



GLACIER WATER SERVICES, INC.

Consolidated Financial Statements

December 30, 2007 and December 31, 2006

(With Independent Auditors' Report Thereon)

GLACIER WATER SERVICES, INC.

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KPMG LLP
Suite 1500
750 B Street
San Diego, CA 92101

Independent Auditors' Report

The Board of Directors
Glacier Water Services, Inc.:

We have audited the accompanying consolidated balance sheets of Glacier Water Services, Inc. and subsidiaries as of December 30, 2007 and December 31, 2006, and the related consolidated statements of operations, stockholders' deficit and comprehensive loss, and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Glacier Water Services, Inc. and subsidiaries as of December 30, 2007 and December 31, 2006, and the results of their operations and their cash flows for each of the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

March 26, 2008

GLACIER WATER SERVICES, INC.

Consolidated Balance Sheets

December 30, 2007 and December 31, 2006

(In thousands, except share data)

Assets	2007	2006
Current assets:		
Cash and cash equivalents	\$ 3,120	3,841
Accounts receivable, net of allowance for doubtful accounts of \$61 and \$96 as of December 30, 2007 and December 31, 2006, respectively	1,617	2,119
Repair parts	2,561	2,180
Prepaid expenses and other	1,161	1,099
Total current assets	8,459	9,239
Property and equipment, net	47,698	54,459
Goodwill	7,080	7,080
Intangible assets, net of accumulated amortization of \$1,279 and \$1,178 as of December 30, 2007 and December 31, 2006, respectively	88	151
Investment in Glacier Water Trust I Common Securities	2,629	2,629
Investment in Glacier Water Trust I Preferred Securities	3,357	3,357
Deferred financing costs, net	4,661	4,739
Other assets	465	474
Total assets	\$ 74,437	82,128
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$ 1,148	1,016
Accrued commissions	2,580	2,353
Accrued liabilities	4,386	4,237
Bank overdraft	2,068	1,750
Current portion of long-term notes payable	57	112
Current portion of deferred rent	50	52
Current portion of obligations under capital lease	—	404
Total current liabilities	10,289	9,924
Long-term debt	87,629	87,629
Long-term line of credit and notes payable	19,197	19,599
Long-term portion of deferred rent	67	111
Total liabilities	117,182	117,263
Commitments and contingencies		
Stockholders' deficit:		
Common stock, \$0.01 par value. Authorized 10,000,000 shares; issued and outstanding 2,690,568, and 2,590,405 shares at December 30, 2007 and December 31, 2006, respectively	44	43
Additional paid-in capital	19,244	22,379
Retained deficit	(29,877)	(24,999)
Treasury stock, at cost, 1,587,606 shares at December 30, 2007 and December 31, 2006	(32,562)	(32,562)
Accumulated other comprehensive income	406	4
Total stockholders' deficit	(42,745)	(35,135)
Total liabilities and stockholders' deficit	\$ 74,437	82,128

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC.

Consolidated Statements of Operations

Years ended December 30, 2007 and December 31, 2006

(In thousands, except share and per share data)

	<u>2007</u>	<u>2006</u>
Revenues	\$ 90,376	87,154
Operating costs and expenses:		
Operating expenses	56,946	53,871
Depreciation and amortization	15,835	15,829
Cost of goods sold	72,781	69,700
Selling, general, and administrative expenses	13,441	12,877
Total operating costs and expenses	86,222	82,577
Income from operations	4,154	4,577
Interest expense	9,032	9,285
Loss before income taxes	(4,878)	(4,708)
Income tax benefit	—	—
Net loss applicable to common stockholders	\$ (4,878)	(4,708)
Basic and diluted loss per share:		
Net loss applicable to common stockholders	\$ (1.85)	(1.93)
Weighted average shares used in calculation	2,642,784	2,434,114
Cash dividend per common share	\$ 1.80	0.80

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC.

