



GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Consolidated Financial Statements

December 28, 2008 and December 30, 2007

(With Independent Auditors' Report Thereon)

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

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KPMG LLP
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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 28, 2008 and December 30, 2007, and the related consolidated statements of operations, stockholders' deficit and comprehensive loss, and cash flows for 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 28, 2008 and December 30, 2007, and the results of their operations and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

March 27, 2009

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 28, 2008 and December 30, 2007

(In thousands, except share data)

Assets	2008	2007
Current assets:		
Cash and cash equivalents	\$ 3,268	3,120
Accounts receivable, net of allowance for doubtful accounts of \$63 and \$61 as of December 28, 2008 and December 30, 2007, respectively	1,678	1,617
Repair parts	2,778	2,561
Prepaid expenses and other	1,009	1,161
Total current assets	8,733	8,459
Property and equipment, net	44,460	47,698
Goodwill	7,080	7,080
Intangible assets, net of accumulated amortization of \$1,207 and \$1,279 as of December 28, 2008 and December 30, 2007, respectively	43	88
Investment in Glacier Water Trust I Common Securities	2,629	2,629
Investment in Glacier Water Trust I Preferred Securities	3,648	3,357
Deferred financing costs, net	4,575	4,661
Other assets	865	465
Total assets	\$ 72,033	74,437
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$ 1,304	1,148
Accrued commissions	2,947	2,580
Accrued liabilities	2,802	4,443
Bank overdraft	1,897	2,068
Current portion of deferred rent	55	50
Total current liabilities	9,005	10,289
Long-term debt	87,629	87,629
Long-term line of credit and notes payable	26,263	19,197
Long-term portion of deferred rent	11	67
Total liabilities	122,908	117,182
Commitments and contingencies		
Stockholders' deficit:		
Common stock, \$0.01 par value. Authorized 10,000,000 shares; issued and outstanding 2,711,473, and 2,690,568 shares at December 28, 2008 and December 30, 2007, respectively	44	44
Additional paid-in capital	15,832	19,244
Retained deficit	(34,104)	(29,877)
Treasury stock, at cost, 1,587,606 shares at December 28, 2008 and December 30, 2007	(32,562)	(32,562)
Accumulated other comprehensive income (loss)	(85)	406
Total stockholders' deficit	(50,875)	(42,745)
Total liabilities and stockholders' deficit	\$ 72,033	74,437

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended December 28, 2008 and December 30, 2007

(In thousands, except share and per share data)

	<u>2008</u>	<u>2007</u>
Revenues	\$ 94,711	90,376
Operating costs and expenses:		
Operating expenses	60,703	56,946
Depreciation and amortization	15,569	15,835
Cost of goods sold	76,272	72,781
Selling, general, and administrative expenses	14,202	13,441
Total operating costs and expenses	90,474	86,222
Income from operations	4,237	4,154
Other expenses (income):		
Interest expense	8,583	9,032
Gain on early retirement of debt	(119)	—
Total other expense	8,464	9,032
Loss before income taxes	(4,227)	(4,878)
Income tax benefit	—	—
Net loss applicable to common stockholders	\$ (4,227)	(4,878)
Basic and diluted loss per share:		
Net loss applicable to common stockholders	\$ (1.56)	(1.85)
Weighted average shares used in calculation	2,702,790	2,642,784
Cash dividend per common share	\$ 1.50	1.80

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Deficit and Comprehensive Loss
Years ended December 28, 2008 and December 30, 2007
(In thousands, except share data)

	Preferred stock		Common stock		Additional paid-in capital	Retained deficit	Treasury stock	Accumulated other comprehensive income (loss)	Total
	Shares	Amount	Shares	Amount					
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)
Exercise of stock options	—	—	20,905	—	325	—	—	—	325
Stock compensation	—	—	—	—	324	—	—	—	324
Dividends on common stock	—	—	—	—	(4,061)	—	—	—	(4,061)
Comprehensive income/(loss):									
Net loss	—	—	—	—	—	(4,227)	—	—	(4,227)
Foreign currency translation adjustment	—	—	—	—	—	—	—	(491)	(491)
Total comprehensive loss									(4,718)
Balance, December 28, 2008	—	\$ —	2,711,473	\$ 44	15,832	(34,104)	(32,562)	(85)	(50,875)

