Castle Brands Inc
Form 10-Q
November 14, 2007

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, 2007

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number 001-32849

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

Delaware 41-2103550

(State or other jurisdiction of
incorporation or organization) (I.R.S. Employer
Identification No.)
570 Lexington Avenue, 29th Floor,
New York, New York 10022 (Address of principal executive offices) (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 is a large accelerated filer, accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Act). See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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 15,629,776 shares of $0.01 par value common stock outstanding at November 13, 2007.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

CASTLE BRANDS INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets

	September 30, 2007 (Unaudited)	March 31, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 3,545,013	$ 1,004,957
Short-term investments	8,053,106	5,912,464
Accounts receivable – net of allowance for doubtful accounts of $196,135 and $352,458	10,669,957	6,503,449
Due from affiliates	11,054	10,328
Inventories	13,635,850	10,716,983
Prepaid expenses and other current assets	1,645,507	1,585,901
TOTAL CURRENT ASSETS	37,560,487	25,734,082
EQUIPMENT – net	759,529	643,753
OTHER ASSETS		
Intangible assets – net of accumulated amortization of $2,276,630 and $2,233,808	13,951,694	13,813,596
Goodwill	12,495,287	13,036,650
Restricted cash	716,362	502,643
Other assets	473,302	795,237
TOTAL ASSETS	$ 65,956,661	$ 54,525,961
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of notes payable and capital leases	$ 464,327	$ 419,308
Accounts payable	4,096,337	5,150,535
Accrued expenses, put warrant payable and derivative instrument	2,793,368	1,987,669
Due to stockholders and affiliates	1,433,810	1,092,755
TOTAL CURRENT LIABILITIES	8,787,842	8,650,267
LONG TERM LIABILITIES		
Senior notes payable	9,501,985	9,354,861
Notes payable and capital leases, less current maturities	9,003,296	9,005,207
Deferred tax liability	2,481,292	2,555,368
	29,774,415	29,565,703
COMMITMENTS AND CONTINGENCIES (Note 15)		
MINORITY INTERESTS	916,255	1,407,645
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value, 5,000,000 shares authorized, none outstanding	—	—
Common stock, $.01 par value, 45,000,000 shares authorized; 15,629,776 and 12,109,741 shares issued and outstanding at September 30, and March 31, 2007, respectively	156,298	121,098
Additional paid in capital	104,210,150	84,086,710
Accumulated deficiency	(67,647,899)	(59,962,237)
Accumulated other comprehensive loss	(1,452,558)	(692,958)
TOTAL STOCKHOLDERS' EQUITY	35,265,991	23,552,613
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 65,956,661	$ 54,525,961

See accompanying notes to the condensed consolidated financial statements.

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

	Three-months Ended September 30,		Six-months Ended September 30,	
	2007	2006	2007	2006
Sales, net	$ 8,920,952	$ 6,252,062	$ 14,545,037	$ 11,712,467
Cost of sales	6,436,721	4,231,445	9,941,259	7,795,504
Gross profit	2,484,231	2,020,617	4,603,778	3,916,963
Selling expense (Note 1L)	4,436,622	4,694,074	8,674,230	8,236,646
General and administrative expense (Note 1L)	2,091,109	1,898,702	4,152,029	4,134,493
Depreciation and amortization	284,274	245,794	555,701	480,288
Net operating loss	(4,327,774)	(4,817,953)	(8,778,182)	(8,934,464)
Other income	—	2,644	—	3,944
Other expense	(10,297)	(9,558)	(21,464)	(15,866)
Foreign exchange gain/(loss)	1,082,609	262,377	1,159,935	659,789
Interest expense, net	(313,354)	(75,931)	(800,814)	(498,607)
Write-off of deferred financing costs in connection with conversion of 6% subordinated convertible notes	—	—	—	(295,368)
Current (charge)/credit on derivative financial instrument	—	(8,666)	189,397	(10,858)
Income tax benefit	37,038	37,038	74,076	74,076
Minority interests	251,020	391,855	491,390	735,214
Net loss	(3,280,758)	(4,218,194)	(7,685,662)	(8,282,140)
Preferred stock dividends	—	—	—	48,238
Net loss attributable to common stockholders	$ (3,280,758)	$ (4,218,194)	$ (7,685,662)	$ (8,330,378)
Net loss attributable to common stockholders per common share, basic and diluted	$ (0.21)	$ (0.35)	$ (0.52)	$ (0.71)
Weighted average shares used in computation, basic and diluted				
Weighted average shares used in computation, basic and diluted	15,629,776	12,009,741	14,898,083	11,716,233

See accompanying notes to the condensed consolidated financial statements.