Consolidated Statements of Stockholders' Deficit and Comprehensive Loss

Years ended December 30, 2007 and December 31, 2006

(In thousands, except share data)

	Preferred stock		Common stock		Additional paid-in capital	Retained deficit	Treasury stock	Accumulated other comprehensive income	Total
	Shares	Amount	Shares	Amount					
Balance, January 1, 2006	—	\$ —	2,322,766	\$ 39	21,529	(20,291)	(32,562)	17	(31,268)
Exercise of stock options	—	—	267,639	4	2,907	—	—	—	2,911
Stock compensation	—	—	—	—	12	—	—	—	12
Dividends on common stock	—	—	—	—	(2,069)	—	—	—	(2,069)
Comprehensive income/(loss):									
Net loss	—	—	—	—	—	(4,708)	—	—	(4,708)
Foreign currency translation adjustment	—	—	—	—	—	—	—	(13)	(13)
Total comprehensive loss									(4,721)
Balance, December 31, 2006	—	—	2,590,405	43	22,379	(24,999)	(32,562)	4	(35,135)
Exercise of stock options	—	—	100,163	1	1,362	—	—	—	1,363
Stock compensation	—	—	—	—	297	—	—	—	297
Dividends on common stock	—	—	—	—	(4,794)	—	—	—	(4,794)
Comprehensive income/(loss):									
Net loss	—	—	—	—	—	(4,878)	—	—	(4,878)
Foreign currency translation adjustment	—	—	—	—	—	—	—	402	402
Total comprehensive loss									(4,476)
Balance, December 30, 2007	—	\$ —	2,690,568	\$ 44	19,244	(29,877)	(32,562)	406	(42,745)

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC.

Consolidated Statements of Cash Flows

Years ended December 30, 2007 and December 31, 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Net loss applicable to shareholders	\$ (4,878)	(4,708)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	15,835	15,829
Stock option compensation expense	297	12
Loss on disposal of assets	98	81
Changes in operating assets and liabilities:		
Accounts receivable	502	(85)
Repair parts	(381)	81
Prepaid expenses and other	(62)	(49)
Cash paid for prepaid contract rights	(1,831)	(1,473)
Other assets	(275)	58
Accounts payable, accrued liabilities and accrued commissions	508	2,019
Net cash provided by operating activities	<u>9,813</u>	<u>11,765</u>
Cash flows from investing activities:		
Investment in property and equipment	<u>(6,916)</u>	<u>(6,245)</u>
Net cash used in investing activities	<u>(6,916)</u>	<u>(6,245)</u>
Cash flows from financing activities:		
Dividends	(4,794)	(2,069)
Principal payments on line of credit and long-term notes payable	(20,527)	(16,694)
Proceeds from long-term notes payable	20,070	9,135
Bank overdraft	318	1,750
Principal payments under capital lease obligations	(404)	(257)
Decrease in deferred rent	(46)	(5)
Proceeds from issuance of common stock	1,363	2,911
Net cash used in financing activities	<u>(4,020)</u>	<u>(5,229)</u>
Net (decrease) increase in cash and cash equivalents	(1,123)	291
Effect of exchange rate changes on cash and cash equivalents	402	(13)
Cash and cash equivalents, beginning of year	<u>3,841</u>	<u>3,563</u>
Cash and cash equivalents, end of year	<u>\$ 3,120</u>	<u>3,841</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 9,301	9,556
Cash paid for income taxes	24	12

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC.

Notes to Consolidated Financial Statements

December 30, 2007 and December 31, 2006

(1) The Company and a Summary of Significant Accounting Policies

(a) *Business*

Glacier Water Services, Inc., a Delaware corporation (Glacier or Company), is primarily engaged in the operation of self-service vending machines that dispense drinking water to consumers. The machines are placed at supermarkets and other retail outlets under commission arrangements with the retailers. The Company's revenues are subject to seasonal fluctuations, with decreased revenues during rainy or cold weather months and increased revenues during dry or hot weather months. The Company's machines are primarily located throughout the Sunbelt and Midwest regions of the United States. On October 3, 2005, Glacier acquired Gestion Bi-Eau Pure, Inc. (Bi-Eau Pure), a privately held water vending company headquartered in Quebec, Canada. The transaction was accounted for as a purchase, and accordingly, the results of operations have been included in the consolidated statements of operations from the date of acquisition. As of December 30, 2007, the Company operated approximately 16,300 machines in 43 states and Canada.

(b) *Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Glacier Water Services, Inc. and its wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated.

