

BOSTON BEER CO INC  
Form 10-Q  
August 09, 2007

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

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2007  
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 1-14092  
THE BOSTON BEER COMPANY, INC.  
(Exact name of registrant as specified in its charter)**

**MASSACHUSETTS**  
(State or other jurisdiction of incorporation  
or organization)

**04-3284048**  
(I.R.S. Employer  
Identification No.)

**One Design Center Place, Suite 850, Boston, Massachusetts**  
(Address of principal executive offices)

**02210**

(Zip Code)

**(617) 368-5000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.)

Yes  No

Number of shares outstanding of each of the issuer's classes of common stock, as of August 3, 2007:

<b>Class A Common Stock, \$.01 par value</b>	<b>10,231,708</b>
<b>Class B Common Stock, \$.01 par value</b>	<b>4,107,355</b>
(Title of each class)	(Number of shares)

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**Table of Contents****PART I.****Item 1. FINANCIAL INFORMATION****THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

	<b>June 30, 2007</b>	<b>December 30, 2006</b>
	(unaudited)	
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 72,040	\$ 63,147
Short-term investments	20,745	19,223
Accounts receivable, net of allowance for doubtful accounts of \$389 and \$451 as of June 30, 2007 and December 30, 2006, respectively	24,249	17,770
Inventories	18,559	17,034
Prepaid expenses and other assets	3,546	2,721
Deferred income taxes	667	667
Total current assets	139,806	120,562
Property, plant and equipment, net	32,930	30,699
Other assets	1,755	1,837
Goodwill	1,377	1,377
Total assets	\$ 175,868	\$ 154,475
<b>Liabilities and Stockholders Equity</b>		
Current Liabilities:		
Accounts payable	\$ 21,739	\$ 17,942
Accrued expenses	22,486	22,928
Total current liabilities	44,225	40,870
Deferred income taxes	1,494	1,494
Other liabilities	3,316	3,522
Total liabilities	49,035	45,886
Commitments and Contingencies		
Stockholders Equity:		
Class A Common Stock, \$.01 par value; 22,700,000 shares authorized; 10,226,304 and 9,992,347 issued and outstanding as of June 30, 2007 and December 30, 2006, respectively	102	100
Class B Common Stock, \$.01 par value; 4,200,000 shares authorized; 4,107,355 issued and outstanding	41	41
Additional paid-in-capital	85,841	80,158
Accumulated other comprehensive loss, net of tax	(197)	(197)
Retained earnings	41,046	28,487

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Total stockholders' equity	126,833	108,589
Total liabilities and stockholders' equity	\$ 175,868	\$ 154,475

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

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**Table of Contents****THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

(unaudited)

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30, 2007</b>	<b>July 1, 2006</b>	<b>June 30, 2007</b>	<b>July 1, 2006</b>
Revenue	\$ 102,301	\$ 87,635	\$ 182,035	\$ 150,373
Less excise taxes	9,433	8,302	16,719	14,152
Net revenue	92,868	79,333	165,316	136,221
Cost of goods sold	40,130	32,276	72,256	56,491
Gross profit	52,738	47,057	93,060	79,730
Operating expenses:				
Advertising, promotional and selling expenses	32,620	29,368	59,126	54,746
General and administrative expenses	6,130	5,381	11,428	10,307
Write-off of brewery costs	3,443		3,443	
Total operating expenses	42,193	34,749	73,997	65,053
Operating income	10,545	12,308	19,063	14,677
Other income, net:				
Interest income	1,074	711	2,039	1,299
Other income, net	172	170	339	231
Total other income, net	1,246	881	2,378	1,530
Income before provision for income taxes	11,791	13,189	21,441	16,207
Provision for income taxes	5,000	5,203	8,882	6,400
Net income	\$ 6,791	\$ 7,986	\$ 12,559	\$ 9,807
Net income per common share basic	\$ 0.48	\$ 0.57	\$ 0.89	\$ 0.71
Net income per common share diluted	\$ 0.46	\$ 0.56	\$ 0.86	\$ 0.69
Weighted-average number of common shares basic	14,204	13,919	14,161	13,888
Weighted-average number of common shares diluted	14,680	14,346	14,638	14,320