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CASTLE BRANDS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Changes in Stockholders' Equity
(Unaudited)

	Common Stock		Additional Paid in Capital	Accumulated Deficiency	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount				
BALANCE, MARCH 31, 2007	12,109,741	$ 121,098	$ 84,086,710	$ (59,962,237)	$ (692,958)	$ 23,552,613
Comprehensive loss						
Net loss				(7,685,662)		(7,685,662)
Foreign currency translation adjustment					(759,600)	(759,600)
Total comprehensive loss						(8,445,262)
Issuance of common stock in private placement, net of issuance costs	3,520,035	35,200	19,583,286			19,618,486
Vesting of stock options as compensation			3,258			3,258
Stock-based compensation			536,896			536,896
BALANCE, SEPTMEBER 30, 2007	15,629,776	$ 156,298	$ 104,210,150	$ (67,647,899)	$ (1,452,558)	$ 35,265,991

See accompanying notes to the condensed consolidated financial statements.

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

Six-months Ended September 30, 2007 2006 CASH FLOWS FROM OPERATING ACTIVITIES Net loss $ (7,685,662) $ (8,282,140) Adjustments to reconcile net loss to net cash used in operating activities Depreciation and amortization 555,701 480,288 Change in allowance for doubtful accounts 36,343 48,591 Minority interest in net loss of consolidated subsidiary (491,390) (735,214) Loss on disposal of fixed assets 1,051 — Write-off of deferred financing costs 321,197 167,196 Current (credit)/charge on derivative financial instrument (189,397) 10,858 Deferred tax benefit (74,076) (74,076) Effect of changes in foreign currency rate (1,038,734) (533,720) Stock-based compensation expense 536,896 771,415 Non-cash interest charge — 283,727 Write-off of deferred financing costs in connection with conversion of 6% subordinated convertible notes — 295,368 Changes in operations, assets and liabilities Increase in accounts receivable (3,933,607) (2,895,645) Increase in due from affiliates — (78,199) Increase in inventory (2,726,693) (1,957,665) Increase in prepaid expenses and supplies (53,338) (278,636) Decrease/(increase) in other assets 151,191 (15,491) Decrease in accounts payable and accrued expenses (248,353) (933,385) Decrease in due to related parties 281,747 254,691 Total adjustments (6,871,462) (5,189,897) NET CASH USED IN OPERATING ACTIVITIES (14,557,124) (13,472,037) CASH FLOWS FROM INVESTING ACTIVITIES Acquisition of property and equipment (212,655) (117,938) Acquisition of intangible assets (12,029) (111,931) Purchase of short-term investments (8,000,000) — Proceeds from sale of short-term investments 5,859,358 — NET CASH USED IN INVESTING ACTIVITIES (2,365,326) (229,869) CASH FLOWS FROM FINANCING ACTIVITIES Repayment of notes payable (10,761,738) (13,541,011) Proceeds from notes payable and warrants 10,776,732 10,855,070 Payments of obligations under capital leases (1,817) (1,729) Increase in restricted cash (170,164) (94,938) Issuance of common stock 21,014,609 31,500,000 Payments for costs of stock issuances (1,396,123) (2,898,063) NET CASH PROVIDED BY FINANCING ACTIVITIES 19,461,499 25,819,329 EFFECTS OF FOREIGN CURRENCY TRANSLATION 1,007 32 NET INCREASE IN CASH AND CASH EQUIVALENTS 2,540,056 12,117,455 CASH AND CASH EQUIVALENTS – BEGINNING 1,004,957 1,392,016 CASH AND CASH EQUIVALENTS – ENDING $ 3,545,013 $ 13,509,471 SUPPLEMENTAL DISCLOSURES Schedule of non-cash investing and financing activities Conversion of redeemable convertible preferred stock, net of fractional shares, by issuance of common stock $ — $ 28,447,667 Issuance of common stock in payment of accrued dividends $ — $ 1,389,765 Conversion of 5% euro denominated convertible subordinated notes by issuance of common stock $ — $ 1,663,173 Conversion of 40% of 6% convertible subordinated notes by issuance of common stock $ — $ 6,000,000 Interest paid $ 732,140 $ 629,063 Income taxes paid $ — $ —
See accompanying notes to the condensed consolidated financial statements.

