CRAFT BREW ALLIANCE, INC.
Form 10-K
March 16, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended: December 31, 2016
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 0-26542

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

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

929 North Russell Street

Portland, Oregon	97227-1733
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (503) 331-7270
Securities Registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.005 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

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 definition of “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the common equity held by non-affiliates of the registrant as of the last day of the registrant’s most recently completed second quarter on June 30, 2016 (based upon the closing price of the registrant’s common stock, as reported by the NASDAQ Stock Market, of $11.52 per share) was $144,099,279.

The number of shares outstanding of the registrant’s common stock as of March 10, 2017 was 19,261,245 shares.

Documents Incorporated by Reference
Portions of the registrant’s definitive Proxy Statement for the 2017 Annual Shareholders’ Meeting are incorporated by reference into Part III.

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INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K 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 “Item 1A. - Risk Factors” and those described from time to time in our future reports filed with the Securities and Exchange Commission. Caution should be taken not to place undue reliance on these forward-looking statements, which speak only as of the date of this annual report.

THIRD-PARTY INFORMATION

In this report, we rely on and refer to information regarding industry data obtained from market research, publicly available information, industry publications, U.S. government sources or other third parties. Although we believe that the third-party sources of information we use are materially complete, accurate and reliable, there is no assurance of the accuracy, completeness or reliability of third-party information.

PART I

Item 1. Business

Overview

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

Our distinctive portfolio combines the power of Kona Brewing Company, a fast-growing national craft beer brand, with an expanding stable of strong regional breweries and innovative lifestyle brands, including Appalachian Mountain Brewery, Cisco Brewers, Omission Brewing Co., Redhook Brewery, Square Mile Cider Co. and Widmer Brothers Brewing. We nurture the growth and development of our brands in today’s increasingly competitive beer market through our state-of-the-art brewing and distribution capability, integrated sales and marketing infrastructure, and strong focus on partnerships, local community and sustainability.

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

In addition to growing and nurturing distinctive brands steeped in local heritage, Craft Brew Alliance is committed to developing innovative new category leaders, such as Omission Beer, which is the #1 beer in the gluten-free beer category, and Square Mile Cider.

As the craft beer market continues to grow and consumers increasingly demand local offerings, Craft Brew Alliance has expanded its portfolio of brands and maximized its brewing footprint through strategic partnerships with emerging craft beer brands in targeted markets. In 2015, we announced strategic partnerships with Appalachian Mountain Brewery, based in Boone, North Carolina; and Cisco Brewers, based in Nantucket, Massachusetts. Through this strategic partnership model, we gain local relevance in select beer geographies, while our partner breweries gain access to our world-class leadership and national brewing and sales infrastructure to grow their brands. In December 2016, we announced a new strategic partnership with Wynwood Brewing Co., a fast-growing craft brewery based in the heart of Miami's multicultural arts district.

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. For more information about CBA and its brands, see "Available Information" on page 13.

We proudly brew our craft beers in four company-owned breweries located in Portland, Oregon; the Seattle suburb of Woodinville, Washington; Portsmouth, New Hampshire; and Kailua-Kona, Hawaii; and, through the end of 2016, one partner brewery in Memphis, Tennessee. 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 are beginning the process of transitioning our current production volume out

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of Memphis into ABCS's facilities. Additionally, we own and operate two 10-barrel innovation breweries in Portland, Oregon and Portsmouth, New Hampshire, which are primarily used for small batch production and limited-release brews.

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. In 2016, Kona, Redhook and Widmer Brothers beers were distributed in all 50 states. Omission Beer continues to expand into new markets in the U.S. and internationally, while Square Mile Cider is currently available in 13 states in the West. Separate from our A-B wholesalers, we maintain an internal independent sales and marketing organization with resources across the key functions of brand management, field marketing, field sales, and national retail sales.

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

Industry Background

We are one of the top six brewers in the craft brewing segment of the U.S. brewing industry. The domestic beer market includes ales and lagers produced by large domestic brewers, international brewers and craft brewers. Shipments of craft beer in the U.S. are estimated by industry sources to have increased by approximately 7% in 2016 over 2015 and by 12% in 2015 over 2014. While the overall domestic market experienced a modest increase in shipments of 0.3% in 2016, the craft beer segment continued its growth and captured market share from the rest of the domestic market. Craft beer shipments in 2016 and 2015 were approximately 14.5% and 13.6%, respectively, of total beer shipped in the U.S. Approximately 30.0 million barrels and 28.1 million barrels, respectively, were shipped in the U.S. by the craft beer segment during 2016 and 2015, while total beer sold in the U.S., including imported beer, was 207.5 million barrels and 206.8 million barrels, respectively. Compared with the other segments of the U.S. brewing industry, craft brewing is a relative newcomer. Twenty years ago, Redhook and Widmer Brothers Brewery were two of the approximately 200 craft breweries in operation. By the end of 2016, the number of craft breweries in operation had grown to more than 5,000. Industry sources estimate that craft beer produced by regional and national craft brewers, similar to us, accounts for approximately two-thirds of total craft beer sales, with one-third of the production brewed by smaller craft breweries.

Our comprehensive portfolio and national scale provide a competitive advantage in today's market environment, which includes craft brewers, domestic specialty beers, and imports. Our distinctive brand portfolio is positioned to address significant changes in consumer trends, including increased demand for innovative flavors and styles, a growing interest in sustainability, and the increasing importance of local relevance. As an example, Kona Brewing is one of the most distinctive craft brewers, with a broad portfolio of beers that reflect a uniquely Hawaiian flavor profile, a recognized track record in sustainable business practices, and deep ties to its local community as Hawaii's oldest and largest craft brewery.

Business Strategy

At Craft Brew Alliance, we believe we have an advantaged strategy that differentiates us in the rapidly evolving craft beer segment.

The central elements of our business strategy include:

- An innovative complementary portfolio of beers and ciders, which includes national lifestyle brands such as Kona and Omission, as well as storied regional craft brands that reflect changing consumer trends around variety, flavor and locale.
- Distinct, authentic craft beer brands with rich stories that are rooted in their local communities, including Widmer Brothers, Redhook Brewery, and Kona Brewing Company, and bold new trailblazers Omission Beer and Square Mile Cider Company, as well as strong regional craft partners such as Appalachian Mountain Brewery and Cisco Brewers.
- A national brewing footprint that allows us to get our beers to market faster, fresher and more efficiently. We have significant flexibility to fully leverage the specific strengths of our distinct breweries and operations. Additionally, we guarantee the quality and consistency of all of our products through fine-tuned processes designed to ensure that everything, from brewing to quality-assurance to warehousing and distribution, meets our high standards. We believe that maximizing production under our direct supervision and through accomplished and expert partners is critical to our success. Further, we believe that our ability to engage in ongoing product innovation and to control product quality provides critical competitive advantages. Each of our breweries is modern, has flexible production capabilities, and is designed to produce beer in smaller batches compared to the national domestic brewers, thereby allowing us to brew a wide variety of brand offerings. We believe that our investment in brewing and logistics technologies enables us to minimize brewery operating costs and consistently produce innovative beer styles.

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- Nationwide sales activation through robust partnerships with leading retailers. We leverage our national sales and marketing capabilities and complementary brand families to create a unique identity in the distribution channel and with the consumer. Our sales force calls on all retail channels nationally, including grocery, drug and convenience stores, something most other craft brewers are not positioned to do.
- National seamless distribution through the Anheuser-Busch wholesaler network alliance. This distribution footprint provides efficiencies in logistics and product delivery, state reporting and licensing, billing and collections. We have realized these efficiencies while maintaining full autonomy over the production, sale and marketing of our products as an independent craft beer company.
- A diverse leadership team with extensive experience in the beer and beverage industries. The team has a proven ability to manage brand lifecycles, from development to turnaround, in both large and growth-company settings.

Brand Overview

Our portfolio includes our owned brands, the Kona Brewing Company, Widmer Brothers Brewing, Redhook Brewery, Omission Beer and Square Mile Cider Company brand families, along with partner brands Appalachian Mountain Brewery and Cisco Brewers.

We produce a variety of specialty craft beers and ciders using traditional brewing methods complemented by American innovation and invention. We brew our beers using high-quality hops, malted barley, wheat, rye and other natural traditional and nontraditional ingredients. To craft our ciders, we use three apple varieties from the Pacific Northwest and then use a lager beer yeast to make a unique and easy-to-drink hard cider.

Below is an overview of our five owned brands:

Kona Brewing Company
Kona Brewing Company was born in Kailua-Kona on the Island of Hawaii in the spring of 1994 by father and son team Cameron Healy and Spoon Khalsa, who had a dream to create fresh, local island brews made with spirit, passion and quality. Today, Kona is Hawaii’s largest and favorite craft brewery, known for top-selling flagship beers Longboard Island Lager and Big Wave Golden Ale and award-winning innovative small-batch beers available across the Islands. The Hawaii-born and Hawaii-based craft brewery prides itself on brewing the freshest beer of exceptional quality closest to market, which helps to minimize its carbon footprint by reducing shipping of raw materials, finished beer and packaging materials.

Kona Brewing Company has become one of the top craft beer brands in the world, while remaining steadfastly committed to its home market through a strong focus on innovation, sustainability and community outreach.

Widmer Brothers Brewing
Widmer Brothers Brewing founders Kurt and Rob Widmer helped create the Pacific Northwest craft beer movement in 1984 when, in their 20s, they began brewing unique interpretations of traditional German beer styles. In 1986, Widmer Brothers Brewing introduced the original American-style Hefeweizen, which elevated the brewery to national acclaim and has long been Oregon’s favorite craft beer. The brewery’s iconic Hefe celebrated its 30th anniversary in 2016 and remains one of the most awarded craft beer brands in the U.S. For more than three decades, Widmer Brothers has continued to push the boundaries of craft beer, developing a variety of beers with an unapologetic, uncompromising commitment to innovation. Based in Portland, Oregon, the brewery currently brews a variety of beers including Hefeweizen, Upheaval IPA, Steel Bridge Porter, Drop Top Amber Ale, and a full seasonal lineup. Additionally, the Widmer Brothers innovation brewery continues to make limited edition, small-batch beers available exclusively in Oregon and at the Widmer Brothers pub in North Portland.

Redhook Brewery

Redhook was born out of the energy and spirit of the early 1980s in the heart of Seattle. While the term didn't exist at the time, Redhook became one of America's first craft breweries with its focus on creating "better beers." From a modest start in a former transmission shop in the Seattle neighborhood of Ballard to a Fremont trolley barn that housed The Trolleyman brewpub, to its current breweries in Woodinville, Washington, and Portsmouth, New Hampshire, Redhook has become one of America's most recognized craft breweries. Redhook will open a 10-barrel brewpub in the Capitol Hill neighborhood of Seattle in 2017.

While Redhook has "grown up" over the past 30 years, one thing has never changed - Redhook is still brewing great beers like ESB and Long Hammer IPA, which is one of the top-ten IPAs in the U.S., along with a variety of seasonal beers. Redhook beers are available on draft and in bottles and cans around the country.

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Omission Beer
Omission is the first craft beer brand in the United States focused exclusively on brewing great-tasting craft beers with traditional ingredients-including malted barley-that are crafted to remove gluten. Brewed in Portland, Oregon, Omission tests the gluten levels in every batch through an independent lab that uses the R5Competitive Eliza test to ensure that gluten levels are less than 20 parts per million. Test results for every batch of Omission beer are available to consumers at: www.omissiontests.com. Omission produces three craft beers specially crafted to remove gluten: Omission Lager, Omission Pale Ale and Omission IPA. Omission has been the #1 beer brand in the gluten-free beer category for well over a year.

Square Mile Cider Company
Launched in 2013, Square Mile Cider is the hard cider for the modern day pioneers celebrating the spirit of the Pacific Northwest. We set out to reinvigorate an enduringly classic American beverage with a blend of hand-selected apples combined with unique Northwest ingredients. Square Mile Cider produces two varieties of hard cider, The Original and Spur & Vine, our hopped version.

