

Castle Brands Inc
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2011

or

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

Commission File Number 001-32849

CASTLE BRANDS INC.
(Exact name of registrant as specified in its charter)

Florida
(State or other jurisdiction of
incorporation or organization)

41-2103550
(I.R.S. Employer
Identification No.)

122 East 42nd Street, Suite 4700,
New York, New York
(Address of principal executive offices)

10168
(Zip Code)

Registrant's telephone number, including area code: (646) 356-0200

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Smaller reporting company

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Non-accelerated filer (Do not check if a smaller reporting company)

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

No

The Company had 107,708,681 shares of \$.01 par value common stock outstanding at November 10, 2011.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CASTLE BRANDS INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets

	September 30, 2011 (Unaudited)	March 31, 2011
ASSETS:		
Current Assets		
Cash and cash equivalents	\$ 547,663	\$ 1,047,372
Accounts receivable — net of allowance for doubtful accounts of \$424,628 and \$461,941, respectively	5,885,482	5,636,494
Due from shareholders and affiliates	387,647	216,361
Inventories— net of allowance for obsolete and slow moving inventory of \$151,019 and \$207,142, respectively	10,423,594	9,869,080
Prepaid expenses and other current assets	922,806	1,008,885
Total Current Assets	18,167,192	17,778,192
Equipment — net		
	593,020	509,554
Other Assets		
Investment in non-consolidated affiliate, at equity	138,224	155,573
Intangible assets — net of accumulated amortization of \$4,538,726 and \$4,171,882, respectively	10,654,490	10,999,335
Goodwill	1,182,938	1,126,010
Restricted cash	476,605	468,007
Other assets	228,142	68,975
Total Assets	\$ 31,440,611	\$ 31,105,646
LIABILITIES AND EQUITY:		
Current Liabilities		
Current maturities of notes payable	\$ 3,471,710	\$ 426,175
Accounts payable	3,701,783	3,444,813
Accrued expenses	551,105	733,551
Due to shareholders and affiliates	2,396,227	1,734,497
Total Current Liabilities	10,120,825	6,339,036
Long-Term Liabilities		
Notes payable and credit facility	3,341,044	5,910,484
Warrant liability	162,034	—
Deferred tax liability	1,888,684	1,962,760
Total Liabilities	15,512,587	14,212,280

Commitments and Contingencies (Note 13)

Equity

Preferred stock, \$.01 par value, 25,000,000 shares authorized, 2,055 shares of series A convertible preferred stock issued and outstanding at September 30, 2011 and none outstanding at March 31, 2011, (liquidation value of \$2,115,702 at September 30, 2011)	20,550	—
Common stock, \$.01 par value, 225,000,000 shares authorized, 107,538,039 shares and 107,202,145 shares issued and outstanding at September 30 and March 31, 2011, respectively	1,075,380	1,072,021
Additional paid-in capital	137,134,402	135,468,120
Accumulated deficit	(121,161,699)	(118,413,246)
Accumulated other comprehensive loss	(1,745,160)	(1,633,502)
Total controlling shareholders' equity	15,323,473	16,493,393
Noncontrolling interests	604,551	399,973
Total equity	15,928,024	16,893,366
Total Liabilities and Equity	\$ 31,440,611	\$ 31,105,646

See accompanying notes to the unaudited condensed consolidated financial statements.

CASTLE BRANDS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Sales, net*	\$ 9,399,954	\$ 8,218,574	\$ 16,792,338	\$ 14,329,069
Cost of sales*	6,107,115	5,194,853	10,753,210	9,079,404
Reversal of provision for obsolete inventory	—	—	—	(24,589)
Gross profit	3,292,839	3,023,721	6,039,128	5,274,254
Selling expense	2,656,399	2,806,555	5,263,180	5,318,008
General and administrative expense	1,185,713	1,343,037	2,454,113	2,588,036
Depreciation and amortization	225,811	229,745	453,956	465,476
Loss from operations	(775,084)	(1,355,616)	(2,132,121)	(3,097,266)
Other income	—	—	—	957
Other expense	—	(300)	—	(300)
Gain (loss) from equity investment in non-consolidated affiliate	108	—	(17,349)	—
Foreign exchange loss	(116,387)	(111,761)	(238,462)	(54,246)
Interest expense, net	(176,731)	(71,697)	(354,272)	(97,240)
Net change in fair value of warrant liability	209,899	—	185,025	—
Income tax benefit	37,038	37,038	74,076	74,076
Net loss	(821,157)	(1,502,336)	(2,483,103)	(3,174,019)
Net income attributable to noncontrolling interests	(99,514)	(134,851)	(204,578)	(185,976)
Net loss attributable to controlling interests	(920,671)	(1,637,187)	(2,687,681)	(3,359,995)
Dividend to preferred shareholders	(49,927)	—	(379,387)	—
Net loss attributable to common shareholders	\$ (970,598)	\$ (1,637,187)	\$ (3,067,069)	\$ (3,359,995)
Net loss per common share, basic and diluted, attributable to common shareholders	\$ (0.01)	\$ (0.02)	\$ (0.03)	\$ (0.03)
Weighted average shares used in computation, basic and diluted, attributable to common shareholders	107,452,007	107,202,145	107,327,758	107,650,369

* Sales, net and Cost of sales include excise taxes of \$1,497,879 and \$1,232,857 for the three months ended September 30, 2011 and 2010, respectively, and \$2,713,498 and \$2,293,253 for the six months ended September 30, 2011 and 2010, respectively.

See accompanying notes to the unaudited condensed consolidated financial statements.

CASTLE BRANDS INC. AND SUBSIDIARIES
Condensed Consolidated Statement of Changes in Equity
(Unaudited)

	Preferred Stock		Common Stock		Additional	Accumulated	Accumulated	Other	Noncontrolling	
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	Comprehensive Income (Loss)	Income	Interests	
BALANCE, MARCH 31, 2011		—\$	—	107,202,145	\$ 1,072,021	\$ 135,468,120	\$(118,413,246)	\$(1,633,502)	\$ 399,973	\$ 10,000
Comprehensive loss										
Net (loss) income							(2,687,681)		204,578	(2,000)
Foreign currency translation adjustment								(111,658)		
Total comprehensive loss										
Issuance of series A convertible preferred stock, net of issuance costs	2,155	21,550				1,523,356				
Conversion of series A convertible preferred stock and accrued dividends	(100)	(1,000)	335,894	3,359	(2,289)		(70)			
Accrued dividends - series A convertible preferred stock						60,702	(60,702)			
Stock-based compensation						84,513				
BALANCE, SEPTEMBER 30, 2011	2,055	\$ 20,550	107,538,039	\$ 1,075,380	\$ 137,134,402	\$(121,161,699)	\$(1,745,160)	\$ 604,551	\$ 10,000	

See accompanying notes to the unaudited condensed consolidated financial statements.