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 28, 2008 and December 28, 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Net loss applicable to shareholders	\$ (4,227)	(4,878)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	15,569	15,835
Stock option compensation expense	324	297
Loss on disposal of assets	19	98
Gain on early retirement of debt	(119)	—
Changes in operating assets and liabilities:		
Accounts receivable	(62)	502
Repair parts	(217)	(381)
Prepaid expenses and other	152	(62)
Cash paid for prepaid contract rights	(2,165)	(1,831)
Other assets	465	(275)
Accounts payable, accrued liabilities, and accrued commissions	(1,064)	508
Net cash provided by operating activities	<u>8,675</u>	<u>9,813</u>
Cash flows from investing activity:		
Investment in property and equipment	<u>(10,919)</u>	<u>(6,916)</u>
Net cash used in investing activity	<u>(10,919)</u>	<u>(6,916)</u>
Cash flows from financing activities:		
Dividends	(4,061)	(4,794)
Principal payments on line of credit and long-term notes payable	(21,879)	(20,527)
Proceeds from long-term notes payable	28,890	20,070
Bank overdraft	(171)	318
Early retirement of long-term debt	(171)	—
Principal payments under capital lease obligations	—	(404)
Decrease in deferred rent	(50)	(46)
Proceeds from issuance of common stock	325	1,363
Net cash provided by (used in) financing activities	<u>2,883</u>	<u>(4,020)</u>
Net increase (decrease) in cash and cash equivalents	639	(1,123)
Effect of exchange rate changes on cash and cash equivalents	(491)	402
Cash and cash equivalents, beginning of year	<u>3,120</u>	<u>3,841</u>
Cash and cash equivalents, end of year	<u>\$ 3,268</u>	<u>3,120</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 8,623	9,301
Cash paid for income taxes	45	24

See accompanying notes to consolidated financial statements.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 28, 2008 and December 30, 2007

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

(a) *Business*

Glacier Water Services, Inc. and subsidiaries (Glacier or Company), a Delaware corporation, 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. The Company also has a wholly owned subsidiary that operates in Eastern Canada as Gestion Bi-Eau Pure, Inc. As of December 28, 2008, the Company operated approximately 17,200 machines in 42 states and Canada.

(b) *Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Glacier Water Services, Inc. and subsidiaries 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 2008 ended on December 28, 2008 and fiscal year 2007 ended on December 30, 2007 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 28, 2008, cash equivalents consist primarily of cash held 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.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

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December 28, 2008 and December 30, 2007

(g) *Investments*

The Company holds investments in Glacier Water Trust I Common Securities of \$2,629,000 at December 28, 2008 and December 30, 2007, and Glacier Water Trust I Preferred Securities of \$3,648,000 and \$3,357,000 at December 28, 2008 and December 30, 2007, respectively, as long term-assets, as discussed in note 3(a). 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.

The Company follows FASB Staff Position (FSP) FAS Nos. 115-1 and 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other than temporary, and on measuring such impairment loss. The Company uses various indicators in determining whether a security is other-than-temporarily impaired, including for debt securities, when it is probable that the contractual interest and principal will not be collected. The debt securities are monitored for changes in credit ratings. Adverse changes in credit ratings could affect the estimated cash flows of the underlying collateral or issuer.

