038	(437,341)	(554,676)
Interest Expense	65,595	42,793	126,914	86,400
Other Income (Expense) Net	35,536	10,957	64,338	23,740
Income (Loss) before Income Taxes	291,171	303,202	(499,917)	(617,336)
Income Tax Provision (Benefit)	8,000	10,000	(51,000)	10,000
Net Income (Loss)	\$ 283,171	\$ 293,202	\$ (448,917)	\$ (627,336)
Basic Earnings (Loss) per Share	\$ 0.03	\$ 0.04	\$ (0.05)	\$ (0.10)
Diluted Earnings (Loss) per Share	\$ 0.03	\$ 0.04	\$ (0.05)	\$ (0.10)

See Accompanying Notes to Financial Statements

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REDHOOK ALE BREWERY, INCORPORATED
STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2005	2004
Operating Activities		
Net Income (Loss)	\$ (448,917)	\$ (627,336)
Adjustments to Reconcile Net Income (Loss) to Net Cash (Used in) Provided by Operating Activities:		
Gain on Disposal of Fixed Assets	(3,000)	
Depreciation and Amortization	1,462,867	1,477,591
Income from Equity Investment in Craft Brands in Excess of Cash Distribution	(148,262)	
Deferred Income Taxes, Net	(70,000)	
Net Change in Operating Assets and Liabilities	(1,684,251)	455,987
Net Cash (Used in) Provided by Operating Activities	(891,563)	1,306,242
Investing Activities		
Expenditures for Fixed Assets	(160,800)	(28,898)
Other, Net		(2,500)
Net Cash (Used in) Provided by Investing Activities	(160,800)	(31,398)
Financing Activities		
Principal Payments on Debt	(225,000)	(225,000)
Issuance of Common Stock	52,020	233,994
Net Cash (Used in) Provided by Financing Activities	(172,980)	8,994
Increase (Decrease) in Cash and Cash Equivalents	(1,225,343)	1,283,838
Cash and Cash Equivalents:		
Beginning of Period	5,589,621	6,123,349
End of Period	\$ 4,364,278	\$7,407,187

See Accompanying Notes to Financial Statements

Table of Contents**REDHOOK ALE BREWERY, INCORPORATED**
NOTES TO FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying financial statements and related notes of Redhook Ale Brewery, Incorporated (the Company) should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004. These financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in 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 financial statements are unaudited but, in the opinion of management, reflect all material adjustments necessary to present fairly the 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.

As more fully described in Note 2, the Company determined that the financial statements and the disclosures in the notes thereto for the quarter ended June 30, 2005 contained in the Quarterly Report on Form 10-Q filed on August 15, 2005, require restatement. All amounts disclosed in the footnotes to the financial statements have been appropriately restated.

2. Restatement of Financial Statements

The Company has restated its previously reported financial statements to correct an error as of and for the year ended December 31, 2004. The Company inadvertently overstated its net operating tax loss carryforwards (NOLs) with the state of New Hampshire by recording NOLs in excess of limits prescribed by state law. This error resulted in an understatement of the Company's income tax provision for the quarter and year ended December 31, 2004 and an overstatement of the Company's deferred tax asset, which is netted against the Company's deferred income tax liability on the Company's balance sheet. This Amendment No. 1 to Form 10-Q/A amends the Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 to reflect the impact of the restatement on retained earnings and deferred income taxes on the balance sheet dated June 30, 2005. The \$301,000 restatement adjustment for the quarter ended December 31, 2004 affected the following items in the Company's balance sheets as of June 30, 2005 and December 31, 2004, respectively:

	As of June 30, 2005	
	As	
	Previously Reported	As Restated
Deferred Income Taxes, Net	\$ 398,798	\$ 699,798
Retained Earnings (Deficit)	(7,790,029)	(8,091,029)
Total Common Stockholders' Equity	61,064,698	60,763,698
Total Liabilities and Common Stockholders' Equity	73,744,725	73,744,725