We also have brewing and distribution arrangements with partner brands, which included the following partners in 2016:

Appalachian Mountain Brewery
Appalachian Mountain Brewery, LLC is dedicated to making seriously delicious craft beer while focusing its business model on community, sustainability and philanthropy. Their Pints for Non-Profits program collaborates with local organizations that are dedicated to enriching the land, water, air and people of the High Country. Appalachian Mountain Brewery has earned numerous awards for its innovative craft beers and ciders, including Boone Creek Blonde Ale, which won a Gold Medal at the U.S. Open Beer Championships in 2016. The brewery’s core portfolio also includes Long Leaf IPA, Spoaty Oaty Pale Ale, and Porter, which is a gold medal winner at the Great International Beer and Cider Competition.

Cisco Brewers
Cisco Brewers is a craft brewery that embodies Nantucket’s “away off shore” lifestyle. Cisco Brewers is a unique operation, proud to be one of the very first producers in the United States crafting beer, wine, and spirits. Their home base is a major attraction for locals and tourists alike, and is regularly highlighted in the media as one of the top destinations on Nantucket Island. Cisco Brewers' year-round offerings include Whale’s Tale Pale Ale, Grey Lady, and Indie IPA.

Developments in Brands and Packaging

Our recent brand and packaging developments include:

Kona Brewing
In 2016, Kona Brewing Co. capitalized on the IPA craft trend with the launch of a new Island-inspired, tropical brew, Hanalei Island IPA, in Hawaii and southern California, followed by a national launch in January 2017. As with all of Kona’s beers, Hanalei Island IPA was named for a specific place in Hawaii, Hanalei Bay in Kauai, and evokes the spirit of Hawaii with distinctive local ingredients. Brewed with Hawaii’s beloved POG (pineapple, orange and guava) juice, Hanalei Island IPA is a coppery, laidback, session-style ale with tropical flavors and just 4.5% alcohol by volume ("ABV"). 2016 represented the seventh consecutive year of double-digit growth for the Hawaiian brewery on the mainland, as Kona continued to expand Longboard Lager and Big Wave distribution across all 50 states. We also added new countries to our distribution network, bringing Kona beers to more than 30 countries.

Widmer Brothers Brewing

In 2016, Widmer Brothers announced the arrival of its flagship beer Hefe in cans. Hefe has been the brewery's flagship beer for 30 years, and the Original American Hefeweizen is still the best-selling craft beer in Oregon. To celebrate Hefe's 30th anniversary in 2016, the storied, award-winning beer was launched in 12-ounce cans in six- and 12-packs in the Oregon market exclusively. As part of its ongoing commitment to its hometown, Widmer Brothers tapped three new beers in 2016 that were themed around the Portland Timbers MLS team. The first, launched in March 2016, was a rye altbier collaboration with Timbers Head Coach Caleb Porter and the Portland Timbers coaching staff called First Star, after the gold star worn by MLS Cup champion teams to signify their title wins. The brewery also tapped Thrill of Victory Cascadian Dark Ale, a collaboration with Columbus Brewing as part of a bet between the two breweries before last year's MLS Championship game between the Timbers and the Columbus Crew. In September 2016, Widmer Brothers Brewing and Portland Timbers Goalkeeper Jake Gleeson teamed up to brew a small-batch, commemorative beer , "Centennial Celebration IPA," a pineapple rye India Pale Ale, to mark the 100th consecutive Portland Timbers regular season match sellout.

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Redhook Brewery

In 2016, Redhook continued to pay homage to its roots as the first craft brewery in Seattle. The brewery launched a new packaging design that evokes the brewery's earliest days in the Emerald City and announced that it will open a new innovation brewery in the historic Capitol Hill neighborhood.

In May 2016, Redhook introduced a new summer seasonal that is a true Seattle original. Summerhook is a golden rye ale made for Seattle summers: picnics at Green Lake, day games at Safeco Field, or warm evenings at the Fremont Solstice Fair. Summerhook is a golden rye ale that features crisp hoppiness and rye malt characteristics. Summerhook's light body and 4.7% ABV make it a refreshing must for the season. Redhook also released a new national beer, American Pale Ale. This hoppy addition to Redhook's year-round lineup, featuring classic red, white and blue packaging, was available nationally starting in July 2016. Redhook's take on the American Pale Ale style integrates classic Chinook and Cascade hop characters into this easy-drinking and full-flavored pale ale. At 4.7% ABV, the sessionable American Pale Ale is a great beer for any occasion throughout the year, including Fourth of July barbeques, game nights, and casual hangouts with friends. American Pale Ale is available nationally in six- and twelve-packs, and on draught. The brewery also continued its partnership with the University of Washington and its beloved football and basketball teams.

Omission Beer

In 2016, Omission Beer maintained its position as the market leader in the gluten-free beer category. Omission IPA continued to expand into new markets across the country, following in the footsteps of Omission Lager and Pale Ale. With a focus on the healthy and active lifestyle consumer, Omission Beer remains a favorite among those consumers seeking a great-tasting beer crafted to remove gluten.

Square Mile Cider Company

In 2016, Square Mile Cider Company continued to expand distribution into 12 states, becoming the number one locally produced cider in the Northwest. The brand, which finds its inspiration from the pioneering spirit of the original Oregon pioneers, continues to offer two varieties: The Original, a classic American hard cider; and Spur & Vine, a hopped version of the classic American hard cider, with the addition of Citra and Galaxy hops.

Brewing Operations

Brewing Facilities

We use highly automated brewing equipment at our four owned production breweries and also operate two smaller, manual brewpub-style brewing systems. As of December 31, 2016, our total owned production capacity was 1,075,000 barrels. Our breweries include:

- Oregon Brewery. Our Oregon Brewery is our largest capacity production brewery and we expect to complete construction on our expansion of the brewery's annual capacity in 2017.
- Washington Brewery. Our Washington Brewery utilizes a 100-barrel brewing system.
- New Hampshire Brewery. Our New Hampshire Brewery utilizes a 100-barrel brewing system and uses an anaerobic waste-water treatment facility that completes the process cycle.
- Hawaiian Brewery. Our Hawaiian Brewery utilizes a 25-barrel brewing system and utilizes a 229-kilowatt photovoltaic solar energy generating system to supply approximately 50 percent of its energy requirements through renewable energy. In 2016, we held a ground breaking ceremony for a new brewery near our existing brewery and pub in Kona. The new brewery, which is being built with sustainability in mind, is scheduled to go online in the first quarter of 2019.
- Innovation Breweries. In 2016, we built a new 10-barrel innovation brewery adjacent to our main Portland production brewery. The brewery is focused on releasing innovative small-batch and limited release beers in the local market. Our New Hampshire innovation brewery system maintains a 3-barrel pilot brewing system and is located on the same

site as our New Hampshire production brewery.

In addition to our owned brewing capacity, we supplemented our 2016 production needs through a brewing partnership with Blues City Brewing in Memphis, Tennessee. This partnership, which began in 2014, provided us the ability to produce up to 100,000 barrels at this location annually. In 2016, we entered into a contract brewing agreement with ABCS and will be transitioning our current production volume out of Memphis into ABCS's facilities during 2017.

Packaging
We package our craft beers in cans, bottles and kegs. All of our production breweries, with the exception of the Hawaiian Brewery, have fully automated bottling and keg lines. The bottle fillers at all of the breweries utilize a carbon dioxide environment during bottling, ensuring that minimal oxygen is dissolved in the beer and extending the beer's shelf life. We offer an assortment of packages to highlight the unique characteristics of each of our beers and to provide greater opportunities for customers to drink

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our beers in more locations and at more events and occasions, matching the active lifestyles and preferences of our consumers. Additionally, in our Portland Widmer Brothers Brewpub, we package our small-batch and innovation beers for consumers in crowlers.

Quality Control

We monitor production and quality control at all of our breweries, with central coordination at the Oregon Brewery. All of the breweries have an on-site laboratory where microbiologists and lab technicians supervise on-site yeast propagation, monitor product quality, test products, measure color and bitterness, and test for oxidation and unwanted bacteria. We also regularly utilize outside laboratories for independent product analysis. In addition, every batch of beer that we produce goes through an internal taste panel to ensure that it meets our taste and profile standards.

Ingredients and Raw Materials

We currently purchase a significant portion of our malted barley from two suppliers and our premium-quality select hops, mostly grown in the Pacific Northwest, from competitive sources. We also periodically purchase small lots of hops from international sources, such as New Zealand and Western Europe, which we use to achieve a special hop character in certain beers. In order to ensure the supply of the hop varieties used in our products, we enter into supply contracts for our hop requirements. We believe that comparable quality malted barley and hops are available from alternate sources at competitive prices, although there can be no assurance that pricing would be consistent with our current arrangements. We currently cultivate our own yeast supply for certain strains and maintain a separate, secure supply in-house. We have access to multiple competitive sources for packaging materials, such as labels, six-pack carriers, crowns, cans and shipping cases.

Contract Brewing

We enter into contract brewing arrangements in an effort to absorb excess capacity under which we produce beer in volumes and per specifications as designated by the arrangements.

During 2016, we shipped 26,700 barrels under contract brewing arrangements, compared to 36,800 barrels in 2015 and 39,700 in 2014.

Brewpubs Operations

We own and operate five brew-pub restaurants and retail stores that support consumer awareness and research and development. Our five brew-pub restaurants allow us to interact directly with over 1.5 million consumers annually in our home markets, which creates a sense of brand loyalty. Our brewers are continually experimenting with different varieties of hops and malts in all styles of beer, and our brewpubs allow us to bring those beers to market in test-size batches in order to evaluate their potential prior to releasing them on a wider basis.

Distribution

With limited exceptions, all brewers in the United States are required to sell their beers to independent wholesalers, who then sell the beers to retailers. We are the only independent craft brewer in the U.S. to have established a wholly-aligned distribution network through our partnership with A-B. This partnership provides us national distribution, which results in both an effective distribution presence in each market and administrative efficiencies. Our beers are available for sale directly to consumers in draft, cans and bottles at restaurants, bars and liquor stores, as well as in cans and bottles at supermarkets, warehouse clubs, convenience stores and drug stores. We sell beer directly to consumers at our brewpubs and breweries.

Our products are distributed in all 50 states, pursuant to a master distributor agreement with A-B that allows us access to A-B’s national distribution network. For additional information regarding our relationship with A-B, see

“Relationship with Anheuser-Busch, LLC” below. Management believes that our competitors in the craft beer segment generally negotiate distribution relationships separately with wholesalers in each locality and, as a result, typically distribute through a variety of wholesalers representing differing national beer brands with uncoordinated territorial boundaries.

In 2016 and 2015, we sold approximately 693,300 barrels and 753,400 barrels, respectively, to the wholesalers in A-B’s distribution network, accounting for 89.4% and 91.4%, respectively, of our shipment volume for the corresponding periods.

Sales and Marketing

In addition to leveraging our owned brewpubs and retail locations, we promote our products through a national sales and marketing network that includes, but is not limited to, i) creating and executing a range of advertising programs; ii) training and educating

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wholesalers and retailers about our products; and iii) promoting our name, product offerings, brands, and experimental beers at local festivals, venues and brewpubs.

We advertise and promote our products through an assortment of media, including television, radio, billboard, print and social media, including Facebook, Twitter and Instagram, in key markets and by participating in cooperative programs with our wholesalers whereby our spending is matched by the distributor. We believe that the financial commitment by the distributor helps align the distributor's interests with ours, and the distributor's knowledge of the local market results in an advertising and promotion program that is targeted in a manner that will best promote our products.

Our breweries also play a significant role in increasing consumer awareness of our products and enhancing our image as a craft brewer. Thousands of visitors per year take tours at our breweries and all of our production breweries have a retail restaurant or pub where our products are served. In addition, several of the breweries have meeting rooms that the public can rent for business meetings, parties and holiday events, and that we use to entertain and educate wholesalers, retailers and the media about our products. At our brewpubs, we sell various items of apparel and other merchandise bearing our trademarks, which creates further awareness of our beers and reinforces our brand image. To further promote retail canned and bottled product sales, and in response to local competitive conditions, we regularly recommend that wholesalers offer discounts to retailers in most of our markets.