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

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**THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	<b>Six months ended</b>	
	<b>June 30,</b>	<b>July 1,</b>
	<b>2007</b>	<b>2006</b>
<b>Cash flows provided by operating activities:</b>		
Net income	\$ 12,559	\$ 9,807
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,939	2,324
Write-off of brewery costs	3,443	
Loss on disposal of property, plant and equipment	2	20
Bad debt expense	20	124
Stock-based compensation expense	1,445	1,012
Excess tax benefit from stock-based compensation arrangements	(1,323)	(663)
Purchases of trading securities	(16,290)	(26,050)
Proceeds from sale of trading securities	14,768	28,475
Changes in operating assets and liabilities:		
Accounts receivable	(6,499)	(9,933)
Inventories	(1,525)	(267)
Prepaid expenses and other assets	(627)	(560)
Accounts payable	3,797	2,588
Accrued expenses	881	2,380
Other liabilities	(206)	(36)
Net cash provided by operating activities	13,384	9,221
<b>Cash flows used in investing activities:</b>		
Purchases of property, plant and equipment	(8,545)	(2,725)
Proceeds from disposal of property, plant and equipment	2	8
Increase in other long-term assets		(548)
Net cash used in investing activities	(8,543)	(3,265)
<b>Cash flows provided by (used in) financing activities:</b>		
Repurchase of Class A common stock		(5,262)
Proceeds from exercise of stock options	2,574	2,158
Excess tax benefit from stock-based compensation arrangements	1,323	663
Net proceeds from sale of investment shares	155	93
Net cash provided by (used in) financing activities	4,052	(2,348)
Change in cash and cash equivalents	8,893	3,608



Cash and cash equivalents at beginning of period	63,147	41,516
Cash and cash equivalents at end of period	\$ 72,040	\$ 45,124
<b>Supplemental disclosure of cash flow information:</b>		
Income taxes paid	\$ 7,203	\$ 4,726

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

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**THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**A. Organization and Basis of Presentation**

The Boston Beer Company, Inc. and its subsidiaries (the Company) are engaged in the business of selling low alcohol beverages throughout the United States and in selected international markets, under the trade names, The Boston Beer Company, Twisted Tea Brewing Company, and HardCore Cider Company. The Company's Samuel Adams® beer and Sam Adams Light® are produced and sold under the trade name, The Boston Beer Company. The accompanying consolidated statement of financial position as of June 30, 2007 and the statements of consolidated operations and consolidated cash flows for the interim periods ended June 30, 2007 and July 1, 2006 have been prepared by the Company, without audit, in accordance with U.S. generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required for complete financial statements by generally accepted accounting principles and should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 30, 2006.

**Management's Opinion**

In the opinion of the Company's management, the Company's unaudited consolidated financial position as of June 30, 2007 and the results of its consolidated operations and consolidated cash flows for the interim periods ended June 30, 2007 and July 1, 2006, reflect all adjustments (consisting only of normal and recurring adjustments) necessary to present fairly the results of the interim periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year.

**B. Short-Term Investments**

The Company's short-term investments consisted of municipal auction rate securities as of June 30, 2007 and December 30, 2006, and were classified as trading securities which are recorded at fair market value and whose change in fair market value is recorded in earnings.

The Company recorded no realized gains or losses on short-term investments for the interim periods ended June 30, 2007 and July 1, 2006.