	As of December 31, 2004	
	As	
	Previously Reported	As Restated
Deferred Income Taxes, Net	\$ 468,798	\$ 769,798
Retained Earnings (Deficit)	(7,341,112)	(7,642,112)
Total Common Stockholders' Equity	61,461,595	61,160,595
Total Liabilities and Common Stockholders' Equity	74,128,224	74,128,224

3. Inventories

Inventories consist of the following:

	June 30, 2005	December 31, 2004
Raw materials	\$1,263,547	\$1,122,290
Work in process	850,312	833,846
Finished goods	577,025	350,543
Promotional merchandise	428,503	480,338
Packaging materials	137,729	213,292
	\$3,257,116	\$3,000,309

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

4. Craft Brands Alliance LLC

On July 1, 2004, the Company entered into agreements with Widmer Brothers Brewing Company (Widmer) with respect to the operation of a joint venture sales and marketing entity, Craft Brands Alliance LLC (Craft Brands). Pursuant to these agreements, the Company manufactures and sells its product to Craft Brands at a price substantially below wholesale pricing levels; Craft Brands, in turn, advertises, markets, sells and distributes the product to wholesale outlets in the western United States pursuant to a distribution agreement between Craft Brands and Anheuser-Busch, Incorporated (A-B).

The Company and Widmer have entered into a restated operating agreement with Craft Brands (the Operating Agreement) that governs the operations of Craft Brands and the obligations of its members.

The Operating Agreement requires the Company to make certain capital contributions to support the operations of Craft Brands. Contemporaneous with the execution of the Operating Agreement, the Company made a 2004 sales and marketing capital contribution in the amount of \$250,000. The agreement designated this sales and marketing capital contribution to be used by Craft Brands for expenses related to the marketing, advertising, and promotion of the Company s products (Special Marketing Expense). The Operating Agreement also requires an additional sales and marketing contribution in 2008 if the volume of sales of Redhook products in 2007 in the Craft Brands territory is less than 92% of the volume of sales of Redhook products in 2003 in the Craft Brands territory. The 2008 contribution, if one is required, cannot exceed \$750,000 and will be required to be paid by the Company in no more than three equal installments made on or before February 1, 2008, April 1, 2008, and July 1, 2008. Widmer has an identical obligation under the Operating Agreement with respect to the 2008 sales and marketing capital contribution and sales of its product. The Operating Agreement also obligates the Company and Widmer to make other additional capital contributions only upon the request and consent of the Craft Brands board of directors.

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REDHOOK ALE BREWERY, INCORPORATED
NOTES TO FINANCIAL STATEMENTS (Continued)
(Unaudited)

The Operating Agreement also requires the Company and Widmer to make loans to Craft Brands to assist Craft Brands in conducting its operations and meeting its obligations. To the extent cash flow from operations and borrowings from financial institutions is not sufficient for Craft Brands to meet its obligations, the Company and Widmer are obligated to lend to Craft Brands the funds the president of Craft Brands deems necessary to meet such obligations. Contemporaneous with the execution of the Operating Agreement, the Company made a member loan of \$150,000.

The Operating Agreement additionally addresses the allocation of profits and losses of Craft Brands. After giving effect to the allocation of the Special Marketing Expense, which is allocated 100% to Redhook up to the 2004 \$250,000 sales and marketing capital contribution, and after giving effect to income attributable to the shipments of the Kona brand, which is shared differently between the Company and Widmer through 2006, the remaining profits and losses of Craft Brands are allocated between the Company and Widmer based on the cash flow percentages of 42% and 58%, respectively. Net cash flow, if any, will generally be distributed monthly to the Company and Widmer based upon these cash flow percentages. No distribution will be made to the Company or Widmer unless, after the distribution is made, the assets of Craft Brands will be in excess of its liabilities, with the exception of liabilities to members, and Craft Brands will be able to pay its debts as they become due in the ordinary course of business.