Relationship with Anheuser-Busch, LLC

Distributor Agreement

The Master A-B Distributor Agreement (the "A-B Distributor Agreement"), as amended in August 2016, provides for the distribution of our brands, as well as those of AMB and Cisco, in all states, territories and possessions of the United States, including the District of Columbia and, except with respect to Kona beers, all U.S. military, diplomatic, and governmental installations in a U.S. territory or possession. Under the A-B Distributor Agreement, we have granted A-B the right of first refusal to distribute our products, including any internally developed new products, but excluding new products that we may acquire. We are responsible for marketing our products to A-B's wholesalers, as well as to retailers and consumers.

As amended in August 2016, the term of the A-B Distributor Agreement will expire on December 31, 2028. The A-B Distributor Agreement is also subject to immediate termination, by either party, upon the occurrence of standard events of default as defined in the agreement. Additionally, the A-B Distributor Agreement may be terminated by A-B, with six months' prior written notice to us, upon the occurrence of any of the following events:

- we engage in incompatible conduct that damages the reputation or image of A B or the brewing industry;
- any A-B competitor or affiliate thereof acquires 10% or more of our outstanding equity securities, and that entity designates one or more persons to our board of directors;
- our current chief executive officer ceases to function in that role or is terminated, and a satisfactory successor, in A B's opinion, is not appointed within six months;
- we are merged or consolidated into or with any other entity or any other entity merges or consolidates into or with us without A-B's prior approval; or
- A-B, its subsidiaries, affiliates, or parent, incur any obligation or expense as a result of a claim asserted against them by or in our name, or by our affiliates or shareholders, and we do not reimburse and indemnify A-B and its corporate affiliates on demand for the entire amount of the obligation or expense.

A-B also has the right to deliver a revocation notice and reinstitute the terms of the A-B Distributor Agreement as they existed prior to August 23, 2016, following a "change of control event" that occurs or for which a definitive agreement is entered into prior to August 23, 2019, and is subsequently completed. A “change of control event” includes, with certain exceptions, (i) the acquisition by a person or group of beneficial ownership on a fully diluted basis of 50% or more of our equity securities (or the equity securities of the surviving entity in any merger, consolidation, share exchange or other business combination involving us), (ii) a change in the composition of our board of directors during any consecutive 12-month period such that the incumbent directors cease to constitute at least a majority of the board of directors, or (iii) the completion of a sale, lease, exchange, or other transfer of (A) the Kona brand or (B) 50% or more of our assets based on fair market value. A-B would have a similar revocation right upon the earliest to occur of (x) our rejection of a “qualifying offer” by A-B, (y) the completion of a transaction implementing A-B’s qualifying offer, and (z) our failure to enter into a definitive transaction agreement with A-B within 120 days following receipt of A-B’s qualifying offer, with certain exceptions. A “qualifying offer” means an offer or proposal on customary terms and conditions, with certain exceptions, made by A-B (or one of its affiliates) for the acquisition of all of our outstanding common stock not owned by A-B or its affiliates, for an aggregate value (subject to adjustment for changes in capitalization) of (a) until August 23, 2017, at least $22.00 per share, (b) from August 24, 2017 through August 23, 2018, at least $23.25 per share, and (c) beginning August 24, 2018, at least $24.50 per share.

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Contract Brewing Agreement

On August 23, 2016, we entered into a Contract Brewing Agreement (the "Brewing Agreement") with A-B Commercial Strategies, LLC ("ABCS"), an affiliate of A-B, pursuant to which ABCS will brew, bottle and package up to 300,000 barrels of our mutually agreed products annually, in facilities owned by ABCS within the United States, for an initial term through December 31, 2026. We are in the process of transitioning our current production volume from our contract brewer in Memphis, Tennessee, to ABCS's facilities. We will share equally with ABCS in any cost savings arising from the Brewing Agreement, provided that our cost savings will equal at least $10.00 per barrel on an aggregate basis, following certain adjustments as set forth in the Brewing Agreement.

The Brewing Agreement provides 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, subject to certain cure rights, (ii) the International Distribution Agreement (as defined below) is terminated pursuant to certain specified provisions thereof, or (iii) subject to certain conditions, if the Master Distributor Agreement (as defined above) is terminated pursuant to certain specified provisions thereof.

In addition, ABCS has the right to terminate the Brewing Agreement, upon 90 days' prior written notice to us, following (i) a change of control event (as defined above) that occurs or for which a definitive agreement is entered into prior to August 23, 2019, and is subsequently completed, or (ii) the earliest of (x) our rejection of a "qualifying offer" (as defined above), (y) the completion of a transaction implementing a qualifying offer, and (z) our failure to enter into a definitive transaction agreement within 120 days following receipt of a qualifying offer, with certain exceptions.

International Distribution Agreement

On August 23, 2016, we also entered into an International Distribution Agreement (the "International Distribution Agreement") with Anheuser-Busch Worldwide Investments, LLC ("ABWI"), an affiliate of A-B, pursuant to which ABWI will be the sole and exclusive distributor of our malt beverage products in jurisdictions outside the United States, subject to the terms and conditions of our agreement with our existing international distributor, CraftCan Travel LLC, and certain other limitations, in each case as set forth in the International Distribution Agreement. Under the International Distribution Agreement, following delivery of notice to us, ABWI may also elect to commence brewing outside of the United States some or all of the products to be distributed in the non-U.S. jurisdictions covered by the International Distribution Agreement.

Under the terms of the International Distribution Agreement, with respect to our exported products produced by us, ABWI will pay us our costs of production plus reasonable out-of-pocket expenses relating to export shipment costs. Additionally, ABWI will pay us an international royalty fee based on volume of our products sold by ABWI, equal to either $40 per barrel or $30 per barrel, depending on certain factors described in the International Distribution Agreement, which royalty fee will be subject to escalation annually, beginning in calendar year 2018, on the terms described in the International Distribution Agreement. For calendar year 2016, 2017 and 2018, ABWI will also pay us one-time fees of $3.0 million, $5.0 million and $6.0 million, respectively. The sum of the fees is recognized in Beer Related Net sales on a straight-line basis over the 10-year contract term, while the fees are collected in the first quarter of the year following the applicable calendar year.

The International Distribution Agreement contains specified termination rights, including, among other things, the right of either party to terminate the International Distribution Agreement if (a) the other party fails to perform any material obligation under the International Distribution Agreement, subject to certain cure rights or (b) the Brewing Agreement is terminated pursuant to certain specified provisions thereof. In addition, ABWI has the right to terminate the International Distribution Agreement upon 90 days' prior written notice to us following (i) a "change of control event" (as defined above) that occurs or for which a definitive agreement is entered into prior to August 23, 2019, and is subsequently completed, or (ii) the earliest of (x) our rejection of a “qualifying offer” (as defined above), (y) the completion of a transaction implementing a qualifying offer, and (z) our failure to enter into a definitive transaction agreement within 120 days following receipt of a qualifying offer, with certain exceptions (each of the foregoing subclauses (x) through (z), a “qualifying offer lapse”). Following termination of the International Distribution Agreement due to a qualifying offer lapse, or any change of control event, ABWI shall have the right to purchase the international distribution rights for each of our brands then being distributed under the International Distribution Agreement at the fair market value of such rights, and on otherwise customary terms and conditions, as set forth in the International Distribution Agreement.

Under the International Distribution Agreement, ABWI will also be required to make a one-time $20.0 million payment to us on August 23, 2019. The payment is being recognized in Beer Related Net sales on a straight-line basis over the 10-year contract term. However, ABWI will not (subject to compliance with certain notice requirements) be obligated to make such one-time payment if, prior to that date, (i) a “change of control event” occurs or a definitive agreement for a transaction constituting a change of control event is entered into, (ii) ABWI (or an affiliate thereof) makes a qualifying offer and there is a qualifying offer lapse or (iii) we enter into a definitive agreement with ABWI (or an affiliate thereof) with respect to a qualifying offer but such agreement

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is subsequently terminated, other than for certain regulatory reasons (in which case the $20.0 million shall remain payable). Unless terminated sooner, the International Distribution Agreement will continue in effect until December 31, 2026.

Exchange Agreement

We have also entered into an Amended and Restated Exchange and Recapitalization Agreement (the “Exchange Agreement”) with A-B, pursuant to which we have granted A-B certain contractual rights. The Exchange Agreement originally was entered into in 2004 as part of a recapitalization in which we redeemed preferred shares held by A-B in exchange for cash and the shares of our common stock currently held by A-B. A-B owned 31.5% of our outstanding shares of common stock at December 31, 2016.

The Exchange Agreement entitles A-B to designate two members of our board of directors. A-B also generally has the right to have a designee on each committee of the board of directors, except where prohibited by law or stock exchange requirements, or with respect to a committee formed to evaluate transactions or proposed transactions between A-B and us. The Exchange Agreement contains limitations on our ability to take certain actions without A-B’s prior consent, including, but not limited to, our ability to issue equity securities or acquire or sell assets or stock, amend our Articles of Incorporation or Bylaws, grant board representation rights, enter into certain transactions with affiliates, distribute our products in the United States other than through A-B or as provided in the A-B Distributor Agreement, or voluntarily terminate our listing on the Nasdaq Stock Market.

On August 23, 2016, A-B and we entered into an amendment to the Exchange Agreement providing A-B with rights, following a “change of control event” or a “qualifying offer,” similar to those described above under “Distributor Agreement.”

Contract pricing may not be commensurate with amounts that an independent market participant would pay due to the related party nature of the agreements.

Fees

We pay fees to A-B in connection with the sale of our products, including margin fees, invoicing, staging and cooperage handling fees, and inventory manager fees.

See Note 17 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for additional information.

Relationship with Pabst Northwest Brewing Company

On January 8, 2016, we entered into brewing agreements ("the brewing agreements") with Pabst Northwest Brewing Company ("Pabst"), a subsidiary of Pabst Brewing Company, under which Pabst has the ability to brew selected Rainier Brewing Company and other brands at our brewery in Woodinville, Washington under a license agreement. The brewing agreements expire on December 31, 2018. During 2016, we recorded $1.6 million in fees earned from Pabst related to a contract brewing volume shortfall in Contract brewing and beer related sales.

In conjunction with the brewing agreements, we granted Pabst an option to purchase the Woodinville brewery and adjacent pub, as well as related assets (together, the "Property"), at any time prior to termination of the brewing agreements. The purchase price of the Property will be $25.0 million if Pabst exercises the option during the first year of the agreement (which has elapsed), $26.0 million if exercise occurs during the second year of the agreement, and $28.0 million if Pabst exercises the option during the third year of the agreement and on or before the close of business on December 31, 2018. Under the option agreement, Pabst conducted an additional diligence review of environmental and title issues relating to the Property, and, upon completion, did not exercise its right to terminate either the brewery agreements or the option agreement. If Pabst does not exercise its option to purchase the Property, it may be required to pay us a termination fee.

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.

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Competition

We compete in the craft brewing market as well as in the much larger alcoholic beverage market, which encompasses domestic and imported beers, flavored alcohol beverages, spirits, wine and ciders.

In 2016, the craft brewing industry continued to experience unprecedented change and competition, characterized by three trends: 1) the growing number and popularity of new local craft breweries that captured market share from established craft breweries, 2) continued acquisition and investment activity between craft brewers, large domestic and foreign brewers, and private equity firms, and 3) continued competitive pressure from international brewers, including Crown, which target both domestic and craft beer drinkers. In 2016, according to industry sources, A B and MillerCoors accounted for almost 80% of total beer shipped in the U.S., excluding imports. In addition, A-B and MillerCoors have continued to invest in existing smaller craft breweries and nurtured separate craft-focused divisions in an effort to capitalize on the growing craft beer segment and consumer trend for locally produced products.

Competition varies by regional market. Depending on the local market preferences and distribution, we have encountered strong competition from microbreweries, regional specialty brewers and several national craft brewers that include MillerCoors' Tenth and Blake Beer Company division ("Tenth and Blake"), Constellation Brands, and A-B's High End division. A-B's High End division includes Goose Island, Blue Point Brewing, 10 Barrel Brewing Company, Elysian, Golden Road, Shock Top, Karbach Brewing and others. Because of the large number of participants and offerings in this segment, along with the accelerating consumer preference for local offerings, the competition for packaged product placements and especially draft beer placements has intensified. Although certain of these competitors distribute their products nationally and may have greater financial and other resources than we have, we believe that we possess certain competitive advantages, including our unique portfolio strategy that combines strong national lifestyle brands supported by distinctive regional craft brands, the scale and specialization of our production breweries, strategically distributed sales and marketing resources, and alignment within the A-B distribution network.