CASTLE BRANDS INC. and SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six months ended September 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (2,483,103)	\$ (3,174,019)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	453,956	465,476
Provision for doubtful accounts	18,034	29,664
Amortization of deferred financing costs	14,117	4,167
Change in fair value of warrant liability	(185,025)	—
Deferred tax benefit	(74,076)	(74,076)
Loss from equity investment in non-consolidated affiliate	17,349	—
Effect of changes in foreign exchange	(56,583)	33,565
Stock-based compensation expense	84,513	84,693
Provision for obsolete inventories	—	(24,589)
Changes in operations, assets and liabilities:		
Accounts receivable	(284,902)	98,286
Due from affiliates	(171,286)	2,192
Inventory	(604,791)	(1,539,394)
Prepaid expenses and supplies	84,960	91,476
Accounts payable and accrued expenses	130,749	(273,080)
Due to related parties	661,730	955,165
Accrued interest	210,277	—
Other assets	(173,284)	113,530
Total adjustments	125,738	(32,925)
NET CASH USED IN OPERATING ACTIVITIES	(2,357,365)	(3,206,944)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(181,498)	(101,901)
Acquisition of intangible assets	(22,000)	(7,848)
Change in restricted cash	(26,480)	236,654
Payments under contingent consideration agreements	(56,928)	(44,508)
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(286,906)	82,397
CASH FLOWS FROM FINANCING ACTIVITIES:		
\$2.5 million revolving credit facility	(2,000,000)	2,000,000
Keltic facility	1,588,467	—
Note payable — Betts & Scholl	(327,648)	(212,271)
Promissory note – Frost Gamma Investments Trust	—	2,000,000
Interim notes – affiliate investors	1,005,000	—
Issuance of series A convertible preferred stock	2,155,000	—
Costs of issuance	(263,034)	—
Proceeds from stock option exercises	—	7,875

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Repurchase of common stock		—	(1,023,475)
NET CASH PROVIDED BY FINANCING ACTIVITIES		2,157,785	2,772,129
EFFECTS OF FOREIGN CURRENCY TRANSLATION		(13,223)	(5,366)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(499,709)	(357,784)
CASH AND CASH EQUIVALENTS — BEGINNING		1,047,372	1,281,141
CASH AND CASH EQUIVALENTS — ENDING	\$	547,663	\$ 923,357
SUPPLEMENTAL DISCLOSURES:			
Schedule of non-cash investing and financing activities:			
Issuance of warrant liability in connection with series A convertible preferred stock	\$	347,059	\$ —
Issuance of common stock in exchange for fine wine inventory in June 2010	\$	—	\$ 840,000
Interest paid	\$	90,028	\$ 54,960

See accompanying notes to the unaudited condensed consolidated financial statements.

CASTLE BRANDS INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements

NOTE 1 — ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements do not include all of the information and footnote disclosures normally included in financial statements prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) and U.S. generally accepted accounting principles (“GAAP”) and, in the opinion of management, contain all adjustments (which consist of only normal recurring adjustments) necessary for a fair presentation of such financial information. Results of operations for interim periods are not necessarily indicative of those to be achieved for full fiscal years. The condensed consolidated balance sheet as of March 31, 2011 is derived from the March 31, 2011 audited financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with Castle Brands Inc.’s (the “Company”) audited consolidated financial statements for the fiscal year ended March 31, 2011 included in the Company’s annual report on Form 10-K for the year ended March 31, 2011, as amended (“2011 Form 10-K”). Please refer to the notes to the audited consolidated financial statements included in the 2011 Form 10-K for additional disclosures and a description of accounting policies.

- A. Description of business and business combination — The consolidated financial statements include the accounts of the Castle Brands Inc., its wholly-owned subsidiaries, Castle Brands (USA) Corp. (“CB-USA”), McLain & Kyne, Ltd. (“McLain & Kyne”), the Company’s wholly-owned foreign subsidiaries, Castle Brands Spirits Group Limited (“CB-IRL”) and Castle Brands Spirits Marketing and Sales Company Limited, and the Company’s 60% ownership interest in Gosling-Castle Partners, Inc. (“GCP”), with adjustments for income or loss allocated based upon percentage of ownership. The accounts of the subsidiaries have been included as of the date of acquisition. All significant intercompany transactions and balances have been eliminated.
- B. Organization and operations — The Company is principally engaged in the importation, marketing and sale of premium and super premium brands of rums, whiskey, liqueurs, vodka, tequila and wine in the United States, Canada, Europe, and Asia. The vodka, Irish whiskeys and certain liqueurs are procured by CB-IRL, billed in Euros and imported from Europe into the United States. The risk of fluctuations in foreign currency is borne by the U.S. entities.
- C. Equity investments - Equity investments are carried at original cost adjusted for the Company’s proportionate share of the investees’ income, losses and distributions. The Company assesses the carrying value of its equity investments when an indicator of a loss in value is present and records a loss in value of the investment when the assessment indicates that an other-than-temporary decline in the investment exists. The Company classifies its equity earnings of non-consolidated affiliate equity investment as a component of net income or loss.
- D. Goodwill and other intangible assets — Goodwill represents the excess of purchase price including related costs over the value assigned to the net tangible and identifiable intangible assets of businesses acquired. Goodwill and other identifiable intangible assets with indefinite lives are not amortized, but instead are tested for impairment annually, or more frequently if circumstances indicate a possible impairment may exist. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives, generally on a straight-line basis, and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.
- E.

Impairment of long-lived assets — Under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310, "Accounting for the Impairment or Disposal of Long-lived Assets", the Company periodically reviews whether changes have occurred that would require revisions to the carrying amounts of its definite lived, long-lived assets. When the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment loss is recognized based on the fair value of the asset.

F. Excise taxes and duty — Excise taxes and duty are computed at standard rates based on alcohol proof per gallon/liter and are paid after finished goods are imported into the United States and then transferred out of "bond." Excise taxes and duty are recorded to inventory as a component of the cost of the underlying finished goods. When the underlying products are sold "ex warehouse", the sales price reflects the taxes paid and the inventoried excise taxes and duties are charged to cost of sales.

G. Foreign currency — The functional currency for the Company's foreign operations is the Euro in Ireland and the British Pound in the United Kingdom. Under ASC 830, "Foreign Currency Matters", the translation from the applicable foreign currencies to U.S. Dollars is performed for balance sheet accounts using exchange rates in effect at the balance sheet date and for revenue and expense accounts using a weighted average exchange rate during the period. The resulting translation adjustments are recorded as a component of other comprehensive income. Gains or losses resulting from foreign currency transactions are shown as a separate line item in the consolidated statements of operations. The Company's vodka, Irish whiskeys and certain liqueurs are procured by CB-IRL and billed in Euros to CB-USA, with the risk of foreign exchange gain or loss resting with CB-USA.

H. Fair value of financial instruments — ASC 825, “Financial Instruments”, defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties and requires disclosure of the fair value of certain financial instruments. The Company believes that there is no material difference between the fair-value and the reported amounts of financial instruments in the Company’s balance sheets due to the short term maturity of these instruments, or with respect to the Company’s debt, as compared to the current borrowing rates available to the Company.

The Company’s investments are reported at fair value in accordance with authoritative guidance, which accomplishes the following key objectives:

- § Defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date;
- § Establishes a three-level hierarchy (“valuation hierarchy”) for fair value measurements;
- § Requires consideration of the Company’s creditworthiness when valuing liabilities; and
- § Expands disclosures about instruments measured at fair value.

The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of the valuation hierarchy are as follows:

- § Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- § Level 2 — inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are directly or indirectly observable for the asset or liability for substantially the full term of the financial instrument.
- § Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

I. Income taxes — Under ASC 740, “Income Taxes”, 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 basis. A valuation allowance is provided to the extent a deferred tax asset is not considered recoverable.

The Company has not recognized any adjustments for uncertain tax positions. The Company recognizes interest and penalties related to uncertain tax positions in general and administrative expense; however, no such provisions for accrued interest and penalties related to uncertain tax positions have been recorded as of September 30, 2011 or 2010.

The Company’s income tax benefit for the six months ended September 30, 2011 and 2010 consists of federal, state and local taxes attributable to GCP, which does not file a consolidated income tax return with the Company. In connection with the investment in GCP, the Company recorded a deferred tax liability on the ascribed value of the acquired intangible assets of \$2,222,222, increasing the value of the asset. The difference between the book basis and tax basis created a deferred tax liability that is being amortized over a period of 15 years (the life of the licensing agreement) on a straight-line basis. For each of the three-month and six-month periods ended September 30, 2011 and 2010, the Company recognized \$37,038 and \$74,076 of deferred tax benefits, respectively.

J. Recent accounting pronouncements — In September 2011, the FASB issued Accounting Standards Update, Intangibles — Goodwill and Other (“ASU No. 2011-08”). ASU No. 2011-08 amends current guidance to allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this amendment an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU No. 2011-08 applies to all companies that have goodwill reported in their

financial statements. The provisions of ASU No. 2011-08 are effective for reporting periods beginning after December 15, 2011, with early adoption options. The Company does not expect the adoption of the standard to have a material impact on the Company's results of operations, cash flows or financial condition.