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

NOTE 1 — ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying 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 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, 2007 is derived from the March 31, 2007 audited financial statements. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the fiscal year ended March 31, 2007 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

A.

Description of business and business combination – Castle Brands Inc. is the successor to Great Spirits Company, LLC, a Delaware limited liability company (''GSC''). GSC was formed in February 1998. In May 2003, Great Spirits (Ireland) Limited (''GSI''), a wholly owned subsidiary of GSC, began operations in Ireland to market GSC's products internationally. GSI has been an inactive entity since December 2003 and was dissolved as of September 30, 2006. In July 2003, GSRWB, Inc. (renamed Castle Brands Inc.) and its wholly owned subsidiary, Great Spirits Corp. (renamed Castle Brands (USA) Corp.) (''CB-USA''), were formed under the laws of Delaware in contemplation of a pending acquisition. On December 1, 2003, Castle Brands Inc. acquired The Roaring Water Bay Spirits Group Limited and The Roaring Water Bay Spirits Marketing and Sales Company Limited and their related entities (collectively, ''Roaring Water Bay''). The acquisition has been accounted for under purchase accounting. Simultaneously, GSC was merged into CB-USA, and Castle Brands Inc. issued stock to GSC's members in exchange for their membership interests in GSC. Subsequent to the acquisition, The Roaring Water Bay Spirits Group Limited was renamed Castle Brands Spirits Group Limited (''CB-IRL'') and The Roaring Water Bay Spirits Marketing and Sales Company Limited was renamed Castle Brands Spirits Marketing and Sales Company Limited (''CB-UK'').

In February 2005, Castle Brands Inc. acquired 60% of the shares of Gosling-Castle Partners Inc. (''GCP''), which holds the worldwide distribution rights (excluding Bermuda) to Gosling's rum and related products.

In October 2006, Castle Brands Inc. acquired all of the outstanding capital stock of McLain & Kyne, Ltd. (''McLain & Kyne'') pursuant to a Stock Purchase Agreement. McLain & Kyne is a Louisville, Kentucky based developer and marketer of three premium small batch bourbons: Jefferson's Reserve, Jefferson's and Sam Houston.

As used herein, the ''Company'' refers to Castle Brands Inc. and, where appropriate, it also refers collectively to Castle Brands Inc. and its direct and indirect subsidiaries, including its majority owned GCP subsidiary.

B.

Principles of consolidation – The consolidated financial statements include the accounts of Castle Brands Inc., its wholly-owned subsidiaries, CB-USA and McLain and Kyne, Castle Brands Inc. wholly-owned foreign subsidiaries, CB-IRL and CB-UK, and its majority owned subsidiary, Gosling-Castle Partners, Inc. 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.

C. Organization and operations – The Company is principally engaged in the manufacture, marketing and sale of fine spirit brands of vodka, whiskey, rums and liqueurs (the ‘‘products’’) in the United States, Canada, Europe, and the Caribbean. Except for Gosling’s rums and bourbon products, which are bottled in the United States, all of the Company’s products are imported from Europe. The vodka, Irish whiskies and certain liqueurs are produced by CB-IRL, billed in euros and imported into the United States. The risk of changes in F/X is borne by the U.S. entities.

D. Cash and cash equivalents – The Company considers all highly liquid instruments with a maturity date at acquisition of three-months or less to be cash and cash equivalents.