We also compete against imported brands, such as Heineken, Stella Artois, Corona Extra and Guinness, which typically have significantly greater financial resources than we have. Although imported beers currently account for a greater share of the U.S. beer market than craft beers, we believe that craft brewers possess certain competitive advantages over some importers, including lower transportation costs, no importation costs, proximity to and familiarity with local consumers, a higher degree of product freshness, eligibility for lower federal excise taxes and absence of exposure to currency fluctuations.

In response to the growth of the craft beer segment, the major domestic national brewers have invested in purchasing small craft breweries. The major national brewers, including Tenth and Blake through MillerCoors, and A-B High End brands through A-B, have significantly greater financial resources than we do and have access to a greater array of advertising and marketing tools to create product awareness of these offerings.

In the past several years, several major distilled spirits producers and national brewers have introduced flavored alcohol beverages. Products such as the Bud Light Rita family, Smirnoff Ice, the hard soda category, and Mike's Hard Lemonade have captured sizable market share in the higher-priced end of the malt beverage industry. We believe sales of these products, along with strong growth in the imported and craft beer segments of the malt beverage industry, contributed to an increase in the overall U.S. alcohol market. These products are particularly popular in certain regions and markets in which we sell our products.

Competition for consumers of craft beers also comes from wine and spirits, which reflects today's millennial consumers who typically drink across three alcoholic beverage categories in a single drinking occasion. Growth in this segment appears to be attributable to competitive pricing, television advertising, increased merchandising and increased consumer interest in local wine and craft spirits. Recently, the wine industry has been aided, on a limited basis, by its ability to sell outside of the three-tier system, allowing sales to be made directly to the consumer. While the craft beer segment competes with wine and spirits, it also benefits from many of the same advantages enjoyed by wine and spirit producers. These include consumers who allow themselves affordable luxuries in the form of high quality alcoholic beverages.

A significant portion of our sales continues to be in the Pacific Northwest and in California, which we believe are among the most competitive craft beer markets in the United States, both in terms of number of participants and consumer awareness. We believe that these areas offer significant competition for our products, not only from other craft brewers but also from the growing wine market and from flavored alcohol beverages. Additionally, we are monitoring the impact of cannabis as more states legalize marijuana for retail sales. Our recent marketing efforts have been focused on promoting the authenticity of our pioneering owned brands and partner brands, the appeal of our newer brands and better segmenting our marketing strategies to communicate the attributes of our portfolio to our target consumers. We believe that our broad array of beers and brands enables us to offer an assortment of flavors and experiences that appeal to more people.

Segment and Enterprise-Wide Information

See Note 11 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for the required segment and enterprise-wide information.

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Regulation

Our business is highly regulated at federal, state and local levels. Various permits, licenses and approvals necessary for our brewery and pub operations and the sale of alcoholic beverages are required from a number of agencies, including the U.S. Treasury Department, the Alcohol and Tobacco Tax and Trade Bureau (“TTB”), the U.S. Department of Agriculture, the U.S. Food and Drug Administration (“FDA”), state alcohol regulatory agencies, and state and local health, sanitation, safety, fire and environmental agencies. In addition, the beer industry is subject to substantial federal and state excise taxes.

The FDA issued a proposed rule in November 2015 on the use of “gluten-free” labeling for fermented and hydrolyzed foods and beverages that may affect our ability to market our Omission Beer. The proposed rule is under review by the Office of Management and Budget and is expected to become final in April 2017. See Item 1A. Risk Factors for additional information.

We operate our breweries under federal licensing requirements imposed by the TTB. The TTB requires the filing of a “Brewer’s Notice” upon the establishment of a commercial brewery and the filing of an amended Brewer’s Notice any time there is a material change in the brewing or warehousing locations, brewing or packaging equipment, brewery ownership, or officers or directors. Our operations are subject to audit and inspection by the TTB at any time.

Management believes that we currently have all of the licenses, permits and approvals required for our current operations. Existing permits or licenses could be revoked if we fail to comply with the terms of such permits or licenses and additional permits or licenses may be required in the future for our current operations or as a result of expanding our operations.

The U.S. federal government currently levies an excise tax of $18 per barrel on beer sold for consumption in the United States; however, brewers, such as us, that produce less than two million barrels annually are taxed at $7 per barrel on the first 60,000 barrels shipped, with shipments above this amount taxed at the normal rate. Certain states also levy excise taxes on alcoholic beverages. 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. In January 2017, the Craft Beverage Modernization and Tax Reform Act (S.236/H.R. 747) was introduced in both the U.S. Senate and the U.S. House of Representatives. If enacted, the act would provide significant tax relief to all brewers and importers. Our benefit would be significant because it would reduce the excise tax from $7 to $3.50 per barrel on the first 60,000 barrels shipped and from $18 to $16 per barrel shipped on the next 6 million barrels shipped.

Federal and State Environmental Regulation

Our brewing operations are subject to environmental regulations and local permitting requirements and agreements regarding, among other things, air emissions, water discharges and the handling and disposal of hazardous wastes. While we have no reason to believe the operation of our breweries violate any such regulation or requirement, if such a violation were to occur, or if environmental regulations were to become more stringent in the future, we could be adversely affected.

Dram Shop Laws

The serving of alcoholic beverages to a person known to be intoxicated may, under certain circumstances, result in the server being held liable to third parties for injuries caused by the intoxicated customer. Our restaurants and brewpubs have addressed this issue by maintaining reasonable hours of operation and routinely performing training for personnel.

Trademarks

We have obtained U.S. trademark registrations for numerous products. Trademark registrations generally include brand names and logos and specific product names. The Kona Brewing Co., Widmer Brothers Brewing, Redhook, and Omission marks and certain other marks are also registered in various foreign countries. We regard our Kona Brewing Co., Widmer Brothers Brewing, Redhook, Omission, Square Mile and other trademarks as having substantial value and as being an important factor in the marketing of our products. We are not aware of any infringing uses that could materially affect our current business or any prior claim to the trademarks that would prevent us from using such trademarks in our business. Our policy is to pursue registration of our material trademarks in our markets whenever possible and to oppose vigorously any infringement of our trademarks.

Employees

At December 31, 2016, we employed approximately 800 people, including 395 employees in the brewpubs and retail stores, 180 employees in production, 135 employees in sales and marketing and 90 employees in corporate and administration. Included in the totals above are 184 part-time employees and 9 seasonal or temporary employees. None of our employees are represented by a union or employed under a collective bargaining agreement. We believe our relations with our employees to be good.

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Available Information

Our Internet address is www.craftbrew.com. There we make available, free of charge, our annual report on Form 10 K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and any amendments to those reports, as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission (“SEC”). Our SEC reports can be accessed through the investor relations section of our website. The information found on our website is not part of this or any other report we file with or furnish to the SEC.

Item 1A. Risk Factors

If we are unable to gauge trends and react to changing consumer preferences in a timely and cost-effective manner, our sales and market share may decrease and our gross margin may be adversely affected.
The costs and management attention involved in maintaining an innovative brand portfolio have been, and are expected to continue to be, significant. If we have not gauged consumer preferences correctly, or are unable to maintain consistently high quality beers as we develop new brands, our overall brand image may be damaged. If this were to occur, our future sales, results of operations and cash flows would be adversely affected. Also, increased costs associated with developing new products may have a negative effect on our gross margin.

Increased competition could adversely affect sales and results of operations.
We compete in the highly competitive craft beer market, as well as in the much larger specialty beer category, which includes the imported beer segment and fuller-flavored beers offered by major brewers. We face increasing competition from producers of wine, spirits and flavored alcohol beverages offered by the larger brewers and spirit producers. We are also monitoring the impact of cannabis as more states legalize marijuana for retail sale. Increased competition could adversely affect our future sales and results of operations. See "Competition" in Part I, Item 1 of this Annual Report on Form 10 K.

Our information systems may experience an interruption or breach in security.
We rely on computer information systems to conduct our business. We have policies and procedures in place to protect against and reduce the occurrence of failures, interruptions, or breaches of security of these systems. However, there can be no assurances that these policies and procedures will eliminate the occurrence of failures, interruptions or breaches of security or that they will adequately restore our systems or minimize any such events. The occurrence of a failure, interruption or breach of security of our computer information systems could result in loss of intellectual property, delays in our production, loss of critical information, or other events, any of which could harm our future sales or operating results.

We manage and store various proprietary information and sensitive or confidential data relating to our business, including sensitive and personally identifiable information. Breaches of our security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us, our employees, or our customers, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our customers or the individuals affected to a risk of loss or misuse of this information. Any such breach, loss, or disclosure could result in litigation and potential liability for us, damage our brand image and reputation, or otherwise harm our business. In addition, our current data protection measures might not protect us against increasingly sophisticated and aggressive threats, while the cost and operational consequences of implementing further data protection measures could be significant.

Our business is sensitive to reductions in discretionary consumer spending.
Consumer demand for luxury or perceived luxury goods, including craft beer, can be sensitive to downturns in the economy and the corresponding impact on discretionary spending. Changes in discretionary consumer spending or

consumer preferences brought about by factors such as perceived or actual general economic conditions, job losses and unemployment or underemployment, perceived or actual declines in disposable consumer income and wealth, and changes in consumer confidence in the economy, could significantly reduce customer demand for craft beer in general, and the products we offer specifically. Furthermore, our consumers may choose to replace our products with the fuller-flavored national brands or other more affordable, although lower quality, alternatives available in the market. Any such decline in consumption of our products would likely have a significant negative impact on our operating results.

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Changes in consumer preferences or public attitudes about alcohol could decrease demand for our products.
If consumers become unwilling to accept our products or if general consumer trends cause a decrease in the demand for beer, including craft beer, our sales and results of operations would be adversely affected. There is no assurance that the craft brewing segment will continue to experience growth in future periods. If the markets for wine, spirits or flavored alcohol beverages continue to grow, this could draw consumers away from the beer industry in general and our products specifically. Further, the alcoholic beverage industry has become the subject of considerable societal and political attention in recent years due to increasing public concern over alcohol-related social problems, including drunk driving, underage drinking and health consequences from the misuse of alcohol. In reaction to these concerns, steps may be taken to restrict advertising by beer producers, to impose additional cautionary labeling or packaging requirements, or to increase excise or other taxes on beer. Any such developments may have a significant adverse impact on our financial condition, operating results and cash flows.

The Food and Drug Administration ("FDA") issued a proposed rule in November 2015 on the use of "gluten-free" labeling for fermented and hydrolyzed foods and beverages that may affect our ability to market our Omission Beer.
CBA launched Omission beer in May 2012 as the first brand of craft beer to be brewed in the United States using conventional beer ingredients (including malted barley, a gluten-containing grain) and "crafted to remove gluten." Omission beers are brewed similarly to other craft beers except that, at the point of fermentation, a brewing enzyme called Brewers Clarex™ is added which breaks apart the gluten protein chains. Samples from each batch are tested internally using the R5 Competitive ELISA method for gluten content before packaging. The beers are then packaged into bottles in a closed packaging environment to eliminate any chance of cross contamination. Packaged samples are also sent to an independent third party lab for testing before the lot is released from the brewery. We post all test results on our website for consumers to view before they decide to purchase the beer.

Omission beers are subject to regulation by the Department of Treasury's Alcohol and Tobacco Tax and Trade Bureau ("TTB"), but as a result of overlapping jurisdictions of the FDA and TTB, the role each agency plays in the regulation of fermented alcohol beverages, and the commitments the two agencies have made to work together to establish consistent gluten labeling policies for comparable alcohol beverage products, the above referenced FDA notice of proposed rulemaking has far-reaching implications for fermented alcohol beverages, like Omission Beer, that are subject to regulation by both the FDA and TTB. In accordance with the TTB's premarket approval requirements, the TTB approved Omission labeling, including its gluten-related claims, as per their policy concerning gluten content statements in the labeling and advertising of malt beverages.

