# GLACIER WATER SERVICES, INC. AND SUBSIDIARIES

Consolidated Financial Statements

January 3, 2010 and December 28, 2008

(With Independent Auditors' Report Thereon)

**GLACIER WATER SERVICES, INC. AND SUBSIDIARIES**

**Table of Contents**


| | Page |
|---|---|
| Independent Auditors' Report | 1 |
| Consolidated Financial Statements: | |
| Consolidated Balance Sheets at January 3, 2010 and December 28, 2008 | 2 |
| Consolidated Statements of Operations for the years ended January 3, 2010 and December 28, 2008 | 3 |
| Consolidated Statements of Stockholders' Deficit and Comprehensive Loss for the years ended January 3, 2010 and December 28, 2008 | 4 |
| Consolidated Statements of Cash Flows for the years ended January 3, 2010 and December 28, 2008 | 5 |
| Notes to Consolidated Financial Statements | 6 |

**KPMG LLP**
Suite 600
4747 Executive Drive
San Diego, CA 92121

# 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 January 3, 2010 and December 28, 2008, 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 January 3, 2010 and December 28, 2008, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

April 19, 2010

KPMG LLP, a U.S. limited liability partnership, is the U.S.
member firm of KPMG International, a Swiss cooperative.

**GLACIER WATER SERVICES, INC. AND SUBSIDIARIES**

Consolidated Balance Sheets

January 3, 2010 and December 28, 2008

(In thousands, except share data)

| **Assets** | | **2009** | **2008** |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 3,710 | 3,268 |
| Accounts receivable, net of allowance for doubtful accounts of $63 as of January 3, 2010 and December 28, 2008 | | 1,583 | 1,678 |
| Repair parts | | 3,084 | 2,778 |
| Prepaid expenses and other | | 1,381 | 1,009 |
| Total current assets | | 9,758 | 8,733 |
| Property and equipment, net | | 43,108 | 44,460 |
| Goodwill | | 7,080 | 7,080 |
| Intangible assets, net of accumulated amortization of $1,234 and $1,207 as of January 3, 2010 and December 28, 2008, respectively | | 32 | 43 |
| Investment in Glacier Water Trust I Common Securities | | 2,629 | 2,629 |
| Investment in Glacier Water Trust I Preferred Securities | | 3,648 | 3,648 |
| Deferred financing costs, net | | 4,481 | 4,575 |
| Other assets | | 762 | 865 |
| Total assets | $ | 71,498 | 72,033 |
| **Liabilities and Stockholders' Deficit** | | | |
| Current liabilities: | | | |
| Accounts payable | $ | 1,443 | 1,304 |
| Accrued commissions | | 3,823 | 2,947 |
| Accrued liabilities | | 3,576 | 2,802 |
| Bank overdraft | | 1,331 | 1,897 |
| Current portion of deferred rent | | 4 | 55 |
| Total current liabilities | | 10,177 | 9,005 |
| Long-term debt | | 87,629 | 87,629 |
| Long-term line of credit and notes payable | | 28,173 | 26,263 |
| Long-term portion of deferred rent | | 17 | 11 |
| Total liabilities | | 125,996 | 122,908 |
| Commitments and contingencies | | | |
| Stockholders' deficit: | | | |
| Preferred Stock, $0.01 par value; liquidation preference $100 per share; 8% cumulative redeemable convertible; Authorized, 100,000 shares; issued and outstanding, 0 shares at January 3, 2010 and December 28, 2008 | | — | — |
| Common stock, $0.01 par value. Authorized, 10,000,000 shares; issued and outstanding, 2,714,873 and 2,711,473 shares at January 3, 2010 and December 28, 2008, respectively | | 44 | 44 |
| Additional paid-in capital | | 12,530 | 15,832 |
| Retained deficit | | (34,799) | (34,104) |
| Treasury stock, at cost, 1,587,606 shares at January 3, 2010 and December 28, 2008 | | (32,562) | (32,562) |
| Accumulated other comprehensive income (loss) | | 289 | (85) |
| Total stockholders' deficit | | (54,498) | (50,875) |
| Total liabilities and stockholders' deficit | $ | 71,498 | 72,033 |

See accompanying notes to consolidated financial statements.

