BULLDOG RESEARCH

Redhook Ale Brewery Inc.
Merger Brewing

May 15, 2008

Redhook Ale Brewery Inc (HOOK)

Rating: HOLD

Current Price: $3.99

Target Price: $4.00

52-Week Range: $3.85 - $8.21

Market Cap: $33.3 million

Div & Yield: N/A

	2006	2007	2008e
EPS	$0.06	-$0.11	-$0.16

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We are initiating coverage of Redhook Ale Brewery Inc. with a **HOLD** rating and a 12-month target price of $4.00, which is in line with the current market price. While we expect the company to continue reporting a net loss for the next several years, it will continually improve its free cash flow. The company's improving free cash flow situation increases the cash available to shareholders. We believe the company should be valued based on the free cash flow it generates rather than an accounting measure of earnings. There are many reasons to be positive about the company's prospects, including its relationship with Anheuser-Busch (BUD), its lack of debt on the balance sheet, and growth of the craft segment of the beer market. However, the most promising catalyst for growth is HOOK's pending merger with Widmer Brothers. While we are bullish on the prospects of a large independent craft brewer with strong brands, we do not have enough information on the private Widmer Brothers to justify changing our HOLD to a BUY.

KEY DRIVERS:

1) Anticipated steady growth in free cash flow.
2) Anheuser-Busch has a 35% stake in the firm, which gives HOOK access to an extensive distribution network as well as the backing of the country's largest brewer.
3) Its pending merger with Widmer Brothers should help the company realize synergies in production and operations which should lead to increased margins.
4) Elimination of debt last year provides more financial flexibility for the firm going forward.

RISKS TO OUR CALL:

1) Environment for raw materials prices could continue to deteriorate and weigh on the company.
2) Potential hiccups could result from the merger with Widmer Brothers.
3) Redhook fails to complete merger with Widmer Brothers.

COMPANY BACKGROUND

Redhook Ale Brewery Incorporated is an independent brewer of craft beer founded in 1981. The company produces its beer in two strategically placed, company owned breweries. One is located in Woodinville, Washington and the other in Portsmouth, New Hampshire. The company distributes its products through two channels: Craft Brands Alliance, a joint venture between the company and Widmer Brothers Brewing Company, and Anheuser-Busch. In addition, the company announced on November 13, 2007 a merger with Widmer Brothers, whereby Widmer Brothers will merge into the company. The new company will be named Craft Brewers Alliance, Inc. and trade under the current ticker, HOOK.

Redhook Ale produces nine distinct beers, each marketed under its own name. The flagship brand is *Redhook ESB*, and other core brands include *Long Hammer IPA*, *Redhook Blonde Ale*, *Blackhook Porter*. The company also offers seasonal brews *Sunrye*, *Late Harvest Autumn*, *Winterhook* and *Copperhook Ales*. The company also brews and sells *Widmer Hefeweizen* under contract with Widmer Brothers.[1]

HOOK BUSINESS STRATEGY

The company has devised a comprehensive business strategy based on several key components.

Craft Beer Segment

Redhook focuses on the production of distinctive, flavorful craft beers. The company produces all of its beer in company-owned facilities. Furthermore, Redhook's beers are actually Kosher certified by the Orthodox Union. HOOK does not compete directly against the large mainstream brewers. Instead, they focus on the niche craft beer segment.

Control of Production in Company-Owned Breweries

The company has made a strategic decision to design and built its own brewing facilities in order to maintain control over process and quality. Redhook designed these facilities to produce beer in small batches, favoring high automation over scale. While owning and operating these facilities does in fact give the company greater control over production, it also makes the company less flexible with respect to changing industry demand. Unless demand for its beers is perfectly in-line with production capabilities, the plants will be operating either at full capacity (introducing opportunity cost) or under capacity. The trend for the company of late has been operating under capacity. In an effort to offset some of this under capacity the company is under contract through the Craft Brands joint venture to brew lower margin Widmer beer. However, we believe the pending merger with Widmer Brothers will lead to increased capacity utilization and greater realization of economies of scale. In addition, HOOK will no longer realize the lower margins associated with brewing on contract for Widmer.

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[1] *Redhook Ale Brewery, Inc., 10-K, March 26, 2008.*

Relationship with Anheuser-Busch

The name of the game in the beverage industry is distribution. To this end, in 1994 the company entered into an agreement with industry leader Anheuser-Busch to distribute its products through its network of 560 independent wholesalers. The company also distributes through Craft Brand Alliance, but Craft Brand Alliance in turn distributes through Anheuser-Busch as well. This distribution agreement has given HOOK access to Anheuser-Busch's vast distribution network and heavily sought after shelf space. HOOK pays a margin fee to Anheuser-Busch for these distribution rights. This fee is reflected in the company's COGS and helps explain the decrease in gross margin over the past few years.