**C. Inventories**

Inventories consist of raw materials, work in process, and finished goods. Raw materials, which principally consist of hops, brewing materials and packaging, are stated at the lower of cost, determined on the first-in, first-out basis, or market. The cost elements of work in process and finished goods inventory consist of raw materials, direct labor and manufacturing overhead. Inventories consist of the following:

	<b>June 30, 2007</b>	<b>December 30, 2006</b>
	<b>(in thousands)</b>	
Raw materials	\$ 11,219	\$ 11,767
Work in process	5,185	3,483
Finished goods	2,155	1,784
	<b>\$ 18,559</b>	<b>\$ 17,034</b>

**D. Write-off of Brewery Costs**

During the second quarter, the Company incurred a \$3.4 million write-off of capitalized costs related to the Freetown, Massachusetts brewery project. The Company concluded that the likelihood of this project significantly diminished as the Company's negotiations with Diageo North America, Inc. progressed and ultimately culminated in the completion of the Contract of Sale for the brewery owned by Diageo in Lehigh Valley, Pennsylvania.

The Company currently anticipates preserving its right to purchase the land in Freetown, Massachusetts in case the due diligence on the Lehigh Valley, Pennsylvania brewery proves unsatisfactory. This may require further extensions

of time for closing under the purchase and sale agreement, or actually closing on the purchase of the land in Freetown, Massachusetts. At June 30, 2007 the Company had approximately \$400,000 of capitalized costs related to its purchase of land in Freetown, Massachusetts.

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**THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**E. Net Income per Share**

The following table sets forth the computation of basic and diluted net income per share:

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30, 2007</b>	<b>July 1, 2006</b>	<b>June 30, 2007</b>	<b>July 1, 2006</b>
	<b>(in thousands, except per share data)</b>			
Net income	\$ 6,791	\$ 7,986	\$ 12,559	\$ 9,807
Shares used in net income per common share basic	14,204	13,919	14,161	13,888
Effect of dilutive securities:				
Stock options	458	418	459	424
Non-vested investment shares and restricted stock	18	9	18	8
Dilutive potential common shares	476	427	477	432
Shares used in net income per common share diluted	14,680	14,346	14,638	14,320
Net income per common share basic	\$ 0.48	\$ 0.57	\$ 0.89	\$ 0.71
Net income per common share diluted	\$ 0.46	\$ 0.56	\$ 0.86	\$ 0.69

**F. Comprehensive Income**

Comprehensive income represents net income, plus minimum pension liability adjustment. The minimum pension liability adjustments for the interim periods ended June 30, 2007 and July 1, 2006 were not material.

**G. Commitments and Contingencies***Purchase Commitments*

The Company had outstanding non-cancelable purchase commitments related to advertising contracts of approximately \$7.2 million at June 30, 2007.

The Company has entered into contracts for the supply of a portion of its hops requirements. These purchase contracts extend through crop year 2013 and specify both the quantities and prices, mostly denominated in euros, to which the Company is committed. Hops purchase commitments outstanding at June 30, 2007 totaled \$30.2 million, based on the exchange rates on that date. Due to demand pressure and a poor crop in 2006, the Company has increased its future hop commitments to levels higher than in recent years, to assure, to the extent currently possible, that adequate hops will be available in future years.

Other outstanding purchase commitments totaled \$1.1 million at June 30, 2007.

*Arrangements with Contract Breweries*

On March 28, 2007, the Company entered into a Brewing Services Agreement (the Agreement) with CBC Latrobe Acquisition, LLC (CBC), a Pennsylvania limited liability company whose sole member is City Brewing Company, LLC of Lacrosse, Wisconsin (City Brewing). Under the Agreement, the Company will be able to brew and package certain of its products at the brewery located in Latrobe, Pennsylvania that was acquired by CBC in 2006. Pursuant to the Agreement, CBC will ensure that a certain minimum capacity will be available to the Company throughout the term of the Agreement. The Company has committed to minimum production levels at the brewery during the 2007 and 2008 calendar years. As a material part of the Agreement, the Company will purchase equipment to be installed at the brewery in Latrobe for upgrades to the brew house, storage of the Company's proprietary yeasts, and packaging of

the Company's products. Under the Agreement, CBC will be able to purchase such equipment from the Company at or prior to the end of the initial term of the Agreement at the amortized value of such equipment. City Brewing, with whom the Company currently has a brewing services agreement with respect to production at City Brewing's brewery located in Lacrosse, Wisconsin, has guaranteed the performance of the Agreement by CBC. As part of the discussion with City Brewing, the Company is in discussions to acquire an ownership interest in the Latrobe Brewery. The expected capital expenditures related to the Agreement and these discussions are between \$3 million and \$7 million of which approximately \$1 million has been spent at June 30, 2007.