The Company has assessed its investment in Craft Brands pursuant to the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 46 Revised, *Consolidation of Variable Interest Entities* and *Interpretation of ARB No. 51* (FIN 46R). FIN 46R clarifies the application of consolidation accounting for certain entities that do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties or in which equity investors do not have the characteristics of a controlling financial interest; these entities are referred to as variable interest entities. Variable interest entities within the scope of FIN 46R are required to be consolidated by their primary beneficiary. The primary beneficiary of a variable interest entity is determined to be the party that absorbs a majority of the entity's expected losses, receives a majority of its expected returns, or both. FIN 46R also requires disclosure of significant variable interests in variable interest entities for which a company is not the primary beneficiary. The Company has concluded that its investment in Craft Brands meets the definition of a variable interest entity but that the Company is not the primary beneficiary. In accordance with FIN 46R, the Company has not consolidated the financial statements of Craft Brands with the financial statements of the Company, but instead accounted for its investment in Craft Brands under the equity method, as outlined by Accounting Principle Board Opinion (APB) No. 18, *The Equity Method of Accounting for Investments in Common Stock*. The equity method requires that the Company recognize its share of the net earnings of Craft Brands by increasing its investment in Craft Brands in the Company's balance sheet and recognizing income from equity investment in the Company's statement of operations. A cash distribution or the Company's share of a net loss reported by Craft Brands is reflected as a decrease in investment in Craft Brands in the Company's balance sheet. The Company does not control the amount or timing of cash distributions by Craft Brands. The Company will periodically review its investment in Craft Brands to insure that it complies with the guidelines prescribed by FIN 46R.

For the three months ended June 30, 2005, the Company's share of Craft Brands' net income totaled \$691,000. During the three months ended June 30, 2005, the Company received cash distributions of \$578,000, representing its share of the net cash flow of Craft Brands.

For the six months ended June 30, 2005, the Company's share of Craft Brands' net income totaled \$951,000. This share of Craft Brands' profit was net of \$135,000 of the Special Marketing Expense that had been incurred by Craft Brands during the same period and was fully allocated to the Company. As of June 30, 2005, the entire \$250,000 2004 sales and marketing capital contribution made by the Company had been used by Craft Brands for designated Special Marketing Expenses and netted against Craft Brands' profits allocated to the Company. In the six months ended June 30, 2005, the Company received cash distributions of \$1,138,000 of which \$335,000 related to 2004 earnings, representing its share of the net cash flow of Craft Brands.

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REDHOOK ALE BREWERY, INCORPORATED
NOTES TO FINANCIAL STATEMENTS (Continued)
(Unaudited)

In conjunction with the sale of Redhook product to Craft Brands, the Company's balance sheets as of June 30, 2005 and December 31, 2004 reflect a trade payable due to Craft Brands of approximately \$513,000 and \$431,000, respectively, and a trade receivable due from Craft Brands of approximately \$1,068,000 and \$399,000, respectively.

During the formation of Craft Brands in 2004, both the Company and Widmer incurred certain start-up expenses, including severance expenses and legal fees. The Company's operating income (loss) for the three months and six months ended June 30, 2004 reflects \$131,000 and \$538,000, respectively, attributable to the Company's share of these start-up expenses. Additionally, during the period March 15, 2004 through June 30, 2004, while the companies sought the regulatory approval required for Craft Brands to become fully operational, the Company and Widmer agreed to share certain sales-related costs, primarily salaries and overhead. The Company's share of these costs for the three months and six months ended June 30, 2004 were \$500,000 and \$554,000, respectively, and are reflected in the Company's statement of operations as selling, general and administrative expenses.