In addition, Anheuser-Busch has taken a 33% ownership stake in HOOK and it also has a 40% ownership stake in Widmer Brothers. As a result of the pending merger, Anheuser-Busch will own approximately 37% of the combined company. We feel strongly that Anheuser-Busch's ownership interest in HOOK will serve to benefit HOOK over the long term. The investment in the company provides Anheuser-Busch with an incentive to aggressively promote the Redhook and Widmer brands as well as give preferential treatment with regards to shelf space. Anheuser-Busch also has matching rights should HOOK receive any buyout offers from other companies. Further reinforcing Anheuser-Busch's commitment to HOOK, it maintains two seats on HOOK's board of directors.

Relationship with Craft Brands Alliance LLC

In mid-2004, Redhook formed a joint venture with Widmer Brothers establishing Craft Brands Alliance LLC. The new company advertises, markets, sells, and distributes both Redhook and Widmer products. In addition to sharing costs, the company believes that the product offerings of each individual company complement each other well, creating synergies to marketing both company's products. In 2007, the companies decided that an official merger would benefit both firms going forward. Craft Brands Alliance will dissolve into Redhook Ale Brewery once the merger is executed. We discuss the merger in more detail below.

Operation of Regional Facilities

The company operates two regional breweries on both US coasts. This strategy allows the company to brew its beer closer to the ultimate point of sale. Doing so allows the company to reduce its transportation costs and also contributes to the image of a local craft brewer both in the Pacific Northwest and Northeast. With the surge in oil prices and resulting rise in gasoline prices over the past few years, this strategy has proven prescient.

Promotion

Redhook promotes its products in similar fashion to other brewers. This is through promotional materials in pubs, signage, price discounts, seasonal products, etc. The company has been creative in its promotional spend though, and more recently, has engaged in co-operative campaigns, whereby the cost of the promotion is shared by both the company and a local distributor. The company believes that this better aligns the interests of both Redhook and its distributors. Not only does Redhook subsidize its promotional costs through these co-operative arrangements, but local distributors are also motivated to promote the product as a result of their financial commitment.

MERGER WITH WIDMER BROTHERS

In late 2007, Redhook announced that it had entered into a merger agreement with Widmer Brothers Brewing Company of Portland, Oregon. The combined company will be renamed Craft Brewers Alliance and will trade under the ticker HOOK. The merger looks to build off of the joint venture, Craft Brands Alliance, and will produce both Redhook and Widmer products under their current names. The proposed merger will be an all stock transaction that will result in Widmer shareholders and existing Redhook shareholders each holding approximately 50% of the shares outstanding in the combined company.

Anheuser-Busch will maintain its ownership stake in the combined company and has an effective right of first-refusal for any corporate transaction. We believe this effectively takes HOOK off the market to outside buyers, as Anheuser-Busch is highly unlikely to allow a competitor to purchase a proven brand in the fast-growing craft beer segment. While Anheuser-Busch itself seems like a logical suitor, we have reason to believe that the company is likely to maintain the status quo, rather than acquire the company. Independence in the craft beer segment is a key attribute to success, and it is unlikely that the Redhook or Widmer brand would succeed under Anheuser-Busch. In addition, the current structure allows Anheuser-Busch to benefit from growth in the segment without a heavy investment in production/brand support.

It is difficult to fully model the effects of the proposed merger as Widmer Brothers is a private enterprise. We do know that the deal is proposed as an all stock transaction and that Widmer shareholders will receive 2.1551 shares of Redhook common stock. Estimates of Widmer Brothers' sales put the annual number of barrels sold slightly above those of Redhook.[2] Some believe that, in dollar terms, the combined company could have estimated sales of about $110 million.[3] However, we believe that, given the 50/50 ownership structure for the merged entity, this suggests the companies are coming to the table with similar financials. Therefore, we use a more conservative estimate of 2x HOOK sales in 2009 for the combined entity and continue our original growth assumptions going forward. We anticipate synergies as a result of the merger, but these are difficult to measure without public financial statements for Widmer Brothers. However, in addition to our model of HOOK, we have attempted to create a pro forma income statement and computation of free cash flows for the merged entity with the anticipated benefit from synergies. We outline potential synergies below.

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[2] *Allison, Melissa. "Redhook buying Widmer Brothers, changing name";* The Seattle Times *13 November 2007.*
[3] *Virgin, Bill. "Redhook, Widmer Brothers will merge, but keep brands";* SeattlePI.com*, 13 November 13 2007.*