E. Investments – The Company follows Statement of Financial Accounting Standards (‘‘SFAS’’) No. 115, Accounting for Certain Investments in Debt and Equity Securities, classifying its investments based on the intended holding period. The Company currently classifies its investments as available-for-sale. Available-for-sale securities are carried at estimated fair value, based on available market information, with unrealized gains and losses, if any, reported as a component of stockholders’ equity. Investments consist primarily of auction rate corporate debt, auction rate municipal securities, government bonds, mutual funds and preferred stock that are highly liquid in nature and represent the investment of cash that is available for current operations. Although original maturities of the Company’s auction rate securities are generally longer than one year, the Company has the right to sell these securities each auction date subject to the availability of buyers. Interest rates on these securities reset at every auction date, generally every twenty eight days.

F. Trade accounts receivable – The Company records trade accounts receivable at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts to reflect anticipated losses on the trade accounts receivable balances. The Company calculates this allowance based on its history of write-offs, level of past due accounts based on contractual terms of the receivables and its relationships with, and economic status of, the Company’s customers.

G. Revenue recognition – Revenue from product sales is recognized when the product is shipped to a customer (generally a distributor), title and risk of loss has passed to the customer in accordance with the terms of sale (FOB shipping point or FOB destination), and collection is reasonably assured. Revenue is not recognized on shipments to control states in the United States until such time as product is sold through to the retail channel.

H. Inventories – Inventories, which comprise distilled spirits, raw materials (bulk spirits, bottles, labels and caps), packaging and finished goods, is valued at the lower of cost or market, using the weighted average cost method. The Company assesses the valuation of its inventories and reduces the carrying value of those inventories that are obsolete or in excess of the Company’s forecasted usage to their estimated net realizable value. The Company estimates the net realizable value of such inventories based on analyses and assumptions including, but not limited to, historical usage, expected future demand and market requirements. Reductions to the carrying value of inventories are recorded in cost of goods sold.

I. 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. As of September 30, and March 31, 2007, goodwill and other indefinite lived intangible assets that arose from acquisitions were $12.5 million and $13.6 million, respectively. Goodwill and other 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 to the estimated residual values and reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company performed its annual impairment assessment on long-lived assets, including indefinite lived intangible assets and goodwill, and concluded that no impairment existed.

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J. 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 Great Britain 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. Historically, the Company’s sales in Ireland have been made ‘‘in-bond’’, net of excise taxes. In September 2007, the Company made an initial sale to its new distributor in Ireland ‘‘ex-bond’’ that included $1,861,995 million in excise taxes and VAT. These taxes are reflected in both our revenues and cost of sales as an equal increase to both. During the three-month and six-month periods ended September 30, 2007 and 2006, the captions for the Company’s revenues and cost of sales included the amounts of excise tax and duties presented in the table below:

	Three-months ended September 30,		Six-months ended September 30,	
	2007	2006	2007	2006
Sales, net	$ 3,025,066	$ 1,488,077	$ 4,328,056	$ 2,622,016
Cost of Sales	$ 3,025,066	$ 1,488,077	$ 4,328,056	$ 2,622,016

K. Foreign currency – The functional currency for the Company’s foreign operations is the euro in Europe, excluding the United Kingdom, the British pound in the United Kingdom, and the Canadian dollar in Canada. The translation from the applicable foreign currencies to U.S. dollars is performed for balance sheet accounts using current 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 accompanying consolidated statements of operations. As indicated in Note 1C, the vodka, Irish whiskies and certain liqueurs are produced by CB-IRL and billed in euros to the U.S. entities, with the risk of foreign exchange gain/loss resting with CB-US. In addition, CBI has funded the continuing operations off the international subsidiaries. At each balance sheet date, the euro denominated balances included on the books of CB-IRL are translated into U.S. dollars at the exchange rate in effect at the balance sheet date, and the resulting foreign currency transaction gain or loss included in net income.

L. Stock-based compensation – Incremental compensation expense for the three-months ended September 30, 2007 and 2006 amounted to $266,708 and $276,921, respectively, of which $115,417 and $136,603 are included in selling expense, respectively, and $151,291 and $140,318 are in general and administrative expense, respectively, in the accompanying condensed consolidated statements of operations. Incremental compensation expense for the six-months ended September 30, 2007 and 2006 amounted to $536,896 and $771,415, respectively, of which $229,579 and $221,472 are included in selling expense, respectively, and $307,317 and $549,943 are in general and administrative expense, respectively, in the accompanying condensed consolidated statements of operations.