(c) *Use of Estimates*

The preparation of consolidated financial statements in conformity with United States generally accepted accounting principles requires that management make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. These estimates and assumptions include, but are not limited to, assessing the following: the recoverability of accounts receivable, repair parts, property and equipment, goodwill and intangible assets, accrued liabilities, deferred tax assets, and the ability to estimate accrued revenues.

(d) *Fiscal Year*

The Company utilizes a fiscal year of 52 or 53 weeks ending on the Sunday closest to December 31. Fiscal year 2007 ended on December 30, 2007 and fiscal year 2006 ended on December 31, 2006 and consisted of 52 weeks or 364 days.

(e) *Other Comprehensive Loss*

Components of other comprehensive loss include net loss and foreign currency translation adjustments.

(f) *Cash and Cash Equivalents*

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. As of December 30, 2007, cash equivalents consist primarily of cash held

GLACIER WATER SERVICES, INC.

Notes to Consolidated Financial Statements

December 30, 2007 and December 31, 2006

in money market accounts and/or certificates of deposit. The Company's policy is to place its cash with high credit quality financial institutions in order to limit the amount of credit exposure.

(g) Investments

The Company holds investments in Trust Common Securities of \$2,629,000 and Trust Preferred Securities of \$3,357,000 as long-term assets at December 30, 2007 and at December 31, 2006 as discussed in note (4a). Investments are accounted for in accordance with Financial Accounting Standards Board (FASB) Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which requires that the Company determine the appropriate classification of investments at the time of purchase based on management's intent and reevaluate such designation as of each balance sheet date. The Trust Preferred Securities are classified as investments being held-to-maturity and, therefore, stated at amortized cost as the Company has the ability and intent to hold the debt securities to the maturity date in 2028.

(h) Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, other current assets and all current liabilities approximate their fair value because of the short-term nature of those instruments. The Company's long-term debt at December 30, 2007 consists of the Trust Preferred Securities, and the long-term notes payable that consist of amounts due in connection with the Bi-Eau Pure acquisition and amounts outstanding under the Company's credit facility (see note 4). The market value of the Trust Preferred Securities at December 30, 2007 and December 31, 2006 was approximately \$84,830,000 and \$84,500,000, respectively. The carrying value of the Company's Trust Preferred Securities was approximately \$85,000,000 at December 30, 2007 and December 31, 2006. The carrying value of the Company's long-term notes payable, including any current portion, was approximately \$19,254,000 and \$19,711,000 at December 30, 2007 and December 31, 2006, respectively. The carrying value of the long-term notes payable approximates the fair value since their terms are equivalent to those generally available in the market place. The Company has no long-term obligations under capital leases as of December 30, 2007, compared to long-term obligations under capital leases with a carrying value of \$404,000 as of December 31, 2006.

(i) Repair Parts

Repair parts consist of machine parts used to maintain vending machines in operation and are stated at cost (moving weighted average). Repair parts consist of operating components that are used to replace or refurbish components installed in vending machines, thereby maintaining the overall life of the vending machine at its estimated useful life.

(j) Long-Lived Assets

The Company evaluates and assesses its long-lived assets for impairment under the guidelines of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Statement of Financial Accounting Standards (SFAS) No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of a Disposal of a Segment of a*

GLACIER WATER SERVICES, INC.

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Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business (as previously defined in that opinion). The Company periodically assesses triggering events for the impairment of long-lived assets. The impairment analysis requires the use of assumptions and judgments regarding the carrying value and estimated lives of these assets. For the years ended December 30, 2007 and December 31, 2006, there has been no impairment of long-lived assets recorded.

(k) Property and Equipment and Depreciation

Property and equipment are recorded at cost and consist of the following (in thousands):

	December 30, 2007	December 31, 2006
Vending equipment	\$ 141,343	138,382
Equipment, furniture and fixtures	3,548	4,440
Land	82	69
Building	777	655
Leasehold improvements	79	73
Capital lease assets	—	1,225
	145,829	144,844
Less accumulated depreciation and amortization	(98,131)	(90,385)
	\$ 47,698	54,459

Depreciation is provided using the straight-line method over the estimated useful lives of the assets as follows:

Vending equipment	13 years
Equipment, furniture, and fixtures	3 to 10 years
Leasehold improvements	Shorter of life of asset or remaining lease term
Capital leases	Shorter of life of asset or remaining lease term