If the FDA's proposed rule becomes final as written, the TTB's policy may be superseded, which would have a significant impact on our ability to market and sell our Omission beers as "crafted to remove gluten" and negatively impact our operating results. CBA fully engaged in the FDA rulemaking process and submitted extensive regulatory, legal and scientific comments to the docket in April 2016. The FDA sent the rule to the Office of Management and Budget for review, and the final rule is expected to be announced in April 2017. Soon thereafter, we expect the TTB to modify its interim policy accordingly and will plan to engage in this process.

We have identified a material weakness in our internal control over financial reporting which could, if not remediated, result in material misstatements in our financial statements.
Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. As disclosed in Item 9A, management identified a material weakness in our internal control over financial reporting related to accounting for complex revenue transactions.

A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a result of this material weakness, our management concluded that our internal control over financial reporting was not effective based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - An Integrated Framework. We are actively engaged in developing a remediation plan designed to address this material weakness. If our remedial measures are insufficient to address the material weakness, or if additional material weaknesses or significant deficiencies in our internal control are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results.

Product safety and quality concerns may have a material adverse effect on our business.

Our success depends in large part on our ability to maintain consumer confidence in the safety and quality of our products. We have rigorous product safety and quality standards which we expect our breweries and our brewing partners to meet. However, we cannot assure you that, despite our strong commitment to product safety and quality, we will always meet these standards. If we, or our brewing partners, fail to comply with applicable product safety and quality standards and our products on the market are, or become, contaminated or adulterated, we may be required to conduct costly product recalls and may become subject to product liability claims and negative publicity, which could cause our reputation and business to suffer.

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We have a continuing relationship with Anheuser-Busch, LLC and the current distribution network that would be difficult to replace.
Substantially all of our products are sold and distributed through A-B's distribution network. If the A-B Distributor Agreement were terminated, we would be faced with a number of operational tasks, including establishing and maintaining direct contracts with the existing wholesaler network or negotiating agreements with replacement wholesalers on an individual basis, and enhancing our credit evaluation, billing and accounts receivable processes. Such an undertaking would require significant effort and substantial time to complete, during which the distribution of our products could be impaired.

We are dependent on our wholesalers for the sale of our products.
Although substantially all of our products are sold and distributed through A-B, we continue to rely heavily on wholesalers, many of which are independent, for the sale of our products to retailers. Independent wholesalers make their own business decisions that may not align with our interests and there is no assurance that the sales efforts of distributors will be effective in generating sales of our products.

Any disruption in the ability of the wholesalers, A-B, or us to distribute products efficiently due to any significant operational problems, such as widespread labor union strikes or the loss of a major wholesaler as a customer, could hinder our ability to get our products to retailers and could have a material adverse impact on our sales, results of operations and cash flows. A-B has been purchasing distributors in states where it is legally permissible, which could impact our distribution if the A-B relationship were to end. 35% of our shipments during 2016 were through A-B owned distributors.

Our agreements with A-B may limit our ability to engage in certain activities and investments.
The Exchange Agreement requires us to obtain A-B's consent prior to undertaking certain activities and investments. For example, we must obtain A-B's consent before acquiring another brewer if the purchase price exceeds $30 million or to purchase a non-brewing entity if the purchase price exceeds $2 million. If A-B opposes strategic or financial investments proposed by our management, A-B may decline to give its consent to activities or investments that our management believes are in the best interest of our shareholders.

A-B has an influential voice in decisions of the board of directors and shareholders.
A-B owns 31.5% of our outstanding common stock, making A-B our largest shareholder. In addition, under the Exchange Agreement, A-B may designate two nominees to our board of directors. These directors also participate on our audit, compensation, and nominating and governance committees as non-voting observers, and one of these directors participates on our strategic planning committee as a voting member. As a result, A-B has an influential voice in deliberations of the board of directors and shareholders. A-B and its affiliates also have the right to terminate our contract brewing arrangements and to rescind certain amendments to our other contracts with them upon the occurrence of certain events. See "Relationship with Anheuser-Busch, LLC" in Item 1. Business above for additional information.

Expansion projects at our Portland and Kona breweries may be subject to various risks, including cost overruns, construction delays, and inability to fully utilize additional production capacity, which may adversely affect our financial condition and results of operations.
During 2015, we announced plans to expand our Portland brewery to increase annual brewing capacity to 750,000 barrels at a total estimated cost of $10 million. We also held a ground-breaking ceremony on the site of a new, state-of-the-art brewing facility in Kailua-Kona, Hawaii, with an annual production capacity of 100,000 barrels at a total estimated cost of approximately $20 million. As with all projects of this magnitude, there is the potential risk of significant cost overruns, which could require us to increase our borrowing under our revolving credit facility or to find additional financing. We may also experience unforeseen construction delays, which could result in our inability to bring one or both of these facilities into production as scheduled, adversely affecting our results of operations and

financial condition. In addition, if we do not achieve sufficient growth in product sales to absorb the increased production capacity following completion of these projects, we will be unable to realize our goals for gross margin improvement, which would have a negative impact on our results of operations and return on investment.

We expect to continue to make strategic investments in improvements aimed at increasing the efficiency, capabilities and capacity of our breweries, improving our ordering and logistics systems, and enhancing the customer experience at our restaurant facilities. Failure to realize the anticipated benefits and generate adequate returns on such capital improvement projects may have a material adverse effect on our results of operations and cash flows.

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Operating breweries at production levels substantially below their current designed capacities could negatively impact our financial results.
As of December 31, 2016, the annual working capacity of our breweries was approximately 1,075,000 barrels. Due to many factors, including seasonality and production schedules of various draft products and bottled products and packages, actual production capacity will rarely, if ever, approach full working capacity. We believe that capacity utilization of the breweries will fluctuate throughout the year, and even though we expect that capacity of our breweries will be efficiently utilized during periods when our sales are strongest, there likely will be periods when the capacity utilization will be lower. We have also reserved significant capacity at our Woodinville brewery for our brewing agreement with Pabst and, if their contract brewing volume is materially short of expectations, as occurred in 2016, we may not operate that brewery at optimum levels. If we experience contraction in our sales and brewing volumes, the resulting excess capacity and unabsorbed overhead will have an adverse effect on our gross margins, operating cash flows and overall financial performance. We periodically evaluate whether we expect to recover the costs of our production breweries over the course of their useful lives. If facts and circumstances indicate that the carrying value of these long-lived assets may be impaired, an evaluation of recoverability will be performed by comparing the carrying value of the assets to projected future undiscounted cash flows along with other quantitative and qualitative analyses. If we determine that the carrying value of such assets does not appear to be recoverable, we will recognize an impairment loss by a charge against current operations, which could have a material adverse effect on our results of operations.

Our sales are concentrated in the Pacific Northwest, California and Hawaii.
Our sales in 2016 were concentrated in Washington, Oregon, California and Hawaii and, consequently, our future sales may be adversely affected by changes in economic and business conditions within these states. We also believe the Pacific Northwest and California are among the most competitive craft beer markets in the United States, both in terms of number of market participants and consumer awareness. The Pacific Northwest and California offer significant competition to our products, not only from other craft brewers, but also from the major domestic brewers, wine producers and flavored alcohol beverages.

We are dependent upon the continued service of our senior management and other key personnel.
Our future success is dependent on the continued service of our senior management and other key employees, particularly Andrew Thomas, our Chief Executive Officer. The loss of the services of our senior management and other key employees could have a material adverse effect on our operations. Additionally, the loss of Andrew Thomas as our Chief Executive Officer, and the failure to find a replacement satisfactory to A-B, would be a termination event under the A-B Distributor Agreement.

We also may be unable to retain existing management, sales, marketing, operational and other support personnel critical to our success, which could result in harm to significant customer relationships, loss of key information, expertise or know-how, and unanticipated recruiting and training costs.

Our gross margin may fluctuate.
Future gross margin may fluctuate and even decline as a result of many factors, including: product pricing levels; sales mix between draft and packaged product sales and within the various bottled product packages; level of fixed and semi-variable operating costs; level of production at our breweries in relation to current production capacity; availability and prices of raw materials, production inputs such as energy and packaging materials; rates charged for freight; and federal and state excise taxes. The high percentage of fixed and semi-variable operating costs causes our gross margin to be particularly sensitive to relatively small changes in sales volume.

Higher health care costs may have an adverse effect on our operating results.
We are self-insured with respect to health care expenses for our employees. During 2015 and 2014, we experienced higher than average medical expense claims, which increased our Selling, general and administrative expenses. If this

trend continues, our operating results may be negatively affected.

A failure in any of our supply chain processes could harm our ability to effectively operate our business.
Our results are highly dependent on our ability to accurately forecast and execute throughout the entire supply chain, including sales forecasting, raw material ordering, brewing and distribution. The combination of our recent growth and increased brand complexity has increased the operating complexity of our business. We cannot guarantee that we will effectively manage such complexity without experiencing planning failures, operating inefficiencies, or other issues that could have an adverse effect on our business.

We engage in electronic communications between third parties, including A-B and our wholesalers, as part of our supply chain processes. Any interruptions or errors in our electronic interfaces may negatively affect our operating activities.

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Unavailability of production at our brewing partner may adversely affect our capacity and disrupt our ability to satisfy demand for our products.
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. In 2016, we entered into a contract brewing agreement with ABCS and, once fully optimized, anticipate producing up to 300,000 barrels of our beer at this facility annually. We are beginning the process of transitioning our current production volume out of Memphis into ABCS's facility.

If production at that facility should be disrupted due to unforeseen circumstances, our ability to produce and ship sufficient quantities of our beer to meet demand in certain key geographic markets, particularly Texas and the southeastern United States, could be significantly impaired, resulting in decreased sales revenue and a negative impact on our wholesaler relationships in those markets.

An increase in excise taxes could adversely affect our financial condition and results of operations.
The U.S. federal government currently levies an excise tax of $18 per barrel on beer sold for consumption in the United States; however, brewers, such as us, that produce less than two million barrels annually, are taxed at $7 per barrel on the first 60,000 barrels shipped, with the remainder of the shipments taxed at the normal rate. The individual states in which we operate also impose excise taxes on beer and other alcohol beverages in varying amounts. Federal and state legislators routinely consider various proposals to impose additional excise taxes on the production of alcoholic beverages, including beer. Any such increases in excise taxes, if enacted, would adversely affect our financial condition, results of operations, and cash flows.

We are subject to tax liabilities imposed by the jurisdictions where we operate.
Tax liabilities may vary significantly and are subject to change. Among others, these taxes include income taxes, property taxes, indirect taxes (excise, sales, use and gross receipts taxes), payroll taxes, and withholding taxes. We may not be able to pass these tax costs on to consumers and remain competitive. New tax laws and regulations and changes to existing tax laws and regulations could materially and adversely affect our financial results.

We are subject to governmental regulations affecting our breweries and brewpubs.
Our business is highly regulated by federal, state, and local laws and regulations. These laws and regulations govern all aspects of the production and distribution of beer, including permitting, licensing, trade practices, labeling, advertising and marketing, distributor relationships and various other matters. A variety of federal, state and local governmental authorities also levy various taxes, license fees and other similar charges and may require bonds to ensure compliance with applicable laws and regulations. Noncompliance with such laws and regulations may cause the Alcohol and Tobacco Tax and Trade Bureau or any particular state or jurisdiction to revoke its license or permit, restricting our ability to conduct business, or result in the imposition of significant fines or penalties. One or more regulatory authorities could determine that we have not complied with applicable licensing or permitting regulations or have not maintained the approvals necessary for us to conduct business within our jurisdiction. If licenses, permits or approvals necessary for our brewery or pub operations were unavailable or unduly delayed, or if any permits or licenses that we hold were to be revoked, or additional permits or licenses were required in the future, including as a result of expanding our operations, our ability to conduct business may be disrupted, which would have a material adverse effect on our financial condition, results of operations and cash flows.

The craft beer business is seasonal in nature, and we are likely to experience fluctuations in results of operations.
Sales of craft beer products are somewhat seasonal, with the first and fourth quarters historically being lower and the rest of the year generating stronger sales. Our sales volume may also be affected by weather conditions and selling days within a particular period. Therefore, the results for any given quarter will likely not be indicative of the results that may be achieved for the full fiscal year. If an adverse event such as a regional economic downturn or poor weather conditions should occur during the second and third quarters, the adverse impact to our revenues would likely

be greater as a result of the seasonality of our business.