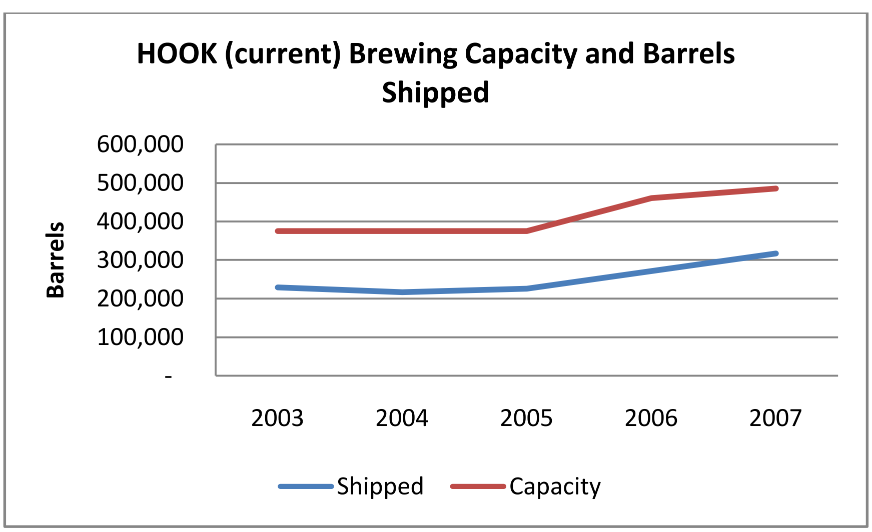
SG&A

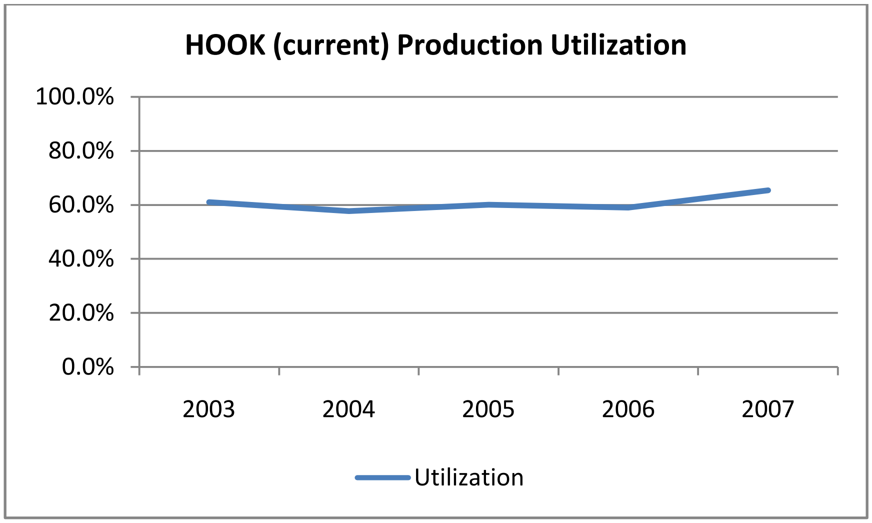
SG&A is one area where the combined company can clearly enjoy synergies. In addition to the obvious labor savings associated with both companies as well as the dissolution of the Craft Brands Alliance joint venture, the company will also benefit in terms of brand support. Craft Brewers Alliance will be able to promote their brands to customers together, rather than having to do so independently. Both companies also currently distribute their products through agreements with Anheuser-Busch and therefore we anticipate no disturbance in distribution upon completion of the merger.

COGS

We believe that the combined companies will be able to enjoy synergies for COGS on two fronts. Brewing beer is a capital-intensive activity that requires a high level of fixed costs associated with operating the brewery. There is a large degree of operating leverage inherent in the business, implying that operating a brewery below capacity will decrease the margin on each unit sold, as the fixed costs are spread over a smaller base. In this merger, we find that Widmer is operating very close to capacity, while HOOK actually has excess capacity in its New Hampshire brewery. Therefore, we believe that the combined company will benefit from the fact that it can brew Widmer brands in New Hampshire and enjoy the benefits of economies of scale. Neither company alone would be able to fully benefit from this excess capacity independently.

For our model of the merged company, we project COGS as a % of sales to decline to approximately 77% for the long-term. This is lower than HOOK's standalone COGS as a % of sales of 80% as a result of synergies between HOOK and Widmer Brothers. We looked to other brewing companies such as The Boston Beer Co. (SAM) and Anheuser-Busch (BUD) for a comparison of COGS as a % of sales to ensure this estimate is in line with that of other firms in the industry. SAM has current COGS as a % of sales of 40%, while BUD's is just below 60%. We believe that post-merger HOOK will ultimately be able to bring their COGS as a % of sales closer to bigger players in the industry, but for now it appears our assumption is fair and conservative.





Source: Redhook Ale Brewery

The second point of synergy is also related to the excess capacity. We valued HOOK on a stand-alone basis and arrived at a HOLD rating. However, we believe that the margins of the company will actually improve - all else being equal - as a result of the elimination of contract brewing. Currently HOOK uses some of its excess capacity to brew Widmer brands, but in doing so realizes smaller margin than on its own brands. These lower margins are incorporated both in sales and COGS on HOOK's stand-alone Income Statement. However, by combining the companies, HOOK will enjoy a wider margin on these same units.

Widmer Brothers Brewing Company

Widmer Brothers Brewing Company was founded in 1984 by Portland, Oregon brothers Rob and Kurt Widmer. The company brews both American and European style craft beers, with its flagship *Widmer Hefeweizen* the most recognized brew in the portfolio. The Widmer Hefeweizen product was the first American Hefeweizen and has won numerous awards. The company also offers *Drop Top Amber Ale*, *Broken Halo IPA*, and seasonal brews *"W" Brewmasters' Release Series*, *OKTO*, and *Snowplow Milk Stout*.