M. Stock warrants – The Company accounted for the warrant and the put option rights as a compound financial instrument in the consolidated financial statements at fair value following the guidelines of EITF 00-19, paragraphs 44 and 45, and paragraphs 11 and 24 of SFAS 150. Changes in the fair value of the compound instrument are recognized in earnings for each reporting period. For the three-months ended September 30, 2007 and 2006, the Company recorded a (credit)/charge for the change in the value of the compound financial instrument of $0 and $8,666 respectively, and a (credit)/charge for the change in the value of the compound financial instrument of $(189,397) and $10,858, for the six-months ended September 30, 2007 and 2006, respectively.

N. Advertising – Advertising costs are expensed when the advertising first appears in its respective medium. Advertising expense, which is included in selling expense, for the three-months ended September 30, 2007 and 2006 was $920,222 and $1,462,782, and $1,772,023 and $2,528,900 for the six-months ended September 30, 2007 and 2006, respectively.

O. Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates include the accounting for items such as evaluating annual impairment tests, allowance for doubtful accounts, inventory, depreciation, amortization and expense accruals.

P. Recent accounting pronouncements – In September 2006, the Financial Accounts Standards Board (''FASB'') issued SFAS No. 157, ''Fair Value Measurements,'' to define fair value, establish a framework for measuring fair value in accordance with generally accepted accounting principles, and expand disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, the beginning of the Company's 2008 fiscal year. The Company is assessing the impact the adoption of SFAS No. 157 will have on the Company's financial position and results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 159, ''The Fair Value Option for Financial Assets and Financial Liabilities'' (SFAS 159), which allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. Subsequent changes in fair value of these financial assets and liabilities would be recognized in earnings when they occur. SFAS 159 further establishes certain additional disclosure requirements. SFAS 159 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. Management is currently evaluating the impact and timing of the adoption of SFAS 159 on the Company's consolidated financial statements.

Q. Reclassifications – Certain prior year balances have been reclassified to conform to the current period classification.

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. Diluted potential common shares consist of incremental shares issuable upon exercise of stock options and warrants and contingent conversion of debentures. In computing diluted net loss per share for the six-months ended September 30, 2007 and 2006, 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 debentures is anti-dilutive.

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

	September 30, 2007	September 30, 2006
Stock options	1,307,625	1,328,500
Stock warrants	2,255,432	598,618
Convertible debentures	1,192,380	1,125,000
Total	4,755,437	3,052,118

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NOTE 3 — INVESTMENTS

The following is a summary of available-for-sale securities:

	Estimated Fair Value September 30, 2007
Mutual funds	$ 8,053,106
Total	$ 8,053,106

The cost of the Company’s short-term investments approximates their fair-values.

NOTE 4 — INVENTORIES

	September 30, 2007	March 31, 2007
Raw materials	$ 2,175,775	$ 1,501,455
Finished goods	11,460,075	9,215,528
Total	$ 13,635,850	$ 10,716,983

As of September 30, and March 31, 2007, 78.5% and 99.1%, respectively, of the raw materials and 10.6% and 13.0%, respectively, of finished goods were located outside of the United States.

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

NOTE 5 — INVESTMENTS AND ACQUISITIONS

Acquisition of McLain & Kyne, Ltd.