5. Refundable Deposits

In conjunction with the shipment of its products to wholesalers, the Company collects refundable deposits on its pallets. In certain circumstances when the pallets are returned to the Company, A-B may return the deposit to the wholesaler. In May 2005, the Company reimbursed A-B approximately \$881,000 for these pallet deposits. This payment is reflected in the Company's statement of cash flows for the six months ended June 30, 2005 as cash used in operating activities and on the Company's balance sheet as of June 30, 2005 as a reduction of refundable deposits.

6. Common Stockholders' Equity

In conjunction with the exercise of stock options granted under the Company's stock option plans, the Company issued 27,000 shares of the Company's common stock (Common Stock) totaling \$52,000 during the six months ended June 30, 2005, including 26,300 shares of Common Stock totaling \$51,000 during the three months ended June 30, 2005. During the six months ended June 30, 2004, the Company issued 135,500 shares of Common Stock totaling \$234,000 including 98,800 shares of Common Stock totaling \$175,000 during the three months ended June 30, 2004.

7. Earnings (Loss) per Share

The Company follows FASB Statement of Financial Accounting Standard (SFAS) No. 128, *Earnings per Share*. Basic earnings (loss) per share is calculated using the weighted average number of shares of Common Stock outstanding. The calculation of adjusted weighted average shares outstanding for purposes of computing diluted earnings (loss) per share includes the dilutive effect of all outstanding convertible redeemable preferred stock and outstanding stock options for periods when the Company reports net income. Outstanding stock options have been excluded from the calculation of diluted loss per share for the six months ended June 30, 2005 because their effect is antidilutive. The outstanding convertible preferred stock and outstanding stock options have been excluded from the calculation of diluted loss per share for the six months ended June 30, 2004 because their effect is antidilutive. The calculation uses the treasury stock method and the as if converted method in determining the resulting incremental average equivalent shares outstanding as applicable.

On July 1, 2004, the Company issued 1,808,243 shares of Common Stock to A-B in exchange for 1,289,872 shares of Series B Preferred Stock held by A-B. The Series B Preferred Stock and the related accretion of offering costs were cancelled.

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REDHOOK ALE BREWERY, INCORPORATED
NOTES TO FINANCIAL STATEMENTS (Continued)
(Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Basic earnings (loss) per share computation:				
Numerator:				
Net income (loss)	\$ 283,171	\$ 293,202	\$ (448,917)	\$ (627,336)
Preferred stock accretion		(11,100)		(22,200)
Income (loss) available to common stockholders	\$ 283,171	\$ 282,102	\$ (448,917)	\$ (649,536)
Denominator:				
Weighted average common shares	8,197,240	6,296,769	8,192,989	6,262,228
Basic earnings (loss) per share	\$ 0.03	\$ 0.04	\$ (0.05)	\$ (0.10)
Diluted earnings (loss) per share computation:				
Numerator:				
Net income (loss)	\$ 283,171	\$ 293,202	\$ (448,917)	\$ (627,336)
Preferred stock accretion				(22,200)
Numerator income (loss) available to common stockholders	\$ 283,171	\$ 293,202	\$ (448,917)	\$ (649,536)
Denominator:				
Weighted average common shares	8,197,240	6,296,769	8,192,989	6,262,228
Effect of dilutive securities:				
Series B convertible preferred stock		1,289,872		
Stock options, net	255,603	125,901		
Denominator for diluted earnings (loss) per share	8,452,843	7,712,541	8,192,989	6,262,228

Diluted earnings (loss) per share	\$	0.03	\$	0.04	\$	(0.05)	\$	(0.10)
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7. Stock-Based Compensation

The Company accounts for its employee stock-based compensation plans using the intrinsic value method, as prescribed by APB No. 25, *Accounting for Stock Issued to Employees*. Under APB 25, because the Company's employee stock options are granted at an exercise price equal to the fair market value of the underlying Common Stock on the date of the grant, no compensation expense is recognized. As permitted, the Company has elected to adopt the disclosure only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148.