DEALING WITH RISING COGS

On the cost side, HOOK faces the same headwind of higher input costs that has plagued the entire beer industry. Gross margin has steadily declined from a high of 39.9% in FY1999 to 18.2% in FY2007, a dramatic decrease of over 50%. This has been due primarily to rising costs for raw materials such as hops and barley, as well as a surge in energy prices which is used in production as well as transport of HOOK's products. We do not anticipate any relief in 2008, despite signs of a weakening economy. Therefore, in our model, we have held COGS as a % of sales steady at roughly 80% for the foreseeable future as the company has struggled to find ways to adapt to higher input costs and adjusts prices to offset the rise. Its 5-year average for COGS is 75.6% and therefore we believe 80% is justified.

Continuing strength in commodity and other input prices could also put pressure on HOOK over the next few years. The Producer Price Index (PPI), which tracks inflation for raw materials used by the US manufacturing sector, is expected to rise 2% in 2008 according to ISI Group.[4] However, the raw materials used in the production of alcoholic beverages consists mostly of foodstuffs and feedstuffs—hops, barley, yeast, and wheat. In 2007, the PPI measure for "foodstuffs and feedstuffs" rose by 25.2% from 2006.[5] Elevated commodity, energy, transport, and packaging costs will continue to be a challenge for HOOK in the near future.

HOOK maintains purchase commitments for malt and hops in order to ensure that it has the necessary supply of malted barley and specialty hops to meet future production requirements. This also enables the company to anticipate changes in input costs and avoid scrambling to purchase raw materials in the open market under unfavorable terms.

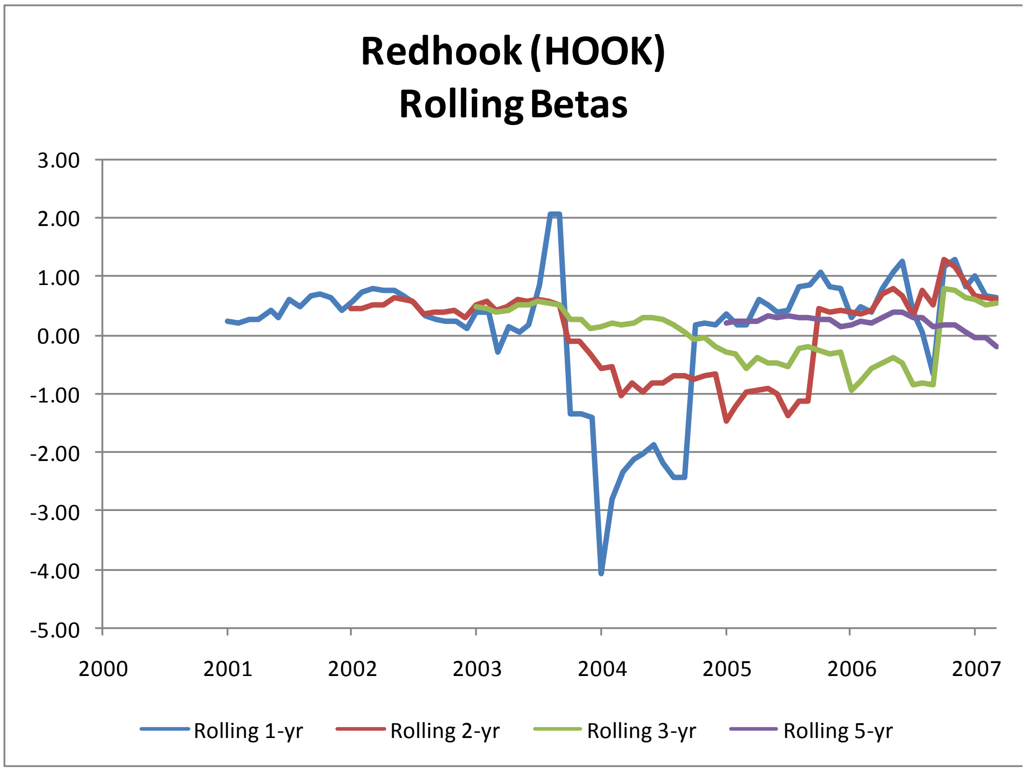
ELIMINATING THE DEBT BURDEN

In 2007, the company used cash on hand to retire approximately nearly all of its $4.7 million in outstanding debt (including term loan and capital lease obligations). The company paid off nearly all of its debt in order to strengthen its balance sheet in anticipation of the merger with Widmer Brothers and any subsequent capital investments.

[4] *ISI Group, Weekly Economic Report, February 11, 2008.*
[5] *Bureau of Labor Statistics (BLS),* Producer Price Indexes*, December 2007.*

CHOOSING THE RIGHT BETA

When compared to the CRSP Market Portfolio, HOOK's beta is anything but smooth. We believe the beta could also be reflective of the fact that the stock is thinly traded. Therefore, we used the most recently reported beta of 1.11.[6]



[6] *Yahoo! Finance, 4/24/2008.*

RISKS TO OUR CALL

After a careful and thorough fundamental analysis and evaluation of HOOK's business as well as macroeconomic factors, we have determined the company is currently undervalued. Below we document the potential risks to our call.