(h) *Fair Value of Financial Instruments*

On December 31, 2007, the Company adopted certain provisions of SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 provides a single definition of fair value and a common framework for measuring fair value as well as new disclosure requirements for fair value measurements used in financial statements. SFAS 157 applies to reported balances that are required or permitted to be measured at fair value under existing pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

In February 2008, the FASB issued Staff Position "Effective Date of FASB Statement No. 157" (FSP No. 157-2), which delayed the adoption date until January 1, 2009 for non-financial assets and liabilities that are measured at fair value on a non-recurring basis, such as goodwill and identifiable intangible assets. The Company does not expect the adoption of the SFAS 157 for non-financial assets and liabilities to have a material impact on our consolidated financial position or results of operations.

On December 31, 2007, the Company also adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which permits companies to choose to measure many financial instruments and certain other items at fair value. However, the Company has not elected to measure any additional financial instruments or other items at fair value under the provisions of this standard.

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated

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amounts. Also, there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values. For fair value disclosure purposes, the Company utilized certain fair value measurement criteria as required under SFAS No. 157 and explained above.

The carrying amounts of our 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 fair value of the Company's investment securities held-to-maturity, (see note 3) are based on using "observable inputs", or if available, quoted market prices (considered to be Level 1 inputs in accordance with SFAS No. 157). The recorded carrying value for the held Glacier Water Trust I Common Securities of \$2,629,000 at December 28, 2008 and December 30, 2007 approximate its fair value. The fair value of the Company held portion of the Glacier Water Trust I Preferred Securities, determined by market prices, was \$2,627,000 and \$3,351,000 at December 28, 2008 and December 30, 2007, respectively, with a carrying value of \$3,648,000 and \$3,357,000 at December 28, 2008 and December 30, 2007, respectively.

The Company's long-term debt at December 28, 2008 and December 30, 2007 consists of the Glacier Water Trust I Common Securities and the Glacier Water Trust I Preferred Securities, and amounts outstanding under the Company's credit facility (see note 3). The carrying value for the Glacier Water Trust I Common Securities long-term debt of \$2,629,000 at December 28, 2008 and December 30, 2007 approximates its fair value. The fair value of the Glacier Water Trust I Preferred Securities long-term debt, determined by market prices, at December 28, 2008 and December 30, 2007 was approximately \$61,200,000 and \$84,830,000, respectively, with a carrying value of approximately \$85,000,000 at December 28, 2008 and December 30, 2007. The carrying value of the Company's long-term notes payable, including any current portion, was approximately \$26,265,000 and \$19,254,000 at December 28, 2008 and December 30, 2007, 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.

(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 Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

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December 28, 2008 and December 30, 2007

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 28, 2008 and December 30, 2007, 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):

	<u>December 28, 2008</u>	<u>December 30, 2007</u>
Vending equipment	\$ 150,558	141,343
Equipment, furniture, and fixtures	3,657	3,548
Land	66	82
Building	624	777
Leasehold improvements	79	79
	154,984	145,829
Less accumulated depreciation and amortization	<u>(110,524)</u>	<u>(98,131)</u>
	<u>\$ 44,460</u>	<u>47,698</u>

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

Vending equipment	5 to 13 years
Equipment, furniture, and fixtures	3 to 10 years
Leasehold improvements	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 2008 and 2007. 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 28, 2008 and December 30, 2007, there was \$252,000 and \$70,000, respectively, of new vending machines in the process of assembly. The Company currently has sufficient machines in storage available for deployment in fiscal 2009. Machines that have been previously installed and are in storage awaiting redeployment are currently being depreciated.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 28, 2008 and December 30, 2007

(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 a few months to five years. At December 28, 2008, prepaid contract rights in the amount of \$715,000 were included in other assets as compared to \$335,000 at December 30, 2007. For the years ended December 28, 2008 and December 30, 2007, \$1,785,000 and \$2,079,000, respectively, is included in depreciation and amortization.

Also included in other assets are net deferred financing costs for the years ended December 28, 2008 and December 30, 2007 of \$2,574,000 and \$2,622,000, respectively, which were incurred in connection with the original issue of the Trust Preferred Securities discussed in note 3 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 28, 2008 and December 30, 2007 of \$2,001,000 and \$2,039,000, respectively, associated with the Exchange Offer discussed in note 3 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 at December 28, 2008 the Company had approximately 17,200 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 28, 2008 and December 30, 2007, the Company recorded approximately \$2,626,000 and \$2,408,000, respectively, of such estimated revenues, which represent an average of approximately 12 days and 10 days, respectively, per machine.