**GLACIER WATER SERVICES, INC. AND SUBSIDIARIES**

Consolidated Statements of Operations

Years ended January 3, 2010 and December 28, 2008

(In thousands, except share and per share data)

| | | 2009 | 2008 |
|---|---|---|---|
| Revenues | $ | 103,803 | 94,711 |
| Operating costs and expenses: | | | |
| Operating expenses | | 66,097 | 60,703 |
| Depreciation and amortization | | 15,166 | 15,569 |
| Cost of goods sold | | 81,263 | 76,272 |
| Selling, general, and administrative expenses | | 14,706 | 14,202 |
| Total operating costs and expenses | | 95,969 | 90,474 |
| Income from operations | | 7,834 | 4,237 |
| Other expenses (income): | | | |
| Interest expense | | 8,406 | 8,583 |
| Gain on early retirement of debt | | — | (119) |
| Total other expense | | 8,406 | 8,464 |
| Loss before income taxes | | (572) | (4,227) |
| Income taxes | | 123 | — |
| Net loss applicable to common stockholders | $ | (695) | (4,227) |
| Basic and diluted loss per share: | | | |
| Net loss per share applicable to common stockholders | $ | (0.26) | (1.56) |
| Weighted average shares used in calculation | | 2,711,836 | 2,702,790 |
| Cash dividend per common share | $ | 1.00 | 1.50 |

See accompanying notes to consolidated financial statements.

**GLACIER WATER SERVICES, INC. AND SUBSIDIARIES**

Consolidated Statements of Stockholders' Deficit and Comprehensive Loss

Years ended January 3, 2010 and December 28, 2008

(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 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) |
| Exercise of stock options | — | — | 3,400 | — | 54 | — | — | — | 54 |
| Cancellation of stock options | — | — | — | — | (997) | — | — | — | (997) |
| Stock compensation | — | — | — | — | 356 | — | — | — | 356 |
| Dividends on common stock | — | — | — | — | (2,715) | — | — | — | (2,715) |
| Comprehensive income (loss): | | | | | | | | | |
| Net loss | — | — | — | — | — | (695) | — | — | (695) |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | 374 | 374 |
| Total comprehensive loss | | | | | | | | | (321) |
| Balance, January 3, 2010 | — | $ — | 2,714,873 | $ 44 | 12,530 | (34,799) | (32,562) | 289 | (54,498) |

See accompanying notes to consolidated financial statements.

**GLACIER WATER SERVICES, INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended January 3, 2010 and December 28, 2008

(In thousands)

| | | 2009 | 2008 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net loss applicable to shareholders | $ | (695) | (4,227) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | | |
| Depreciation and amortization | | 15,166 | 15,569 |
| Deferred financing costs | | 94 | 86 |
| Stock option compensation expense | | 356 | 324 |
| Loss on disposal of assets | | 251 | 19 |
| Gain on early retirement of debt | | — | (119) |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | | 95 | (62) |
| Repair parts | | (306) | (217) |
| Prepaid expenses and other | | (372) | 152 |
| Cash paid for prepaid contract rights | | (1,696) | (2,165) |
| Other assets | | (258) | 379 |
| Accounts payable, accrued liabilities, and accrued commissions | | 1,789 | (1,064) |
| Net cash provided by operating activities | | 14,424 | 8,675 |
| Cash flows from investing activity: | | | |
| Investment in property and equipment | | (11,997) | (10,919) |
| Net cash used in investing activity | | (11,997) | (10,919) |
| Cash flows from financing activities: | | | |
| Dividends | | (2,715) | (4,061) |
| Principal payments on line of credit and long-term notes payable | | (18,605) | (21,879) |
| Proceeds from long-term notes payable | | 20,515 | 28,890 |
| Cancellation of stock options | | (997) | — |
| Bank overdraft | | (566) | (171) |
| Early retirement of long-term debt | | — | (171) |
| Decrease in deferred rent | | (45) | (50) |
| Proceeds from issuance of common stock | | 54 | 325 |
| Net cash provided by (used in) financing activities | | (2,359) | 2,883 |
| Net increase in cash and cash equivalents | | 68 | 639 |
| Effect of exchange rate changes on cash and cash equivalents | | 374 | (491) |
| Cash and cash equivalents, beginning of year | | 3,268 | 3,120 |
| Cash and cash equivalents, end of year | $ | 3,710 | 3,268 |
| Supplemental disclosures of cash flow information: | | | |
| Cash paid for interest | $ | 8,158 | 8,623 |
| Cash paid for income taxes | | 49 | 45 |