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**THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**H. Income Taxes**

The Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48), which is an interpretation of SFAS No. 109, *Accounting for Income Taxes*, in the first quarter of 2007. This interpretation clarifies the accounting and financial statement reporting for uncertainty in income taxes recognized by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The adoption of FIN No. 48 did not result in an adjustment to the beginning balance of retained earnings and also did not result in any material adjustments to reserves for uncertain tax positions. As of the Company's adoption date of December 31, 2006, the Company had approximately \$4.4 million of gross unrecognized income tax benefits. Of this total, \$2.9 million (state amounts net of federal benefit) represent the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate. As of June 30, 2007, there were no material changes to the Company's unrecognized income tax benefits.

The Company's practice is to classify interest and penalties related to income tax matters in income tax expense. As of its adoption date of December 31, 2006, the Company had \$0.6 million accrued for interest and penalties. As of June 30, 2007, there were no material changes to the Company's accrued interest and penalties.

The Company is subject to federal income tax as well as income tax of multiple state jurisdictions. The Company's federal income tax returns remain subject to examination for fiscal years 2003 through 2005. The Company's state income tax returns remain subject to examination for fiscal years 2003 through 2005. Federal income tax returns for 2004 and 2005, as well as certain state income tax returns for 2002 and 2003, are currently under examination.

Depending upon the outcome of state income tax return examinations that the Company is currently undergoing, it is reasonably possible that certain of the Company's amounts of unrecognized tax benefits could significantly decrease within twelve months of the date of this report. Based on the information that is available, the Company is not able to determine the amount of the possible decrease to its unrecognized tax benefits.

**I. Contract of Sale for Brewery in Lehigh Valley**

On August 1, 2007, the Company entered into a Contract of Sale (the "Contract of Sale") with Diageo North America, Inc. ("Diageo") to purchase the brewery owned by Diageo located in Upper Macungie Township in Lehigh Valley, Pennsylvania (the "Brewery") for a purchase price of \$55 million. The purchase of the land, building and equipment is expected to take place in June 2008, assuming successful completion of the Company's due diligence and the payment of the balance of the deposit. Upon the execution of the Contract of Sale, the Company paid an initial deposit of \$1 million. A further deposit of \$9 million is payable at the end of the due diligence period, provided that the Company has not previously exercised its right to terminate the Contract of Sale.

It is estimated that the Brewery will initially increase the Company's annual production capacity by approximately 1.6 million barrels. The Company anticipates that the Brewery will require substantial investment and renovation in order to brew the Company's Samuel Adams® craft beers. The cost of upgrading and renovating the Brewery is currently estimated by the Company to be in the range of \$30 million to \$75 million, but, until the Company completes its evaluation of the Brewery and its potential during the due diligence period, it will not be possible to estimate precisely the total cost of any required renovation and upgrades or the operating and financial statement impact to the Company. The Company currently believes that, once this initial investment and renovation is completed, the Brewery's annual capacity has the potential to expand to over 2 million barrels with only modest incremental investment.

The Contract of Sale provides that, upon satisfactory completion of the due diligence period, the Company may begin work to upgrade and renovate the facility. The Contract of Sale anticipates that the facility will remain in operation during the transition. It is anticipated that most, if not all, of Diageo's current employees at the facility shall become employees of the Company upon the completion of the purchase.