The Company's vending equipment was depreciated using a 10% estimated salvage value during fiscal years 2007 and 2006. Costs associated with installing vending equipment are capitalized and depreciated over five years, which is the normal contractual period with the retailers. All maintenance, repair and minor refurbishment costs are charged to operations as incurred. Additions and major improvements are capitalized. Certain long-term repair parts are classified as vending equipment and are depreciated over a 3, 5, or 10 year estimated useful life. Costs associated with the assembly of vending machines are accumulated until finished machines are ready for installation at a retail location, at which time the costs are transferred to property and equipment. As of December 30, 2007 and December 31, 2006, there was \$70,000 and \$0, respectively, of new vending machines in the process of assembly. The Company currently has sufficient machines in storage available for deployment in fiscal 2008. Machines that have been previously installed and are in storage awaiting redeployment are currently being depreciated.

GLACIER WATER SERVICES, INC.

Notes to Consolidated Financial Statements
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(l) Other Assets

Included in other assets are prepaid contract rights, which consist of fees paid to retailers for future benefits associated with the ongoing placement of the Company's vending equipment at those locations. These fees are amortized over the life of the contract, generally ranging from three to five years. At December 30, 2007, prepaid contract rights in the amount of \$335,000 were included in other assets as compared to \$347,000 at December 31, 2006. For the years ended December 30, 2007 and December 31, 2006, \$2,079,000 and \$1,895,000, respectively, is included in depreciation and amortization.

Also included in other assets are net deferred financing costs for the years ended December 30, 2007 and December 31, 2006 of \$2,622,000 and \$2,665,000, respectively, which were incurred in connection with the original issue of the Trust Preferred Securities discussed in note 4 and are amortized using the effective interest method over the period ending January 2028, the date of the mandatory redemption of the securities. Additional net deferred financing costs for the years ended December 30, 2007 and December 31, 2006 of \$2,039,000 and \$2,074,000, respectively, associated with the Exchange Offer discussed in note 4 are also included in other assets and are also amortized using the effective interest method through the period ending January 2028.

(m) Revenue Recognition

The Company recognizes revenue from the sale of its product at the point of purchase, which occurs when the customer vends the water and pays for the product. Due to the fact that the Company has approximately 16,300 vending machines, it is impractical to visit all machines at the end of each reporting period. Consequently, the Company estimates the revenue from the last time each machine was serviced until the end of the reporting period, based on the most current daily volume of each machine. For the years ended December 30, 2007 and December 31, 2006, the Company recorded approximately \$2,408,000 and \$2,115,000, respectively, of such estimated revenues, which represent an average of approximately 10 days per machine in both years.

(n) Segment and Geographic Reporting

Glacier operates in a single business segment providing high quality, low priced drinking water dispensed to consumers through self-service vending machines and containers sold to retailers for resale. As of December 30, 2007, the Company operated approximately 16,300 machines in 43 states and Canada.

(o) Income Taxes

Deferred tax liabilities and assets reflect the net tax effects, using enacted tax rates in effect for the year in which the differences are expected to reverse, of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

GLACIER WATER SERVICES, INC.

Notes to Consolidated Financial Statements

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(p) *Stock Based Compensation*

The Company had an employee stock-based compensation plan, which is described more fully in note 8. The Company's Stock Option Program expired in March 2004 and no options have been issued since that time.

Effective January 2, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment*, which replaces SFAS No. 123, *Accounting for Stock-Based Compensation* and supersedes Accounting Principles Board Opinion No. 25 (APB Opinion No. 25), *Accounting for Stock Issued to Employees*. Under the fair value recognition provisions of SFAS No. 123R, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period, or the vesting period. The Company elected the modified prospective method in implementing SFAS No. 123R, which does not require a revision to prior period financial statements for comparative purposes. The adoption of SFAS No. 123R had no material impact on the Company's consolidated financial statements.

The fair value of the stock options granted is recognized to expense over the requisite service period. There were no stock options granted after the SFAS No. 123R effective date of January 2, 2006. For stock options granted prior to January 2, 2006, which continued to vest in 2006 and 2007, the Company will continue to record expenses using the straight-line method.