(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 28, 2008, the Company operated approximately 17,200 machines in 42 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.

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In July 2006, FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

(p) Stock Based Compensation

The Company had an employee stock-based compensation plan, which is described more fully in note 7. The Company's Stock Option Program expired in March 2004 and no options have been issued since that time.

The Company accounts for stock based compensation in accordance with 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 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 2007 and 2008, the Company will continue to record expenses using the straight-line method.

The Company has granted a performance based restricted stock grant to members of management, issued on December 3, 2008 and January 26, 2007. The grant consists of a total of 85,000 restricted shares of common stock, the vesting of which is subject to achieving specific earning targets in 2011. As of December 28, 2008, there were 82,500 shares outstanding. The grant of the restricted stock is accounted for under SFAS No. 123R, resulting in estimated compensation cost of a total of \$1,689,000, which will be recognized as an expense straight-line over the requisite service period of three years for the December 3, 2008 and five years for the January 26, 2007 issuance.

During fiscal years 2008 and 2007, the Company recorded total stock compensation expenses of \$324,000 and \$297,000, respectively.

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(q) *Recent Accounting Pronouncements*

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141(R)). SFAS 141(R) retains the fundamental requirements that purchase method of accounting be used for all business combinations, for an acquirer to be identified for each business combination, and retains the guidance for identifying and recognizing intangible assets separately from goodwill. SFAS 141(R) requires an acquirer to recognize the assets acquired, liabilities assumed and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, changes the recognition of assets acquired and liabilities assumed arising from contingencies, and changes the recognition and measurement of contingent consideration. In addition, SFAS 141(R) requires that costs incurred to effect the acquisition and restructuring costs that the acquirer expected, but is not obligated to incur, be recognized as an expense separately from the business combination. SFAS 141(R) will also require additional disclosure of information surrounding a business combination, including additional information regarding the nature and financial impact of the business combination. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company believes that the adoption of SFAS 141(R) on December 29, 2008 will not have a material impact on the consolidated financial statements.

(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.

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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 2008 and 2007, a total of 146,951 and 183,560 potentially dilutive securities, respectively, were not used to calculate diluted loss per share because of their anti-dilutive effect.

	<u>December 28,</u> <u>2008</u>	<u>December 30,</u> <u>2007</u>
	(In thousands, except share and per share data)	
Numerator for basic earnings per share – net loss applicable to common shareholders	\$ (4,227)	(4,878)
Denominator – shares:		
Weighted average common shares for basic loss per share	2,702,790	2,642,784
Dilutive potential shares for diluted loss per share	2,702,790	2,642,784
Loss per share:		
Basic and dilutive loss applicable to common shareholders	\$ (1.56)	(1.85)

(s) ***Goodwill***

SFAS No. 142, *Goodwill and Other Intangible Assets*, establishes financial accounting and reporting standards for acquired goodwill and other intangible assets. Under SFAS No. 142, goodwill and indefinite-lived intangible assets are not amortized but are reviewed at least annually for impairment. Separable intangible assets that have finite useful lives will continue to be amortized over their respective useful lives.

SFAS No. 142 requires that goodwill be tested for impairment on at least an annual basis or whenever events or changes in circumstances indicate that the carrying value of goodwill may not be recoverable. The Company completed this testing as of December 28, 2008 and concluded that no impairment existed.