In June 2011, the FASB issued Accounting Standards Update 2011-05, Presentation of Comprehensive Income ("ASU 2011-05"), which revises the manner in which entities present comprehensive income in their financial statements. The new guidance amends ASC No. 220, Comprehensive Income, and gives reporting entities the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. ASU 2011-05 does not change the items that must be reported in other comprehensive income. This new guidance is effective for reporting periods beginning after December 15, 2011 and is to be applied retrospectively. The Company does not expect the adoption of the standard to have a material impact on the Company's results of operations, cash flows or financial condition.

NOTE 2 — BASIC AND DILUTED NET LOSS PER COMMON SHARE

Basic net loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per common share is computed giving effect to all dilutive potential common shares that were outstanding during the period that are not anti-dilutive. Diluted potential common shares consist of incremental shares issuable upon exercise of stock options and warrants or conversion of convertible preferred stock outstanding. In computing diluted net loss per share for the three months and six months ended September 30, 2011 and 2010, no adjustment has been made to the weighted average outstanding common shares as the assumed exercise of outstanding options and warrants and the assumed conversion of convertible preferred stock is anti-dilutive.

Potential common shares not included in calculating diluted net loss per share are as follows:

	Six months ended September 30,	
	2011	2010
Stock options	6,086,400	4,529,000
Warrants to purchase common stock	5,471,227	2,016,814
Convertible preferred stock	7,088,820	-
Total	18,646,447	6,545,814

NOTE 3 — INVENTORIES

	September 30, 2011	March 31, 2011
Raw materials	\$ 3,302,131	\$ 2,318,260
Finished goods – net	7,121,463	7,550,820
Total	\$ 10,423,594	\$ 9,869,080

As of September 30 and March 31, 2011, 36% and 37%, respectively, of raw materials and 1% and 3%, respectively, of finished goods were located outside of the United States.

The Company recorded a reversal of its allowance for obsolete and slow moving inventory of \$24,589 during the six months ended September 30, 2010. This reversal was recorded as the Company was able to sell certain goods included in the allowance recorded during previous fiscal years. The reversal was recorded as a reduction in cost of sales. The Company did not record any reversal for the three months and six months ended September 30, 2011, nor for the three months ended September 30, 2010. The Company estimates the allowance for obsolete and slow moving inventory based on analyses and assumptions including, but not limited to, historical usage, expected future demand and market requirements.

Inventories are stated at the lower of weighted average cost or market.

NOTE 4 — EQUITY INVESTMENT

Investment in DP Castle Partners, LLC

In August 2010, CB-USA formed DP Castle Partners, LLC (“DPCP”) with Drink Pie, LLC to manage the manufacturing and marketing of Travis Hasse’s Original Apple Pie Liqueur, Cherry Pie Liqueur and any future line extensions of the brand. DPCP has the exclusive global rights to produce and market Travis Hasse’s Original Pie Liqueurs and CB-USA has the global distribution rights for this brand. DPCP pays a per case royalty fee to Drink Pie, LLC under a licensing agreement. CB-USA purchases the finished product from DPCP at a pre-determined margin and then uses its existing infrastructure, sales force and distributor network to sell the product and promote the brands. Finished goods are sold to CB-USA FOB – Production and CB-USA bears the risk of loss on both inventory and third-party receivables. Revenues and cost of sales are recorded at their respective gross amounts on the books and records of CB-USA. For the three months and six months ended September 30, 2011, CB-USA purchased \$67,937 in finished goods from DPCP under the distribution agreement. As of September 30, 2011, DPCP was indebted to CB-USA in the amount of \$169,453 which is included in due from shareholders and affiliates on the accompanying condensed consolidated balance sheet. At September 30, 2011, CB-USA owned 20% of the entity and, under the terms of the agreement, will increase its stake in DPCP based on achieving case sale targets. The Company has accounted for this investment under the equity method of accounting. This investment balance was \$138,224 and \$155,573 at September 30 and March 31, 2011, respectively.

NOTE 5 — ACQUISITIONS

Acquisition of McLain & Kyne

On October 12, 2006, the Company acquired all of the outstanding capital stock of McLain & Kyne. As consideration for the acquisition, the Company paid \$2,000,000, consisting of \$1,294,800 in cash and 100,000 shares of its common stock, valued at \$705,200, at closing. Under the McLain & Kyne agreement, as amended, the Company was required to pay an earn-out, not to exceed \$4,000,000, to the sellers based on the financial performance of the acquired business through March 31, 2011. The Company is also required to pay an earn-out based on the case sales of Jefferson's Presidential Select for a specified amount of cases, rather than a fixed period of time. For the six months ended September 30, 2011 and 2010, the sellers earned \$56,928 and \$44,508, respectively, under this agreement. The earn-out payments have been recorded as an increase to goodwill.

NOTE 6 — GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the six months ended September 30, 2011 were as follows:

	Amount
Balance as of March 31, 2011	\$ 1,126,010
Payments under McLain and Kyne agreement	56,928
Balance as of September 30, 2011	\$ 1,182,938

Intangible assets consist of the following:

	September 30, 2011	March 31, 2011
Definite life brands	\$ 170,000	\$ 170,000
Trademarks	557,947	535,948
Rights	8,271,555	8,271,555
Distributor relationships	664,000	664,000
Product development	28,262	28,262
Patents	994,000	994,000
Other	28,480	28,480
	10,714,244	10,692,245
Less: accumulated amortization	4,538,726	4,171,882
Net	6,175,518	6,520,363
Other identifiable intangible assets — indefinite lived*	4,478,972	4,478,972
	\$ 10,654,490	\$ 10,999,335

Accumulated amortization consists of the following:

	September 30, 2011	March 31, 2011
Definite life brands	\$ 154,885	\$ 149,218

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Trademarks	180,606	164,015
Rights	3,581,296	3,305,321
Distributor relationships	133,044	99,600
Product development	10,175	8,140
Patents	478,720	445,588
Accumulated amortization	\$ 4,538,726	\$ 4,171,882

* Other identifiable intangible assets — indefinite lived consists of product formulations.

NOTE 7 — RESTRICTED CASH

At September 30 and March 31, 2011, the Company had €350,527 or \$476,605 (translated at the September 30, 2011 exchange rate) and €331,969 or \$468,007 (translated at the March 31, 2011 exchange rate), respectively, of cash restricted from withdrawal and held by a bank in Ireland as collateral for overdraft coverage, creditors' insurance, customs and excise guaranty, and a revolving credit facility. In April 2010, the Company reduced the aggregate amount of the credit facilities, and the commensurate cash restricted from withdrawal, by €185,000 or \$236,654 (translated at the exchange rate then in effect).

NOTE 8 — NOTES PAYABLE AND CREDIT FACILITY

	September 30, 2011	March 31, 2011
Notes payable consist of the following:		
Note payable (A)	\$ 107,354	\$ 426,175
Note payable (B)	216,869	211,580
Credit agreement (C)	500,000	2,500,000
Note payable (D)	2,280,877	2,170,575
Note payable (E)	1,083,479	1,028,329
Note payable (F)	1,035,708	—
Credit agreement (G)	1,588,467	—
Total	\$ 6,812,754	\$ 6,336,659