See accompanying notes to consolidated financial statements.

## (1) Summary of Significant Accounting Policies

### *(a) Description of 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 January 3, 2010, the Company operated approximately 18,300 machines in 42 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 intercompany accounts and transactions have been eliminated.

### *(c) Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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, useful lives of property and equipment, valuation of goodwill, intangible assets, investments, deferred tax assets, fixed assets and repair parts, stock–based compensation, 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 2009 ended on January 3, 2010 and fiscal year 2008 ended on December 28, 2008 and consisted of 53 weeks and 52 weeks, respectively.

### *(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 January 3, 2010, 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.



(Continued)

### *(g) Accounts Receivable*

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are included in net cash provided by operating activities in the consolidated statements of cash flows. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses adjusted to take into account current market conditions and customers' financial condition, the amount of receivables in dispute, and the current receivables aging and current payment patterns. The Company reviews its allowance for doubtful accounts monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

### *(h) Investments*

The Company holds investments in Glacier Water Trust I Common Securities of $2,629,000 at January 3, 2010 and December 28, 2008, and Glacier Water Trust I Preferred Securities of $3,648,000 at January 3, 2010 and December 28, 2008, respectively, as long term-assets, as discussed in note 3(a). Investments are accounted for in accordance with Financial Accounting Standards Board (FASB) authoritative guidance for investments, 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 the FASB authoritative guidance for investments 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.

### *(i) Fair Value of Financial Instruments*

On December 31, 2007, the Company adopted certain provisions of the FASB authoritative guidance for fair value measurements, which provide 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. The guidance applies to reported balances that are required or permitted to be measured at fair value under existing guidance; accordingly, the standard does not require any new fair value measurements of reported balances.

As permitted by the authoritative guidance, the Company has elected to defer adoption of the fair value guidance for nonfinancial assets and liabilities that are measured at fair value on a nonrecurring basis, such as goodwill and identifiable intangible assets. The Company does not expect the adoption of the guidance for nonfinancial assets and liabilities to have a material impact on our consolidated financial position or results of operations.



(Continued)

The authoritative guidance 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 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 the authoritative guidance and explained above.

The following table presents the financial assets and liabilities measured at fair value on a recurring basis as of January 3, 2010 (in thousands):

| | | Fair value measurements at reporting date using | | |
|---|---|---|---|---|
| | **January 3, 2010** | **Quoted prices in active markets (Level l )** | **Significant other observable inputs (Level 2)** | **Significant unobservable inputs (Level 3)** |
| Assets: | | | | |
| Glacier Water Trust I Common Securities | $ 2,629 | 2,629 | — | — |
| Glacier Water Trust I Preferred Securities | 3,648 | 3,167 | — | — |
| | $ 6,277 | 5,796 | — | — |
| Liabilities: | | | | |
| Investment in Glacier Water Trust I Common Securities | $ 2,629 | 2,629 | — | — |
| Investment in Glacier Water Trust I Preferred Securities | 85,000 | 73,780 | — | — |
| Long-term notes payable | 28,173 | — | 28,173 | — |
| | $ 115,802 | 76,409 | 28,173 | — |

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 the guidance).