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REDHOOK ALE BREWERY, INCORPORATED
NOTES TO FINANCIAL STATEMENTS (Continued)
(Unaudited)

The following table illustrates the effect on net income (loss) and earnings (loss) per share for the three and six months ended June 30, 2005 and 2004 had compensation cost for the Company's stock options been recognized based upon the estimated fair value on the grant date under the fair value methodology.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
Net income (loss), as reported	\$283,171	\$293,202	\$(448,917)	\$(627,336)
Add: Stock-based employee compensation expense as reported under APB 25				
Less: Stock-based employee compensation expense determined under fair value based method for all options, net of related tax effects	(27,270)	(45,473)	(36,153)	(99,022)
Pro forma net income (loss)	\$255,901	\$247,729	\$(485,070)	\$(726,358)
Earnings (loss) per share:				
Basic as reported	\$ 0.03	\$ 0.04	\$ (0.05)	\$ (0.10)
Basic pro forma	\$ 0.03	\$ 0.04	\$ (0.06)	\$ (0.12)
Diluted as reported	\$ 0.03	\$ 0.04	\$ (0.05)	\$ (0.10)
Diluted pro forma	\$ 0.03	\$ 0.03	\$ (0.06)	\$ (0.12)

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

Overview

Since its formation, the Company has focused its business activities on the brewing, marketing and selling of craft beers in the United States. The Company produces its specialty bottled and draft products in two Company-owned breweries, one in the Seattle suburb of Woodinville, Washington (the Washington Brewery) and the other in Portsmouth, New Hampshire (the New Hampshire Brewery). Prior to July 1, 2004, the Company's sales consisted predominantly of sales of beer to third-party distributors and Anheuser-Busch, Inc. (A-B) through the Company's Distribution Alliance with A-B (the Alliance or the Distribution Alliance). Since July 1, 2004, the Company's sales have consisted predominately of sales of product to Craft Brands Alliance LLC (Craft Brands) and A-B. Craft Brands is a joint venture sales and marketing entity between the Company and Widmer Brothers Brewing Company (Widmer). The Company and Widmer manufacture and sell their product to Craft Brands at a price substantially below wholesale pricing levels; Craft Brands, in turn, advertises, markets, sells and distributes the product to wholesale outlets in the western United States through a distribution agreement between Craft Brands and A-B. Profits and losses of Craft Brands are generally shared between the Company and Widmer based on the cash flow percentages of 42% and 58%, respectively. In Washington state, due to state liquor regulations, the Company sells its products directly to third-party beer distributors and returns a portion of the revenue to Craft Brands based upon a contractually determined formula. The Company continues to sell its product in the midwest and eastern United States through sales to A-B pursuant to the July 1, 2004 A-B Distribution Agreement. For additional information regarding Craft Brands and the A-B Distribution Agreement, see Part 1, Item 1, Business Production Distribution, Relationship with Anheuser-Busch, Incorporated and Relationship with Craft Brands Alliance LLC of the Company's Annual Report on Form 10K for the fiscal year ended December 31, 2004, and Craft Brands Alliance LLC below. In addition to sales of beer, the Company derives other revenues from sources including the sale of retail beer, food, apparel and other retail items in its two brewery pubs.

The Company's gross sales and net loss for the six months ended June 30, 2005 totaled \$17,066,000 and \$449,000, respectively, compared to gross sales and a net loss of \$20,834,000 and \$627,000, respectively, for the same period in 2004. However, comparability of the Company's 2005 operating results relative to the results for the same period in 2004 is significantly impacted by the July 1, 2004 formation of Craft Brands and the July 1, 2004 A-B Distribution Agreement, as sales for the first half of 2005 in the western United States were made to Craft Brands at discounted rates.

The Company's sales volume (shipments) increased 0.9% to 113,200 barrels for the six months ended June 30, 2005 as compared to 112,200 barrels for the same 2004 period. Sales in the craft beer industry generally reflect a degree of seasonality, with the first and fourth quarters historically being the slowest and the rest of the year typically demonstrating stronger sales. The Co