- A. In connection with the Betts & Scholl asset acquisition in September 2009, the Company issued a secured promissory note in the aggregate principal amount of \$1,094,541 to Betts & Scholl, LLC, an entity affiliated with Dennis Scholl, who became a director of the Company at the time of the acquisition. This note was secured by the Betts & Scholl inventory acquired by the Company under a security agreement. This note provided for an initial payment of \$250,000, paid at closing, and for eight equal quarterly payments of principal and interest, with the final payment initially due on September 21, 2011. Interest under this note accrued at an annual rate of 0.84%, compounded quarterly. In December 2010, the Company amended the terms of the note to provide that the quarterly payments of principal and interest due December 21, 2010 and March 21, 2011, each in the amount of approximately \$107,000, would not be due and payable until the maturity date of such note and that such installment payments would bear interest, payable on such maturity date, at the rate of 11% per annum, compounded quarterly. In August 2011, \$220,731 of principal and accrued interest was paid on this note in connection with the closing of the revolving loan agreement with Keltic Financial Partners II, LP (the "Keltic Facility"), as described in Note 8G. At September 30, 2011, \$107,354 of principal due on this note is included in current liabilities. In October 2011, the remaining \$107,354 due on this note was converted into Series A Preferred Stock and 2011 Warrants (each as defined in Note 9) as part of the private placement transaction described in Note 9, following shareholder and NYSE Amex approval of such transaction.
- B. In December 2009, GCP issued a promissory note (the "GCP Note") in the aggregate principal amount of \$211,580 to Gosling's Export (Bermuda) Limited in exchange for credits issued on certain inventory purchases. The GCP Note matures on April 1, 2020, is payable at maturity, subject to certain acceleration events, and calls for annual interest of 5%, to be accrued and paid at maturity. At September 30, 2011, \$216,869, consisting of \$211,580 of principal and \$5,289 of accrued interest, due on the GCP Note is included in long-term liabilities.
- C. In December 2009, the Company entered into a \$2,500,000 revolving credit agreement with, among others, Frost Gamma Investments Trust, an entity affiliated with Phillip Frost, M.D., a director and principal shareholder of the

Company, Vector Group Ltd., a greater than 10% shareholder of the Company, Lafferty Ltd., a greater than 5% shareholder of the Company, IVC Investors, LLLP, an entity affiliated with Glenn Halpryn, a director of the Company, Mark E. Andrews, III, the Company's Chairman, and Richard J. Lampen, the Company's President and Chief Executive Officer. Under the credit agreement, the Company was able to borrow from time to time up to \$2,500,000 to be used for working capital or general corporate purposes. Borrowings under the credit agreement were to mature on April 1, 2013 and bore interest at a rate of 11% per annum, payable quarterly. The Company paid an aggregate commitment fee of \$50,000 to the lenders under the credit agreement. Amounts could be repaid and reborrowed under the revolving credit agreement without penalty. The note was secured by the inventory and trade accounts receivable of CB-USA, subject to certain exceptions, pursuant to a security agreement. Borrowings under this facility occurred as follows: \$1,000,000 on April 23, 2010, \$1,000,000 on September 14, 2010 and \$500,000 on October 22, 2010. In August 2011, \$2,030,137 of principal and accrued interest was paid on this note in connection with the closing of the Keltic Facility as described in Note 8G. At September 30, 2011, \$500,000 of principal due on this credit agreement was outstanding and is included in long-term liabilities. In October 2011, the remaining \$500,000 outstanding under this facility, and accrued but unpaid interest thereon, was converted into Series A Preferred Stock and 2011 Warrants as part of the private placement transaction described in Note 9, following shareholder and NYSE Amex approval of such transaction and the revolving credit agreement terminated.

D. In June 2010, the Company issued a \$2,000,000 promissory note to Frost Gamma Investments Trust. Borrowings under the note were to mature on June 21, 2012 and bore interest at a rate of 11% per annum. Interest accrued quarterly and was payable at maturity. The note could be prepaid in whole or in part at any time prior to maturity without penalty, but with payment of accrued interest to the date of prepayment. At September 30, 2011, \$2,280,877, consisting of \$2,000,000 of principal and \$280,877 of accrued interest is included in current liabilities. In October 2011, this note, and accrued but unpaid interest thereon, was converted into Series A Preferred Stock and 2011 Warrants as part of the private placement transaction described in Note 9, following shareholder and NYSE Amex approval of such transaction.

- E. In December 2010, the Company issued promissory notes in the aggregate principal amount of \$1,000,000 to Frost Gamma Investments Trust, Vector Group Ltd., IVC Investors, LLLP, Mark E. Andrews, III and Richard J. Lampen. Borrowings under these notes were to mature on June 21, 2012 and bore interest at a rate of 11% per annum. Interest accrued quarterly and was payable at maturity. These notes could be prepaid in whole or in part at any time prior to maturity without penalty, but with payment of accrued interest to the date of prepayment. At September 30, 2011, \$1,083,479, consisting of \$1,000,000 of principal and \$83,479 of accrued interest is included in current liabilities. In October 2011, these notes, and accrued but unpaid interest thereon, were converted into Series A Preferred Stock and 2011 Warrants as part of the private placement transaction described in Note 9, following shareholder and NYSE Amex approval of such transaction.
- F. In June 2011, certain directors, officers and other affiliates of the Company agreed to purchase an aggregate of \$1,005,000 of Series A Preferred Stock and 2011 Warrants as part of the private placement transaction described in Note 9, subject to shareholder approval of such issuance in accordance with NYSE Amex rules. Pending such shareholder approval, the Company issued an aggregate of \$1,005,000 in promissory notes to these affiliate purchasers, which notes and accrued but unpaid interest thereon converted automatically into Series A Preferred Stock and 2011 Warrants in October 2011 following shareholder and NYSE Amex approval of such transaction. These notes bore interest at 10% per annum and were to mature 18 months from the date of issuance. The affiliate purchasers include Frost Gamma Investments Trust, Richard Lampen, Mark Andrews and certain of his affiliates, John Glover, the Company's Chief Operating Officer, and Alfred J. Small, the Company's Senior Vice President, Chief Financial Officer, Treasurer and Secretary. At September 30, 2011, \$1,035,708, consisting of \$1,005,000 of principal and \$30,708 of accrued interest, is included in long-term liabilities.
- G. In August 2011, the Company and CB-USA entered into the Keltic Facility, a revolving loan agreement ("Loan Agreement") with Keltic Financial Partners II, LP, a Delaware limited partnership ("Keltic"), providing for availability (subject to certain terms and conditions) of a facility of up to \$5,000,000 for the purpose of providing the Company and CB-USA with working capital. The Company and CB-USA are referred to individually and collectively as the Borrower. The Keltic Facility expires on August 19, 2014. The Borrower may borrow up to the maximum amount of the Keltic Facility, provided that the Borrower has a sufficient borrowing base (as defined in the Loan Agreement). The Keltic Facility interest rate is the rate that, when annualized, is the greatest of (a) the Prime Rate plus 3.25%, (b) the LIBOR Rate plus 5.75%, and (c) 6.50%. Interest is payable monthly in arrears, on the first day of every month on the average daily unpaid principal amount of the Keltic Facility. After the occurrence and during the continuance of any "Default" or "Event of Default" (as defined under the Loan Agreement) the Borrower is required to pay interest at a rate that is 3.25% per annum above the then applicable Keltic Facility interest rate. In addition to a \$100,000 commitment fee, Keltic will also receive an annual facility fee and a collateral management fee. The Loan Agreement contains standard borrower representations and warranties for asset based borrowing and a number of reporting obligations and affirmative and negative covenants. The Loan Agreement includes negative covenants that, among other things, restrict the Borrower's ability to create additional indebtedness, dispose of properties, incur liens, and make distributions or cash dividends. At September 30, 2011, the Company was in compliance, in all material respects, with the covenants under the Keltic Facility. At September 30, 2011, \$1,588,467 is included in long-term liabilities.

NOTE 9 — EQUITY

Preferred stock issuance – In June 2011 the Company entered into agreements relating to a private placement (the "June 2011 Private Placement") of an aggregate of approximately \$7,100,000 of newly-designated 10% Series A Convertible Preferred Stock, par value \$0.01 per share ("Series A Preferred Stock"). As part of the June 2011 Private Placement, the Company completed a private offering to third-party investors of \$2,155,000 of Series A Preferred Stock for its stated value of \$1,000 per share and warrants ("2011 Warrants"), to purchase 50% of the number of shares of the Company's common stock, issuable upon conversion of such Series A Preferred Stock. Subject to adjustment (including dilutive

issuances), the Series A Preferred Stock is convertible into common stock at a conversion price of \$0.304 per share and the 2011 Warrants have an exercise price of \$0.38 per share.