The Company's long-term debt at January 3, 2010 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 January 3, 2010 and December 28, 2008 approximates its fair value. The fair value of the Glacier Water Trust I Preferred Securities long-term debt is determined by market prices (considered to be Level 1 inputs in accordance with the guidance). The carrying value of the long-term notes payable approximates the fair value since their terms are based on the prime rate plus/minus an applicable margin that is consistent with terms available to market participants of a similar size and operations (considered to be Level 2 inputs in accordance with the guidance).

***(j) 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.

***(k) Long-Lived Assets***

The Company evaluates and assesses its long-lived assets for impairment under the FASB authoritative guidance for property, plant and equipment. This guidance addresses financial accounting and reporting for the impairment or disposal of long-lived assets. 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 January 3, 2010 and December 28, 2008, there has been no impairment of long-lived assets recorded.

***(l) Property and Equipment and Depreciation***

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

| | | January 3, 2010 | December 28, 2008 |
|---|---|---|---|
| Vending equipment | $ | 160,396 | 150,558 |
| Equipment, furniture, and fixtures | | 3,696 | 3,657 |
| Land | | 77 | 66 |
| Building | | 725 | 624 |
| Leasehold improvements | | 79 | 79 |
| | | 164,973 | 154,984 |
| Less accumulated depreciation and amortization | | (121,865) | (110,524) |
| | $ | 43,108 | 44,460 |

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 2009 and 2008. 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 January 3, 2010 and December 28, 2008, there was $0 and $252,000, respectively, of new vending machines in the process of assembly. The Company currently has sufficient machines in storage available for deployment in fiscal 2010. Machines that have been previously installed and are in storage awaiting redeployment are currently being depreciated

***(m) 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 January 3, 2010, prepaid contract rights in the amount of $653,000 were included in other assets as compared to $715,000 at December 28, 2008. For the years ended January 3, 2010 and December 28, 2008, $1,758,000 and $1,785,000, respectively, is included in depreciation and amortization.

***(n) Deferred Financing Costs***

Net deferred financing costs as of January 3, 2010 and December 28, 2008 consists of $2,521,000 and $2,574,000, 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 as of January 3, 2010 and December 28, 2008 consists of $1,960,000 and $2,001,000, respectively, associated with the Exchange Offer discussed in note 3 are also amortized using the effective-interest method through the period ending January 2028.

***(o) 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 January 3, 2010 the Company had approximately 18,300 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 January 3, 2010 and December 28, 2008, the Company recorded approximately $2,848,000 and $2,626,000, respectively, of such estimated revenues, which for both year ends represent an average of approximately 12 days per machine.

***(p) 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 January 3, 2010, the Company operated approximately 18,300 machines in 42 states and Canada.

***(q) Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Beginning with the adoption of the current FASB authoritative guidance for income taxes, the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Prior to the adoption of this authoritative guidance, the Company recognized the effect of income tax positions only if such positions were probable of being sustained. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

***(r) 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 the FASB authoritative guidance on stock compensation. Under the fair value recognition provisions of the guidance, 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 certain provisions of the guidance became effective on January 2, 2006. All stock options granted prior to January 2, 2006 have been fully vested.

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 January 3, 2010, there were 82,500 shares outstanding. The grant of the restricted stock is

accounted for under the FASB authoritative guidance on stock compensation, 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 issuance and five years for the January 26, 2007 issuance.

During fiscal years 2009 and 2008, the Company recorded total stock compensation expenses of $356,000 and $324,000, respectively, all of which is associated to the restricted stock grants as discussed in note 7.

### *(s)* ***Recent Accounting Pronouncements***

In June 2009, the FASB issued authoritative guidance on the FASB Accounting Standards Codification (ASC) as the single source of authoritative U.S. accounting and reporting standards, other than guidance issued by the Securities and Exchange Commission. The Company has adopted ASC as the exclusive authoritative reference for use in its financial statements issued for its period ending January 3, 2010 and December 28, 2008, and the adoption did not have an impact on the consolidated financial condition and results of operations.