The Company granted a one-time performance based restricted stock grant to members of management on January 26, 2007. The grant consists of 85,000 restricted shares of common stock, the vesting of which is subject to achieving specific earning targets in 2011. As of December 30, 2007, there were 77,500 shares outstanding. The grant of the restricted stock is accounted for under SFAS No. 123R, resulting in estimated compensation cost of \$1,579,000, which will be recognized as an expense straight line over the requisite service period of five years.

During fiscal year 2007 and 2006, the Company recorded total stock compensation expenses of \$297,000 and \$12,000, respectively.

(q) *Recent Accounting Pronouncements*

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value on a contract-by-contract basis. SFAS No. 159 applies to all reporting entities and contains financial statement presentation and disclosure requirements for assets and liabilities reported at fair value as a consequence of the election. SFAS No. 159 becomes effective at the beginning of 2008. The impact of adoption of SFAS No. 159 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 sets out a framework for measuring fair value and requires additional disclosures about fair-value measurements. SFAS No. 157 becomes effective at the beginning of 2008. The impact of adopting SFAS No. 157 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

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In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*. Interpretation No. 48 applies to all tax positions accounted for under SFAS No. 109, *Accounting for Income Taxes*, including tax positions acquired in a business combination. Interpretation No. 48 was effective at the beginning of 2008. Management believes the impact of adopting Interpretation No. 48 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

(r) Loss Per Common Share

Basic earnings per share are computed based upon the weighted average number of common shares outstanding during the period. Diluted earnings per share are based upon the weighted average number of common shares outstanding and potentially dilutive securities during the period.

Potentially dilutive securities include shares issuable in connection with options granted under the Company's stock option plans using the treasury stock method. For fiscal years 2007 and 2006, a total of 183,560 and 235,728 potentially dilutive securities, respectively, were not used to calculate diluted loss per share because of their anti-dilutive effect.

	December 30, 2007	December 31, 2006
	(In thousands, except share and per share data)	
Numerator for basic earnings per share – net loss applicable to common shareholders	\$ (4,878)	(4,708)
Denominator – shares:		
Weighted average common shares for basic loss per share	2,642,784	2,434,114
Dilutive potential shares for diluted loss per share	2,642,784	2,434,114
Loss per share:		
Basic and dilutive loss applicable to common shareholders	\$ (1.85)	(1.93)

(2) Acquisitions

On February 8, 2002, Glacier acquired substantially all of the assets of the Pure Fill Corporation and its wholly owned subsidiaries, National Water Services, Pure Fill Finance Corporation and Pure Fill Container Corporation, (collectively, Pure Fill) for a purchase price of \$6,064,000. The excess of purchase price over acquired net assets was \$4,129,000 and is classified as goodwill.

On October 7, 2003, Glacier acquired Water Island, Inc. (Water Island) for a purchase price of \$6,068,000. The excess of purchase price over acquired net assets was \$2,739,000 and is classified as goodwill.

On October 3, 2005, the Company acquired 100% of the outstanding common stock of Gestion Bi-Eau Pure Management, Inc. for a purchase price of approximately \$1,179,000 in cash and \$65,000 payable on

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each of the first and second anniversaries of the acquisition and \$43,000 payable on January 1, 2007 and January 1, 2008 for a total purchase price of \$1,395,000. Gestion Bi-Eau Pure Management, Inc. was a privately held company headquartered in Montreal, Canada. This acquisition was consummated principally to expand the Company's water vending operations and customer base in Canada. The transaction was accounted for as a purchase, and accordingly, the results of operations have been included in the consolidated statements of operations from the date of acquisition. The allocation of fair values of assets and liabilities was based upon a third party appraisal. The excess of purchase price over acquired net assets was \$212,000 and is classified as goodwill. Intangible assets of \$99,000 and \$79,000 were assigned to registered trademarks and contracts, respectively (collectively, Bi-Eau Pure Intangible Assets). The Bi-Eau Pure Intangible Assets are subject to amortization and have a weighted average useful life of four years. For the years ended December 30, 2007 and December 31, 2006, the Company recorded amortization of \$49,000 and \$56,000, respectively, related to the Bi-Eau Pure Intangible Assets. The transaction was financed with cash on hand and borrowings under the Company's credit facility.