Competitive Landscape Creates Opportunity
Given the increase in craft and micro breweries, it is possible that HOOK will lose market share and not compete successfully against stronger brands such as Sam Adams. In addition, large mainstream brewers have been adding craft beer to their portfolios and it is difficult for HOOK to compete in terms of marketing and promotion of their products.

Merger Failure
While the company expects its merger with Widmer Brothers to create a stronger entity, there exists the possibility that the merger will fail to realize the anticipated benefits. In addition, failure to complete the merger could stifle the company's ability to digest increasing raw materials prices. Additionally, it would eliminate a consistent source of revenue as Widmer outsources some production to HOOK. It is likely that Widmer would bring production back in-house and therefore HOOK would be left with greater spare capacity and increased COGS as a result.

Input Costs
Continued strength in the price of malted barley, hops, and other raw materials will adversely affect margins for the company. The company is not in a very good position to absorb further input price hikes.

HOOK VALUATION

Method/Valuation:

We forecast several key financial drivers from 2008 through 2012 to create our projected financial statements for Redhook. From the projected cash flow statement, we forecast free cash flows and terminal value. We then discounted free cash flows using a weighted average cost of capital (WACC) of 9.93%.

For our terminal growth rate, we used 5% which is in line with estimates for long-term nominal y/y GDP growth. We consider this a very conservative estimate based on HOOK's position in its life cycle as well as the strength in the craft beer segment of the market. However, we believe a conservative valuation is in order for this company.

Beta and WACC:

We believe that using the WACC is the correct method by which to value the firm. The firm currently has zero debt in the capital structure, and we do not have visibility into management's plans for debt going forward. While it is possible the company will need to take on debt at some point to expand capacity, HOOK currently has production capacity in its New Hampshire brewery that will be able to produce both Redhook and Widmer brands. As a result, we are comfortable using the WACC at this time, but understand that we may need to revisit the valuation should the company take on debt in the future.

We used the Capital Asset Pricing Model (CAPM) to determine the cost of equity for Redhook. For the risk-free rate (R_f), we used the current yield on the 10-year T-Bill of 3.73%[7] reduced by 1% to adjust for the risk premium that is already applied to long-term government bonds. As previously discussed, we assumed a beta of 1.11 based on the 3-year beta derived from monthly stock market returns and published on Yahoo! Finance. We analyzed HOOK's historical beta, but it has proven inconsistent. *(see Exhibit 3 for further details)*

[7] *Bloomberg.com, 4/23/2008.*

Key Assumptions:

Sales Growth:
For 2008 and beyond we have forecast a 3.1% growth figure. This is based on the company's 10-year sales growth average. We consider this to be a very conservative estimate as the company realized annual sales growth of 14.8% in 2006 and 16.1% in 2007. However, the company's sales growth has been quite volatile throughout its history and therefore we believe using the 10-year average is fair.

COGS Growth:
There has been a clear rise in COGS as a percent of sales over the past few years as displayed in this report. We expect COGS as a percent of sales to remain elevated for the foreseeable future. While the 5-year average for COGS as a percent of sales is 75.6%, the current environment for commodity prices leads us to believe the company will face COGS closer to that of 2007 which was 81.8%. We do believe the merger with Widmer Brothers will allow the combined company to realize more favorable economies of scale and have therefore forecast COGS as a percent of sales of 80% for the next several years. We still consider this to be a conservative estimate.

SG&A
SG&A as a percent of sales has averaged 23.4% over the past 5 years. We expect the company to maintain SG&A at this level and perhaps realize even lower SG&A as a % of sales as a result of synergies from its merger with Widmer Brothers.

Depreciation & Amortization
We expect HOOK to maintain depreciation and amortization expense of 4.9% of PP&E Net which is consistent with its 5-year average.

Receivables, Inventories, Non-operating Income/Expense, Payables, Accrued Expenses, Other Current Assets, Other Current Liabilities, Other Assets, and Deferred Taxes:
Historical averages for these categories have been consistent and we expect that to continue for the foreseeable future. Therefore, we used the 5-year averages for all.

Income Taxes:
Management has indicated the company's effective tax rate for 2008 will be 19.5%, therefore we use this effective tax rate going forward. However, we anticipate the company will realize losses over the next several years and will therefore pay no income tax and perhaps even realize the benefit of a tax refund.

Total Debt:
The company retired nearly all of its outstanding debt in 2007, using cash on hand. Therefore, in our WACC calculation, we used a target debt as % of the capital structure of 0% for the foreseeable future.