(t) ***Reclassifications***

Certain prior year amounts in the financial statements have been reclassified to conform to current year presentation.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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(2) Supplementary Balance Sheet Information

(a) Other Assets

Other assets consist of the following (in thousands):

	<u>December 28, 2008</u>	<u>December 30, 2007</u>
Prepaid contract rights, net	\$ 715	335
Other	150	130
Total other assets	<u>\$ 865</u>	<u>465</u>

(b) Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	<u>December 28, 2008</u>	<u>December 30, 2007</u>
Accrued compensation, benefits and related taxes	\$ 1,853	2,103
Accrued property, sales, income and other taxes	345	336
Accrued interest	293	424
Accrued dividends	—	1,345
Other accrued liabilities	311	235
Total accrued liabilities	<u>\$ 2,802</u>	<u>4,443</u>

(3) 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.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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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 145,922 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 28, 2008 and December 30, 2007, there were 3,254,078 and 3,265,705 Trust Preferred Securities outstanding (other than the 145,922 and 134,295 held by the Company), respectively.

(b) *Line of Credit and Notes Payable*

On July 17, 2008, City National Bank modified its credit facility with the Company to \$30,000,000 from the \$27,000,000 established on August 1, 2007. 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, 2008 until its maturity in December 2010, was modified to eliminate reductions to the \$30,000,000 facility. The revised credit facility requires monthly interest payments at City National Bank's prime rate less 0.25% (3.00% per annum at December 28, 2008 and 7.00% per annum at December 30, 2007). The July 17, 2008 modification removed the unused facility fee and continues to contain certain customary financial covenants, which restrict indebtedness and the level of dividends and capital expenditures. The Company 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 28, 2008 and December 30, 2007 with all covenants under this credit facility. As of December 28, 2008 and December 30, 2007, there was \$26,263,000 and \$19,195,000 outstanding on the credit facility, respectively, which is included in long-term notes payable. Availability under the \$30,000,000 revolving credit facility was \$3,737,000 as of December 28, 2008, and at December 30, 2007, under the \$27,000,000 revolving credit facility, there was \$7,805,000 available. In addition, the Company had \$2,000 and \$59,000 at December 28, 2008 and December 30, 2007, respectively, of notes payable associated with the Bi-Eau Pure subsidiary in Canada.

(4) **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 \$67,000 as of December 28, 2008.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

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

Fiscal year:		
2009	\$	1,071
2010		465
2011		278
2012		110
		<hr/>
Total minimum lease payments	\$	<u>1,924</u>

Total lease expense for the years ended December 28, 2008 and December 30, 2007 was \$1,991,000 and \$1,924,000, respectively.

(b) Contingencies

The Company is not involved in any legal proceedings or claims as of December 28, 2008.

(5) Income Taxes

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

	<u>December 28, 2008</u>	<u>December 30, 2007</u>
Deferred tax liabilities:		
Property and equipment	\$ 6,384	7,678
Deferred tax assets:		
Alternative minimum tax credit	(1,070)	(1,070)
Net operating loss	(16,052)	(16,061)
Accruals and reserves	(634)	(524)
Other, net	(103)	(179)
	<hr/>	<hr/>
Total gross deferred tax assets	(17,859)	(17,834)
Valuation allowance	11,475	10,156
	<hr/>	<hr/>
Total deferred tax assets, net	(6,384)	(7,678)
	<hr/>	<hr/>
Net deferred tax liabilities	\$ —	—
	<hr/>	<hr/>

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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

	Fiscal year ended	
	December 28, 2008	December 30, 2007
Federal statutory rate	34.0%	34.0%
State and local taxes, net of federal benefit	—	(0.2)
Other, net	3.2	(0.5)
Change in valuation allowance	(37.2)	(33.3)
Effective rate	—%	—%

The realization of deferred tax assets is dependent upon the Company's ability to generate taxable income in future years. 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 28, 2008 and December 30, 2007.

In July 2006, the FASB issued FIN 48 which is effective for fiscal years beginning after December 15, 2006 and was implemented by the Company for the fiscal year ending December 30, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The total amount of deferred tax assets that has been adjusted and unrecognized from the implementation of FIN 48, prior to any valuation allowance adjustments, as of December 28, 2008 and December 30, 2007 is zero.