The Company estimates that amortization expense related to Pure Fill, Water Island, and Bi-Eau Pure intangible assets to be \$35,000, \$20,000, \$20,000, and \$15,000 for the fiscal years 2008 through 2011.

(3) Supplementary Balance Sheet Information

(a) Other Assets

Other assets consist of the following (in thousands):

	December 30, 2007	December 31, 2006
Prepaid contract rights, net	\$ 335	347
Other	130	127
Total other assets	\$ 465	474

(b) Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	December 30, 2007	December 31, 2006
Accrued compensation, benefits and related taxes	\$ 2,103	2,340
Accrued property, sales, income and other taxes	336	221
Accrued interest	424	464
Accrued dividends	1,345	1,038
Other accrued liabilities	178	174
Total accrued liabilities	\$ 4,386	4,237

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Notes to Consolidated Financial Statements
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(4) Long-Term Debt, Line of Credit and Notes Payable

(a) *Company Obligated Mandatorily Redeemable Preferred Securities*

On January 27, 1998, Glacier Water Trust I (the Trust), a newly created Delaware business trust and a wholly owned subsidiary of the Company, issued 105,154 common securities to the Company and completed a public offering of 3,400,000 of 9.0625% Cumulative Trust Preferred Securities with a liquidation amount of \$25.00 per security (the Trust Preferred Securities and together with the common securities, the Trust Securities). The Subordinated Debentures mature on January 31, 2028 but may be redeemed at the option of the Company at any time since January 31, 2003. The Trust exists for the sole purpose of issuing Trust Securities and purchasing Subordinated Debentures. Concurrent with the issuance of such securities, the Trust invested the proceeds therefrom in an aggregate principal amount of \$85,000,000 of 9.0625% Junior Subordinated Debentures issued by the Company.

Pursuant to an Exchange Offer, which commenced on February 26, 2003 and expired on April 11, 2003, a total of 983,880 shares of Common Stock were exchanged for a total of 787,105 Trust Preferred Securities at a ratio of one share of Common Stock for eight-tenths of a Trust Preferred Security. The Exchange Offer increased long-term debt by approximately \$19,678,000, which represents the total liquidation value of the 787,105 Trust Preferred Securities.

The Trust is considered a variable interest entity under FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R). Prior to FIN 46R, variable interest entities were generally consolidated by an enterprise when the enterprise had a controlling financial interest through ownership of a majority voting interest in the entity. Under FIN 46R, a variable interest entity should be consolidated by its primary beneficiary. Because the Company is not the primary beneficiary of the Trust, the financial statements of the Trust are no longer included in the consolidated financial statements of the Company. FIN 46R may be adopted either by recording a cumulative effect adjustment as of the date of the adoption, or restating prior period financial statements. The Company opted to restate prior period financial statements. As a result of the deconsolidation, the Company has recorded its ownership of 105,154 Common Trust Securities of the Trust and its ownership of 134,295 shares of Trust Preferred Securities as long-term assets and has recorded the Junior Subordinated Debentures as long-term debt at a face value of \$87,629,000. At December 30, 2007 and December 31, 2006, there were 3,265,705 Trust Preferred Securities outstanding (other than the 134,295 held by the Company).

(b) *Line of Credit and Notes Payable*

On August 1, 2007, City National Bank modified its credit facility with the Company to \$27,000,000 from the \$30,000,000 established on June 30, 2005. The other modification was that the credit availability on the revised revolving credit facility, which was scheduled to be reduced by \$1,500,000 every three months beginning July 1, 2007 until its maturity in December 2010, was moved to beginning July 1, 2008 until its maturity in December 2010. The revised credit facility requires monthly interest payments at City National Bank's prime rate less 0.25% (7.00% per annum at December 30, 2007 and 8.00% per annum at December 31, 2006). The revolving credit facility requires a quarterly unused facility fee of 0.125% per annum and continues to contain certain customary financial covenants, which restrict indebtedness and capital expenditures. The Company

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pledged certain assets such as repair parts and equipment as collateral for its obligations under the credit facility. The Company was in compliance at December 30, 2007 and at December 31, 2006 with all covenants under this credit facility. As of December 30, 2007 and December 31, 2006, there was \$19,195,000 and \$19,550,000 outstanding on the credit facility, respectively, which is included in long-term notes payable. Availability under the \$27,000,000 revolving credit facility was \$7,805,000 as of December 30, 2007, and at December 31, 2006, under the \$30,000,000 revolving credit facility, there was \$10,450,000 available. In addition, the Company had \$59,000 and \$101,000 at December 30, 2007 and December 31, 2006, respectively, of notes payable associated with the Bi-Eau Pure subsidiary in Canada.