As a part of the purchase and sale arrangement, Diageo and the Company also entered into a Packaging Services Agreement dated August 1, 2007 (the "Packaging Services Agreement"), under which the Company has agreed to blend and package the Diageo products currently being produced at the Brewery by Diageo. The Packaging Services

Agreement will take effect on the date on which the Company purchases the Brewery and will have a term of approximately two years. It is anticipated that the volume of Diageo products being produced at the Brewery will decline over the term, while, at the same time, the volume of the Company's products being produced there will increase.

**Table of Contents****PART I. Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is a discussion of the significant factors affecting the consolidated operating results, financial condition and liquidity and cash flows of the Company for the three and six-month periods ended June 30, 2007 as compared to the three and six-month periods ended July 1, 2006. This discussion should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations, and the Consolidated Financial Statements of the Company and Notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2006.

**RESULTS OF OPERATIONS**

Boston Beer's flagship product is Samuel Adams Boston Lager®. For purposes of this discussion, Boston Beer's core brands include all products sold under the Samuel Adams®, Sam Adams®, Twisted Tea® and HardCore® trademarks.

Core brands do not include the products brewed at the Company's brewery, located in Cincinnati, Ohio under contract arrangements for third parties. Volume produced under contract arrangements is referred to below as non-core products.

***Three Months Ended June 30, 2007 compared to Three Months Ended July 1, 2006***

**Net revenue.** Net revenue increased by \$13.5 million or 17.1% to \$92.9 million for the three months ended June 30, 2007, as compared to \$79.3 million for the three months ended July 1, 2006. The increase was primarily due to an increase in volume as well as an increase in net revenue per barrel of approximately 1.6%.

**Volume.** Total shipment volume increased by 15.2% to 507,000 barrels for the three months ended June 30, 2007, as compared to 440,000 barrels for the three months ended July 1, 2006. Shipment volume for the non-core products increased by 4,000 barrels to 12,000 barrels. Shipment volume for the core brands increased by 14.6% to 494,000 barrels, due primarily to increases in the Samuel Adams® brand family offset by a slight decline in the Twisted Tea® brand family shipments. The growth in the Samuel Adams® brand family shipments was driven by double-digit growth rates in Samuel Adams® Seasonal, Samuel Adams Boston Lager®, and Samuel Adams® Brewmaster's Collection.

Shipments to date and orders in-hand suggest that core shipments for the first nine months of 2007 could be up approximately 15%. Actual shipments may differ, however, and no inferences should be drawn with respect to shipments in future periods.

Depletions, or sales by the wholesalers to retailers, of the Company's core brands for the second quarter of 2007 increased by approximately 16% over the same period in 2006. The Company believes that inventories at wholesalers at June 30, 2007 were at appropriate levels.

**Net Selling Price.** The selling price per barrel for core brands increased by 2.0% to \$186.54 per barrel for the three months ended June 30, 2007, as compared to \$182.94 for the same period last year. This increase in net revenue per barrel is due to price increases implemented in the first quarter offset by changes in package and product mix.

**Gross profit.** Gross profit for core brands was \$106.24 per barrel for the three months ended June 30, 2007, as compared to \$108.61 for the three months ended July 1, 2006. Gross margin for core brands was 57.0% for the three months ended June 30, 2007, as compared to 59.4% for the three months ended July 1, 2006. The decrease in gross profit per barrel and gross margin is primarily due to an increase in cost of goods sold per barrel as compared to the prior year, only partially offset by price increases and a favorable shift in package and product mix.

Cost of goods sold for core brands increased by \$5.97 per barrel to \$80.30 per barrel and was 43.0% as a percentage of net revenue for the three months ended June 30, 2007, as compared to \$74.33 per barrel and 40.6% as a percentage of net revenue for the three months ended July 1, 2006. The increase is due primarily to higher package material and ingredient costs partially offset by a favorable shift in package and product mix. The Company expects most of these cost pressures on package material and ingredient costs to continue during the remainder of the year.

The Company has been experiencing some issues at the brewery it owns in Cincinnati due, at least in part, to the extended operating hours which have stretched production capacity above normal operating levels. The exact future cost impact of these issues cannot currently be estimated until the Company has fully evaluated all the improvements required.