We may be unable to access public or private debt markets to fund our operations and contractual commitments at competitive rates, on commercially reasonable terms, or in sufficient amounts, if at all.
We depend, in part, on our revolving line of credit with Bank of America, N.A. ("BofA"), to fund our operations and commitments for capital expenditures. Our capital expenditures in 2017 are expected to range from $16 million to $20 million. A number of factors could cause us to incur increased borrowing costs and to have greater difficulty accessing public and private markets for debt. These factors include general economic conditions, disruptions or declines in the global capital markets, our financial performance or outlook, and credit. An adverse change in any or all of these factors may materially adversely affect our ability to fund our operations and contractual or financing commitments.

If our business does not perform as expected, including if we generate less revenue than anticipated from our operations or encounter significant unexpected costs, we may fail to comply with the financial covenants under our credit facilities. If we do not comply with our financial covenants and we do not obtain a waiver or amendment, BofA may elect to cause all amounts owed to become immediately due and payable. Any default may require us to seek additional capital or modifications to our credit facilities, which

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may not be available or which may be costly. Any of these risks and uncertainties could have a material adverse effect on our business, financial position, results of operations, and cash flows.

We have entered into strategic relationships with certain regional brewers that increase the complexity and execution risks of our operations.
We have entered into strategic relationships with certain regional brewers, including Appalachian Mountain Brewery in North Carolina and Cisco Brewers in Massachusetts. These new relationships have added to the complexity of our operations, including brewing, packaging, marketing and selling their brands, with increased demands on our management team. There can be no assurance that we will be able to take full advantage of these strategic opportunities without experiencing unexpected costs, operating challenges or control deficiencies.

Our option agreement with Pabst Northwest Brewing Company may not culminate in the sale of our Woodinville brewing facility.
On January 8, 2016, we entered into brewing agreements with Pabst under which Pabst has the ability to brew selected Rainier Brewing Company and other brands at our brewery in Woodinville, Washington under a license agreement. The agreements expire on December 31, 2018.

In conjunction with the brewing agreements, we granted Pabst an option to purchase the Woodinville brewery and adjacent pub, as well as related assets (together, the "Property"), at any time prior to termination of the brewing agreements. The purchase price of the Property will be $25.0 million if Pabst exercises the option during the first year of the agreement (which has elapsed), $26.0 million if exercise occurs during the second year of the agreement, and $28.0 million if Pabst exercises the option during the third year of the agreement and on or before the close of business on December 31, 2018. Under the option agreement, Pabst conducted an additional diligence review of environmental and title issues relating to the Property, and, upon completion, did not exercise its right to terminate either the brewery agreements or the option agreement. If Pabst does not exercise its option to purchase the Property, it may be required to pay us a termination fee.

If Pabst does not exercise the option, we will retain ownership and operation of the Woodinville brewery, which could have an adverse effect on our results of operations if our planned alternative uses for the facility's brewing capacity do not materialize. See "Relationship with Pabst Northwest Brewing Company" included in Part I, Item 1 of this Form 10-K for additional information.

Acquisitions subject us to various risks, including risks relating to selection and pricing of acquisition targets, integration of acquired companies into our business and assumption of unanticipated liabilities.
We have completed two acquisitions since 2008 and may pursue additional acquisitions or joint venture or investment opportunities. We cannot assure, however, that we will be able to identify or take advantage of such opportunities. If we do pursue such transactions, we may not realize the anticipated benefits. Acquisitions involve many risks, including risks relating to the assumption of unforeseen liabilities of an acquired business, adverse accounting charges resulting from the acquisition, and difficulties in integrating acquired companies into our business, both from a cultural perspective, as well as with respect to technological integration. Our inability to successfully integrate acquired businesses or manage joint ventures may lead to increased costs, failure to generate expected returns, or even a total loss of amounts invested, any of which could have a material adverse effect on our financial condition and results of operations.

Changes in state laws regarding distribution arrangements may adversely impact our operations.
States in which we have a significant sales presence may enact legislation that significantly alters the competitive environment for the beer distribution industry. Any change in the competitive environment in those states could have an adverse effect on our future sales and results of operations and may impact the financial stability of wholesalers on which we rely.

We may experience a shortage of kegs necessary to distribute draft beer.
We distribute our draft beer in kegs that are owned by us. During periods when we experience stronger sales, we may need to rely on kegs leased from A-B to address the additional demand. If shipments of draft beer increase, we may experience a shortage of available kegs to fill sales orders. If we cannot meet our keg requirements through either lease or purchase, we may be required to delay some draft shipments. Such delays could have an adverse impact on sales and relationships with wholesalers and A-B.

Reduced involvement by the founders of Widmer Brothers Brewing Company in promoting that brand family may adversely affect sales.
Kurt R. Widmer ("Kurt") and Robert P. Widmer ("Rob"), the founders of Widmer Brothers Brewing Company, are integrated in our current Widmer Brothers brand family messaging and we rely on the positive public perception of their images. Reduced involvement of Kurt and Rob in promoting the Widmer brand may have a negative effect on sales of Widmer Brothers beers.

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We are dependent on certain suppliers for key raw materials, packaging materials and production inputs.
Although we seek to maintain back-up and alternative suppliers for all key raw materials and production inputs, we are reliant on certain third parties for key raw materials, packaging materials and utilities. Any disruption in the willingness or ability of these third parties to supply these critical components could hinder our ability to continue production of our products, which could have a material adverse impact on our financial condition, results of operations and cash flows.

Any change in, or violation of, federal and state environmental regulations could adversely affect our operations.
Our brewing operations are subject to environmental regulations and local permitting requirements and agreements regarding, among other things, air emissions, water discharges and the handling and disposal of hazardous wastes. While we have no reason to believe the operation of our breweries violates any such regulation or requirement, if such a violation were to occur, or if environmental regulations were to become more stringent in the future, we could be adversely affected.

A small number of shareholders hold a significant ownership percentage of our common stock and uncertainty over their continuing ownership plans could cause the market price of our common stock to decline.
As noted above, A B has a significant ownership stake in us. In addition, Kurt and Rob Widmer, as well as another founder, together beneficially own approximately 2.9 million shares, or 15.3%, of our common stock. Collectively, these two groups own 46.8% of our equity. All of these shares are available for sale in the public market, subject to volume, manner of sale and other requirements under the Securities Act of 1933. Such sales in the public market, or the perception that such sales may occur, could cause the market price of our common stock to decline.

We do not intend to pay and are limited in our ability to declare or pay dividends; accordingly, shareholders must rely on stock appreciation for any return on their investment in us.
We do not anticipate paying cash dividends. Further, under our loan agreement with BofA, we are not permitted to declare or pay a dividend unless we meet certain financial covenants. As a result, only appreciation of the price of our common stock will provide a return to shareholders. Investors seeking cash dividends should not invest in our common stock.

The fair value of our intangible assets, including goodwill, may become impaired.
As a result of the acquisition of Kona Brewing Company, we have recognized a significant increase in our total intangible assets, including goodwill. As of December 31, 2016, we had $29.1 million in an assortment of intangible assets, on a net basis, which represented nearly 14.4% of our total assets. If any circumstances were to occur, such as economic recession or other factors causing a reduction in consumer demand, or for any other reason we were to experience a significant decrease in sales growth, which had a negative impact on our estimated cash flows associated with these assets, our analyses of these assets may conclude that a decrease in the fair value of these assets occurred. In that event, we would be required to recognize a potentially significant loss on impairment of these assets. Any such impairment loss would be charged against current operations in the period of change.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own and operate four highly-automated, small-batch production breweries: the Oregon Brewery, the Washington Brewery, the New Hampshire Brewery, and the Hawaiian Brewery, as well as two small, innovation brewing systems in Portland, Oregon and Portsmouth, New Hampshire. We lease the sites upon which the Hawaiian Brewery and Brewpubs, the New Hampshire Breweries and Brewpub, the Portland Innovation Brewery, and Oregon Brewpub are located, in addition to our office space and warehouse locations in Portland, Oregon for our corporate, administrative and sales functions. In 2014, we entered into a lease for space in Southern California for our national sales office, which expires in 2019. In 2015, we entered into a long-term land lease for the location of our new Kona brewery, which expires in 2064, and, in 2016 we entered into a lease for our new Redhook pub in Seattle, which expires in 2026. Certain of these leases are with related parties. See Notes 16 and 17 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this report for further discussion regarding these arrangements.

Certain information regarding our production breweries is as follows (capacity in thousands of barrels):

Production Breweries	Square Footage	Current Annual Capacity
Oregon Brewery	185,000	630
Washington Brewery	128,000	220
New Hampshire Brewery	125,000	215
Hawaiian Brewery	11,000	10
		1,075

Construction is currently underway to increase the annual capacity of the Oregon brewery to 750,000 barrels and, in 2016, we broke ground on a new 100,000 barrel brewery near our existing brewery and pub in Kona, which is expected to be fully operational in the first quarter of 2019.

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. In 2016, we entered into a contract brewing agreement with ABCS and are transitioning our current production volume out of Memphis into ABCS's facilities.

Substantially all of our personal property and fixtures, as well as the real properties associated with the Oregon Brewery, secure our loan agreement with BofA. See Note 8 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this report.

Item 3. Legal Proceedings

We are involved, from time to time, in claims, proceedings and litigation arising in the normal course of business. We believe that, to the extent that any pending or threatened litigation involving us or our properties exists, such litigation is not likely to have a material adverse effect on our financial condition, cash flows or results of operations.

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See Note 19, "Subsequent Event," in the Notes to Consolidated Financial Statements found in Part II, Item 8 of this Form 10-K, for additional information related to legal proceedings.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock trades on the NASDAQ Stock Market ("NASDAQ") under the trading symbol BREW. The table below sets forth, for the fiscal quarters indicated, the reported high and low closing sale prices of our common stock, as reported on NASDAQ:

2015	High	Low
Quarter 1	$13.65	$10.89
Quarter 2	14.17	10.15
Quarter 3	11.17	7.11
Quarter 4	9.72	6.83
2016	High	Low
Quarter 1	$9.02	$7.02
Quarter 2	11.52	7.56
Quarter 3	21.38	10.69
Quarter 4	18.52	13.60

We had 696 common shareholders of record as of March 10, 2017.

We have not declared or paid any dividends during our existence. Under the terms of our loan agreement with BofA, we are permitted to declare or pay dividends without BofA's consent, subject to limitations. We anticipate that, for the foreseeable future, all earnings will be retained for the operation and expansion of our business and that we will not pay cash dividends. The payment of dividends, if any, in the future, will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, capital and operating requirements, restrictions in future financing agreements, our general financial condition, and general business conditions.

Equity Compensation Plans
Information regarding securities authorized for issuance under equity compensation plans is included in Part III, Item 12 of this Form 10-K.

Recent Sales of Unregistered Securities
None.

Issuer Purchases of Equity Securities
We did not repurchase any of our common stock during the fourth quarter of 2016.

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Stock Performance Graph

The following line-graph presentation compares cumulative five-year shareholder returns on an indexed basis, assuming a $100 initial investment and reinvestment of dividends, of (a) Craft Brew Alliance, Inc., (b) a broad-based equity market index and (c) an industry-specific index. The broad-based market index used is the NASDAQ Composite Index and the industry-specific index used is the S&P 500 Beverages Index.

Total Return to Shareholders
(includes reinvestment of dividends)
COMPARISON OF CUMULATIVE FIVE YEAR TOTAL RETURN

	Base Period	Indexed Returns Year Ended				
Company/Index	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Craft Brew Alliance, Inc.	$ 100.00	$ 107.64	$ 272.76	$ 221.59	$ 139.04	$ 280.73
NASDAQ Composite	100.00	115.91	160.32	181.80	192.21	192.21
S&P 500 Beverages Index	100.00	105.15	125.59	141.32	153.99	154.01

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Item 6. Selected Financial Data

The selected consolidated financial data below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included elsewhere in this Form 10-K.