In December 2007, the FASB issued authoritative guidance for business combinations retaining 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. The guidance 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, the guidance 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. The guidance will also require additional disclosure of information surrounding a business combination, including additional information regarding the nature and financial impact of the business combination. This guidance 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 adopted the FASB authoritative guidance during fiscal year 2009, and the adoption did not have an impact on the consolidated financial condition and results of operations.

In December 2009, the FASB issued authoritative guidance for consolidations and improvements to financial reporting by enterprises involved with Variable Interest Entities (VIEs). The authoritative guidance revises the test for determining the primary beneficiary of a VIE from a primarily quantitative risks and rewards calculation based on the VIE’s expected losses and expected residual returns to a primarily qualitative analysis based on identifying the party or related-party group (if any) with (a) the power to direct the activities that most significantly impact the VIE’s economic performance and (b) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be significant to the VIE. The authoritative guidance requires kick-out rights and participating rights to be ignored in evaluating whether a variable interest holder meets the power criterion unless those rights are unilaterally exercisable by a single party or related party group. The authoritative guidance also revises the criteria for determining whether fees paid by an


(Continued)

entity to a decision maker or another service provider are a variable interest in the entity and revises the previous guidance scope characteristic that identifies an entity as a VIE if the equity-at-risk investors as a group do not have the right to control the entity through their equity interests to address the impact of kick-out rights and participating rights on the analysis. Finally, the authoritative guidance adds a new requirement to reconsider whether an entity is a VIE if the holders of the equity investment at risk as a group lose the power, through the rights of those interests, to direct the activities that most significantly impact the VIE's economic performance, and requires a company to reassess on an ongoing basis whether it is deemed to be the primary beneficiary of a VIE. This authoritative guidance is effective for periods beginning after December 15, 2009 and may not be early adopted. The Company expects that the adoption of this authoritative guidance will not have a material impact on its consolidated financial statements.

***(t) Loss Per Common Share***

Basic loss per share is computed based upon the weighted average number of common shares outstanding during the period. Diluted loss per share is 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 2009 and 2008, a total of 111,938 and 146,951 potentially dilutive securities, respectively, were not used to calculate diluted loss per share because of their anti-dilutive effect.

| | | **January 3, 2010** | **December 28, 2008** |
|---|---|---|---|
| | | (In thousands, except share and per share data) | |
| Numerator for basic earnings per share – net loss applicable to common shareholders | $ | (695) | (4,227) |
| Denominator – shares: | | | |
| Weighted average common shares for basic loss per share | | 2,711,836 | 2,702,790 |
| Dilutive potential shares for diluted loss per share | | 2,711,836 | 2,702,790 |
| Loss per share: | | | |
| Basic and dilutive loss per share applicable to common shareholders | $ | (0.26) | (1.56) |

***(u) Goodwill***

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is reviewed for impairment at least annually in accordance with the FASB authoritative guidance for intangibles, goodwill and other assets. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of

goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

The Company performs its annual impairment review of goodwill at January 3, 2010 and when a triggering event occurs between annual impairment tests. No impairment loss was recorded for the years ended January 3, 2010 or December 28, 2008.

### *(v) Reclassifications*

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

## (2) Supplementary Balance Sheet Information

### *(a) Other Assets*

Other assets consist of the following (in thousands):

| | | January 3, 2010 | December 28, 2008 |
|---|---|---|---|
| Prepaid contract rights, net | $ | 653 | 715 |
| Other | | 109 | 150 |
| Total other assets | $ | 762 | 865 |

### *(b) Accrued Liabilities*

Accrued liabilities consist of the following (in thousands):

| | | January 3, 2010 | December 28, 2008 |
|---|---|---|---|
| Accrued compensation, benefits and related taxes | $ | 2,234 | 1,853 |
| Accrued property, sales, income and other taxes | | 313 | 345 |
| Accrued interest | | 428 | 293 |
| Accrued taxes payable | | 123 | — |
| Other accrued liabilities | | 478 | 311 |
| Total accrued liabilities | $ | 3,576 | 2,802 |

## (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 after 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 VIE under FASB authoritative guidance for consolidation of VIEs. Under earlier FASB guidance on this subject, VIEs 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 the updated guidance, a VIE 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. As provided under the provisions of the guidance, the guidance 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 January 3, 2010 and December 28, 2008, there were 3,254,078 Trust Preferred Securities outstanding (other than the 145,922 held by the Company).