Based on current cost increase knowledge and pricing expectations, 2007 full year gross margin as a percent of net revenue could be down as much as two percentage points below full year 2006 levels.

The Company includes freight charges related to the movement of finished goods from its manufacturing locations to distributor locations in its advertising, promotional and selling expense line item. As such, the Company's gross margins may not be comparable to other entities that classify costs related to distribution differently.

**Advertising, promotional and selling.** Advertising, promotional and selling expenses increased by \$3.3 million, or 11.1%, to \$32.6 million for the three months ended June 30, 2007, as compared to \$29.4 million for the three months ended July 1, 2006. The increase is primarily due to increases in freight expenses to wholesalers, advertising and promotion costs and sales force salary and benefit costs. Advertising, promotional and selling expenses for core brands were 35.4% of net revenue, or \$66.03 per barrel, for the three months ended June 30, 2007, as compared to 37.2% of net revenue, or \$68.14 per barrel, for the three months ended July 1, 2006. The Company will invest in advertising and promotional campaigns that it believes are effective, but there is no guarantee that such investment will generate sales growth.

**Table of Contents****PART I. Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**

The Company conducts certain advertising and promotional activities in the wholesalers' markets, and the wholesalers make contributions to the Company for such efforts. These amounts are included in the Company's statement of operations as reductions to advertising, promotional and selling expenses. Historically, contributions from wholesalers for advertising and promotional activities have amounted to between 2% and 4% of net sales. The Company may adjust its promotional efforts in the wholesalers' markets if changes occur in these promotional contribution arrangements, depending on the industry and market conditions.

**General and administrative.** General and administrative expenses increased by \$0.7 million, or 13.9%, to \$6.1 million for the three months ended June 30, 2007, as compared to \$5.4 million for the same period last year. The increase primarily reflects increases in salary and benefit costs and depreciation related to the leasehold improvements at the new corporate headquarters.

**Write-off of Brewery Costs.** During the second quarter, the Company incurred a \$3.4 million write-off of capitalized costs related to the Freetown, Massachusetts brewery project. The Company concluded that the likelihood of this project significantly diminished as the Company's negotiations with Diageo North America progressed and ultimately culminated in the completion of the Contract of Sale for the brewery owned by Diageo in Lehigh Valley, Pennsylvania.

**Total other income, net.** Total other income, net, increased by \$0.4 million to \$1.2 million for the three months ended June 30, 2007 primarily due to higher interest rates earned on increased average cash and investment balances during the second fiscal quarter of 2007 as compared to the same period in 2006.

**Provision for income taxes.** The Company's effective tax rate increased to approximately 42.4% for the three months ended June 30, 2007 from 39.4% for the same period last year. This increase in the effective tax rate is due to an increase in federal income taxes related to prior periods. The Company expects the effective tax rate to be approximately 40.5% for the full year 2007.

***Six Months Ended June 30, 2007 compared to Six Months Ended July 1, 2006***

**Net revenue.** Net revenue increased by \$29.1 million or 21.4% to \$165.3 million for the six months ended June 30, 2007 from \$136.2 million for the six months ended July 1, 2006. The increase is primarily due to an increase in shipment volume of Boston Beer's core brands, price increases maintained from the first quarter 2007 and a shift in the package and product mix.

**Volume.** Total shipment volume increased by 18.2% to 903,000 barrels for the six months ended June 30, 2007 as compared to the same period 2006. Shipment volume for core brands increased by 18.5% to 885,000 barrels for the six months ended June 30, 2007 as compared to 747,000 barrels in the same period 2006. The increase in core shipment volume was due to an increase in shipments of all Samuel Adams's family brands, offset by a slight decline in shipments of Twisted Tea's. Contract shipment volume increased by 1,000 barrels for the first six months of 2007 over the same period last year.

**Selling Price.** The net revenue per barrel for core brands increased by approximately 2.4% to \$185.47 per barrel for the six months ended June 30, 2007 as compared to the prior year. This increase in net revenue per barrel is due to price increases implemented in the first quarter offset by changes in package and product mix.