In thousands, except per share amounts	Year Ended December 31,				
Statement of Operations Data	2016	2015	2014	2013	2012
Net sales	$202,507	$204,168	$200,022	$179,180	$169,287
Cost of sales	142,908	141,972	141,312	128,919	119,261
Gross profit	59,599	62,196	58,710	50,261	50,026
Selling, general and administrative expenses	59,224	57,932	53,000	46,461	44,890
Operating income	375	4,264	5,710	3,800	5,136
Interest expense and other income (expense), net	(681)	(546)	(611)	(537)	(659)
Income (loss) before provision for income taxes	(306)	3,718	5,099	3,263	4,477
Provision for income taxes	14	1,500	2,022	1,304	1,951
Net income (loss)	$(320)	$2,218	$3,077	$1,959	$2,526
Basic and diluted net income (loss) per share	$(0.02)	$0.12	$0.16	$0.10	$0.13
Shares used in basic per share calculations	19,225	19,152	19,038	18,923	18,862
Shares used in diluted per share calculations	19,225	19,175	19,126	19,042	18,934

	December 31,				
	2016	2015	2014	2013	2012
Balance Sheet Data					
Cash and cash equivalents	$442	$ 911	$ 981	$2,726	$5,013
Working capital	15,226	10,838	8,050	5,782	5,207
Total assets	202,549	190,334	178,601	170,286	165,664
Current portion of long-term debt and capital leases	1,317	507	1,157	710	642
Long-term debt and capital leases, net of current portion	27,946	18,991	13,720	11,050	12,440
Other long-term obligations	21,988	20,962	19,738	18,303	17,903
Shareholders' equity	119,661	118,738	115,417	111,232	108,195

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

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

Our distinctive portfolio combines the power of Kona Brewing Company, a fast-growing national craft beer brand, with an expanding stable of strong regional breweries and innovative lifestyle brands, including Appalachian Mountain Brewery, Cisco Brewers, Omission Brewing Co., Redhook Brewery, Square Mile Cider Co. and Widmer Brothers Brewing. 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 2008 and has become one of the fastest-growing craft brands in the U.S. As part of CBA, Kona has expanded its reach across all 50 U.S. states and approximately 30 international markets, while remaining deeply rooted in Hawaii.

In addition to growing and nurturing distinctive brands steeped in local heritage, Craft Brew Alliance is committed to developing innovative new category leaders, such as Omission Beer, which is the #1 beer in the gluten-free beer category and Square Mile Cider, the #1 local hard cider in the Pacific Northwest.

As the craft beer market continues to grow and consumers increasingly demand local offerings, Craft Brew Alliance has expanded its portfolio of brands and maximized its brewing footprint through strategic partnerships with emerging craft beer brands in targeted markets. In 2015, we announced strategic partnerships with Appalachian Mountain Brewery, based in Boone, North Carolina; and Cisco Brewers, based in Nantucket, Massachusetts. Through this strategic partnership model, we gain local relevance in select beer geographies, while our partner breweries gain access to our world-class leadership and national brewing and sales infrastructure to grow their brands. In December 2016, we announced a new strategic partnership with Wynwood Brewing Co., a fast-growing craft brewery based in the heart of Miami's multicultural arts district.

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. For more information about CBA and its brands, see "Available Information" on page 13.

We proudly brew our craft beers in four company-owned breweries located in Portland, Oregon; the Seattle suburb of Woodinville, Washington; Portsmouth, New Hampshire; and Kailua-Kona, Hawaii; and one partner brewery in Memphis, Tennessee. However, 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 are beginning the process of transitioning our current production volume out of Memphis into ABCS's facilities. Additionally, we own and operate two small innovation breweries, primarily used for small batch production and limited-release brews, in Portland, Oregon 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. In 2016, Kona, Redhook and Widmer Brothers beers were distributed in all 50 states. Omission Beer continues to expand into new markets in the U.S. and internationally, while Square Mile Cider is currently available in 13 states in the West. Separate from our A-B wholesalers, we maintain an internal independent sales and marketing organization with resources across the key functions of brand management, field marketing, field sales, and national retail sales.

We operate in two segments: Beer Related operations and 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, four of which are located adjacent to our Beer Related operations, as well as other merchandise sales, and sales of our beers directly to customers.

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Following is a summary of our financial results:

	Net Sales	Net Income	Number of Barrels Sold
2016	$202.5 million	$(0.3) million	775,600
2015	$204.2 million	$2.2 million	824,400
2014	$200.0 million	$3.1 million	830,200

Brewing Arrangement with Pabst Northwest Brewing Company

On January 8, 2016, we entered into brewing agreements with Pabst Northwest Brewing Company ("Pabst"), a subsidiary of Pabst Brewing Company, under which Pabst began brewing selected Rainier Brewing Company and other brands at our brewery in Woodinville, Washington, in the second quarter of 2016 under a licensing agreement. We are continuing to operate the Woodinville brewery and the adjacent Redhook Forecaster's brewpub under the agreements, which expire on December 31, 2018. For additional information, see Note 18 of Notes to Consolidated Financial Statements, included in Part II, Item 8 of this Annual Report on Form 10-K.

Agreements with Anheuser-Busch, LLC

On August 23, 2016, we entered into a Contract Brewing Agreement (the “Brewing Agreement”) with A-B Commercial Strategies, LLC (“ABCS”), an affiliate of A-B, pursuant to which ABCS will brew, bottle and package up to 300,000 barrels of our mutually agreed products annually, in facilities owned by ABCS within the United States, for an initial term through December 31, 2026.

On August 23, 2016, we also entered into an International Distribution Agreement (the “International Distribution Agreement”) with Anheuser-Busch Worldwide Investments, LLC (“ABWI”), an affiliate of A-B, pursuant to which ABWI will become our sole and exclusive distributor of our malt beverage products in jurisdictions outside the United States, subject to the terms and conditions of our agreement with our existing international distributor, CraftCan Travel LLC, and certain other limitations, in each case as set forth in the International Distribution Agreement. Unless terminated sooner, the International Distribution Agreement will continue in effect until December 31, 2026.

On August 23, 2016, we entered into Amendment No. 3 to the A-B Distributor Agreement. Pursuant to Amendment No. 3, the A-B Distributor Agreement was extended through December 31, 2028 (the “Term”), and the existing margin fee structure of $0.25 per case-equivalent will apply throughout the Term. Without Amendment No. 3, beginning on January 1, 2019, a margin fee of $0.75 per case equivalent would have been payable by us under the A-B Distributor Agreement. Amendment No. 3 also provides that, beginning on January 1, 2019, we will reinvest an aggregate amount equal to $0.25 per case equivalent in sales and marketing efforts for our products, subject to specified terms and conditions.

For additional information, see Note 17 of Notes to Consolidated Financial Statements, included in Part II, Item 8 of this Annual Report on Form 10-K.

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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)]:

	Year Ended December 31,		
	2016	2015	2014
Sales	106.5 %	107.1 %	107.3 %
Less excise tax	6.5	7.1	7.3
Net sales	100.0	100.0	100.0
Cost of sales	70.6	69.5	70.6
Gross profit	29.4	30.5	29.4
Selling, general and administrative expenses	29.2	28.4	26.5
Operating income	0.2	2.1	2.9
Interest expense	(0.4)	(0.3)	(0.2)
Other expense, net	—	—	(0.1)
Income (loss) before income taxes	(0.2)	1.8	2.5
Income tax provision	—	0.7	1.0
Net income (loss)	(0.2)%	1.1 %	1.5 %

(1) Percentages may not sum due to rounding.

Segment Information

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

	Year Ended December 31,		
2016	Beer Related	Brewpubs	Total
Net sales	$173,657	$28,850	$202,507
Gross profit	$55,667	$3,932	$59,599
Gross margin	32.1 %	13.6 %	29.4 %
2015			
Net sales	$176,343	$27,825	$204,168
Gross profit	$58,610	$3,586	$62,196
Gross margin	33.2 %	12.9 %	30.5 %
2014			
Net sales	$173,687	$26,335	$200,022
Gross profit	$55,174	$3,536	$58,710
Gross margin	31.8 %	13.4 %	29.4 %

Net Sales by Category

The following tables set forth a comparison of Net sales by category (dollars in thousands):

	Year Ended December 31,		Dollar Change	% Change
Sales by Category	2016	2015		
A-B and A-B related[(1)]	$167,725	$177,380	$(9,655)	(5.4)%
Contract brewing and beer related[(2)]	19,052	13,376	5,676	42.4 %
Excise taxes	(13,120)	(14,413)	1,293	(9.0)%
Net beer related sales	173,657	176,343	(2,686)	(1.5)%
Brewpubs[(3)]	28,850	27,825	1,025	3.7 %
Net sales	$202,507	$204,168	$(1,661)	(0.8)%

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Sales by Category	Year Ended December 31, 2015	2014	Dollar Change	% Change
A-B and A-B related[1]	$177,380	$176,161	$1,219	0.7 %
Contract brewing and beer related[2]	13,376	12,113	1,263	10.4 %
Excise taxes	(14,413)	(14,587)	174	(1.2)%
Net beer related sales	176,343	173,687	2,656	1.5 %
Brewpubs[3]	27,825	26,335	1,490	5.7 %
Net sales	$204,168	$200,022	$4,146	2.1 %

(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, and the international distribution fees earned from ABWI.

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

(3) 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):

Year Ended December 31,	2016 Shipments	2015 Shipments	Increase (Decrease)	% Change	Change in Depletions[1]
A-B and A-B related[2]	693,300	753,400	(60,100)	(8.0)%	— %
Contract brewing and beer related[3]	72,600	60,600	12,000	19.8 %	
Brewpubs	9,700	10,400	(700)	(6.7)%	
Total	775,600	824,400	(48,800)	(5.9)%	

Year Ended December 31,	2015 Shipments	2014 Shipments	Increase (Decrease)	% Change	Change in Depletions[1]
A-B and A-B related[2]	753,400	766,600	(13,200)	(1.7)%	— %
Contract brewing and beer related[3]	60,600	52,700	7,900	15.0 %	
Brewpubs	10,400	10,900	(500)	(4.6)%	
Total	824,400	830,200	(5,800)	(0.7)%	

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

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

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

The decrease in sales to A-B and A-B related in 2016 compared to 2015 was primarily due to a decrease in domestic shipments, partially offset by increases in unit pricing. A primary cause of the decrease was due to a decrease in domestic shipments of the Redhook and Widmer Brothers brands as we concentrate on their home markets of Washington and Oregon, respectively, as well as decreases in shipments of our Omission brand. The decrease was partially offset by the continued successful focus on national distribution of Kona. During the first quarter of 2016, we closed our largest and most efficient brewery, located in Portland, for approximately two weeks as we installed new equipment to further increase capacity and efficiency. This closure resulted in a temporary decrease of shipments across our brands in 2016 compared to 2015. We also experienced increased pressure from wholesalers who wanted to decrease their inventory levels at the end of 2016, resulting in lower than expected shipment volumes.

The increase in sales to A-B and A-B related in 2015 compared to 2014 was primarily due to a shift in package mix from draft to packaged, which has a higher selling price per barrel than draft, and price increases. These increases were partially offset by a decrease in shipments primarily due to reductions in our wholesaler inventory levels in the first quarter of 2015. During the same period of 2014, wholesalers were building inventory levels in response to low levels at the end of 2013.

The average revenue per barrel on shipments of beer through the A-B distribution network increased by 2.8% in 2016 compared to 2015, and 2.4% in 2015 compared to 2014, primarily due to pricing increases and shifts in brand, package and geographic mix.

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Price changes implemented by us have generally followed craft beer market pricing trends. During 2016, 2015 and 2014, we sold 89.4%, 91.4% and 92.3%, respectively, of our beer through A B at wholesale pricing levels.

The increase in contract brewing and beer related sales in 2016 compared to 2015 was primarily due to contract brewing volume for Cisco Brewers beers, as well as alternating proprietorship fees earned from Appalachian Mountain Brewing Company for leasing the Portsmouth Brewery, which began during the first quarter of 2016, an increase in international shipments of our beers, which sell at a higher rate per barrel than contract brewing sales, as we expanded into additional countries, $1.2 million of fees earned related to the international distribution agreement with ABWI, and $1.6 million of fees earned from Pabst related to a contract brewing volume shortfall. These increases were partially offset by decreases in our other contract brewing volume.