(5) Commitments and Contingencies

(a) Leases

The Company leases certain vehicles, warehouse and office facilities under noncancelable operating leases that expire on various dates through 2012. The Company leases the corporate office located in Vista, California and other facilities that have terms that include annual rate increases, and as such, the Company has recorded a deferred rent liability of \$117,000 as of December 30, 2007.

Future minimum lease payments under noncancelable operating leases with initial terms of one or more years are as follows (in thousands):

Fiscal year:		
2008	\$	1,011
2009		798
2010		308
2011		178
2012		108
		<hr/>
Total minimum lease payments	\$	<u>2,403</u>

A capital lease payment of \$404,000 was made in early 2007 to retire the Company's one capital lease outstanding at the end of 2006.

Total lease expense for the years ended December 30, 2007 and December 31, 2006 was \$1,924,000 and \$1,767,000, respectively.

(b) Contingencies

The Company is involved in various legal proceedings and claims arising in the ordinary course of business, none of which, in the opinion of management, is expected to have a material effect on the Company's consolidated financial position, results of operations or liquidity.

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(6) Income Taxes

Deferred tax liabilities and assets result from the following (in thousands):

	December 30, 2007	December 31, 2006
Deferred tax liabilities:		
Property and equipment	\$ 7,678	8,890
Deferred tax assets:		
Alternative minimum tax credit	(1,070)	(1,070)
Net operating loss	(16,061)	(17,059)
Manufacturer's investment credit	(100)	(654)
Accruals and reserves	(524)	(295)
Other, net	(79)	(84)
Total gross deferred tax assets	(17,834)	(19,162)
Valuation allowance	10,156	10,272
Total deferred tax assets, net	(7,678)	(8,890)
Net deferred tax liabilities	\$ —	—

The Company's effective income tax rate differs from the federal statutory rate as follows:

	Fiscal years ended	
	December 30, 2007	December 31, 2006
Federal statutory rate	(34.0)%	(34.0)%
State and local taxes, net of federal benefit	0.2	0.2
Other, net	0.5	0.5
Change in valuation allowance	33.3	33.3
Effective rate	—%	—%

The realization of deferred tax assets is dependent upon the Company's ability to generate taxable income in future years. Based on risk factors and net operating loss carryforwards, realization cannot be assured. Management believes it is not more likely than not that the deferred tax asset will be realized and, therefore, has recorded a valuation allowance for the net balance as of December 30, 2007 and December 31, 2006.

At December 30, 2007, the Company had federal and California income tax net operating loss carryforwards of \$50,508,000 and \$12,644,000, respectively, which will begin to expire in 2012 and 2013 for U.S. federal and state income tax purposes, respectively. The alternative minimum tax credit does not have an expiration date and the remaining portion of the Manufacturer's investments credit will begin to expire in 2008.

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(7) Stockholders' Equity

The board of directors has authorized the purchase of up to 750,000 shares of the Company's common stock in the open market. As of December 30, 2007, 603,726 shares had been repurchased under this program. No shares were acquired in 2007. As of December 30, 2007, there were 1,587,606 shares of common stock held in treasury. As of December 30, 2007, the Company is authorized to repurchase an additional 146,274 shares, approximately 5.4% of the Company's total shares outstanding.