### *(b) Line of Credit and Notes Payable*

On December 22, 2009, City National Bank modified its revolving line of credit commitment, (the 'credit facility') with the Company to $33,000,000 from the $30,000,000 established on July 17, 2008. The revised credit facility requires monthly interest payments at City National Bank's prime rate less 0.25% (3.00% per annum at January 3, 2010 and at December 28, 2008) on the portion of the credit facility below $30,000,000, and if the credit facility is utilized above $30,000,000 at City National Bank's prime rate plus 0.25%. In the event the Company does not meet certain covenant ratios, the interest rate may be raised to prime rate plus 0.25% on the portion of the credit facility below $30,000,000 and prime rate plus 0.75% on the portion utilized above $30,000,000. The December 22, 2009 modification continues to contain other 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 January 3, 2010 and December 28, 2008 with all covenants under this credit facility. As of January 3, 2010 and December 28, 2008, there was $28,173,000 and $26,263,000 outstanding on the credit facility, respectively, which is included in long term notes payable. Availability under the $33,000,000 credit facility was $4,827,000 as of January 3, 2010, and at December 28, 2008, under the $30,000,000 credit facility, there was $3,737,000 available.

Subsequent to the Company's fiscal year end on April 8, 2010, City National Bank modified its credit facility with the Company to extend the expiration date on the credit facility, which was previously set to expire on July 17, 2010, to July 1, 2012. The credit facility terms and conditions remain unchanged through July 17, 2010. Thereafter, the monthly interest payments will then be computed at City National Bank's prime rate plus between 0.25% and 1.00% per annum, depending on certain covenant ratios, but in no case will the interest rate be less than 4.00% per annum. The Company will also pay an annual loan fee equal to 0.5% of the credit facility. Beginning January 1, 2011, the credit facility will also reduce by $1,500,000 at the beginning of each calendar quarter through the balance of the term. All other terms and conditions remained consistent with the current credit facility.

In addition, the Company had $0 and $2,000 at January 3, 2010 and December 28, 2008, 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 2015. 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 $21,000 as of January 3, 2010.

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

| | | |
|---|---|---|
| Fiscal year: | | |
| 2010 | $ | 834 |
| 2011 | | 680 |
| 2012 | | 464 |
| 2013 | | 363 |
| 2014 | | 429 |
| 2015 | | 438 |
| Total minimum lease payments | $ | 3,208 |

Total lease expense for the years ended January 3, 2010 and December 28, 2008 was $2,051,000 and $1,991,000, 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.

## (5) Income Taxes

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

| | | January 3, 2010 | December 28, 2008 |
|---|---|---|---|
| Deferred tax liabilities: | | | |
| Property and equipment | $ | 6,736 | 6,384 |
| Deferred tax assets: | | | |
| Alternative minimum tax credit | | (1,070) | (1,070) |
| Net operating loss | | (15,434) | (16,052) |
| Accruals and reserves | | (1,144) | (634) |
| Other, net | | (21) | (103) |
| Total gross deferred tax assets | | (17,669) | (17,859) |
| Valuation allowance | | 10,933 | 11,475 |
| Total deferred tax assets, net | | (6,736) | (6,384) |
| Net deferred taxes | $ | — | — |

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

| | Fiscal year ended | |
|---|---|---|
| | January 3, 2010 | December 28, 2008 |
| Federal statutory rate | 34.0% | 34.0% |
| State and local taxes | (21.6) | — |
| Other, net | (79.1) | 3.2 |
| Change in valuation allowance | 45.1 | (37.2) |
| Effective rate | (21.6)% | —% |

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 January 3, 2010 and December 28, 2008. The impact of the Company's wholly owned Canadian subsidiary's deferred tax asset and offsetting valuation allowance are immaterial.