The increase in contract brewing and beer related sales in 2015 compared to 2014 was primarily due to an increase in international shipments of our beers, which sell at a higher rate per barrel than contract brewing sales, as we expanded into additional countries, as well as increased pricing on our contract brewing sales. The increase in contract brewing and beer related sales was partially offset by a decline in our contract brewing shipment volume.

Excise taxes vary directly with the volume of beer shipped.

Brewpubs sales increased in 2016 compared to 2015, primarily as a result of higher guest counts at our Kona brewpub on the island of Oahu in Hawaii, partially offset by decreases in guest counts at our Redhook brewpub in Woodinville, Washington. The Hawaii brewpubs also have higher revenue per guest than the Redhook and Widmer Brothers brewpubs. The increase in Brewpubs sales at our Kona brewpub on Oahu in 2016 compared to 2015 was primarily due to the closure of the brewpub in the first quarter of 2015 for three weeks for a full remodel.

Brewpubs sales increased in 2015 compared to 2014, primarily as a result of higher guest counts at both of our brewpubs in Hawaii. The Hawaii brewpubs also have higher revenue per guest than the Redhook and Widmer Brothers brewpubs, which additionally experienced lower guest counts at the Portland and Woodinville locations. The increase in pub sales was partially offset by the closure of the Redhook Pub in Portsmouth, New Hampshire for seven days due to inclement weather, closure of our Kona Pub on the island of Oahu for three weeks for a full remodel in the first quarter of 2015, and a decrease in beer shipment volume through our Brewpubs.

The overall decrease in volume in 2016 compared to 2015 reflected the decrease in our Widmer Brothers and Redhook Brewery brands as we continue to reposition them in the marketplace, as well as Omission, partially offset by the strong growth in our Kona Brewing brand.

The overall decrease in volume in 2015 compared to 2014 reflected the decrease in our Widmer Brothers and Redhook Brewery brands as we continue to reposition them in the marketplace, partially offset by the strong growth in our Kona Brewing and Omission Beer brands.

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Shipments by Brand

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

Year Ended December 31,	2016 Shipments	2015 Shipments	Increase (Decrease)	% Change	Change in Depletions
Kona	397,400	352,100	45,300	12.9 %	17 %
Widmer Brothers	148,100	175,700	(27,600)	(15.7)%	(17)%
Redhook	127,200	185,900	(58,700)	(31.6)%	(23)%
Omission	42,900	51,500	(8,600)	(16.7)%	(11)%
All other(1)	33,300	22,400	10,900	48.7 %	70 %
Total(2)	748,900	787,600	(38,700)	(4.9)%	— %

Year Ended December 31,	2015 Shipments	2014 Shipments	Increase (Decrease)	% Change	Change in Depletions
Kona	352,100	300,600	51,500	17.1 %	15 %
Widmer Brothers	175,700	209,100	(33,400)	(16.0)%	(9)%
Redhook	185,900	202,200	(16,300)	(8.1)%	(12)%
Omission	51,500	49,800	1,700	3.4 %	10 %
All other(1)	22,400	28,800	(6,400)	(22.2)%	(14)%
Total(2)	787,600	790,500	(2,900)	(0.4)%	— %

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

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

The increase in our Kona brand shipments in 2016 compared to 2015 was primarily due to increases in domestic and international shipments, primarily led by demand for Big Wave Golden Ale.

The increase in our Kona brand shipments in 2015 compared to 2014 was primarily due to increases in shipments of Big Wave Golden Ale and variety packs, and the reintroduction of Pipeline Porter during the third quarter of 2015, partially offset by a decrease in Koko Brown.

The decrease in our Widmer Brothers brand shipments in 2016 compared to 2015 was primarily due to a strategic decision to focus on the home market of Oregon, led by decreases in Hefeweizen brand shipments.

The decrease in our Widmer Brothers brand shipments in 2015 compared to 2014 was primarily due to decreases in Hefeweizen draft, Upheaval IPA and Alchemy Ale, partially offset by the summer seasonal which switched to Hefe Shandy from Citra Blonde. Hefeweizen packaged beer had stabilized and benefited from the introduction of the new Hefeweizen packaging in collaboration with the Portland Timbers.

The decrease in our Redhook brand shipments in 2016 compared to 2015 was primarily due to a strategic decision to focus on the home market of Washington, led by decreased shipments of Longhammer IPA and ESB.

The decrease in our Redhook brand shipments in 2015 compared to 2014 was primarily due to decreases in our KCCO series, a craft beer brand developed in partnership with theChive, a photo entertainment website, Audible Ale and Longhammer IPA.

The decrease in our Omission brand shipments in 2016 compared to 2015 was primarily due to lower demand for the Pale Ale style.

The increase in our Omission brand shipments in 2015 compared to 2014 was primarily due to the continued success of, and demand for, the IPA and Lager styles of our beer that is crafted to remove gluten.

The increase in our All other shipments in 2016 compared to 2015 was primarily due to increases in the shipment volumes related to our new distribution agreements with Cisco Brewers and Appalachian Mountain Brewing, partially offset by decreases in our Resignation and Square Mile brand families.

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The decrease in our All other shipments in 2015 compared to 2014 was primarily due to a decrease in the shipment volume of our Resignation brand family, partially offset by increases in the shipment volumes related to our Square Mile brand family and new distribution agreement with Appalachian Mountain Brewing.

Shipments by Package

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

	2016		2015		2014	
Year Ended December 31,	Shipments	% of Total	Shipments	% of Total	Shipments	% of Total
Draft	171,100	22.8 %	180,700	22.9 %	198,500	25.1 %
Packaged	577,800	77.2 %	606,900	77.1 %	592,000	74.9 %
Total	748,900	100.0%	787,600	100.0%	790,500	100.0%

The package mix was relatively consistent in 2016 compared to 2015.

The shift in mix from draft to packaged in 2015 compared to 2014 was primarily the result of our Kona brand family becoming a larger share of our overall shipments by brand family, which is more heavily weighted to packaged sales, and the growth of Omission, which is only available in packaged.

Cost of Sales

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

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

	Year Ended December 31,		Dollar	
	2016	2015	Change	% Change
Beer Related	$117,990	$117,733	$ 257	0.2 %
Brewpubs	24,918	24,239	679	2.8 %
Total	$142,908	$141,972	$ 936	0.7 %

	Year Ended December 31,		Dollar	
	2015	2014	Change	% Change
Beer Related	$117,733	$118,513	$(780)	(0.7)%
Brewpubs	24,239	22,799	1,440	6.3 %
Total	$141,972	$141,312	$660	0.5 %

The increase in Beer Related Cost of sales in 2016 compared to 2015 was primarily due to increases in brewery costs and distribution rates per barrel, partially offset by decreases in shipment volume and component material costs on a per barrel basis. The brewery costs per barrel in 2016 increased as we continued to absorb several key strategic operational enhancements completed during the first quarter of 2016 and were also negatively impacted by the temporary closure of our largest-volume brewery in Portland to implement the enhancements, which led to a decrease in brewing volume in the first quarter of 2016. 2016 was also negatively impacted by lower capacity utilization at the Woodinville brewery as production volume for owned brands was moved from Woodinville to Portland in anticipation of increased contract brewing volume in Woodinville. Contract brewing volume was lower than anticipated, resulting in under absorption of fixed overhead costs in Woodinville.

Early in the fourth quarter of 2016, we laid off approximately half of our production employees at our Woodinville brewery. The fourth quarter costs of the layoff were immaterial and effectively offset by the cost savings in the fourth quarter.

The decrease in Beer Related Cost of sales in 2015 compared to 2014 was primarily due to more favorable distribution costs per barrel, decreases in our cost of component materials, and the decrease in shipments discussed above. The decrease in Cost of sales was partially offset by an increase in brewery costs per barrel at our owned breweries and the mix shift from draft to packaged beers, as the cost per barrel of packaged beer is higher than draft.

Brewpubs Cost of sales increased in 2016 compared to 2015 primarily due to increases in Sales at our Kona brewpub on the island of Oahu. The increase was also partially due to expenses associated with the start up of our Seattle brewpub with anticipated opening in 2017.

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Brewpubs Cost of sales increased in 2015 compared to 2014 primarily due to increases in Sales and employee-related costs. The increase was also due to additional labor costs relating to training and overhead following the temporary closure of our Kona Pub on the island of Oahu for three weeks for a full remodel in the first quarter of 2015.

Capacity Utilization

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

	Year Ended December 31,		
	2016	2015	2014
Capacity utilization	67%	71%	75%

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. In 2016, we entered into a contract brewing agreement with ABCS and are beginning the process of transitioning our current production volume out of Memphis into ABCS's facilities.

Gross Profit

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

	Year Ended December 31,		Dollar	
	2016	2015	Change	% Change
Beer Related	$55,667	$58,610	$(2,943)	(5.0)%
Brewpubs	3,932	3,586	346	9.6 %
Total	$59,599	$62,196	$(2,597)	(4.2)%

	Year Ended December 31,		Dollar	
	2015	2014	Change	% Change
Beer Related	$58,610	$55,174	$3,436	6.2 %
Brewpubs	3,586	3,536	50	1.4 %
Total	$62,196	$58,710	$3,486	5.9 %

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

	Year Ended December 31,		
	2016	2015	2014
Beer Related	32.1%	33.2%	31.8%
Brewpubs	13.6%	12.9%	13.4%
Total	29.4%	30.5%	29.4%

The decrease in the Beer Related Gross profit in 2016 compared to 2015 was primarily due to the increase in brewery costs per barrel at our owned breweries as we temporarily closed our most efficient brewery in Portland, Oregon in the first quarter of 2016, higher distribution rates per barrel and a decrease in shipment volume, partially offset by an increase in unit pricing, decreased component materials costs, fees earned from Pabst and ABWI, and increased alternating proprietorship fees earned.

The decrease in the Beer Related gross margin rate in 2016 compared to 2015 was primarily due to higher brewery and distribution costs per barrel, partially offset by fees earned from Pabst and ABWI, as well as improved unit pricing and lower component material costs per barrel. Beer Related gross margin was also negatively impacted by lower capacity utilization at the Woodinville brewery as production volume for owned brands was moved from Woodinville to Portland in anticipation of increased contract brewing volume in Woodinville. Contract brewing volume was lower than anticipated, resulting in under absorption of fixed overhead costs in Woodinville.

The increases in the Brewpubs Gross profit and gross margin rate in 2016 compared to 2015 were primarily due to higher guest counts at our Kona brewpub on the island of Oahu in Hawaii, which has a higher revenue per guest than the Redhook and Widmer Brothers brewpubs, and cost management achievements at both Kona brewpub locations, partially offset by expenses associated with the start up of our Seattle brewpub.

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The increase in the Beer Related Gross profit in 2015 compared to 2014 was due to favorable pricing increases, lower distribution costs per barrel and decreases in our component materials costs, partially offset by the increase in brewery costs per barrel and decline in shipment volume.

The increase in the Beer Related gross margin rate in 2015 compared to 2014 was primarily due to increases in pricing, improved distribution costs per barrel and the decrease in component materials costs, partially offset by higher brewery costs per barrel, as well as the effect of changes in product mix.

The decrease in the Brewpubs gross margin rate in 2015 compared to 2014 was primarily due to the closures of two of our brewpubs, as discussed above.

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):

	Year Ended December 31, 2016	2015	Dollar Change	% Change
	$59,224	$57,932	$1,292	2.2 %
As a % of Net sales	29.2 %	28.4 %		

	Year Ended December 31, 2015	2014	Dollar Change	% Change
	$57,932	$53,000	$4,932	9.3 %
As a % of Net sales	28.4 %	26.5 %		

The increase in SG&A in 2016 compared to 2015, both in dollars and as a percentage of Net sales, was primarily due to increases in expense related to brand marketing, international support and emerging business, partially offset by decreases in employment costs.

The increase in SG&A in 2015 compared to 2014, both in dollars and as a percentage of Net sales, was primarily due to planned increases in sales and marketing spending, as well as an increase in employee-related costs.

Interest Expense

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

	Year Ended December 31, 2016	2015	Dollar Change	% Change
Interest expense	$709	$572	$ 137	24.0 %

	Year Ended December 31, 2015	2014	Dollar Change	% Change

Interest expense	$572	$431	$ 141	32.7 %

	Year Ended December 31,		
	2016	2015	2014
Average debt outstanding	$27,548	$18,530	