APPENDIX

Exhibit 1: Income Statement (Historical)

(in millions)	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07
INCOME STATEMENT					
Sales (Net)	38.72	33.37	31.10	35.71	41.47
y/y % change	*3.4%*	*-13.8%*	*-6.8%*	*14.8%*	*16.1%*
Cost of Goods Sold	25.68	24.23	24.61	27.92	33.92
% of sales	*66.3%*	*72.6%*	*79.1%*	*78.2%*	*81.8%*
Gross Profit	**13.04**	**9.15**	**6.49**	**7.80**	**7.55**
Gross margin	*33.7%*	*27.4%*	*20.9%*	*21.8%*	*18.2%*
Selling, General, & Admin Expenses	11.69	8.17	6.78	6.85	8.84
% of sales	*30.2%*	*24.5%*	*21.8%*	*19.2%*	*21.3%*
EBITDA	**1.35**	**0.97**	**-0.29**	**0.95**	**-1.29**
Depreciation, Depletion, & Amortiz	3.03	2.94	2.94	3.00	2.86
% of PP&E (net)	*4.6%*	*4.7%*	*4.9%*	*5.2%*	*5.1%*
EBIT	**-1.68**	**-1.97**	**-3.23**	**-2.05**	**-4.16**
Operating margin	*-4.3%*	*-5.9%*	*-10.4%*	*-5.7%*	*-10.0%*
Interest Expense	0.19	0.19	0.27	0.35	0.30
% of debt	*3.1%*	*3.4%*	*5.2%*	*7.3%*	*648.8%*
Non-Operating Income/Expense	0.06	1.24	2.54	3.04	3.34
% of sales	*0.2%*	*3.7%*	*8.2%*	*8.5%*	*8.1%*
Special Items	0.00	0.00	-0.03	0.00	0.00
% of sales	*0.0%*	*0.0%*	*-0.1%*	*0.0%*	*0.0%*
Pretax Income	**-1.81**	**-0.92**	**-0.98**	**0.64**	**-1.12**
Income Taxes - Total	0.03	0.03	0.22	0.13	-0.18
% of pretax income	*-1.7%*	*-3.3%*	*-22.4%*	*20.3%*	*15.8%*
Minority Interest	0.00	0.00	0.00	0.00	0.00
% of pretax income	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Income Before Extraordinary Items & Discontinued Operations (EI&DO)	**-1.88**	**-0.98**	**-1.20**	**0.52**	**-0.94**
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Discontinued Operations	0.00	0.00	0.00	0.00	0.00
Net Income (Loss)	**-1.84**	**-0.95**	**-1.20**	**0.52**	**-0.94**
Income Before EI&DO	-1.88	-0.98	-1.20	0.52	-0.94
Preferred Dividends	0.04	0.02	0.00	0.00	0.00
Available for Common Before EI&DO	-1.88	-0.98	-1.20	0.52	-0.94
Common Stk Equivalents - Savings	0.00	0.00	0.00	0.00	0.00
Adjusted Available for Common	-1.88	-0.98	-1.20	0.52	-0.94
EARNINGS PER SHARE:					
Primary - Excluding EI&DO	-0.30	-0.14	-0.15	0.06	-0.11
Primary - Including EI&DO	-0.30	-0.14	-0.15	0.06	-0.11
Fully Diluted - Excluding EI&DO EI&DO	-0.30	-0.14	-0.15	0.06	-0.11
Fully Diluted - Including EI&DO	-0.30	-0.14	-0.15	0.06	-0.11
COMMON SHARES:					
for Primary EPS Calculation	6.24	7.23	8.21	8.25	8.35
for Fully Diluted EPS Calculation	6.24	7.23	8.21	8.53	8.35
Outstanding at Fiscal Year End	6.23	8.19	8.22	8.28	8.35
% change in common shares	*-6.7%*	*15.9%*	*13.6%*	*0.5%*	*1.3%*

Exhibit 2: Income Statement (Projected)