Holders of Series A Preferred Stock are entitled to receive cumulative dividends at the rate per share (as a percentage of the stated value per share) of 10% per annum, whether or not declared by the Company's Board of Directors, which are payable in shares of the Company's common stock upon conversion of the Series A Preferred Stock or upon a liquidation. For the three months and six months ended September 30, 2011, the Company recorded accrued dividends of \$49,927 and \$60,702, respectively, included as an increase in the accumulated deficit and in additional paid-in capital on the accompanying condensed consolidated balance sheets.

As part of the June 2011 Private Placement, certain directors, officers and other affiliates of the Company agreed to purchase an aggregate of \$1,005,000 of Series A Preferred Stock and 2011 Warrants on substantially the same terms described above, subject to shareholder approval of such issuance in accordance with NYSE Amex rules. Pending such shareholder approval, the Company issued an aggregate of \$1,005,000 in promissory notes to these affiliate purchasers. These notes, and accrued but unpaid interest thereon, converted automatically into Series A Preferred Stock and 2011 Warrants in October 2011 following shareholder and NYSE Amex approval of such transaction. These notes bore interest at 10% per annum and were to mature 18 months from the date of issuance, subject to prior conversion upon shareholder approval. The affiliate purchasers include Frost Gamma Investments Trust, Richard Lampen, Mark Andrews, and certain of his affiliates, John Glover and Alfred Small.

Also as part of the June 2011 Private Placement, certain holders of the Company's outstanding debt, including directors, officers and other affiliates agreed to purchase shares of Series A Preferred Stock and 2011 Warrants in exchange for approximately \$4,000,000 aggregate principal amount of the Company's existing debt, and accrued but unpaid interest thereon, on substantially the same terms described above, subject to shareholder approval of such issuance in accordance with NYSE Amex rules. The affiliate debt holders include Frost Gamma Investments Trust, Vector Group Ltd., Richard Lampen, Mark Andrews, Lafferty Ltd., IVC Investments, LLLP, and Betts & Scholl, LLC, (which agreed to convert principal amount, but not accrued but unpaid interest thereon). In October 2011, these notes, and accrued but unpaid interest thereon, were converted into Series A Preferred Stock and 2011 Warrants following shareholder and NYSE Amex approval of such transaction.

If the Company sells or grants any option to purchase or any right to reprice, or otherwise dispose of or issue (or announce any sale, grant or option to purchase or other disposition), any common stock or common stock equivalents entitling any person to acquire common stock at an effective price per share that is lower than the then conversion price of the Series A Preferred Stock, the holders of the Series A Preferred Stock and 2011 Warrants will be entitled to an adjusted conversion price and additional shares of common stock upon exercise the 2011 Warrants.

The Company agreed to register for resale the shares of common stock issuable upon conversion of the Series A Preferred Stock and the exercise of the 2011 Warrants.

A beneficial conversion feature ("BCF") of \$318,705 was calculated as the difference between the beneficial conversion price of the Series A Preferred Stock and the fair value of the Company's common stock at the issuance date, multiplied by the number of shares into which the Series A Preferred Stock were convertible. As the Series A Preferred is perpetual and convertible at any time at the option of the holder, there is no defined accretion period available. The Company has determined that the BCF should be recognized as a fully accreted deemed dividend on the Preferred Stock in the three months ended June 30, 2011.

The holders of Series A Preferred Stock are entitled to the number of votes equal to the number of shares of common stock into which such shares of preferred stock could be converted and are subject to anti-dilution provisions. The Series A Preferred Stock ranks senior to all classes of common stock and the Company may not issue any capital stock that is senior to the Series A Preferred Stock unless such issuance is approved by the affirmative vote of the holders of a majority of the then outstanding shares of the Series A Preferred Stock voting separately as a class.

Upon any liquidation, the holders of Series A Preferred Stock will be entitled to receive an amount equal to the stated value of \$1,000 per share, plus any accrued and unpaid dividends thereon and any other fees then due.

If the average daily volume of the Company's common stock exceeds \$100,000 per trading day and the Volume Weighted Average Price (as defined in the articles of designation of the Series A Preferred Stock) for at least 20 trading days during any 30 consecutive trading day period exceeds \$0.76 (subject to adjustment), the Company may convert all or any portion of the outstanding Series A Preferred Stock into shares of common stock. In the event of a Fundamental Transaction (as defined in the articles of designation of the Series A Preferred Stock), the Company may convert all of the Series A Preferred Stock plus all accrued but unpaid dividends thereon into common stock concurrently with the consummation of such Fundamental Transaction.

Common stock - In August 2011, a holder of Series A Preferred Stock converted 50 shares of Series A Preferred Stock, and accrued dividends thereon, into 167,490 shares of common stock.

In September 2011, a holder of Series A Preferred Stock converted 50 shares of Series A Preferred Stock, and accrued dividends thereon, into 168,404 shares of common stock.

NOTE 10 — WARRANTS

The 2011 Warrants issued in connection with the Series A Preferred Stock have an exercise price of \$0.38 per share and are exercisable for a period of five years. The exercise price of the 2011 Warrants is equal to 125% of the conversion price of the Series A Preferred Stock.

The Company accounted for the 2011 Warrants in the condensed consolidated financial statements as a liability at their initial fair value of \$347,059. Changes in the fair value of the 2011 Warrants will be recognized in earnings for each subsequent reporting period. At September 30, 2011, the fair value of the 2011 Warrants was included in the balance sheet under the caption Warrant liability payable of \$162,034. For the three months and six months ended September 30, 2011, the Company recorded a gain for the change in the value of the 2011 Warrants of \$209,899 and \$185,025, respectively.

The fair value of the warrants is a Level 3 fair value under the valuation hierarchy and was estimated using the Black-Scholes option pricing model utilizing the following assumptions:

	September 30, 2011		June 12, 2011 (issue date)	
Risk-free interest rate	0.42	%	0.56	%
Expected option life in years	2.38		2.50	
Expected stock price volatility	65	%	65	%
Expected dividend yield	0	%	0	%

NOTE 11 — FOREIGN CURRENCY FORWARD CONTRACTS

The Company enters into forward contracts from time to time to reduce its exposure to foreign currency fluctuations. The Company recognizes in the balance sheet derivative contracts at fair value, and reflects any net gains and losses currently in earnings. At September 30, 2011 and 2010, the Company had no forward contracts outstanding. Gain or loss on foreign currency forward contracts, which was de minimis during the periods presented, is included in other income and expense.

NOTE 12 — STOCK-BASED COMPENSATION

In June 2011, the Company granted to certain employees options to purchase an aggregate of 167,150 shares of the Company's common stock at an exercise price of \$0.31 per share under the Company's 2003 Stock Incentive Plan. The options, which expire in June 2021, vest 33.3% on each of the first three anniversaries of the grant date. The Company has valued the options at \$31,010 using the Black-Scholes option pricing model.

In June 2011, the Company granted to employees, directors and certain consultants options to purchase an aggregate of 1,426,000 shares of the Company's common stock at an exercise price of \$0.33 per share under the Company's 2003 Stock Incentive Plan. The options, which expire in June 2021, vest 25% on each of the first four anniversaries of the grant date. The Company has valued the options at \$285,954 using the Black-Scholes option pricing model.

Stock-based compensation expense for the three months ended September 30, 2011 and 2010 and for the six months ended September 30, 2011 and 2010 amounted to \$52,736 and \$48,404, respectively and \$84,513 and \$84,693, respectively. At September 30, 2011, total unrecognized compensation cost amounted to \$555,863, representing 3,796,250 unvested options. This cost is expected to be recognized over a weighted-average period of 8.74 years. There were no options exercised during the six months ended September 30, 2011 and options for 10,600 shares were exercised during the six months ended September 30, 2010. The Company did not recognize any related tax benefit for the six months ended September 30, 2011 and 2010 from these option exercises.