In July 2006, the FASB issued updated authoritative guidance for income tax which is effective for fiscal years beginning after December 15, 2006 and was implemented by the Company for the fiscal year ended December 30, 2007. This guidance clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with previous FASB authoritative guidance for income tax, 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 the more recent guidance, 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, the updated guidance addresses 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 the updated FASB authoritative guidance for income tax, prior to any valuation allowance adjustments, as of January 3, 2010 and December 28, 2008 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 January 3, 2010, the Company had federal and California income tax net operating loss carryforwards of $42,411,000 and $11,592,000, 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 $8,748,000 and $3,616,000, respectively, related to stock option deduction windfalls that will be realized in additional paid-in capital (APIC) when utilized to reduce taxes paid. The alternative minimum tax credit does not have an expiration date.

The Company does not foresee material changes to its gross uncertain income tax position liability within the next twelve months.

## (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 January 3, 2010, 603,726 shares had been repurchased under this program. No shares were acquired in 2009. As of January 3, 2010, there were 1,587,606 shares of common stock held in treasury. As of January 3, 2010, 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 January 3, 2010 and December 28, 2008:

| Declared date | Record date | Payment date | Dividend per common share | Dividend amount | Dividend type |
|---|---|---|---|---|---|
| 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 |
| 12/21/2009 | 12/22/2009 | 12/30/2009 | 1.00 | 2,715,000 | 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 the FASB authoritative guidance for stock compensation 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 provisions of current authoritative guidance 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(r).

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.

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

| | Number of shares | | Weighted average exercise price |
|---|---|---|---|
| Balance at December, 28, 2008 | 179,845 | $ | 10.27 |
| Granted | — | | — |
| Exercised | (3,400) | | 15.66 |
| Canceled | (39,179) | | 10.76 |
| Expired | — | | — |
| Balance at January 3, 2010 | 137,266 | $ | 9.99 |
| Exercisable at January 3, 2010 | 137,266 | $ | 9.99 |

On May 18, 2009, the Board of Directors authorized a Company program to purchase from employees holding unexercised vested common stock options a portion of those employee options for their in-the-money values for a total cash amount, not to exceed $1,000,000. Under the program, 39,179 employee options were canceled with a resulting $997,000 reduction to additional paid-in capital.

There are 137,266 options outstanding under the 1994 Stock Option Plan at January 3, 2010 with exercise prices between $7.95 and $15.60, with a weighted average exercise price of $9.99 and a weighted average remaining contractual life of approximately one year. At January 3, 2010, 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 January 3, 2010, there were 82,500 shares outstanding. The grant of the restricted stock is accounted for under the FASB authoritative guidance for stock compensation 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 January 3, 2010 was $713,000.

The significant assumptions relating to the compensation cost for the 12 months ended January 3, 2010 as a result of the valuation of the restricted stock grant issuances were as follows:

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

**(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 $16,500 in calendar year 2009), 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 $260,000 and $233,000 for fiscal years 2009 and 2008, respectively.

**(9) Significant Customers**

The following table sets forth the customers that represent approximately 10% or more of the Company's total revenues in fiscal years 2009 and 2008, after the effect of any consolidations that occurred as a result of any acquisition or mergers by the retailers:

| | Fiscal year ended | |
|---|---|---|
| | **January 3, 2010** | **December 28, 2008** |
| Company A | 12.16% | 12.05% |
| Company B | 9.32 | 10.00 |

**(10) Related Party Transactions**

The Company has used Kayne Anderson Capital Advisors, L.P. to manage the Company's investments during fiscal years 2009 and 2008. 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 2009 and 2008 to Kayne Anderson Capital Advisors, L.P. in connection with investment management fees.

**(11) Subsequent Events**

The Company has evaluated subsequent events from the balance sheet date through April 19, 2010, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.