(in millions)	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12
INCOME STATEMENT					
Sales (Net)	42.76	44.08	45.45	46.86	48.32
y/y % change	*3.1%*	*3.1%*	*3.1%*	*3.1%*	*3.1%*
Cost of Goods Sold	34.21	35.27	36.36	37.49	38.66
% of sales	*80.0%*	*80.0%*	*80.0%*	*80.0%*	*80.0%*
Gross Profit	**8.55**	**8.82**	**9.09**	**9.37**	**9.66**
Gross margin	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Selling, General, & Admin Expenses	10.00	10.31	10.63	10.96	11.30
% of sales	*23.4%*	*23.4%*	*23.4%*	*23.4%*	*23.4%*
EBITDA	**-1.45**	**-1.50**	**-1.54**	**-1.59**	**-1.64**
Depreciation, Depletion, & Amortiz	2.41	2.75	2.97	3.20	3.45
% of PP&E (net)	*4.5%*	*5.4%*	*6.2%*	*7.2%*	*8.4%*
EBIT	**-3.86**	**-4.25**	**-4.51**	**-4.80**	**-5.09**
Operating margin	*-9.0%*	*-9.6%*	*-9.9%*	*-10.2%*	*-10.5%*
Interest Expense	0.00	0.00	0.00	0.00	0.00
% of debt	*8.9%*	*8.9%*	*8.9%*	*8.9%*	*8.9%*
Non-Operating Income/Expense	2.45	2.52	2.60	2.68	2.77
% of sales	*5.7%*	*5.7%*	*5.7%*	*5.7%*	*5.7%*
Special Items	-0.01	-0.01	-0.01	-0.01	-0.01
% of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Pretax Income	**-1.43**	**-1.73**	**-1.92**	**-2.12**	**-2.34**
Income Taxes - Total	-0.28	-0.34	-0.38	-0.41	-0.46
% of pretax income	*19.5%*	*19.5%*	*19.5%*	*19.5%*	*19.5%*
Minority Interest	0.00	0.00	0.00	0.00	0.00
% of pretax income	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Income Before Extraordinary Items & Discontinued Operations (EI&DO)	**-1.15**	**-1.39**	**-1.55**	**-1.71**	**-1.88**
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Discontinued Operations	0.00	0.00	0.00	0.00	0.00
Net Income (Loss)	**-1.15**	**-1.39**	**-1.55**	**-1.71**	**-1.88**
Income Before EI&DO	-1.15	-1.39	-1.55	-1.71	-1.88
Preferred Dividends	0.00	0.00	0.00	0.00	0.00
Available for Common Before EI&DO	-1.15	-1.39	-1.55	-1.71	-1.88
Common Stk Equivalents - Savings	0.00	0.00	0.00	0.00	0.00
Adjusted Available for Common	-1.15	-1.39	-1.55	-1.71	-1.88
EARNINGS PER SHARE:					
Primary - Excluding EI&DO	-0.14	-0.17	-0.19	-0.20	-0.23
Primary - Including EI&DO	-0.14	-0.17	-0.19	-0.20	-0.23
Fully Diluted - Excluding EI&DO EI&DO	-0.14	-0.17	-0.19	-0.20	-0.23
Fully Diluted - Including EI&DO	-0.14	-0.17	-0.19	-0.20	-0.23
COMMON SHARES:					
for Primary EPS Calculation	8.35	8.35	8.35	8.35	8.35
for Fully Diluted EPS Calculation	8.35	8.35	8.35	8.35	8.35
Outstanding at Fiscal Year End	8.35	8.35	8.35	8.35	8.35

Exhibit 3: Beta and WACC Calculations

Beta Calculations

	HOOK
Equity Beta	1.11
Credit Rating	
Debt Beta	0
% Equity in Capital Structure	100.0%
% Debt in Capital Structure	0.0%
Asset Beta	1.11
Unlevered Betas	1.11
Target Debt Ratio	0.0%
Relevered Beta	1.11

Discount Rate Calculation (WACC)

Value of debt at end of 2007	$0.1
Value of equity at end of 2007	$34.7
Fraction of debt in capital structure	$0.0
Discount rate on debt	
Tax rate	19.5%
Beta	1.11
Equity premium	6.50%
Fraction of equity in capital structure	100%
10-year Treasury Rate	3.73%
Risk free rate	2.73%
Discount rate on equity	9.95%
WACC	9.93%

Exhibit 4: Discounted Cash Flow Analysis

Free Cash Flow

	2008	2009	2010	2011	2012
Net Income	-1.15	-1.39	-1.55	-1.71	-1.88
Depreciation & Amortization	2.41	2.75	2.97	3.20	3.45
CapEx	0.00	0.00	0.00	0.00	0.00
Change in Net Working Capital	-1.39	-0.04	-0.04	-0.04	-0.04
FREE CASH FLOW	**2.65**	**1.39**	**1.46**	**1.53**	**1.61**

Discounted Free Cash Flow Analysis

	'07	'08E	'09E	'10E	'11E	'12E	TV
FCF	$5.5	$2.7	$1.4	$1.5	$1.5	$1.6	$34.3
DCF	$5.5	$2.4	$1.2	$1.1	$1.1	$1.0	$21.4
EV	$33.6						
2007 Total Debt	$0.0						
Capital Avl. To EH	$33.5						

Share Value	**$4.01**

Current Price	**$3.99**

Perpetuity Growth Method

Weighted Average Cost of Capital	9.93%
Growth Rate of FCF after 2012	5.00%
Terminal Value	$34
Present Value of Terminal Value	$21
Enterprise Value	$34
LESS: Debt, Minority Interest	$0
# of shares outstanding	8.35

Equity Value *(mm)*	**$34**

Current Market Value *(mm)*	**$33**

Exhibit 5: Combined Income Statement (Projected)