The Company is subject to taxation in the United States and Canada. The Company is currently not under examination by the Internal Revenue Service or any other taxing authority.

At December 28, 2008, the Company had federal and California income tax net operating loss carryforwards of \$43,818,000 and \$11,897,000, respectively, which will begin to expire in 2012 for U.S. federal and state income tax purposes. Deferred tax assets corresponding to such net operating losses are offset by a full valuation allowance. In addition, the Company has federal and California excess tax benefit carryovers of \$7,172,000 and \$3,246,000, respectively, related to stock option deduction windfalls that will be realized in APIC when utilized to reduce taxes paid. 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 2009.

The Company does not foresee material changes to its gross FIN 48 liability within the next twelve months.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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(6) 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 28, 2008, 603,726 shares had been repurchased under this program. No shares were acquired in 2008. As of December 28, 2008, there were 1,587,606 shares of common stock held in treasury. As of December 28, 2008, 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 during the years ended December 28, 2008 and December 30, 2007:

Declared date	Record date	Payment date	Dividend per common share	Dividend amount	Dividend type
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
3/18/2008	4/16/2008	4/30/2008	0.50	1,353,000	Reduction of additional paid-in capital
6/17/2008	7/16/2008	7/30/2008	0.50	1,353,000	Reduction of additional paid-in capital
9/9/2008	10/16/2008	10/30/2008	0.50	1,355,000	Reduction of additional paid-in capital

(7) 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 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.

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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

	<u>Shares</u>	<u>Weighted average exercise price</u>
Outstanding at December 31, 2006	\$ 312,663	12.07
Exercised	(100,163)	13.62
Canceled	(11,750)	20.17
Outstanding at December 30, 2007	200,750	10.82
Exercised	(20,905)	15.55
Canceled	—	—
Outstanding at December 28, 2008	\$ <u>179,845</u>	10.27

There are 179,845 options outstanding under the 1994 Stock Option Plan at December 28, 2008 with exercise prices between \$7.95 and \$16.13, with a weighted average exercise price of \$10.27 and a weighted average remaining contractual life of approximately two years. At December 28, 2008, all of these options are exercisable.

The Company granted a one-time performance based restricted stock grant to members of management, issued on December 3, 2008 and January 26, 2007. The grant consists of a total of 85,000 restricted shares of common stock, the vesting of which being subject to achieving specific earning targets in 2011. During the year 2007, one grant was canceled, and during 2008, a new grant was issued. As of December 28, 2008, there were 82,500 shares outstanding. The grant of the restricted stock is accounted for under SFAS No. 123R resulting in estimated cumulative total compensation cost of \$1,689,000, which will be recognized as an expense straight-line over the requisite service period of three years for the issuance on December 3, 2008 and of five years for the issuance on January 26, 2007. The remaining unamortized balance as of December 28, 2008 was \$1,070,000.

The significant assumptions relating to the compensation cost for the 12 months ended December 28, 2008 as a result of the valuation of the restricted stock grant issuances were as follows:

	December 3, 2008	January 26, 2007
Date of issuance		
Dividend yield	—%	—%
Volatility	76.3	53.1
Risk-free interest rate	0.3	4.8
Expected term (years)	3.1	4.9

GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

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(8) 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 \$15,500 in calendar year 2008), 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 \$233,000 and \$228,000 for fiscal years 2008 and 2007, respectively.

(9) Significant Customers

The following table sets forth the customers that represent 10% or more of the Company's total revenues in fiscal years 2008 and 2007, after the effect of any consolidations that occurred as a result of any acquisition or mergers by the retailers:

	Fiscal year ended	
	December 28, 2008	December 30, 2007
Company A	12.05%	13.43%
Company B	10.00	10.30

(10) Related Party Transactions

The Company has used Kayne Anderson Capital Advisors, L.P. to manage the Company's investments during fiscal years 2008 and 2007. 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 years 2008 and 2007 to Kayne Anderson Capital Advisors, L.P. in connection with investment management fees.