NOTE 13 — COMMITMENTS AND CONTINGENCIES

A. The Company has entered into a supply agreement with Irish Distillers Limited ("Irish Distillers"), which provides for the production of Irish whiskeys for the Company through 2022, subject to annual extensions thereafter, provided that the Company and Irish Distillers agree on the amount of liters of pure alcohol to be provided in the following year. Under this agreement, the Company is obligated to notify Irish Distillers annually of the amount of liters of pure alcohol it requires for the current contract year and contracts to purchase that amount. For the contract year ending June 30, 2012, the Company has contracted to purchase approximately €545,262 or \$741,382 (translated at the September 30, 2011 exchange rate) in bulk Irish whiskey. The Company is not obligated to pay Irish Distillers for any product not yet received. During the term of this supply agreement, Irish Distillers has the

right to limit additional purchases above the commitment amount.

B. The Company leases office space in New York, NY, Dublin, Ireland and Houston, TX. The New York, NY lease began on May 1, 2010 and expires on April 30, 2012 and provides for monthly payments of \$16,779. The Dublin lease commenced on March 1, 2009 and extends through November 30, 2013 and provides for monthly payments of €1,250 or \$1,700 (translated at the September 30, 2011 exchange rate). The Houston, TX lease commenced on February 24, 2000 and extends through January 31, 2012 and provides for monthly payments of \$1,693. The Company has also entered into non-cancelable operating leases for certain office equipment.

NOTE 14 — CONCENTRATIONS

A. Credit Risk — The Company maintains its cash and cash equivalents balances at various large financial institutions that, at times, may exceed federally and internationally insured limits. The Company did not exceed the limits in effect as of September 30, 2011 and exceeded insured limits in effect at September 30, 2010 by approximately \$200,000.

B. Customers — Sales to three customers accounted for approximately 45.1% and 43.5% of the Company's revenues for the three months ended September 30, 2011 and 2010, respectively (of which one customer accounted for 32.5% and 28.4%, respectively, of total sales). Sales to three customers accounted for approximately 44.3% and 43.5% of the Company's revenues for the six months ended September 30, 2011 and 2010, respectively, (of which one customer accounted for 30.3% and 27.9%, respectively, of total sales). Sales to three customers accounted for approximately 36.1% of accounts receivable at September 30, 2011.

NOTE 15 — GEOGRAPHIC INFORMATION

The Company operates in one reportable segment — the sale of premium beverage alcohol. The Company's product categories are rum, whiskey, liqueurs, vodka, tequila and wine. The Company reports its operations in two geographic areas: International and United States.

The condensed consolidated financial statements include revenues and assets generated in or held in the U.S. and foreign countries. The following table sets forth the amounts and percentage of consolidated revenue, consolidated results from operations, consolidated net loss attributable to common shareholders, consolidated income tax benefit and consolidated assets from the U.S. and foreign countries and consolidated revenue by category.

	Three Months ended September 30,			
	2011		2010	
Consolidated Revenue:				
International	\$ 1,020,058	10.9%	\$ 725,185	8.8%
United States	8,379,896	89.1%	7,493,389	91.2%
Total Consolidated Revenue	\$ 9,399,954	100.0%	\$ 8,218,574	100.0%
Consolidated Results from Operations:				
International	\$ (18,994)	2.5%	\$ (92,524)	6.8%
United States	(756,090)	97.5%	(1,263,092)	93.2%
Total Consolidated Results from Operations	\$ (775,084)	100.0%	\$ (1,355,616)	100.0%
Consolidated Net Loss Attributable to Controlling Interests:				
International	\$ (64,394)	7.0%	\$ (149,485)	9.1%
United States	(856,277)	93.0%	(1,487,702)	90.9%
Total Consolidated Net Loss Attributable to Controlling Interests	\$ (920,671)	100.0%	\$ (1,637,187)	100.0%
Income tax benefit:				
United States	37,038	100.0%	37,038	100.0%
Consolidated Revenue by category:				
Rum	\$ 3,319,600	35.3%	\$ 3,014,299	36.7%
Liqueurs	2,382,458	25.3%	2,216,698	27.0%
Whiskey	1,733,760	18.5%	1,138,569	13.9%
Vodka	991,154	10.5%	991,129	12.1%
Tequila	76,528	0.8%	95,395	1.2%
Wine	110,907	1.2%	290,072	3.5%
Other*	785,547	8.4%	472,412	5.6%
Total Consolidated Revenue	\$ 9,399,954	100.0%	\$ 8,218,574	100.0%

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	Six Months ended September 30,			
	2011		2010	
Consolidated Revenue:				
International	\$ 1,981,510	11.8%	\$ 1,521,172	10.6%
United States	14,810,828	88.2%	12,807,897	89.4%
Total Consolidated Revenue	\$ 16,792,338	100.0%	\$ 14,329,069	100.0%
Consolidated Results from Operations:				
International	\$ (43,311)	2.0%	\$ (77,206)	2.5%
United States	(2,088,810)	98.0%	(3,020,060)	97.5%
Total Consolidated Results from Operations	\$ (2,132,121)	100.0%	\$ (3,097,266)	100.0%
Consolidated Net Loss Attributable to Controlling Interests:				
International	\$ (250,968)	9.3%	\$ (209,071)	6.2%
United States	(2,436,713)	90.7%	(3,150,924)	93.8%
Total Consolidated Net Loss Attributable to Controlling Interests	\$ (2,687,681)	100.0%	\$ (3,359,995)	100.0%
Income tax benefit:				
United States	74,076	100.0%	74,076	100.0%
Consolidated Revenue by category:				
Rum	\$ 6,416,355	38.2%	\$ 5,693,932	39.7%
Liqueurs	3,852,473	22.9%	3,407,015	23.8%
Whiskey	2,675,650	15.9%	2,007,989	14.0%
Vodka	1,976,509	11.8%	1,811,533	12.6%
Tequila	169,022	1.0%	168,995	1.2%
Wine	414,385	2.5%	460,074	3.2%
Other*	1,287,944	7.7%	779,531	5.5%
Total Consolidated Revenue	\$ 16,792,338	100.0%	\$ 14,329,069	100.0%

	As of September 30, 2011		As of March 31, 2011	
Consolidated Assets:				
International	\$ 2,899,993	9.2%	2,640,896	8.5%
United States	28,540,618	90.8%	28,464,750	91.5%
Total Consolidated Assets	\$ 31,440,611	100.0%	31,105,646	100.0%

*Includes related non-beverage alcohol products.

NOTE 16 — SUBSEQUENT EVENTS

Exchange of debt for Series A Preferred Stock – In October 2011, the Company completed the exchange of various tranches of its outstanding debt for shares of Series A Preferred Stock and 2011 Warrants, as part of the June 2011

Private Placement described in Note 9, following shareholder and NYSE Amex approval of the same.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We develop and market premium brands in the following beverage alcohol categories: rum, whiskey, liqueurs, vodka, tequila and wine. We distribute our products in all 50 U.S. states and the District of Columbia, in twelve primary international markets, including Ireland, Great Britain, Northern Ireland, Germany, Canada, Bulgaria, France, Russia, Finland, Norway, Sweden, China and the Duty Free markets, and in a number of other countries in continental Europe and Latin America. We market the following brands, among others, Gosling's Rum®, Jefferson's®, Jefferson's Reserve® and Jefferson's Presidential Select™ bourbons, Clontarf® Irish whiskey, Pallini® liqueurs, Boru® vodka, Knappogue Castle Whiskey®, Tierras™ tequila, Travis Hasse's Original® Pie Liqueurs, A. de Fussigny® Cognacs and Betts & Scholl™ wines, including the CC:™ line of wines.