The Company declared the following cash dividends to holders of the Company's common stock:

<u>Declared date</u>	<u>Record date</u>	<u>Payment date</u>	<u>Dividend per common share</u>	<u>Dividend amount</u>	<u>Dividend type</u>
9/25/2006	10/16/2006	10/30/2006	\$ 0.40	1,032,000	Reduction of additional paid-in capital
11/26/2006	1/16/2007	1/30/2007	0.40	1,038,000	Reduction of additional paid-in capital
3/20/2007	4/16/2007	4/30/2007	0.40	1,042,000	Reduction of additional paid-in capital
6/28/2007	7/16/2007	7/30/2007	0.40	1,066,000	Reduction of additional paid-in capital
9/13/2007	10/16/2007	10/30/2007	0.50	1,342,000	Reduction of additional paid-in capital
12/7/2007	1/16/2008	1/30/2008	0.50	1,345,000	Reduction of additional paid-in capital *

* payment made on January 30, 2008

(8) Stock Option Plans

The Company has options outstanding under the 1994 Stock Compensation Program (the Program). The Program was terminated in 2004. For the fiscal year ended December 31, 2006, the Company accounted for this plan under APB Opinion No. 25 under which no compensation cost was recognized, since the exercise price of the option was not less than the market price of the stock on the grant date. Effective January 2, 2006, the Company adopted SFAS No. 123R under which compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period, or the vesting period as described in note 1(p).

The Program provided for the issuance of incentive and nonqualified stock options to key employees, including directors and consultants. Incentive stock options were granted at no less than the fair market value on the date of the grant. Nonqualified options were granted at prices determined by the board of directors, but at no less than 85% of the fair market value on the date of the grant. Options generally have a term of 10 years and become exercisable at a rate of 25% per annum. Supplemental options granted to

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directors for their services in lieu of cash fees have a term of five years and become exercisable one year following the date of the grant.

A summary of the status of the Company's stock option plans and activity is as follows:

	Shares	Weighted average exercise price
Balance as of January 1, 2006	581,802	\$ 11.47
Exercised	(267,639)	10.88
Canceled	(1,500)	18.62
	312,663	12.07
Outstanding at December 31, 2006		
Exercised	(100,163)	13.62
Canceled	(11,750)	20.17
	200,750	10.82
Outstanding at December 30, 2007		

There are 200,750 options outstanding under the 1994 Stock Option Plan at December 30, 2007 with exercise prices between \$7.95 and \$26.50, with a weighted average exercise price of \$10.82 and a weighted average remaining contractual life of three years. At December 30, 2007, all of these options are exercisable, and their weighted average exercise price is \$10.82.

The Company granted a one-time performance based restricted stock grant to members of management on January 26, 2007. The grant consists of 85,000 restricted shares of common stock, the vesting of which being subject to achieving specific earning targets in 2011. As of December 30, 2007, there were 77,500 shares outstanding. The grant of the restricted stock is accounted for under SFAS No. 123R resulting in estimated total compensation cost of \$1,579,000, which will be recognized as an expense straight line over the requisite service period of five years. The remaining unamortized balance as of December 30, 2007 was \$1,283,000.

The significant assumptions relating to the compensation cost for the 12 months ended December 30, 2007 as a result of the valuation of the restricted stock grant were as follows:

Dividend yield	—%
Volatility	53.1
Risk-free interest rate	4.8
Expected Term (years)	4.9

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(9) 401(k) Savings Plan

The Company has a 401(k) Savings Plan (the Plan), which allows eligible employees to contribute a percentage of their pre-tax compensation (subject to annual limitations of the lesser of 60% of eligible compensation or \$15,000 in calendar year 2007), with the Company making discretionary matching contributions as determined each year by the plan administrator. Employees vest immediately in their contributions and vest in the Company discretionary matching contributions over a five-year period of service. The Company's discretionary matching contributions were approximately \$228,000 and \$93,000 for fiscal years 2007 and 2006, respectively.

(10) Significant Customers

The following table sets forth the customers that represent 10% or more of the Company's total revenues in fiscal years 2007 and 2006, after the effect of any consolidations that occurred as a result of any acquisition or mergers by the retailers:

	Fiscal years ended	
	December 30, 2007	December 31, 2006
Company A	13.43%	13.08%
Company B	10.30	10.67

(11) Related Party Transactions

The Company has used Kayne Anderson Capital Advisors, L.P. to manage the Company's investments during fiscal 2007 and 2006. One board member is currently employed as a senior executive of Kayne Anderson Capital Advisors, L.P. and is a shareholder of the Company. The Company incurred no costs during fiscal 2007 and 2006 to Kayne Anderson Capital Advisors, L.P. in connection with investment management fees.