On October 12, 2006, the Company acquired all of the outstanding capital stock of McLain & Kyne, Ltd. pursuant to a Stock Purchase Agreement (the ‘‘Agreement’’). McLain & Kyne is a Louisville, Kentucky-based developer and marketer of three premium small batch bourbons: Jefferson’s Reserve, Jefferson’s and Sam Houston. As consideration for the acquisition, the Company has paid $2,000,000, consisting of $1,294,800 in cash and issued 100,000 shares of its common stock, valued at $705,200. The Company will also pay an earn-out to the sellers based on the financial performance of the acquired business. The aggregate amount of such earn-out payments, which shall not exceed $4,000,000, will be determined by a calculation based on the gross margin (as defined in the Agreement) recognized by the Company from the sales of McLain & Kyne’s bourbons through March 31, 2011. As a result of the purchase price allocation, the Company recorded goodwill of $768,805. Under the purchase method of accounting, tangible and identifiable intangible assets acquired and liabilities assumed are recorded at their estimated fair values. The estimated fair values and useful lives of intangible assets acquired are tentative and have been supported by a preliminary third party valuation based on weighted average cost of capital vs. return on invested capital. The fair values allocated to McLain & Kyne’s net tangible and intangible assets are as follows: current assets of $100,021, inventory of $53,866, tradenames of $941,000, and customer relationships of $169,000 and current liabilities of $32,692. The tradenames have been determined to have indefinite useful lives and accordingly, consistent with FAS 142, no amortization will be recorded in the Company’s consolidated income statements. Instead, the related intangible asset will be tested for impairment at least annually, with any related impairment charge recorded to the statement of operations at the time of determining such impairment. The customer relationships are being amortized on a straight-line basis over a period of 15 years.

The operating results of the McLain & Kyne business are reflected in the accompanying consolidated financial statements from the date of acquisition and were not material.

The Agreement also provides for, among other things, representations, warranties, indemnities and ‘‘piggyback’’ registration rights for the shares issued.

The following table presents unaudited pro forma information about sales and net loss had the operations of the above described acquisition been combined with the Company's business as of the first day of the period shown.

	Three Months Ended September 30, 2006	Six Months Ended September 30, 2006
Net sales	$ 6,557,133	12,170,073
Operating loss	$ 4,856,612	8,992,452
Net income	$ 4,237,523	8,369,036
Earnings per share:		
Basic	$ 0.35	0.71
Diluted	$ 0.35	0.71
Weighted average shares:		
Basic	12,009,741	11,716,233
Diluted	12,009,741	11,716,233

In management's opinion, the unaudited pro forma results of operations are not indicative of the actual results that would have occurred had the above acquisitions been consummated at the beginning of the periods presented or of future operations of the combined companies under the Company's management.

Investment in Gosling-Castle Partners Inc.

In February 2005, the Company entered into a stock subscription agreement for 60% of the stock of Gosling Partners, Inc., whose name was subsequently changed to Gosling-Castle Partners Inc.

NOTE 6 — INTANGIBLE ASSETS

Intangible assets consist of the following:

	September 30, 2007	March 31, 2007
Definite life brands	$ 296,886	$ 308,909
Trademarks	475,802	408,222
Rights	9,036,793	9,036,793
Patents	994,000	825,000
Distribution relationships	—	416,000
Supply relationships	732,000	732,000
Other	28,480	28,480
	11,563,961	11,755,404
Less: accumulated amortization	2,276,630	2,233,808
Net	9,287,331	9,521,596
Other identifiable intangible assets – indefinite life		
Trade names and formulations	4,664,363	4,292,000
	$ 13,951,694	$ 13,813,596

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Accumulated amortization consists of the following:

	September 30, 2007	March 31, 2007
Brands	$ 235,906	$ 230,992
Trademarks	50,408	25,790
Rights	1,496,066	1,220,093
Patents	213,650	183,333
Distribution relationship	416,000	329,600
Supply relationship	280,600	244,000
Accumulated amortization	$ 2,692,630	$ 2,233,808

Amortization expense for the three-months ended September 30, 2007 and 2006 totaled $238,176 and $203,954 respectively, and $453,418 and $402,002 for the six-months ended September 30, 2007 and 2006, respectively.

On September 1, 2006, the Company delivered notice to a certain distributor that it was terminating its distribution agreement. As a result of the delivery of the notice, the distribution agreement has been terminated, as provided for by its terms, as of September 15, 2007. The Company has adjusted the estimated useful life of the underlying intangible asset to agree to the termination date.

Estimated aggregate amortization expense for each of the five succeeding years is as follows:

For the years ending September 30,	Amount
2008	$ 898,248
2009	794,469
2010	739,003
2011	739,003
2012	739,003