Our objective is to continue building a distinctive portfolio of global premium and super premium spirits and wine brands as we move towards profitability. To achieve this, we continue to seek to:

- § increase revenues from our more profitable brands. We continue to focus our distribution relationships, sales expertise and targeted marketing activities on our more profitable brands;
- § improve value chain and manage cost structure. We have undergone a comprehensive review and analysis of our supply chains and cost structures both on a company-wide and brand-by-brand basis. This included personnel reductions throughout our company; restructuring our international distribution system; reducing certain inventory levels; changing distributor relationships in certain markets; moving production of certain products to a lower cost facility in the U.S.; and reducing general and administrative costs. We continue to review costs and seek to reduce expense; and
- § selectively add new premium brands to our portfolio. We intend to continue developing new brands and pursuing strategic relationships, joint ventures and acquisitions to selectively expand our premium spirits and fine wine portfolio, particularly by capitalizing on and expanding our partnering capabilities. Our criteria for new brands focuses on underserved areas of the beverage alcohol marketplace, while examining the potential for direct financial contribution to our company and the potential for future growth based on development and maturation of agency brands. We evaluate future acquisitions and agency relationships on the basis of their potential to be immediately accretive and their potential contributions to our objectives of becoming profitable and further expanding our product offerings. We expect that future acquisitions, if consummated, would involve some combination of cash, debt and the issuance of our stock.

Recent Events

Exchange of Debt for Series A Preferred Stock

In October 2011, we completed the exchange of various tranches of our outstanding debt for shares of Series A Preferred Stock, as described in "June 2011 Private Placement" below. We obtained shareholder approval of the debt exchange in accordance with NYSE Amex rules at our 2010/2011 annual meeting of shareholders in September 2011.

Keltic Facility

In August 2011, we entered into a revolving loan agreement ("Loan Agreement") with Keltic Financial Partners II, LP, a Delaware limited partnership ("Keltic"), which we refer to as the Keltic Facility, providing for availability (subject to certain terms and conditions) of a facility of up to \$5,000,000 for the purpose of providing working capital. The Keltic Facility expires on August 19, 2014. We may borrow up to the maximum amount of the Keltic Facility, provided that we have a sufficient borrowing base (as defined in the Loan Agreement). The Keltic Facility interest rate

is the rate that, when annualized, is the greatest of (a) the Prime Rate plus 3.25%, (b) the LIBOR Rate plus 5.75%, and (c) 6.50%. Interest is payable monthly in arrears, on the first day of every month on the average daily unpaid principal amount of the Keltic Facility. After the occurrence and during the continuance of any "Default" or "Event of Default" (as defined under the Loan Agreement) we are required to pay interest at a rate that is 3.25% per annum above the then applicable Keltic Facility interest rate. In addition to a \$100,000 commitment fee, Keltic will also receive an annual facility fee and a collateral management fee. The Loan Agreement contains standard borrower representations and warranties for asset based borrowing and a number of reporting obligations and affirmative and negative covenants. The Loan Agreement includes negative covenants that, among other things, restrict our ability to create additional indebtedness, dispose of properties, incur liens, and make distributions or cash dividends. At September 30, 2011, we were in compliance, in all material respects, with the covenants under the Keltic Facility.

June 2011 Private Placement

In June 2011, we entered into agreements relating to a private placement of an aggregate of approximately \$7.1 million of newly-designated 10% Series A Convertible Preferred Stock, which we refer to as Series A Preferred Stock. We refer to this transaction as the June 2011 private placement. Holders of Series A Preferred Stock are entitled to receive cumulative dividends at the rate per share (as a percentage of the stated value per share) of 10% per year, whether or not declared by our board, which dividends are payable in shares of our common stock upon conversion of the Series A Preferred Stock or upon a liquidation. As part of the June 2011 private placement, we completed a private offering of approximately \$2.2 million of Series A Preferred Stock for its stated value of \$1,000 per share and warrants, which we refer to as the 2011 Warrants, to purchase 50% of the number of shares of our common stock issuable upon conversion of such Series A Preferred Stock. Subject to adjustment (including dilutive issuances), the Series A Preferred Stock is convertible into common stock at a conversion price of \$0.304 per share and the 2011 Warrants have an exercise price of \$0.38 per share.

Also as part of the June 2011 private placement, certain of our directors, officers and other affiliates agreed to purchase an aggregate of approximately \$1.0 million of Series A Preferred Stock and 2011 Warrants on substantially the same terms described above, subject to shareholder approval of such issuance in accordance with NYSE Amex rules. Pending such shareholder approval, we issued an aggregate of \$1.0 million in promissory notes to these affiliate purchasers. These notes, and accrued but unpaid interest thereon, converted automatically into Series A Preferred Stock and 2011 Warrants in October 2011 following shareholder and NYSE Amex approval of such transaction. These notes bore interest at 10% per year and were to mature 18 months from the date of issuance, subject to prior conversion. The affiliate purchasers include Frost Gamma Investments Trust, an entity affiliated with Dr. Phillip Frost, a director and principal shareholder of our company, Mr. Richard Lampen, our chief executive officer and a director of our company, Mr. Mark Andrews, our chairman of the board, and certain of his affiliates, Mr. John Glover, our chief operating officer, and Mr. Alfred Small, our senior vice president, chief financial officer, treasurer and secretary.

Also as part of the June 2011 private placement, certain holders of our outstanding debt, including certain of our directors, officers and other affiliates, agreed to purchase shares of Series A Preferred Stock and 2011 Warrants in exchange for approximately \$4.0 million aggregate principal amount of our existing debt, and accrued but unpaid interest thereon, on substantially the same terms described above, subject to shareholder approval of such issuance in accordance with NYSE Amex rules. The affiliate debt holders include Frost Gamma Investments Trust, Vector Group Ltd., a principal shareholder of ours, Mr. Lampen, Mr. Andrews, Lafferty Ltd., a principal shareholder of our company, IVC Investments, LLLP, an entity affiliated with Mr. Glenn Halpryn, a director of ours, and Betts & Scholl, LLC, an entity affiliated with Dennis Scholl, a director of ours (which converted principal, but not accrued but unpaid interest thereon). These notes and accrued but unpaid interest thereon converted into Series A Preferred Stock and 2011 Warrants in October 2011 following shareholder and NYSE Amex approval of such transaction.

If we sell or grant any option to purchase or any right to reprice, or otherwise dispose of or issue (or announce any sale, grant or option to purchase or other disposition), any common stock or common stock equivalents entitling any person to acquire common stock at an effective price per share that is lower than the then conversion price of the Series A Preferred Stock, the holders of the Series A Preferred Stock and the 2011 Warrants will be entitled to an adjusted conversion price and additional shares of common stock upon the exercise of the 2011 Warrants.

We have filed a registration statement relating to the shares of common stock issuable upon conversion of the Series A Preferred Stock and the exercise of the 2011 Warrants.

Currency Translation

The functional currencies for our foreign operations are the Euro in Ireland and the British Pound in the United Kingdom. With respect to our consolidated financial statements, the translation from the applicable foreign currencies to U.S. Dollars is performed for balance sheet accounts using exchange rates in effect at the balance sheet date and for revenue and expense accounts using a weighted average exchange rate during the period. The resulting translation adjustments are recorded as a component of other comprehensive income.

Where in this report we refer to amounts in Euros or British Pounds, we have for your convenience also in certain cases provided a conversion of those amounts to U.S. Dollars in parentheses. Where the numbers refer to a specific balance sheet account date or financial statement account period, we have used the exchange rate that was used to perform the conversions in connection with the applicable financial statement. In all other instances, unless otherwise indicated, the conversions have been made using the exchange rates as of September 30, 2011, each as calculated from the Interbank exchange rates as reported by Oanda.com. On September 30, 2011, the exchange rate of the Euro and the British Pound in exchange for U.S. Dollars was €1.00 = U.S. \$1.35968 (equivalent to U.S. \$1.00 = €0.735467) and £1.00 = U.S. \$1.56253 (equivalent to U.S. \$1.00 = £0.63987).

These conversions should not be construed as representations that the Euro and British Pound amounts actually represent U.S. Dollar amounts or could be converted into U.S. Dollars at the rates indicated.