**Gross profit.** Gross profit for core brands was \$104.68 per barrel for the six months ended June 30, 2007, as compared to \$106.28 for the six months ended July 1, 2006. Gross margin for core products was 56.4% for the first six months of 2007, as compared to 58.7% for the same period in 2006. The decrease in gross profit per barrel and gross margin is primarily due to an increase in cost of goods sold per barrel as compared to the prior year, only partially offset by price increases and a shift in package and product mix.

Cost of goods sold for core products increased by 8.0% or \$6.01 per barrel to \$80.79 per barrel for the six months ended June 30, 2007, as compared to \$74.78 per barrel for the same period last year. The increase is due primarily to higher package material and ingredient costs partially offset by a shift in package and product mix.

**Advertising, promotional and selling.** Advertising, promotional and selling expenses increased by \$4.4 million, or 8.0%, to \$59.1 million for the six months ended June 30, 2007, as compared to \$54.7 million for the six months ended July 1, 2006. Advertising, promotional and selling expenses for core brands were 36.0% of net revenue, or \$66.81 per

barrel, for the six months ended June 30, 2007, as compared to 40.5% of net revenue, or \$73.29 per barrel, for the six months ended July 1, 2006. This increase was a result of increased freight costs, increases in advertising costs, sales force salary and benefit costs and promotional costs, offset somewhat by a decrease in package redesign costs.

**General and administrative.** General and administrative expenses increased by 10.9% or \$1.1 million to \$11.4 million for the six months ended June 30, 2007 as compared to the same period last year. The increase in general and administrative expenses is primarily due to an increase in salary and benefit costs and depreciation related to the leasehold improvements at the new corporate headquarters offset by a decrease in legal costs related to the class action lawsuit.

**Other income, net.** Other income, net, increased by \$0.8 million to \$2.4 million for the six months ended June 30, 2007 as compared to the same period ended July 1, 2006. This increase is due to interest earned on cash balances due to higher interest yields in the Company's investment portfolio and a higher average cash balance in 2007.

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**PART I. Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**

**Write-off of Brewery Costs.** During the second quarter, the Company incurred a \$3.4 million write-off of capitalized costs related to the Freetown, Massachusetts brewery project. The Company concluded that the likelihood of this project significantly diminished as the Company's negotiations with Diageo North America progressed and ultimately culminated in the completion of the Contract of Sale for the brewery owned by Diageo in Lehigh Valley, Pennsylvania.

**Provision for income taxes.** The Company's effective tax rate increased to approximately 41.4% for the six months ended June 30, 2007 from 39.5% for the same period last year. The increase in the effective tax rate, as compared to the prior year, is due to an increase in federal taxes related to prior periods.

**LIQUIDITY AND CAPITAL RESOURCES**

Cash and cash equivalents increased by \$8.9 million to \$72.0 million as of June 30, 2007 from \$63.1 million as of December 30, 2006. For the six months ended June 30, 2007, the increase in cash and cash equivalents was mainly due to net income of \$12.6 million and proceeds related to stock-based compensation arrangements of \$2.7 million offset by capital expenditures primarily related to keg purchases to support volume growth, the new brewery project and other brewery equipment.

Cash flows provided by operating activities were \$13.4 million and \$9.2 million for the six months ended June 30, 2007 and July 1, 2006, respectively. Cash provided by operating activities increased primarily due to an increase in net income adjusted for depreciation and the write-off of brewery costs and timing changes in the collection of accounts receivable offset by the timing of purchases and sales of short-term investments.

Cash flows used in investing activities increased by \$5.3 million due to higher capital expenditures in the six months ended 2007 primarily related to keg purchases to support volume growth, the new brewery project and other brewery equipment.

The Company continues to pursue its strategy of combining brewery ownership with brewing at breweries owned by others. The brewing arrangements with breweries owned by others have historically allowed the Company to take advantage of the excess capacity at those breweries, providing the Co