(in millions)	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12
INCOME STATEMENT					
Sales (Net)	42.76	85.51	88.17	90.91	93.73
y/y % change	*3.1%*	*100.0%*	*3.1%*	*3.1%*	*3.1%*
Cost of Goods Sold	34.21	68.41	69.65	70.91	72.17
% of sales	*80.0%*	*80.0%*	*79.0%*	*78.0%*	*77.0%*
Gross Profit	**8.55**	**17.10**	**18.52**	**20.00**	**21.56**
Gross margin	*20.0%*	*20.0%*	*21.0%*	*22.0%*	*23.0%*
Selling, General, & Admin Expenses	10.00	20.01	20.28	20.91	21.56
% of sales	*23.4%*	*23.4%*	*23.0%*	*23.0%*	*23.0%*
EBITDA	**-1.45**	**-2.90**	**-1.76**	**-0.91**	**0.00**
Depreciation, Depletion, & Amortiz	2.41	8.55	5.76	6.22	6.69
% of PP&E (net)	*4.5%*	*8.7%*	*6.2%*	*7.2%*	*8.4%*
EBIT	**-3.86**	**-11.45**	**-7.53**	**-7.13**	**-6.69**
Operating margin	*-9.0%*	*-13.4%*	*-8.5%*	*-7.8%*	*-7.1%*
Interest Expense	0.00	0.00	0.00	0.00	0.00
% of debt	*8.9%*	*8.9%*	*8.9%*	*8.9%*	*8.9%*
Non-Operating Income/Expense	2.45	4.89	5.05	5.20	5.36
% of sales	*5.7%*	*5.7%*	*5.7%*	*5.7%*	*5.7%*
Special Items	-0.01	-0.01	-0.01	-0.01	-0.01
% of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Pretax Income	**-1.43**	**-6.57**	**-2.49**	**-1.93**	**-1.34**
Income Taxes - Total	-0.28	-1.28	-0.49	-0.38	-0.26
% of pretax income	*19.5%*	*19.5%*	*19.5%*	*19.5%*	*19.5%*
Minority Interest	0.00	0.00	0.00	0.00	0.00
% of pretax income	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Income Before Extraordinary Items & Discontinued Operations (EI&DO)	**-1.15**	**-5.29**	**-2.01**	**-1.56**	**-1.08**
Extraordinary Items	0.00	0.00	0.00	0.00	0.00
Discontinued Operations	0.00	0.00	0.00	0.00	0.00
Net Income (Loss)	**-1.15**	**-5.29**	**-2.01**	**-1.56**	**-1.08**
Income Before EI&DO	-1.15	-5.29	-2.01	-1.56	-1.08
Preferred Dividends	0.00	0.00	0.00	0.00	0.00
Available for Common Before EI&DO	-1.15	-5.29	-2.01	-1.56	-1.08
Common Stk Equivalents - Savings	0.00	0.00	0.00	0.00	0.00
Adjusted Available for Common	-1.15	-5.29	-2.01	-1.56	-1.08
EARNINGS PER SHARE:					
Primary - Excluding EI&DO	-0.14	-0.63	-0.24	-0.19	-0.13
Primary - Including EI&DO	-0.14	-0.63	-0.24	-0.19	-0.13
Fully Diluted - Excluding EI&DO EI&DO	-0.14	-0.63	-0.24	-0.19	-0.13
Fully Diluted - Including EI&DO	-0.14	-0.63	-0.24	-0.19	-0.13
COMMON SHARES:					
for Primary EPS Calculation	8.35	8.35	8.35	8.35	8.35
for Fully Diluted EPS Calculation	8.35	8.35	8.35	8.35	8.35
Outstanding at Fiscal Year End	8.35	8.35	8.35	8.35	8.35

Exhibit 6: Combined Discounted Cash Flow Analysis

Free Cash Flow

	2008	2009	2010	2011	2012
Net Income	-1.15	-5.29	-2.01	-1.56	-1.08
Depreciation & Amortization	2.41	8.55	5.76	6.22	6.69
CapEx	0.00	0.00	0.00	0.00	0.00
Change in Net Working Capital	-1.39	-1.20	0.05	0.06	0.07
FREE CASH FLOW	**2.65**	**4.46**	**3.70**	**4.60**	**5.55**

Discounted Free Cash Flow Analysis

	'07	'08E	'09E	'10E	'11E	'12E	TV
FCF	$5.5	$2.7	$4.5	$3.7	$4.6	$5.5	$118.1
DCF	$5.5	$2.4	$3.7	$2.8	$3.1	$3.5	$73.6
EV	$94.6						
2007 Total Debt	$0.0						
Capital Avl. To EH	$94.5						

Share Value	**$5.66**

Current Price	**$3.99**

Perpetuity Growth Method

Weighted Average Cost of Capital	9.93%
Growth Rate of FCF after 2012	5.00%
Terminal Value	$118
Present Value of Terminal Value	$74
Enterprise Value	$95
LESS: Debt, Minority Interest	$0
# of shares outstanding	16.71
Equity Value *(mm)*	**$95**
Current Market Value *(mm)*	**$67**

Exhibit 7: Merger & Acquisition Activity, 1993-Present[8]

HOOK:

Capital IQ

Redhook Ale Brewery Inc. (NasdaqNM:HOOK) > Transaction Summary > M&A/Private Placements

Transaction Summary							
Announced Date	**Closed Date**	**Transaction Type**	**Role**	**Target**	**Buyer/Investors**	**Sellers**	**Size ($mm)**
Nov-13-2007	-	Merger/Acquisition	Buyer	Widmer Brothers Brewing Company	**Redhook Ale Brewery Inc. (NasdaqNM:HOOK)**	Anheuser-Busch, Inc.	50.03
1993	-	Private Placement	Target	**Redhook Ale Brewery Inc. (NasdaqNM:HOOK)**	Northwood Ventures, L.L.C.		-

* denotes proprietary relationship information.

[8] *Source: Capital IQ*

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