Critical Accounting Policies

There are no material changes from the critical accounting policies set forth in Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our annual report on Form 10-K for the year ended March 31, 2011, as amended, which we refer to as our 2011 Annual Report. Please refer to that section for disclosures regarding the critical accounting policies related to our business.

Financial performance overview

The following table provides information regarding our case sales for the periods presented based on nine-liter equivalent cases, which is a standard spirits industry metric (table excludes related non-beverage alcohol products):

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	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Cases				
United States	71,186	65,825	127,370	111,667
International	14,962	12,628	28,897	25,596
Total	86,148	78,453	156,267	137,263
Rum				
Rum	33,375	31,680	64,167	58,112
Vodka	18,197	18,031	36,362	32,941
Liqueurs	21,354	19,403	34,635	30,526
Whiskey	11,396	6,886	16,877	12,249
Tequila	367	376	846	634
Fine Wine	966	1,791	2,732	2,515
Other	493	286	648	286
Total	86,148	78,453	156,267	137,263
Percentage of Cases				
United States	82.6%	83.9%	81.5%	81.4%
International	17.4%	16.1%	18.5%	18.6%
Total	100.0%	100.0%	100.0%	100.0%
Rum				
Rum	38.8%	40.4%	41.1%	42.4%
Vodka	21.1%	23.0%	23.3%	24.0%
Liqueurs	24.8%	24.6%	22.2%	22.2%
Whiskey	13.2%	8.8%	10.8%	8.9%
Tequila	0.4%	0.5%	0.5%	0.5%
Fine Wine	1.1%	2.3%	1.7%	1.8%
Other	0.6%	0.4%	0.4%	0.2%
Total	100.0%	100.0%	100.0%	100.0%

Results of operations

The table below provides, for the periods indicated, the percentage of net sales of certain items in our consolidated financial statements:

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Sales, net*	100.0 %	100.0 %	\$ 100.0 %	100.0 %
Cost of sales*	65.0 %	63.2 %	64.0 %	63.4 %
Reversal of provision for obsolete inventory	0.0 %	0.0 %	0.0 %	(0.2) %
Gross profit	35.0 %	36.8 %	36.0 %	36.8 %
Selling expense	28.3 %	34.1 %	31.3 %	37.1 %
General and administrative expense	12.6 %	16.4 %	14.6 %	18.1 %

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Depreciation and amortization	2.4 %	2.8 %	2.7 %	3.2 %
Loss from operations	(8.2)%	(16.5)%	(12.7)%	(21.6)%
Other income	0.0 %	0.0 %	0.0 %	0.0 %
Other expense	0.0%	0.0%	0.0%	0.0%
Gain (loss) from equity investment in non-consolidated affiliate	0.0%	0.0%	(0.1)%	0.0%
Foreign exchange loss	(1.2)%	(1.4)%	(1.4)%	(0.4)%
Interest expense, net	(1.9)%	(0.9)%	(2.1)%	(0.7)%
Net change in fair value of warrant liability	2.2 %	0.0 %	1.1 %	0.0 %
Income tax benefit	0.4 %	0.5 %	0.4 %	0.5 %
Net loss	(8.7)%	(18.3)%	(14.8)%	(22.2)%
Net loss attributable to noncontrolling interests	(1.1)%	(1.6)%	(1.2)%	(1.3)%
Net loss attributable to controlling interests	(9.8)%	(19.9)%	(16.0)%	(23.5)%
Dividend to preferred shareholders	(0.5)%	0.0 %	(2.3)%	0.0 %
Net loss attributable to common shareholders	(10.3)%	(19.9)%	(18.3)%	(23.5)%

The following is a reconciliation of net loss attributable to common shareholders to EBITDA, as adjusted:

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Net loss attributable to common shareholders \$	(970,598)	(1,637,187)	(3,067,069)	(3,559,995)
Adjustments:				
Interest expense, net	176,731	71,697	354,272	97,240
Income tax benefit	(37,038)	(37,038)	(74,076)	(74,076)
Depreciation and amortization	225,811	229,745	453,956	465,476
EBITDA (loss)	(605,094)	(1,372,783)	(2,332,917)	(2,871,355)
Allowance for doubtful accounts	11,123	14,864	18,034	29,664
Allowance for obsolete inventory	—	—	—	(24,589)
Stock-based compensation expense	52,737	48,404	84,513	84,693
Other income	—	—	—	(957)
Other expense	—	300	—	300
Gain (loss) from equity investment in non-consolidated affiliate	(108)	—	17,349	—
Foreign exchange loss	116,386	111,761	238,463	54,246
Net change in fair value of warrant liability	(209,899)	—	(185,025)	—
Net income attributable to noncontrolling interests	99,515	134,851	204,578	185,976
Dividend to preferred shareholders	49,927	—	379,387	—
EBITDA, as adjusted	(485,413)	(1,062,603)	(1,575,618)	(2,542,022)

Earnings before interest, taxes, depreciation and amortization, or EBITDA, adjusted for allowances for doubtful accounts and obsolete inventory, non-cash compensation expense, net change in fair value of warrants payable and dividend to preferred shareholders is a key metric we use in evaluating our financial performance. EBITDA is considered a non-GAAP financial measure as defined by Regulation G promulgated by the SEC under the Securities Act of 1933, as amended. We consider EBITDA, as adjusted, important in evaluating our performance on a consistent basis across various periods. Due to the significance of non-cash and non-recurring items, EBITDA, as adjusted, enables our Board of Directors and management to monitor and evaluate the business on a consistent basis. We use EBITDA, as adjusted, as a primary measure, among others, to analyze and evaluate financial and strategic planning decisions regarding future operating investments and allocation of capital resources. We believe that EBITDA, as adjusted, eliminates items that are not indicative of our core operating performance, or do not involve a cash outlay, such as stock-based compensation expense. Our presentation of EBITDA, as adjusted, should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items or by non-cash items, such as non-cash compensation, which is expected to remain a key element in our long-term incentive compensation program. EBITDA, as adjusted, should be considered in addition to, rather than as a substitute for, income from operations, net income and cash flows from operating activities.

Our EBITDA, as adjusted, improved 54.3% to a loss of (\$0.5) million for the three months ended September 30, 2011, as compared to a loss of (\$1.1) million for the comparable prior-year period, primarily as a result of our increased sales and lower selling and general and administrative expense. Our EBITDA, as adjusted, improved 38.0% to a loss of (\$1.6) million for the six months ended September 30, 2011, as compared to a loss of (\$2.5) million for the comparable prior-year period, primarily as a result of our increased sales and lower selling and general and administrative expense.

Three months ended September 30, 2011 compared with three months ended September 30, 2010

Net sales. Net sales increased 14.4% to \$9.4 million for the three months ended September 30, 2011, as compared to \$8.2 million for the comparable prior-year period. Our U.S. case sales as a percentage of total case sales decreased to 82.6% for the three months ended September 30, 2011, as compared to 83.9% for the comparable prior-year period due to growth in certain international markets. We continue to focus on our faster growing and more profitable markets both in the U.S. and internationally. U.S. net sales increased to \$8.4 million for the three months ended September 30, 2011 from \$7.5 million for the comparable prior-year period. 2011 U.S. net sales include \$0.2 million in sales from our Jefferson's Rye, which we launched in June 2011. The growth in U.S. sales also reflects the momentum for our Gosling's rums, Pallini Limoncello, Jefferson's Bourbons and Clontarf Irish whiskey.

The table below presents the increase or decrease, as applicable, in case sales by product category for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010:

	Increase/(decrease) in case sales		Percentage increase/(decrease)	
	Overall	U.S.	Overall	U.S.
Rum	1,695	293	5.4%	1.1%
Vodka	166	1,209	0.9%	8.6%
Liqueurs	1,951	2,116	10.1%	11.1%
Whiskey	4,510	2,370	65.5%	58.1%
Tequila	(9)	(9)	(2.4)%	(2.4)%
Wine	(825)	(825)	(46.1)%	(46.1)%
Other	207	207	72.4%	72.4%
Total	7,695	5,361	9.8%	8.1%